

TELKONET INC
Form S-1/A
May 28, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

AMENDMENT NO. 2 TO
FORM S-1

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

Telkonet, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Utah	4899	87-0627421
(State or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number)

10200 Innovation Drive
Suite 300
Milwaukee, WI 53226
(414) 223-0473

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Jason L. Tienor

Chief Executive Officer
Telkonet, Inc.
10200 Innovation Drive
Suite 300
Milwaukee, WI 53226
(414) 223-0473

(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copy to:

Howard J. Barr
General Counsel
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10200 Innovation Drive
Suite 300
Milwaukee, WI 53226

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(414) 223-0473

Approximate date of commencement of proposed sale to the public: As soon as practicable after this registration statement becomes effective, provided that this rights offering may not be effected unless our shareholders approve an increase in our authorized common stock.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

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

Large Accelerated filer <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>
		(Do not check if a smaller reporting company)	

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), shall determine.

THE INFORMATION IN THIS PROSPECTUS IS NOT COMPLETE AND MAY BE CHANGED. THESE SECURITIES MAY NOT BE SOLD NOR MAY OFFERS TO BUY THESE SECURITIES BE ACCEPTED PRIOR TO THE TIME THE REGISTRATION STATEMENT FILED WITH THE SECURITIES AND EXCHANGE COMMISSION BECOMES EFFECTIVE. THIS PROSPECTUS IS NOT AN OFFER TO SELL THESE SECURITIES AND IT IS NOT SOLICITING AN OFFER TO BUY THESE SECURITIES IN ANY STATE WHERE THE OFFER OR SALE IS NOT PERMITTED.

SUBJECT TO COMPLETION—DATED _____

PRELIMINARY PROSPECTUS

TELKONET, INC.

Up to [] Shares of Common Stock
And Warrants to Purchase [] Shares of Common Stock
Issuable upon Exercise of Rights to Subscribe for Such Shares and Warrants

We are distributing, at no charge to holders of shares of our common stock, other than those who hold shares of our common stock solely as participants in the Telkonet, Inc. 401(k) Plan, and holders of shares of our Series A convertible redeemable preferred stock, transferable subscription rights to subscribe for shares of our common stock and transferable warrants to purchase additional shares of our common stock. We refer to this offering as the “rights offering.” We are offering the subscription rights in this rights offering to holders of our common stock and holders of our Series A convertible redeemable preferred stock of record as of 5:00 p.m., Eastern time, on [], 2010, the record date. Our shareholders will receive one transferable subscription right for every share of our common stock held of record and every share of our common stock into which our Series A convertible redeemable preferred stock held of record is convertible as of 5:00 p.m., Eastern time, on the record date. Pursuant to the terms of the rights offering, the rights may only be exercised for a maximum of [] shares of common stock and related warrants, or \$[] of subscription proceeds.

Each transferable subscription right entitles the holder (including holders of subscription rights acquired during the subscription period) to subscribe for one share of our common stock at the subscription price of \$[] per share and to receive a warrant to purchase one additional share of our common stock at an exercise price of \$[], or []% of the subscription price, for a period of five years after the date of issuance, which we refer to as the basic subscription right. In addition, rights holders who fully exercise their basic subscription rights will be entitled, subject to limitations, to subscribe for additional shares of our common stock and warrants that remain unsubscribed as a result of any unexercised basic subscription rights, which we refer to as the over-subscription right, at the subscription price of \$[] per share. Unless we otherwise agree in writing, a person or entity, together with related persons or entities, may not exercise subscription rights (including over-subscription rights) to purchase shares of our common stock that, when aggregated with their existing ownership, would result in such person or entity, together with any related persons or entities, owning in excess of twenty percent (20%) of our issued and outstanding shares of common stock following the closing of the transactions contemplated by this rights offering.

The subscription rights will expire if they are not exercised by 5:00 p.m., Eastern time, on [], 2010, but we may extend the rights offering for additional periods ending no later than []. Our board of directors may cancel the rights offering for any reason or no reason at any time before it expires. If we cancel the rights offering, the subscription agent will return all subscription payments received, without interest or deduction, as soon as practicable. Additionally, the rights offering may not be effected unless our shareholders approve an increase in our authorized common stock.

You should carefully consider whether to exercise your subscription rights before the rights offering expires. All exercises of subscription rights are generally irrevocable, even if you later learn information that you consider to be unfavorable to the exercise of your subscription rights. If, however, we amend the rights offering to allow for an extension of the rights offering for a period of more than 30 days after the most recently announced expiration date, or we make a fundamental change to the terms set forth in this prospectus, or to the extent you have the right to cancel your subscription under applicable law, you may cancel your subscription and receive a refund of any money you have advanced without interest or deduction. The purchase of our common stock and warrants involves a high degree of risk.

You should read “Risk Factors” beginning on page 16 of this prospectus and all other information included in this prospectus in its entirety before you decide whether to exercise your rights. Our board of directors is making no recommendation regarding your exercise of the subscription rights and neither is Source Capital Group, Inc., the dealer-manager for the rights offering.

Our common stock is quoted on the OTC Bulletin Board under the symbol “TKOI.” The shares of common stock issued in this rights offering and pursuant to the terms of the warrants will also be quoted on the OTC Bulletin Board under the same symbol. The last reported sale price of our common stock on May 25, 2010 was \$0.11 per share. The subscription rights are transferable during the course of the subscription period, and we intend to apply for quotation of the subscription rights on the OTC Bulletin Board under the symbol “[].” The warrants to be issued pursuant to the rights offering are separately transferable following their issuance through their expiration date of [], 2015, and we intend to apply for quotation of the warrants on the OTC Bulletin Board under the symbol “[].”

The dealer-manager has agreed to use its reasonable efforts to advise and assist us in our efforts to solicit subscriptions of the rights distributed to holders of our common stock and Series A convertible redeemable preferred stock and has no obligation to purchase or procure purchases of the common stock and warrants offered by this prospectus.

OFFERING SUMMARY

	Per Subscription Right	Aggregate (1)
Subscription Price	\$[]	\$[]
Dealer Manager Fee (2)	\$[]	\$[]
Proceeds, before Expenses, to Us	\$[]	\$[]

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- (1) Assumes that this rights offering is fully subscribed for and that the maximum offering amount is \$[] of subscription proceeds.
 - (2) In connection with the rights offering, we have agreed to pay Source Capital Group, Inc., the dealer-manager for this rights offering, a fee equal to 8% of the gross proceeds of this offering. Source Capital Group, Inc. is an underwriter within the meaning of Section 2(a)(11) of the Securities Act of 1933, as amended, and any fees or commissions received by it will be underwriting discounts or commissions under such act.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed on the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

Dealer-Manager

Source Capital Group, Inc.

The date of this prospectus is [], 2010.

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ABOUT THIS PROSPECTUS

Unless otherwise stated or the context otherwise requires, the terms “Telkonet,” “we,” “us,” and “our” refer to Telkonet, Inc and, where appropriate, to Telkonet, Inc. and its subsidiaries.

You should rely only on the information contained or incorporated by reference in this prospectus. We have not authorized anyone to provide you with additional or different information. If anyone provides you with additional, different, or inconsistent information, you should not rely on it. We are not making an offer to sell securities in any jurisdiction in which, or to any person to whom, the offer or sale is not permitted. You should assume that the information in this prospectus is accurate only as of the date on the front cover of this prospectus, and any information we have incorporated by reference is accurate only as of the date of the document incorporated by reference, in each case, regardless of the time of delivery of this prospectus or any exercise of the rights. Our business, financial condition, results of operations, and prospects may have changed since those dates.

Telkonet, Telkonet iBridge, Telkonet iWire System, Telkonet SmartEnergy, EthoStream and E-Zone are registered trademarks of Telkonet. This prospectus also includes other trademarks and service marks of Telkonet, including Recovery Time, Series 5 and Telkonet Networked SmartEnergy, as well as trademarks of other persons. All other trademarks, tradenames and service marks appearing in this prospectus are the property of their respective owners.

MARKET AND INDUSTRY DATA

Unless we indicate otherwise, we base the information concerning our industry contained in this prospectus on our general knowledge of and expectations concerning the industry. Our market position, market share and industry market size are based on our estimates using our internal data and estimates, data from various industry analyses, internal research and adjustments and assumptions that we believe to be reasonable. We have not independently verified data from industry analyses and cannot guarantee their accuracy or completeness. In addition, we believe that data regarding the industry, market size and our market position and market share within such industry provide general guidance but are inherently imprecise. Further, our estimates and assumptions involve risks and uncertainties and are subject to change based on various factors, including those discussed in the “Risk Factors” section of this prospectus and the other information contained herein. These and other factors could cause results to differ materially from those expressed in the estimates and assumptions.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements contained in this prospectus contain forward-looking statements and information, which involve risks and uncertainties. Forward-looking statements provide our current expectations and forecasts about future events, and include statements regarding our future results of operations and financial position, business strategy, budgets, projected costs, plans and objectives of management for future operations. The words “may,” “continue,” “estimate,” “intend,” “plan,” “will,” “believe,” “project,” “expect,” “anticipate” and similar expressions may identify forward-looking statements, but the absence of these words does not necessarily mean that a statement is not forward-looking.

These forward-looking statements include, among other things, statements about:

The competitive and rapidly-evolving nature of our industry;

The potential effect of competing products on our business;

Our ability to obtain capital, use internally generated cash or debt, or use shares of our common stock to finance future acquisitions;

Our reliance on a limited number of third party suppliers and the potential effects of such reliance;

The expected timing for the completion of the transactions described in this prospectus;

The expected effect of the transactions described in this prospectus on our company;

Estimates regarding our capital requirements, and anticipated timing of the need for additional funds;

The condition of the financial markets; and

The current economic downturn.

Any or all of our forward-looking statements may turn out to be inaccurate. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. Forward-looking statements may be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties, including the risks, uncertainties and assumptions described in “Risk Factors.” In light of these risks, uncertainties and assumptions, the forward-looking events and circumstances contained in this prospectus may not occur as contemplated, and actual results could differ materially from those anticipated or implied by the forward-looking statements.

You should read this prospectus with the understanding that our actual future results may be materially different from what we expect. We qualify all of the forward-looking statements in this prospectus by these cautionary statements.

In addition, our past results are not necessarily indicative of our future results. We discuss these and other uncertainties in the “Risk Factors” section of this prospectus beginning on page 16. Unless required by law, we undertake no obligation to publicly update or revise any forward-looking statements to reflect new information or future events or otherwise.

QUESTIONS AND ANSWERS RELATING TO THE RIGHTS OFFERING

The following are examples of what we anticipate will be common questions about the rights offering. The answers are based on selected information from this prospectus. The following questions and answers do not contain all of the information that may be important to you and may not address all of the questions that you may have about the rights offering. This prospectus contains more detailed descriptions of the terms and conditions of the rights offering and provides additional information about us and our business, including potential risks related to the rights offering, our common stock, our business and our prospects.

What is the rights offering?

A rights offering is a distribution of subscription rights on a pro rata basis to existing shareholders of a company. We are distributing, at no charge to holders of shares of our common stock, other than those who hold shares of our common stock solely as participants in the Telkonet, Inc. 401(k) Plan, and holders of shares of our Series A convertible redeemable preferred stock, subscription rights to purchase up to an aggregate of [] shares of our common stock. For each share of common stock subscribed for by the holder of the subscription right, the holder will also receive without additional charge a warrant to purchase one share of our common stock at an exercise price of \$[] per share at any time until its expiration date of [], 2015. You will receive one subscription right for every share of common stock that you owned and every share of common stock into which shares of our Series A convertible redeemable preferred stock that you owned were convertible as of 5:00 p.m., Eastern time, on [], 2010, the record date for the rights offering. The subscription rights will be evidenced by subscription rights certificates, which will be distributed to the record holders of our common stock and Series A convertible redeemable preferred stock. As described below, this offering is limited to aggregate subscription proceeds of \$[].

What is the basic subscription right?

The basic subscription right gives our shareholders the opportunity during the subscription period to purchase one share of our common stock at the subscription price of \$[] per share and to receive without additional charge a warrant to purchase one additional share of our common stock at \$[], or []% of the subscription price, at any time until its expiration date of [], 2015. The subscription rights are transferable during the course of the subscription period, and we intend to apply for quotation of the subscription rights on the Over-the-Counter Bulletin Board, or the OTC Bulletin Board, under the symbol “[].” The warrants to be issued pursuant to this offering are separately transferable following their issuance and through their expiration date of [], 2015, and we intend to apply for quotation of the warrants on the OTC Bulletin Board under the symbol “[].”

A holder may exercise any number of his, her or its basic subscription rights or may choose not to exercise any subscription rights at all. A holder may sell his, her or its subscription rights if a market develops or may let them expire worthless at the end of the subscription period. Unless we otherwise agree in writing, a person or entity, together with related persons or entities, may not exercise subscription rights (including over-subscription rights) to purchase shares of our common stock that, when aggregated with their existing ownership, would result in such person or entity, together with any related persons or entities, owning in excess of twenty percent (20%) of our issued and outstanding shares of common stock following the closing of the transactions contemplated by this rights offering.

For example, if you own 1,000 shares of our common stock on the record date, you will be granted one right for every share of our common stock you own at that time, representing the right to subscribe for up to an aggregate of 1,000 shares of our common stock and to receive without additional charge warrants to purchase up to an aggregate of 1,000 additional shares of our common stock. If you hold your shares in the name of a broker, dealer, custodian bank, trustee or other nominee who uses the services of the Depository Trust Company, or DTC, then DTC will issue one right to the nominee for every share of our common stock you beneficially own at the record date.

If basic subscription rights are exercised for more than \$[], then the total number of exercised basic subscription rights to be fulfilled will be limited to \$[] and reduced on a pro rata basis based on the number of shares subscribed for by each such holder as part of their basic subscription rights, subject to adjustment to eliminate fractional shares, and any excess subscription amount received by the subscription agent will be returned, without interest or deduction, as soon as practicable.

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What is the over-subscription right?

If a holder elects to exercise all of his, her or its basic subscription rights, such holder may also elect, subject to limitations, to subscribe for additional shares of our common stock that remain unsubscribed as a result of any unexercised basic subscription rights. The over-subscription right allows a holder to subscribe for an additional amount equal to up to []% of the shares and warrants for which such holder was otherwise entitled to subscribe. The over-subscription rights will only be fulfilled if the basic subscription rights are not exercised for at least \$[] and only to the extent that aggregate subscription proceeds (including from over-subscription rights) are no more than \$[].

For example, if you own 1,000 shares of our common stock on the record date and exercise your basic subscription right to subscribe for all (but not less than all) 1,000 shares of our common stock which are available for you to subscribe for, then you may also concurrently exercise your over-subscription right to subscribe for up to an aggregate of [] additional shares of our common stock that may remain unsubscribed as a result of subscription rights holders not exercising their basic subscription rights for an aggregate of \$[], subject to the pro rata adjustments described below. Accordingly, if your basic and over-subscription rights are exercised and honored in full, you would receive a total of [] shares of our common stock in this rights offering, and warrants to purchase up to an aggregate of [] additional shares of our common stock. Payments in respect of over-subscription rights are due at the time payment is made for the basic subscription right.

What happens if subscription rights holders exercise their respective over-subscription rights to purchase additional shares of common stock?

We will allocate any remaining available shares of our common stock pro rata among subscription rights holders who exercised their respective over-subscription rights, based on the number of over-subscription shares of our common stock to which they subscribed. The number of shares of our common stock each over-subscribing rights holder may be allocated on a pro rata basis will be rounded down to eliminate fractional shares.

Payments for basic subscriptions and over-subscriptions will be deposited upon receipt by the subscription agent and held in a segregated account with the subscription agent pending a final determination of the number of shares of our common stock to be issued pursuant to the basic and over-subscription rights. If the pro rated number of shares of our common stock allocated to you in connection with your basic or over-subscription right is less than your basic or over-subscription request, then the excess funds held by the subscription agent on your behalf will be returned to you, without interest or deduction, as soon as practicable after the rights offering has expired and all prorating calculations and reductions contemplated by the terms of the rights offering have been effected. We will deliver certificates representing your shares of our common stock and warrants or credit your account at your nominee holder with shares of our common stock and warrants that you purchased pursuant to your basic and over-subscription rights as soon as practicable after the rights offering has expired and all prorating calculations and reductions contemplated by the terms of the rights offering have been effected.

Why are we conducting the rights offering?

We are conducting the rights offering to raise equity capital to support our operations and strengthen our balance sheet. We anticipate that proceeds from the offering will be applied toward the expansion of our sales and marketing operations, general working capital purposes, potential acquisitions of complementary businesses and research and development. Additionally, we may use a portion thereof to pay the expenses of defending, settling and/or paying unfavorable judgments against us in litigation in which we are a defendant. See "Use of Proceeds." Our board of directors has elected a rights offering over other types of financings because a rights offering provides our existing shareholders the opportunity to participate in this offering first, and our board of directors believes this will result in

less dilution of our existing shareholders' ownership interest in our company than if we issued securities to new investors.

Additionally, on November 19, 2009, we completed a private placement of 215 shares of Series A convertible redeemable preferred stock, par value \$0.001 per share, and warrants to purchase an aggregate of 1,628,800 shares of common stock, par value \$0.001 per share, to certain accredited investors pursuant to a securities purchase agreement, or Securities Purchase Agreement, entered into on November 16, 2009.

Pursuant to Section 4.13 of the Securities Purchase Agreement, we agreed, as soon as practicable following the closing of the private placement, subject to approval of the board of directors, to conduct a rights offering entitling holders of our common stock to purchase the number of equity securities mutually determined by the board of directors and the purchasers in the private placement at the price and terms mutually determined by the board of directors and such purchasers. Shareholders fully exercising their subscription rights in the rights offering were to be entitled to an over-subscription right to purchase all or any part of the balance of any such remaining unsubscribed equity securities.

The board first discussed the possibility of conducting a rights offering in late August 2009, while in discussions with a third party about the conduct of a private placement (that ultimately culminated in the Securities Purchase Agreement). Based on information obtained during the due diligence process in connection with the private placement, the board acquired the understanding that certain of our shareholders expressed an interest in participating in a rights offering after the private placement to offset the potential dilutive effect of the private placement. Between August 2009 and November 19, 2009, when we completed the private placement transaction as previously disclosed in Item 1.01 of our Current Report filed with the SEC on November 25, 2009, the board focused exclusively on the conduct and completion of the private placement. The board began actively planning to conduct a rights offering following the completion of the private placement transaction in November 2009. In December 2009, members of the board and executive management met with various investment banking organizations experienced in conducting rights offerings to discuss both the potential for success of such an offering and, assuming a decision to move forward, to determine which investment banking organization would best serve our interests. The board selected Source Capital Group, Inc. as the dealer-manager for our rights offering, and on January 7, 2010, by resolution, approved our conduct of a rights offering and the engagement of Source Capital Group, Inc. as the dealer-manager for the rights offering. Source Capital Group, Inc. is an underwriter within the meaning of Section 2(a)(11) of the Securities Act of 1933, as amended, and any fees or commissions received by it will be underwriting discounts or commissions under such act.

Prior to approving the rights offering, our board of directors carefully considered current market conditions and financing opportunities, as well as the potential dilution of the ownership percentage of the existing holders of our common stock that may be caused by the rights offering. After weighing the foregoing factors, the board of directors determined that the rights offering is in the best interests of our company. Although we believe that the rights offering will strengthen our financial condition, our board of directors is not making any recommendation as to whether you should exercise your subscription rights in the rights offering.

The rights offering may not be effected unless our shareholders approve an increase in our authorized common stock. Pursuant to our Preliminary Proxy Statement on Schedule 14A, filed May [], 2010, File No. 001-31972, we are seeking shareholder approval of an amendment to the Telkonet, Inc. Amended and Restated Articles of Incorporation, as amended, to increase the number of authorized shares of our common stock from 155,000,000 to 575,000,000.

Do we intend to conduct a reverse split?

Pursuant to Section 4.16 of the Securities Purchase Agreement, we agreed, as soon as practicable following the closing of the Private Placement, subject to the approval of the board of directors, to conduct a reverse stock split of our issued and outstanding common stock. The primary objective of the reverse split was to effect an increase in the price per share of our common stock in order to maintain the listing of our common stock on the NYSE Amex, LLC (the "Exchange"). The board initially considered conducting a reverse split beginning in May 2009, when the Exchange expressed its opinion that it was appropriate for us to effect a reverse split in light of the low selling price of our common stock. In its June 25, 2009 response to the Exchange, we requested that the Exchange reconsider its request that we conduct a reverse stock split to and provide us the necessary time to achieve its goals and initiatives as outlined in its plan of compliance. Management stated its belief then that, as we executed on our plan and as the global economy began to recover from the current recession, our stock price would increase. We also expressed our belief that a reverse stock split, absent other positive developments at our company, would not, in the long term, sustain a trading price high enough to satisfy the Exchange's additional listing standards. Following a hearing held on October 29, 2009 to appeal a determination by the staff of the Exchange regarding the delisting of our common stock from the Exchange, we were informed, on November 3, 2009, that the hearing panel had confirmed the staff's recommendation that our common stock be delisted from the Exchange. After considering the costs to our company of compliance with the continued listing requirements of the Exchange and other factors, we determined that it was not in the best interests of our company and its shareholders to appeal the delisting of our securities from the

Exchange and approved the voluntary delisting of the securities. The Exchange suspended trading in our stock effective at the open of business on November 14, 2009 and delisting of our stock from the Exchange became effective on March 29, 2010.

After further considering a reverse stock split pursuant to the terms of the Securities Purchase Agreement, the board concluded again in January 2010 that the conduct of a reverse split was not in our company's best interests. The board was significantly concerned that a reverse split, without a contemporaneous change in our company's finances would be perceived negatively, and that the desired effect, i.e., an increase in the price per share, would be short lived. The board considered the history of company share prices following a reverse split and found that the majority eventually trade lower post-split. The board also believes that the conduct of a reverse split in order to effect a temporary increase in stock price would be inconsistent with our longer term objectives of building shareholder value through positive business development. There can be no assurance that we will not in the future seek to conduct a reverse stock split to rationalize outstanding shares and relist our common stock on the NYSE AMEX or Nasdaq .

Do we intend to enter into standby agreements in connection with the rights offering?

Source Capital Group, Inc., the dealer-manager for the rights offering, will act as a standby placement agent for any unsubscribed shares in the offering. Any shares (and related warrants) not subscribed for by the holders of the subscription rights during the rights offering will be reoffered to the public at a price of \$____ per share (and related warrant), which is the same as the exercise price of the subscription rights. The dealer-manager will have the ability to solicit any unsubscribed shares (together with related warrants) for a period of thirty business days after the closing of the rights offering. Source Capital Group, Inc. is an underwriter within the meaning of Section 2(a)(11) of the Securities Act of 1933, as amended, and any fees or commissions received by it will be underwriting discounts or commissions under such act.

What special arrangements have been made with respect to Utah?

Because Source Capital Group, Inc., the dealer-manager for the rights offering, is not registered in the State of Utah, it may not solicit the exercise of rights held by shareholders in the State of Utah or solicit purchasers from the State of Utah for any unsubscribed shares (together with related warrants). For this reason, we have agreed with the dealer-manager that we may retain a member of FINRA, duly registered in the State of Utah, to solicit the exercise of rights and purchasers for any unsubscribed shares (together with related warrants) from purchasers in Utah. If such other FINRA member succeeds in getting Utah shareholders to exercise their rights or finding purchasers in Utah for any of the unsubscribed shares (together with related warrants), Source Capital Group, Inc., will reallow to such other FINRA member half of the 8% cash fee that it is entitled to receive in connection with the gross proceeds received by us from such Utah shareholders whom such other FINRA member succeeded in getting to exercise rights and from such Utah purchasers whom such other FINRA member succeeded in getting to purchase any unsubscribed shares (together with related warrants).

How was the \$[] per share subscription price determined?

The subscription price per share for the rights offering was set by our board of directors. In determining the subscription price, our board of directors considered, among other things, our cash needs, the historical and current market price of our common stock, the fact that holders of subscription rights will have an over-subscription right, the terms and expenses of this offering relative to other alternatives for raising capital (including fees payable to the dealer-manager), the size of this offering and the general condition of the securities market. Based upon these factors, our board of directors and the purchasers in the private placement determined that the subscription price per share represented an appropriate subscription price.

We did not seek or obtain an opinion of a financial advisor in establishing the subscription price. The subscription price will not necessarily be related to our book value, tangible book value, multiple of earnings or any other established criteria of fair value and may or may not be considered the fair value of our common stock offered in this offering. You should not assume or expect that, after this offering, our shares of common stock will trade at or above the subscription price in any given time period. The market price of our common stock may decline during or after the rights offering, and you may not be able to sell the underlying shares of our common stock purchased during the rights offering at a price equal to or greater than the subscription price. You should obtain a current quote for our common stock before exercising your subscription rights and make your assessment of our business and financial condition, our prospects for the future, and the terms of this rights offering.

Am I required to exercise all of the subscription rights I receive in the rights offering?

No. You may exercise any number of your subscription rights, or you may choose not to exercise any subscription rights. You may also try to sell all of the subscription rights you decide not to exercise if a trading market develops for such rights. Although we will attempt to satisfy all oversubscription requests in full, we cannot assure you that we will fill any over-subscriptions.

If you do not exercise any subscription rights, the number of shares of our common stock and preferred stock that you own will not change. However, if you choose not to exercise your subscription rights, your ownership interest in our company will be diluted by other shareholder purchases. In addition, if you do not exercise your basic subscription right in full, you will not be entitled to participate in the over-subscription right. See “Risk Factors — If you do not exercise your subscription rights, your percentage ownership in our company will be diluted.”

How soon must I act to exercise my subscription rights?

If you received a rights certificate and elect to exercise any or all of your subscription rights, the subscription agent must receive your completed and signed rights certificate and payments before the rights offering expires on [], 2010, at 5:00 p.m., Eastern time. If you hold your shares in the name of a broker, dealer, custodian bank or other nominee, your nominee may establish a deadline before the expiration of the rights offering by which you must provide it with your instructions to exercise your subscription rights. Although our board of directors may, in its discretion, extend the expiration date of the rights offering, we currently do not intend to do so. Our board of directors may cancel the rights offering at any time. If the rights offering is cancelled, all subscription payments received will be returned, without interest or deduction, as soon as practicable.

Although we will make reasonable attempts to provide this prospectus to our shareholders, the rights offering and all subscription rights will expire on the expiration date, whether or not we have been able to locate each person entitled to subscription rights.

May I transfer or sell my subscription rights if I do not want to purchase my shares?

Yes. The subscription rights are transferable during the course of the subscription period, and we intend to apply for quotation of the subscription rights on the OTC Bulletin Board under the symbol “[]” beginning on or about [], 2010, until 5:00 p.m., Eastern time, on [], 2010, the scheduled expiration date of this rights offering. However, the subscription rights are a new issue of securities with no prior trading market, and we cannot provide you any assurances as to the liquidity of the trading market for the subscription rights or as to the prices at which such subscription rights may trade during the subscription period.

Are we requiring a minimum overall subscription to complete the rights offering?

No. We are not requiring an overall minimum subscription to complete the rights offering. However, our board of directors reserves the right to cancel the rights offering for any reason, including, but not limited to, if we do not receive aggregate subscriptions that we believe will satisfy our capital-raising objectives.

Can the board of directors cancel, extend or amend the rights offering?

Yes. Our board of directors may decide to cancel the rights offering at any time and for any reason before the rights offering expires. If our board of directors cancels the rights offering, we will issue a press release to inform our shareholders of the cancellation, and any money received from subscribing shareholders will be returned, without interest or deduction, as soon as practicable.

We may also elect to extend the rights offering and the period for exercising your subscription rights for additional periods ending no later than [], although we do not presently intend to do so. If we elect to extend the expiration of the rights offering, we will issue a press release announcing such extension no later than 9:00 a.m., Eastern time, on the next business day after the previously scheduled date of expiration of the rights offering, and you will have at least ten trading days following such announcement during which to exercise your subscription rights. We will extend the duration of the rights offering as required by applicable law or regulation and may choose to extend it if we decide to give investors more time to exercise their subscription rights in this rights offering. If we elect to extend the rights offering for a period of more than 30 days beyond the most recently announced expiration date, then holders who have previously exercised their subscription rights may cancel their subscriptions and receive a refund of all money advanced.

Our board of directors also reserves the right to amend or modify the terms of the rights offering. If we should make any fundamental changes to the terms set forth in this prospectus, we will file a post-effective amendment to the registration statement in which this prospectus is included, offer potential purchasers who have previously subscribed for rights the opportunity to cancel their subscriptions and issue a refund of any money advanced by those shareholders electing to cancel their subscriptions, and recirculate an updated prospectus after the post-effective amendment is declared effective with the SEC. In addition, upon such event, we may extend the expiration date of this rights offering if required by applicable law, to allow holders of rights ample time to make new investment decisions, or for us to recirculate updated documentation. Promptly following any such occurrence, we will issue a press release announcing any changes with respect to this rights offering and the new expiration date. The terms of the rights offering cannot be modified or amended after the expiration date of the rights offering. Although we do not presently intend to do so, we may choose to amend or modify the terms of the rights offering for any reason, including, without limitation, in order to increase participation in the rights offering. Such amendments or modifications may include a change in the subscription price although no such change is presently contemplated.

Has our board of directors made a recommendation to our shareholders regarding the rights offering?

No. Neither our board of directors nor the dealer-manager is making any recommendation regarding your exercise of the subscription rights. Shareholders who exercise subscription rights will incur investment risk on new money invested. We cannot predict the price at which our shares of common stock will trade after the offering. The market price for our common stock may decrease to an amount below the subscription price, you may not be able to sell the underlying shares of our common stock in the future at the same price or a higher price. You should make your decision based on your assessment of our business and financial condition, our prospects for the future, the terms of the rights offering and the information contained in this prospectus. See "Risk Factors" for a discussion of some of the risks involved in investing in the securities offered in the rights offering. The warrants may never trade at a price greater than their exercise price. In addition, the aggregate proceeds you receive from the sale of the common stock

you subscribe for and from the sale of the warrants you receive upon exercise of your subscription rights may be less than your subscription price.

Will our directors and executive officers participate in the rights offering?

Our directors and executive officers may participate in the rights offering but are not obligated to do so. If our directors and executive officers, and their affiliates, choose to participate in this rights offering, they will pay the same subscription price per share as all other purchasers.

Jason L. Tienor, Jeffrey J. Sobieski, Richard J. Leimbach, our Chief Executive Officer (and director), Chief Operating Officer and Chief Financial Officer, respectively and Anthony J. Paoni, our Chairman of the Board, participated in our November 2009 private placement of Series A convertible redeemable preferred stock and warrants, as described below. On November 16, 2009, we entered into an Executive Officer Reimbursement Agreement with each of Messrs. Tienor, Sobieski and Leimbach, pursuant to which these executive officers participated in the private placement by converting a portion of our outstanding indebtedness owed to them into shares of Series A convertible redeemable preferred stock and warrants to purchase shares of our common stock. Mr. Tienor converted \$20,000 of outstanding indebtedness into four shares of Series A convertible redeemable preferred stock (convertible into 55,096 shares of common stock) and warrants to purchase 30,304 shares of common stock; Mr. Leimbach converted \$10,000 of outstanding indebtedness into two shares of Series A convertible redeemable preferred stock (convertible into 27,548 shares of common stock) and warrants to purchase 15,152 shares of common stock; and Mr. Sobieski converted \$20,000 of outstanding indebtedness into four shares of Series A convertible redeemable preferred stock (convertible into 55,096 shares of common stock) and warrants to purchase 30,304 shares of common stock. Anthony Paoni, Chairman of our board of directors, also participated in the private placement, purchasing five shares of Series A convertible redeemable preferred stock (convertible into 68,870 shares of common stock) and warrants to purchase 37,880 shares of common stock, for an aggregate purchase price of \$25,000. The combined participation of our officers and directors was less than 7% of the value of the private placement.

At the time of the preparation of the private placement documents, it was not contemplated that officers and/or directors would participate in the private placement. The forms of agreements associated with the private placement were developed and approved in connection with a private placement we began pursuing in August, 2009 that contemplated an investment in the amount of Five Million Dollars (\$5,000,000) by a third party investor as Lead Investor, and certain co-investors to be identified by the Lead Investor. It was not then, nor at any point in time while we were working with Lead Investor, contemplated that officers and/or directors would participate in the offering, however, beginning in October 2009 the Lead Investor began encouraging and demanding management and officer participation in the offering both to assist in reaching the \$5,000,000 benchmark and to show management/board support of the transaction.

After working diligently with the Lead Investor between August 2009 and early November, 2009, the board of directors concluded that we would be unable to consummate the transaction as contemplated, due principally to the Lead Investor's failure to identify sufficient co-investors. We were facing significant cash demands due in large part to the need to place substantial deposits for the early 2010 manufacturing of energy management products. Advance orders were necessitated by the planned shutdown of our third party manufacturer in China during the month of February 2010 for the Chinese New Year. Because of the foregoing, we were forced to rapidly consider other financing options. Several investors that had expressed a willingness to participate in the Lead Investor transaction, all existing shareholders of our company, expressed a willingness to participate in a financing. Only just prior to the consummation of the private placement in November did Messrs. Paoni, Tienor, Sobieski, and Leimbach agree to participate in the transaction, the purpose and intent of which was to complete a capital raise in excess of \$1,000,000 in order to meet our capital requirements.

The Lead Investor transaction and the private placement ultimately consummated were priced above market. The private placement that was consummated was on substantially the same terms and conditions negotiated with the Lead Investor. Those terms were agreed upon after a lengthy negotiation and after our board had considered multiple competing term sheets – none of which came close to matching the economic and other terms contained in the Lead Investor term sheet. Each participating officer and director purchased shares at the same price and on the same terms and conditions as the four outside investors. We benefitted substantially by the participation of its officers and directors in that it enabled us to achieve our goal of raising in excess of \$1,000,000 while also enabling us to satisfy a portion of its outstanding obligations to Messrs. Tienor, Sobieski and Leimbach other than through payments in cash. In light of the foregoing, the participation of Messrs. Paoni, Tienor, Sobieski, and Leimbach in the private

placement transaction did not pose a conflict of interest. The private placement transaction was unanimously approved by our board of directors.

The following table sets forth our outstanding indebtedness as at May 12, 2010 owed to our officers and directors:

	Salary	BOD Fees	Consulting	Expenses	Advances	Total
Jason L. Tienor	\$ 34,526	\$ -	\$ -	\$ -	\$ 25,000	\$ 59,526
Jeffrey J. Sobieski	37,880			1,125	25,000	64,005
Richard J. Leimbach	51,080			2,004		53,084
Anthony J. Paoni		164,000	68,000	2,127		234,127
Thomas C. Lynch		170,000				170,000
Warren V. Musser		278,333				278,333

Our directors and executive officers will have the right to participate in the rights offering based on the number of shares of our common stock held by them, and the number of shares of our common stock into which shares of Series A convertible redeemable preferred stock held by them were convertible, as of the record date, however we do not contemplate allowing such persons to participate in the rights offering by converting such indebtedness or any portion thereof.

How do I exercise my subscription rights if I own shares in certificate form?

If you hold a Telkonet, Inc. stock certificate and you wish to participate in the rights offering, you must take the following steps:

deliver payment to the subscription agent before 5:00 p.m., Eastern time, on [], 2010; and

deliver a properly completed and signed rights certificate to the subscription agent before 5:00 p.m., Eastern time, on [], 2010.

In certain cases, you may be required to provide additional documentation or signature guarantees.

Please follow the delivery instructions on the rights certificate. Do not deliver documents to Telkonet. You are solely responsible for completing delivery to the subscription agent of your subscription documents, rights certificate and payment. You should allow sufficient time for delivery of your subscription materials to the subscription agent so that the subscription agent receives them by 5:00 p.m., Eastern time, on [], 2010.

If you send a payment that is insufficient to exercise the number of subscription rights you requested, or if the number of subscription rights you requested is not specified in the forms, the payment received will be applied to exercise your subscription rights to the fullest extent possible based on the amount of the payment received, subject to the availability of subscription rights under the over-subscription right and the elimination of fractional subscription rights.

What should I do if I want to participate in the rights offering but my shares are held in the name of a broker, dealer, custodian bank or other nominee?

If you hold your shares of common stock or Series A convertible redeemable preferred stock through a broker, dealer, custodian bank or other nominee, then your nominee is the record holder of the shares you own. The record holder must exercise the subscription rights on your behalf. If you wish to purchase our common stock through the rights offering, you should contact your broker, dealer, custodian bank or nominee as soon as possible. Please follow the instructions of your nominee. Your nominee may establish a deadline that may be before the expiration date of the rights offering.

When will I receive my new shares and warrants?

If you purchase shares of our common stock and warrants in the rights offering, you will receive your new shares and warrants as soon as practicable after the closing of the rights offering.

After I send in my payment and rights certificate, may I cancel my exercise of subscription rights?

No. All exercises of subscription rights are generally irrevocable unless the rights offering is cancelled, even if you later learn information that you consider to be unfavorable to the exercise of your subscription rights. You should not exercise your subscription rights unless you are certain that you wish to purchase shares of our common stock in the rights offering at a subscription price of \$[] per share and to receive related warrants to purchase shares of our common stock at an exercise price of \$[] per share. If, however, we amend the rights offering to allow for an extension of the rights offering for a period of more than 30 days after the most recently announced expiration date, or we make a fundamental change to the terms set forth in this prospectus, or to the extent you have the right to cancel your subscription under applicable law, you may cancel your subscription and receive a refund of any money you have advanced without interest or deduction.

Are there any conditions to completing the rights offering?

No, there are no express conditions to completion of the rights offering. As described above, however, our board of directors may determine, in its discretion, not to proceed with the rights offering. Factors that could impact our board of directors' decision whether to proceed with the rights offering include economic and market conditions, our business and financial condition and prospects, the availability of alternative sources of capital and the level of interest among our shareholders in participating in the rights offering. Additionally, the rights offering may not be effected unless our shareholders approve an increase in our authorized common stock. If the rights offering is cancelled for any reason, any subscription payments delivered to the subscription agent will be returned without interest or deduction.

What effects will the rights offering have on our outstanding common stock?

As of May 14, 2010, we had 96,967,129 shares of our common stock issued and outstanding, and 215 shares of our Series A convertible redeemable preferred stock issued and outstanding, which are convertible into an aggregate of 2,961,429 shares of our common stock. Another 11,144,212 shares are subject to unexercised options granted pursuant to our Stock Option Plan, or reserved for issuance in connection with future grants under the Stock Option Plan. In addition, up to 12,158,941 shares of our common stock are reserved for issuance upon the exercise of warrants and conversion of our outstanding convertible debentures, of which 4,621,212 shares reserved for issuance cannot be issued unless our stockholders remove the 20% limitation on the number of shares that could be issued pursuant to the exercise of warrants and conversion of convertible debentures issued to YA Global Investments, L.P., or YA Global. The number of shares of common stock and related warrants that we will issue in this rights offering will depend on the number of shares that are subscribed for in the rights offering. If the subscription rights are exercised in full, we will have [] shares of common stock outstanding after consummation of the rights offering, not including the shares of common stock that will be issuable upon the exercise of the warrants issued in the rights offering.

The issuance of shares of common stock and warrants in the rights offering will dilute, and thereby reduce, your proportionate ownership in our shares of common stock. If you fully exercise your basic subscription right, your ownership interest will not be diluted. In addition, if the subscription price is less than the market price of our common stock it will likely reduce the market price per share of shares you already hold.

How much capital will we receive from the rights offering?

If all of the subscription rights (including all over-subscription rights) are exercised in full by our shareholders, we estimate that the net proceeds to us from the rights offering, after deducting estimated offering expenses, will be approximately \$[] million. Unless our board of directors elects to increase the maximum offering amount, we will raise no more than \$[] in gross proceeds in this rights offering. It is possible, however, that all of the subscription rights being offered to existing shareholders might not be exercised, or that we will elect to cancel the rights offering altogether. However, if all of the subscription rights are not exercised, we have retained Source Capital Group, Inc., the dealer-manager of the rights offering, to act as our standby placement agent in connection with our reoffering of the shares of common stock (and related warrants) not subscribed for to the public at a price of \$[] per share (and related warrant), which is the same as the exercise price of the subscription rights. Source Capital Group, Inc. is an underwriter within the meaning of Section 2(a)(11) of the Securities Act of 1933, as amended, and any fees or commissions received by it will be underwriting discounts or commissions under such act.

Are there risks in exercising my subscription rights?

Yes. The exercise of your subscription rights involves risks. Exercising your subscription rights involves the purchase of shares of our common stock and related warrants. You should consider this investment as carefully as

you would consider any other equity investment. Among other things, you should carefully consider the risks described under the heading “Risk Factors” in this prospectus.

If the rights offering is not completed, will my subscription payment be refunded to me?

Yes. The subscription agent will hold all funds it receives in a segregated bank account until completion of the rights offering. If the rights offering is not completed, all subscription payments received by the subscription agent will be returned, without interest or deduction, as soon as practicable. If you own shares in “street name,” it may take longer for you to receive your subscription payment because the subscription agent will return payments through the record holder of your shares.

What fees or charges apply if I exercise my subscription rights?

We will not charge any fee or sales commission to subscription rights holders for exercising their subscription rights (other than the subscription price). However, if you exercise your subscription rights through a broker, dealer, custodian bank or other nominee, you are responsible for paying any fees your record holder may charge you.

What expenses will be incurred by us in connection with the rights offering?

We have engaged Source Capital Group, Inc. as our dealer-manager and financial advisor in connection with the rights offering. Source Capital Group, Inc. is an underwriter within the meaning of Section 2(a)(11) of the Securities Act of 1933, as amended, and any fees or commissions received by it will be underwriting discounts or commissions under such act. The dealer-manager will not be obligated to purchase any of the shares and warrants offered in the rights offering. Under the terms and subject to the conditions contained in a dealer-manager agreement, we have agreed to pay the dealer-manager, as compensation for its services on completion of the rights offering, a cash fee equal to 8% of the gross proceeds of the rights offering, less the \$15,000 advance we paid to the dealer-manager. We have also agreed to indemnify the dealer-manager and its respective affiliates against certain liabilities arising under the Securities Act of 1933, as amended. The dealer-manager does not make any recommendation with respect to such securities.

Where can I find a discussion of certain U.S. federal income tax considerations of receiving or exercising my subscription rights?

For U.S. federal income tax purposes, we take the position that you should not recognize income or loss in connection with the receipt or exercise of subscription rights in the rights offering. You should consult your tax advisor as to your particular tax consequences resulting from the rights offering. For a detailed discussion, see "Certain U.S. Federal Income Tax Considerations."

To whom should I send my forms and payment?

Our subscription agent for the rights offering is []. If your shares are held in the name of a broker, dealer or other nominee, then you should send your subscription documents, rights certificate and subscription payment to that record holder. If you are the record holder, then you should send your subscription documents, rights certificate and subscription payment by hand delivery, first class mail or courier service to our subscription agent at:

By Mail, Hand or Overnight Courier:

[•]

We will pay the fees and expenses of our subscription agent and expect that we will enter into an agreement to indemnify the subscription agent against certain liabilities that it may incur in connection with the rights offering.

You are solely responsible for completing delivery to the subscription agent of your subscription documents, rights certificate and payment. You should allow sufficient time for delivery of your subscription materials to the subscription agent.

Whom should I contact if I have other questions?

If you have any questions regarding our company or the rights offering, please contact [], our information agent for the rights offering, at [], Monday through Friday, between 8:00 a.m. and 5:00 p.m., Eastern time.

PROSPECTUS SUMMARY

This summary highlights information contained elsewhere in this prospectus. This summary is not complete and may not contain all of the information that you should consider before deciding whether or not you should exercise your rights. You should read the entire prospectus carefully, including the section entitled “Risk Factors” beginning on page 16 of this prospectus and all information included in this prospectus in its entirety before you decide whether to exercise your rights.

Our Business

Telkonet, Inc. develops, and manufactures and sells proprietary energy efficiency and smart grid networking technology. Our SmartEnergy and Series 5 SmartGrid networking technologies enable us to develop innovative clean technology products and have helped position us as a leading clean technology provider.

Our Telkonet SmartEnergy, or TSE, and Networked Telkonet SmartEnergy, or NTSE, platforms incorporate Recovery Time™, an energy management technology that continuously monitors climate conditions and automatically adjusts a room’s temperature to account for the presence or absence of an occupant in an effort to save energy while ensuring occupant comfort. This technology is particularly attractive to our customers in the hospitality area and owners of multi-dwelling units, who are continually seeking ways to reduce costs without impacting customer satisfaction. By reducing energy usage automatically when a space is not being utilized, our customers can realize significant cost savings without diminishing occupant comfort.

Our Series 5 system uses powerline communications, or PLC, technology to transform a site’s existing internal electrical infrastructure into an ethernet network backbone. With its powerful 200 Mbps chip, the system offers a competitive alternative in grid communications, transforming a traditional power management system into a “smart grid” that delivers electricity in a manner that saves energy, reduces cost and increases reliability. Our PLC platform provides a compelling solution for substation automation, power generation, renewable facilities, manufacturing and research environments by providing a rapidly-deployed, low cost alternative to structured cable or fiber. By leveraging the existing electrical wiring within a site to transport data, our PLC solutions enable customers to deploy sensing and control systems to locations without the need for new network wiring, and without the security risks associated with wireless systems.

We also operate one of the largest hospitality high-speed Internet access, or HSIA, networks in the United States through our EthoStream Hospitality Network. With a customer base of approximately 2,350 properties representing over 205,000 hotel rooms, this network has created a ready opportunity for us to market our energy efficiency solutions. It also provides a marketing opportunity for our more traditional HSIA offerings, including the Telkonet iWire System. The iWire System offers a fast and cost effective way to deliver commercial high-speed broadband access from an internet portal, or IP, “platform” using a building’s existing electrical infrastructure to convert electrical outlets into high-speed data ports without the installation of additional wiring or major disruption of business activity

Corporate Information

Our principal executive offices are located at 10200 Innovation Drive, Suite 300, Milwaukee, WI 53226. Our reports that are filed pursuant to the Securities Exchange Act of 1934 are posted on our website at www.telkonet.com.

The Rights Offering

The following summary describes the principal terms of the rights offering, but is not intended to be complete. See the information under the heading “The Rights Offering” in this prospectus for a more detailed description of the terms and conditions of the rights offering.

Securities offered

We are distributing, at no charge, to the holders of our common stock, other than those who hold shares of our common stock solely as participants in the Telkonet, Inc. 401(k) plan, and to the holders of our Series A convertible redeemable preferred stock, as of 5:00 p.m., Eastern time on [], 2010, which we refer to as the record date, transferable subscription rights to subscribe for shares of our common stock and warrants to purchase shares of common stock at an exercise price of \$[] per share. We will distribute one right to the holder of record of every share of common stock that is held by the holder of record on the record date, and one right to the holder of record of every share of Series A convertible redeemable preferred stock for every share of common stock into which such shares of Series A convertible redeemable preferred stock were convertible on the record date, or, in the case of shares held of record by brokers, dealers, custodian banks, or other nominees, as a beneficial owner of such shares. We anticipate that the total purchase price for the securities sold in this rights offering will be \$[]. We can give no assurances, however, as to the level of participation in this rights offering.

Basic subscription right

Each transferable subscription right entitles the holder (including holders of subscription rights acquired during the subscription period) to subscribe for one share of our common stock at the subscription price of \$[] per share (calculated as described below in this summary under “— Subscription Price”) and to receive without additional charge a warrant to purchase one additional share of our common stock at \$[], or []% of the subscription price, for a period of five years ending on [], 2015, which we refer to as the basic subscription right.

If the basic subscription rights are exercised for an amount in excess of \$[], the basic subscription rights that have been exercised will be reduced on a pro rata basis, subject to adjustment to eliminate fractional shares, so that the total exercise price of the basic subscription rights shall equal \$[], and any excess subscription amount received by the subscription agent will be returned, without interest or deduction, as soon as practicable after the rights offering has expired and all prorating calculations and reductions contemplated by the terms of the rights offering have been effected.

Basic subscription rights may only be exercised for whole numbers of shares of our common stock and warrants to purchase whole numbers of shares of our common stock; no fractional shares of common stock will be issued in this offering. If the basic subscription rights are exercised for an amount in excess of \$[], the number of shares of common stock each subscription rights holder may acquire will be rounded down to result in delivery of whole shares.

Over-subscription right

The subscription rights holders who fully exercise their basic subscription rights will be entitled, subject to limitations, to subscribe for additional shares of our common stock and warrants to purchase whole numbers of shares of our common stock (and related warrants) that remain unsubscribed as a result of any unexercised basic subscription rights, which we refer to as the over-subscription right, at the same subscription price of \$[] per share. The over-subscription right allows a holder to subscribe for an additional amount equal to up to []% of the shares and warrants for which such holder was otherwise entitled to subscribe.

After all basic subscription rights have been fulfilled, shares of our common stock that remain unsubscribed for, if any, will be allocated to fulfill those over-subscription rights that have been exercised. If the combination of basic subscription rights and over-subscription rights are exercised for an amount equal to or in excess of \$[], then basic subscription rights will be fulfilled and any common stock and warrants to purchase whole numbers of shares of our common stock that remain unsubscribed for will be allocated on a pro rata basis to fulfill those over-subscription rights that have been exercised and the over-subscription rights that have been exercised will be reduced on a pro rata basis, subject to adjustment to eliminate fractional shares, so that the total exercise price of the basic subscription rights and over-subscription rights shall equal \$[]. If the basic subscription rights are exercised for an amount equal to or in excess of \$[], then no over-subscription rights will be fulfilled and any excess subscription amount received by the subscription agent will be returned, without interest or deduction, as soon as practicable after the rights offering has expired and all prorating calculations and reductions contemplated by the terms of the rights offering have been effected.

Over-subscription rights may only be exercised for whole numbers of shares of our common stock and warrants to purchase whole numbers of shares of our common stock; no fractional shares of common stock will be issued in this offering. The number of remaining shares of common stock each over-subscribing rights holder may acquire will be rounded down to result in delivery of whole shares.

Limitation on purchase of common stock

Unless we otherwise agree in writing, a person or entity, together with related persons or entities, may not exercise subscription rights (including over-subscription rights) to purchase shares of our common stock that, when aggregated with their existing ownership, would result in such person or entity, together with any related persons or entities, owning in excess of twenty percent (20%) of our issued and outstanding shares of common stock following the closing of the transactions contemplated by this rights offering. See “The Rights Offering — Limit on How Many Shares of Common Stock You May Purchase in the Rights Offering.”

In addition, those who hold shares of our common stock solely through the Telkonet, Inc. 401k Plan will not have the opportunity to participate in the basic subscription right or over-subscription right in respect of those shares.

Record date

5:00 p.m., Eastern time, on [], 2010.

Commencement date of subscription period 5:00 p.m., Eastern time, on [], 2010.

Expiration date of rights offering 5:00 p.m., Eastern time, on [], 2010, unless extended by us as described under “—Extension, cancellation and amendment.” Any subscription rights not exercised at or before the expiration date and time will have no value and expire without any payment to the holders of those unexercised subscription rights. To exercise subscription rights, the subscription agent must actually receive all required documents and payments before the expiration date and time, provided that if you cannot deliver your subscription rights certificate to the subscription agent on time, you may follow the guaranteed delivery procedures described under “The Rights Offering — Guaranteed Delivery Procedures.”

Subscription price \$[] per share of common stock and warrant, payable in immediately available funds. To be effective, any payment related to the exercise of the right must clear prior to the expiration of the rights offering.

Use of proceeds Although the actual amount will depend on participation in the rights offering, we expect the gross proceeds from the rights offering to be approximately \$[], or net proceeds equal to approximately \$[]. We intend to use the proceeds of the rights offering for expanding our sales and marketing operations, general working capital purposes, potential acquisitions of complementary businesses and research and development. Additionally, we may use a portion thereof to pay the expenses of defending, settling and/or paying unfavorable judgments against us in litigation in which we are a defendant.

Transferability of subscription rights The subscription rights may be transferred or assigned during the subscription period.

If your shares are held of record by a broker, custodian bank or other nominee on your behalf, you may sell your subscription rights by contacting your broker, custodian bank or other nominee through which you hold your common stock.

If you are a record holder of a subscription rights certificate, you may transfer your subscription rights through the subscription agent, in which case you must deliver your properly executed subscription rights certificate, with appropriate instructions, to the subscription agent. The subscription agent will only facilitate subdivisions, transfers or sales of subscription rights until 5:00 p.m., Eastern time, on [], 2010, three business days prior to the scheduled [], 2010 expiration date of this rights offering. You may also choose to sell your subscription rights through a broker, custodian bank or other nominee.

The deadline to sell your subscription rights is subject to extension if we extend the expiration date of this rights offering, as described below in this summary under “—Extension, cancellation and amendment.” We intend to apply for quotation of the subscription rights on the OTC Bulletin Board under the symbol “[]” beginning on or about [], 2010, until 4:00 p.m., Eastern time, on [], 2010, the last business day prior to the scheduled expiration date of this rights offering.

Transferability of warrants The warrants to be issued pursuant to this offering will be separately transferable following their issuance and through their expiration on [], 2015, and we intend to apply for quotation of the warrants on the OTC Bulletin Board under the symbol “[]” beginning on or about [], 2010, until 4:00 p.m., Eastern time, on [], 2015.

No recommendation Neither our board of directors nor the dealer-manager makes any recommendation to you about whether you should exercise, sell or let expire any of your subscription rights. You are urged to make an independent investment decision about whether to exercise your rights based on your own assessment of our business and the rights offering. We cannot assure you that the market price for our common stock at the subscription price will be above the subscription price or that anyone purchasing shares of our common stock at the subscription price will be able to sell those shares in the future at the same or a higher price. Please see the section of this prospectus entitled “Risk Factors” for a discussion of some of the risks involved in investing in our common stock.

No minimum subscription requirement

There is no minimum subscription requirement. At the discretion of our board of directors, we may consummate the rights offering regardless of the amount raised from the exercise of basic and over-subscription rights by the expiration date

Revocation

All exercises of basic and over-subscription rights are generally irrevocable, even if you later learn of information that you consider to be unfavorable to the exercise of your subscription rights. You should not exercise your subscription rights unless you are certain that you wish to purchase shares of our common stock at a subscription price of \$[] per share and to receive related warrants to purchase shares of our common stock at an exercise price of \$[] per share. If, however, we amend the rights offering to allow for an extension of the rights offering for a period of more than 30 days after the most recently announced expiration date, or we make a fundamental change to the terms set forth in this prospectus, or to the extent you have the right to cancel your subscription under applicable law, you may cancel your subscription and receive a refund of any money you have advanced.

Certain United States federal income tax considerations We intend to take the position that a holder of shares of our common stock or Series A convertible redeemable preferred stock should not recognize income, gain, or loss for U.S. federal income tax purposes in connection with the receipt, exercise or expiration of subscription rights in the rights offering. However, the tax rules governing the subscription rights are complex and this result is not free from doubt. You should consult your own tax advisor as to the particular tax consequences to you of the receipt, exercise or expiration of the subscription rights in light of your particular circumstances. For a more detailed discussion, see “Certain U.S. Federal Income Tax Considerations.”

Extension, cancellation and amendment

Extension. Our board of directors may extend the expiration date for exercising your subscription rights for additional periods ending no later than [] in its sole discretion, although it does not currently have any plans to do so. If we extend the expiration date, you will have at least additional ten trading days during which to exercise your subscription rights. Any extension of this offering will be followed as promptly as practicable by an announcement, and in no event later than 9:00 a.m., Eastern time, on the next business day following the previously scheduled expiration date. We will extend the duration of the rights offering as required by applicable law or regulation and may choose to extend it if we decide to give investors more time to exercise their subscription rights in this rights offering. If we elect to extend the rights offering for a period of more than 30 days beyond the most recently announced expiration date, then holders who have previously exercised their subscription rights may cancel their subscriptions and receive a refund of all money advanced without interest or deduction.

Cancellation. We may cancel the rights offering at any time and for any reason or no reason prior to the expiration date. In addition, the rights offering may not be effected unless our shareholders approve an increase in our authorized common stock. Any cancellation of this offering will be followed as promptly as practicable by announcement thereof, and in no event later than 9:00 a.m., Eastern time, on the next business day following the cancellation. In the event that we cancel this rights offering, all subscription payments that the subscription agent has received will be returned, without interest or deduction, as soon as practicable.

Amendment. Our board of directors also reserves the right to amend or modify the terms of the rights offering. If we should make any fundamental changes to the terms set forth in this prospectus, we will file a post-effective amendment to the registration statement in which this prospectus is included, offer

potential purchasers who have subscribed for rights the opportunity to cancel such subscriptions and issue a refund of any money advanced by such shareholder without interest or deduction and recirculate an updated prospectus after the post-effective amendment is declared effective by the SEC. In addition, upon such event, we may extend the expiration date of this rights offering to allow holders of rights ample time to make new investment decisions and for us to recirculate updated documentation. Promptly following any such occurrence, we will issue a press release announcing any changes with respect to this rights offering and the new expiration date. The terms of the rights offering cannot be modified or amended after the expiration date of the rights offering. Although we do not presently intend to do so, we may choose to amend or modify the terms of the rights offering for any reason, including, without limitation, in order to increase participation in the rights offering. Such amendments or modifications may include a change in the subscription price although no such change is presently contemplated.

Procedure for exercising rights

To exercise your subscription rights, you must take the following steps:

If you are a registered holder of our common stock or Series A convertible redeemable preferred stock, the subscription agent must receive your payment for each share of common stock subscribed for pursuant to your basic subscription right and over-subscription right at the initial subscription price of \$[] per share and properly completed subscription rights certificate before 5:00 p.m., Eastern time, on [], 2010. You may deliver the documents and payments by mail or commercial carrier. If regular mail is used for this purpose, we recommend using registered mail, properly insured, with return receipt requested.

If you are a beneficial owner of shares that are registered in the name of a broker, dealer, custodian bank, or other nominee, or if you would prefer that an institution conduct the transaction on your behalf, you should instruct your broker, dealer, custodian bank, or other nominee to exercise your subscription rights on your behalf and deliver all documents and payments to the subscription agent before 5:00 p.m., Eastern time, on [], 2010.

If you wish to purchase shares of our common stock through the rights offering, please promptly contact any broker, dealer, custodian bank, or other nominee who is the record holder of your shares. We will ask your record holder to notify you of the rights offering. You should complete and return to your record holder the appropriate subscription documentation you receive from your record holder.

If you cannot deliver your subscription rights certificate to the subscription agent prior to the expiration of the rights offering, you may follow the guaranteed delivery procedures described under “The Rights Offering — Guaranteed Delivery Procedures.”

Foreign shareholders

We will not mail subscription rights certificates to foreign shareholders whose address of record is outside the United States, or is an Army Post Office or Fleet Post Office address. The subscription agent will hold the subscription rights certificates for such holder’s account. To exercise subscription rights, shareholders with such addresses must notify the subscription agent and timely follow the procedures described in “The Rights Offering—Foreign Shareholders.”

Subscription agent

[]

Information agent

[]

Dealer-manager and standby placement agent

Source Capital Group, Inc. Source Capital Group, Inc. is an underwriter within the meaning of Section 2(a)(11) of the Securities Act of 1933, as amended, and any fees or commissions received by it will be underwriting discounts or commissions under such act.

Shares outstanding before the rights offering

As of May 14, 2010, we had 96,967,129 shares of our common stock issued and outstanding, and 215 shares of our Series A convertible redeemable preferred stock issued and outstanding, which are convertible into an aggregate of 2,961,429 shares of our common stock. Another 11,144,212 shares are subject to unexercised options granted pursuant to our Stock Option Plan, or reserved for issuance in connection with future grants under the Stock Option Plan. In addition, up to 12,158,941 shares of our common stock are reserved for issuance upon the exercise of

warrants and conversion of our outstanding convertible debentures, of which 4,621,212 shares reserved for issuance cannot be issued unless our stockholders remove the 20% limitation on the number of shares that could be issued pursuant to the exercise of warrants and conversion of convertible debentures issued to YA Global. The rights offering may not be effected unless our shareholders approve an increase in our authorized common stock.

Shares outstanding after completion of the rights offering

Up to [] shares of our common stock will be outstanding, assuming the maximum offering amount is subscribed for pursuant to this rights offering. These amounts include 2,961,410 shares of common stock issuable upon the conversion of our outstanding Series A convertible redeemable preferred stock and exclude:

the shares of common stock that are reserved for issuance under unexercised options and warrants described above under “Shares outstanding before the rights offering”; and

the shares of common stock that will be issuable upon the exercise of the warrants to be issued in the rights offering.

Fees and expenses

We will pay the fees and expenses related to the rights offering, including the fees and certain out-of-pocket expenses of the dealer-manager. We have engaged Source Capital Group, Inc. as our dealer-manager and financial advisor in connection with the rights offering. Under the terms and subject to the conditions contained in a dealer-manager agreement, we have agreed to pay the dealer-manager, as compensation for its services on completion of the rights offering, a cash fee equal to 8% of the gross proceeds of the rights offering. Source Capital Group, Inc. is an underwriter within the meaning of Section 2(a)(11) of the Securities Act of 1933, as amended, and any fees or commissions received by it will be underwriting discounts or commissions under such act.

Trading symbols

Common Stock. Our common stock is quoted on the OTC Bulletin Board under the symbol "TKOI" The shares of common stock issued in this rights offering and pursuant to the terms of the warrants will also be quoted on the OTC Bulletin Board under the same symbol.

Subscription Rights. The subscription rights are transferable during the course of the subscription period, and we intend to apply for quotation of the subscription rights on the OTC Bulletin Board under the symbol "[]" beginning on or about [], 2010, until 4:00 p.m., Eastern time, on [], 2010, the last business day prior to the scheduled expiration date of this rights offering.

Warrants. The warrants to be issued pursuant to this offering will be separately transferable upon issuance and through their expiration date of [], 2015, and we intend to apply for quotation of the warrants on the OTC Bulletin Board under the symbol "[]" beginning on or about [], 2010, until 4:00 p.m., Eastern time, on [], 2015.

Distribution arrangements

Source Capital Group, Inc. will act as dealer-manager for this rights offering and standby placement agent for any shares (and related warrants) not subscribed for by the holders of subscription rights. Under the terms and subject to the conditions contained in the dealer-manager agreement, the dealer-manager will provide marketing assistance, including the solicitation of offers to purchase the transferable subscription rights and the solicitation of offers to purchase any shares (and related warrants) that are not subscribed for by the holders of subscription rights when such shares (and related warrants) are reoffered by us to the public at a price of \$_____ per share (and related warrant), which is the same as the exercise price of the subscription rights, in connection with this rights offering. We have agreed to provide compensation to the dealer-manager in connection with the rights offering, as described above under

“Fees and expenses.” The dealer-manager does not make any recommendation with respect to such subscription rights (including with respect to the exercise, expiration or sale of such subscription rights), or the shares of common stock and warrants obtained upon the exercise of subscription rights or in the standby offering, if any. The dealer-manager will not be subject to any liability to us in rendering the services contemplated by the dealer-manager agreement except for any act of bad faith or gross negligence by the dealer-manager. Source Capital Group, Inc. is an underwriter within the meaning of Section 2(a)(11) of the Securities Act of 1933, as amended, and any fees or commissions received by it will be underwriting discounts or commissions under such act.

Risk Factors

Before you exercise your subscription rights to purchase shares of our common stock and related warrants, you should carefully consider risks described in the section entitled “Risk Factors,” beginning on page 16 of this prospectus.

RISK FACTORS

Investing in our securities involves a high degree of risk. You should carefully consider the specific risks described below, before making an investment decision. Any of the risks we describe below could cause our business, financial condition, or operating results to suffer. The market price of our common stock could decline if one or more of these risks and uncertainties develop into actual events. You could lose all or part of your investment. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition, operating results, or prospects. Some of the statements in this section of the prospectus are forward-looking statements. For more information about forward-looking statements, please see the section of this prospectus entitled “Special Note Regarding Forward-Looking Statements.”

Risks Related to the Rights Offering

The price of our common stock is volatile and may decline before or after the subscription rights expire.

The market price of our common stock could be subject to wide fluctuations in response to numerous factors, some of which are beyond our control. These factors include, among other things, actual or anticipated variations in our costs of doing business, operating results and cash flow, the nature and content of our earnings releases and our competitors' earnings releases, changes in financial estimates by securities analysts, business conditions in our markets and the general state of the securities markets and the market for other financial stocks, changes in capital markets that affect the perceived availability of capital to companies in our industry, and governmental legislation or regulation, as well as general economic and market conditions, such as downturns in our economy and recessions.

Once you exercise your subscription rights, you may not revoke them unless we subsequently amend the terms of the rights offering or such revocation is required by applicable law. We cannot assure you that the market price of the shares of our common stock will not decline after you elect to exercise your subscription rights. If you exercise your subscription rights and, afterwards, the trading market price of our shares of common stock decreases below the subscription price, you will have committed to buying shares of our common stock at a price above the prevailing market price and could have an immediate unrealized loss. Our common stock is traded on the OTC Bulletin Board under the symbol “TKOI,” and the last reported sales price of our common stock on the OTC Bulletin Board on April 21, 2010 was \$0.14 per share. Moreover, we cannot assure you that following the exercise of your subscription rights you will be able to sell your shares of common stock at a price equal to or greater than the subscription price. Until shares are delivered upon expiration of the rights offering, you will not be able to sell our common stock or warrants that you obtained by exercising your subscription rights.

The subscription price determined for the rights offering is not necessarily an indication of the fair value of our common stock.

The subscription price of \$[] per share is not necessarily related to our book value, tangible book value, multiple of earnings or any other established criteria of fair value and may or may not be considered the fair value of our common stock to be offered in the rights offering. After the date of this prospectus, shares of our common stock may trade at prices below the subscription price.

If you do not exercise your subscription rights, your percentage ownership in our company will be diluted.

Assuming we sell the maximum number of shares of our common stock and related warrants in connection with the rights offering, we will issue approximately [] shares of our common stock and warrants to purchase approximately [] additional shares of our common stock. If you choose not to exercise your basic subscription rights and you do not exercise your over-subscription right prior to the expiration of the rights offering and we sell any shares to other

existing shareholders or to third parties, your relative ownership interest in our common stock will be diluted.

We may cancel the rights offering at any time without further obligation to you.

We may, in our sole discretion, cancel the rights offering before it expires. If we cancel the rights offering, neither we, nor the dealer-manager or the subscription agent, will have any obligation to you with respect to the rights except for the obligation of the subscription agent to return any payment received, without interest or deduction, as soon as practicable.

If you do not act promptly and follow the subscription instructions, your exercise of subscription rights will be rejected.

If you desire to exercise your subscription rights, you must act promptly to ensure that the subscription agent actually receives all required forms and payments before the expiration of the rights offering at 5:00 p.m., Eastern time, on [], 2010, unless we extend the rights offering for additional periods ending no later than [], 2010. If you are a beneficial owner of shares, you must act promptly to ensure that your broker, dealer, custodian bank or other nominee acts for you and that the subscription agent receives all required forms and payments before the rights offering expires. We are not responsible if your nominee fails to ensure that the subscription agent receives all required forms and payments before the rights offering expires. If you fail to complete and sign the required subscription forms, send an incorrect payment amount, or otherwise fail to follow the subscription procedures that apply to the exercise of your subscription rights before the rights offering expires, the subscription agent will reject your subscription or accept it only to the extent of the payment received. Neither we nor the dealer-manager nor our subscription agent undertakes any responsibility or action to contact you concerning an incomplete or incorrect subscription form or payment, nor are we or they under any obligation to correct such forms or payment. We have the sole discretion to determine whether a subscription exercise properly complies with the subscription procedures.

You will not be able to sell the shares of common stock and warrants you obtain by exercising your subscription rights in the rights offering until you receive your stock certificates and warrants or your account at the nominee is credited with the common stock and warrants.

If you exercise your subscription rights in the rights offering by submitting a rights certificate and payment, we will mail you a stock certificate and warrant as soon as practicable after [], 2010, or such later date to which the rights offering may be extended. If your shares are held by a broker, dealer, custodian bank or other nominee and you exercise your subscription rights, your account with your nominee will be credited with the shares of our common stock and warrants you purchased in the rights offering as soon as practicable after the expiration of the rights offering, or such later date to which the rights offering may be extended. Until your stock certificates and warrants have been delivered or your account is credited, you may not be able to sell your shares or warrants even though we expect the common stock and warrants issued in the rights offering will be listed for trading on the OTC Bulletin Board. The price of our common stock and/or warrants may decline between the time you decide to sell your shares and/or warrants and the time you are actually able to sell your shares and/or warrants.

Because our management will have broad discretion over the use of the net proceeds from the rights offering, you may not agree with how we use the proceeds, and we may not invest the proceeds successfully.

We currently anticipate that we will use the net proceeds of the rights offering for expanding our sales and marketing operations, general working capital purposes, potential acquisitions of complementary businesses and research and development. Our management may allocate the proceeds among these purposes as it deems appropriate. In addition, market factors may require our management to allocate portions of the proceeds for other purposes. Accordingly, you will be relying on the judgment of our management with regard to the use of the proceeds from the rights offering, and you will not have the opportunity, as part of your investment decision, to assess whether we are using the proceeds appropriately. It is possible that we may invest the proceeds in a way that does not yield a favorable, or any, return for us.

The rights offering does not require a minimum amount of proceeds for us to close the offering, which means that if you exercise your rights, you may acquire additional shares of our common stock when we continue to require additional capital.

There is no minimum amount of proceeds required to complete the rights offering and your exercise of your subscription rights is generally irrevocable, even if you later learn of information that you consider to be unfavorable to the exercise of your subscription rights. Therefore, if you exercise the basic subscription right or the over-subscription right, but we do not sell the entire amount of securities being offered in this rights offering and the rights offering is not fully subscribed, you may be investing in a company that continues to require additional capital. If, however, we amend the rights offering to allow for an extension of the rights offering for a period of more than 30 days after the most recently announced expiration date, or we make a fundamental change to the terms set forth in this prospectus, or to the extent you have the right to cancel your subscription under applicable law, you may cancel your subscription and receive a refund of any money you have advanced.

Once you exercise your subscription right, you may not revoke your subscription, even if the rights offering is extended by our board of directors, and you could be committed to buying shares of our common stock above the prevailing market price.

Once you exercise your subscription rights, you may not revoke the exercise of such rights. If our board of directors elects in its discretion to extend the period during which subscription rights may be exercised in the rights offering, you still may not revoke the exercise of your subscription rights. However, if we amend the rights offering to allow for an extension of the rights offering for a period of more than 30 days after the previously announced expiration date, or make a fundamental change to the terms set forth in this prospectus, or to the extent you have the right to cancel your subscription under applicable law, you may cancel your subscription and receive a refund of any money you have advanced. The public trading market price of our common stock may decline before the subscription rights expire. If you exercise your subscription rights and, afterwards, the public trading market price of our common stock decreases below the subscription price, you will have committed to buying shares of our common stock at a price above the prevailing market price. Our common stock is traded on the OTC Bulletin Board under the symbol "TKOI," and the last reported sale price of our common stock on the OTC Bulletin Board on [April 21, 2010] was \$0.14 per share. After you exercise your subscription rights, you may be unable to sell your shares of our common stock at a price equal to or greater than the subscription price you paid for such shares, and you may lose all or part of your investment in our common stock.

We may amend or modify the terms of the rights offering at any time prior to the expiration of the rights offering in our sole discretion.

Our board of directors reserves the right to amend or modify the terms of the rights offering in its sole discretion. Although we do not presently intend to do so, we may choose to amend or modify the terms of the rights offering for any reason, including, without limitation, in order to increase participation in the rights offering. Such amendments or modifications may include a change in the subscription price although no such change is presently contemplated. If we should make any fundamental changes to the terms set forth in this prospectus, we will file a post-effective amendment to the registration statement in which this prospectus is included, offer potential purchasers who have subscribed for rights the opportunity to cancel such subscriptions and issue a refund of any money advanced by such shareholder and recirculate an updated prospectus after the post-effective amendment is declared effective with the SEC. In addition, upon such event, we may extend the expiration date of this rights offering to the extent required under applicable law, to allow holders of rights ample time to make new investment decisions, or for us to recirculate updated documentation. Promptly following any such occurrence, we will issue a press release announcing any changes with respect to this rights offering and the new expiration date. The terms of the rights offering cannot be modified or amended after the expiration date of the rights offering .

Risks Relating to the Ownership of Our Common Stock

The market price of our common stock has been and may continue to be volatile.

The trading price of our common stock has been and may continue to be highly volatile and could be subject to wide fluctuations in response to various factors. Some of the factors that may cause the market price of our common stock to fluctuate include:

- fluctuations in our quarterly financial and operating results or the quarterly financial results of companies perceived to be similar to us;

- changes in estimates of our financial results or recommendations by securities analysts;

- changes in general economic, industry and market conditions;

- failure of any of our products to achieve or maintain market acceptance;

- changes in market valuations of similar companies;

- success of competitive products;

- changes in our capital structure, such as future issuances of securities or the incurrence of additional debt;

- announcements by us or our competitors of significant products, contracts, acquisitions or strategic alliances;

- regulatory developments in the United States, foreign countries or both;

- litigation involving our company, our general industry or both;

- additions or departures of key personnel; and

investors' general perception of us.

In addition, if the market for technology stocks or the stock market in general experiences a loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, financial condition or results of operations. If any of the foregoing occurs, it could cause our stock price to fall and may expose us to class action lawsuits that, even if unsuccessful, could be costly to defend and a distraction to management.

If securities or industry analysts do not continue to publish research or publish inaccurate or unfavorable research about our business, our stock price and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that securities or industry analysts publish about us or our business. We do not control these analysts. If one or more of the analysts who covers us downgrades our stock or publishes inaccurate or unfavorable research about our business, our stock price would likely decline. If one or more of these analysts ceases coverage of our company or fails to publish reports on us regularly, demand for our stock could decrease, which could cause our stock price and trading volume to decline.

Anti-takeover provisions in our charter documents and Utah law could discourage delay or prevent a change of control of our company and may affect the trading price of our common stock.

We are a Utah corporation and the anti-takeover provisions of the Utah Control Shares Acquisition Act may discourage, delay or prevent a change of control by limiting the voting rights of control shares acquired in a control share acquisition. In addition, our Amended and Restated Articles of Incorporation and bylaws may discourage, delay or prevent a change in our management or control over us that shareholders may consider favorable. Among other things, our Amended and Restated Articles of Incorporation and bylaws:

authorize the issuance of “blank check” preferred stock that could be issued by our board of directors to thwart a takeover attempt;

provide that vacancies on our board of directors, including newly created directorships, may be filled only by a majority vote of directors then in office, except a vacancy occurring by reason of the removal of a director without cause shall be filled by vote of the shareholders; and

limit who may call special meetings of shareholders.

These provisions could have the effect of delaying or preventing a change of control, whether or not it is desired by, or beneficial to, our shareholders.

We do not currently intend to pay dividends on our common stock and, consequently, the ability to achieve a return on an investment in our common stock will depend on appreciation in the price of our common stock.

We do not expect to pay cash dividends on our common stock. Any future dividend payments are within the absolute discretion of our board of directors and will depend on, among other things, our results of operations, working capital requirements, capital expenditure requirements, financial condition, contractual restrictions, business opportunities, anticipated cash needs, provisions of applicable law and other factors that our board of directors may deem relevant. We may not generate sufficient cash from operations in the future to pay dividends on our common stock.

Our common stock was delisted from NYSE Amex LLC and is currently listed for trading on the Over-the-counter Bulletin Board.

Prior to November 13, 2009, our common stock was listed for trading on NYSE Amex LLC, or the Exchange, under the symbol “TKO.” On May 18, 2009, we received a letter from the Exchange notifying us that we were out of compliance with the Exchange’s continued listing standards due to the impairment of our existing financial condition. In the opinion of the Exchange, our historical losses in relation to our overall operations and existing financial resources caused our financial condition to become so impaired that it appeared questionable as to whether we would be able to continue operations and/or meet our obligations as they mature. On June 25, 2009, we submitted a plan to the Exchange advising of the actions we had taken, and planned to take, that would bring us into compliance with the applicable listing standards within the six month cure period. On August 27, 2009, we were notified of the Exchange’s intention to delist our common stock because our plan did not reasonably demonstrate the ability to regain compliance with the continued listing standards of the Exchange. On November 3, 2009, we received notice from the Exchange informing us that the Hearing Panel had confirmed the Staff’s recommendation that our common stock be delisted from the Exchange. After considering the costs to us of compliance with the continued listing requirements of the Exchange and other factors, we determined that it was not in the best interests of our company and our shareholders to appeal the delisting of our common stock from the Exchange and approved the voluntary delisting of the securities. The Exchange suspended trading in our common stock effective at the open of business on November 13, 2009, at which time our common stock began trading on the Over-the-Counter market’s Pink Sheets under the

symbol “TKOI.PK.” On December 7, 2009, we received FINRA approval for trading on the OTC Bulletin Board. Our common stock began trading on the OTC Bulletin Board on December 8, 2009 under the symbol “TKOI.” The delisting of our common stock from the Exchange may have had a negative impact on the market’s perception of our company and could also adversely affect our stock price, trading volume, and ability to effect financing and strategic transactions, such as private placements or public offerings of our securities and acquisitions of complementary businesses through shares of our common stock. In addition, our stockholders’ ability to trade or obtain quotations on our shares may be more limited than they otherwise would be if our common stock were listed on the Exchange because of lower trading volumes and transaction delays on the OTC Bulletin Board.

Our common stock may be subject to “Penny Stock” restrictions.

If the price of our common stock remains at less than \$5 per share, we will be subject to so-called penny stock rules which could decrease our stock’s market liquidity. The Securities and Exchange Commission has adopted regulations which define a “penny stock” to include any equity security that has a market price of less than \$5 per share or an exercise price of less than \$5 per share, subject to certain exceptions. For any transaction involving a penny stock, unless exempt, the rules require the delivery to and execution by the retail customer of a written declaration of suitability relating to the penny stock, which must include disclosure of the commissions payable to both the broker/dealer and the registered representative and current quotations for the securities. Finally, the broker/dealer must send monthly statements disclosing recent price information for the penny stocks held in the account and information on the limited market in penny stocks. Those requirements could adversely affect the market liquidity of such stock. There can be no assurance that the price of our common stock will rise above \$5 per share so as to avoid these regulations.

We have a large number of shares of common stock underlying outstanding debentures and warrants that may become available for future sale, and the sale of these shares may result in dilution.

As of March 31, 2010, we had 96,673,771 shares of common stock issued and outstanding. In addition, as of that date, YA Global held secured convertible debentures in an aggregate principal amount of \$1,606,023, which we refer to as the Debentures, under which the principal and accrued interest may be converted into an estimated 10,706,820 shares of common stock at current market prices, and outstanding warrants to purchase up to 4,621,212 shares of common stock. The number of shares of common stock issuable upon conversion of the Debentures may increase if the market price of our common stock declines. The number of shares of common stock issuable by us to YA Global pursuant to the terms of the Debentures, all other debentures and the warrants issued to holders of the Debentures cannot exceed an aggregate of 19.99% of the total issued and outstanding shares (calculated in accordance with applicable principal market rules and regulations) of our common stock (subject to appropriate adjustment for stock splits, stock dividends, or other similar recapitalizations affecting the common stock), unless we first obtain shareholder approval. We refer to this limitation as the Exchange Cap. The Exchange Cap is applicable for conversion of the Debentures and exercises of the warrants, in the aggregate, and we are not obligated to issue any shares of common stock upon conversion of the Debentures or exercise of the warrants in excess of the Exchange Cap unless and until we first obtain shareholder approval to exceed the Exchange Cap. On May 28, 2009, our shareholders voted against a proposal to remove the Exchange Cap, which would have allowed YA Global to potentially acquire in excess of 19.99% of the outstanding shares of our common stock. If our shareholders later approve the removal of the Exchange Cap, all of the shares, including all of the shares issuable upon conversion of the Debentures and upon exercise of our warrants, may be sold without restriction. The sale of these shares may adversely affect the market price of our common stock.

The continuously adjustable conversion price feature of our outstanding debentures held by YA Global may encourage investors to make short sales in our common stock, which could have a negative effect on the price of our common stock.

Due to the Exchange Cap, we are not currently under an obligation to issue shares of common stock to YA Global upon conversion of the Debentures. If, however, our shareholders approve removal of the Exchange Cap, the Debentures would be convertible into shares of our common stock at a 10% discount to the ten day volume weighted average trading price of the common stock prior to the conversion. The significant downward pressure on the price of the common stock as the selling stockholder converts and sells material amounts of common stock could encourage short sales by investors. This could place further downward pressure on the price of our common stock. The selling stockholder could sell common stock into the market in anticipation of covering the short sale by converting their securities, which could cause further downward pressure on the stock price. In addition, not only the sale of shares issued upon conversion or exercise of outstanding convertible debt, warrants and options, but also the mere perception that these sales could occur, may adversely affect the market price of our common stock.

The issuance of additional shares of common stock upon conversion of the Debentures and the exercise of outstanding warrants may cause immediate and substantial dilution to our existing shareholders.

Due to the Exchange Cap, we are not currently under an obligation to issue shares of common stock to YA Global upon conversion of the Debentures. If, however, our shareholders approve the removal of the Exchange Cap, this may result in substantial dilution to the interests of other shareholders because the holders of the Debentures and related warrants may ultimately convert the full outstanding amount under the Debentures into shares of common stock, exercise the warrants in full and sell the shares of common stock issued upon such conversion and exercise. Although YA Global may not convert its Debentures and/or exercise its warrants if such conversion or exercise would cause it to own more than 4.99% of our outstanding common stock, this restriction does not prevent YA Global from converting and/or exercising some of its holdings and then converting the rest of its holdings. In this way, YA Global

could sell more than 4.99% of our outstanding common stock while never holding more than this limit. If the Exchange Cap is removed, there is no upper limit on the number of shares that may be issued which will have the effect of further diluting the proportionate equity interest and voting power of holders of our common stock, including investors in this offering.

Further issuances of equity securities may be dilutive to current stockholders.

Although the funds that were raised in our debenture offerings, the note offerings and the private placement are being used for general working capital purposes, it is likely that we will be required to seek additional capital in the future. This capital funding could involve one or more types of equity securities, including convertible debt, common or convertible preferred stock and warrants to acquire common or preferred stock. Such equity securities could be issued at or below the then-prevailing market price for our common stock. Any issuance of additional shares of our common stock will be dilutive to existing stockholders and could adversely affect the market price of our common stock.

The exercise of options and warrants outstanding and available for issuance may adversely affect the market price of our common stock.

As of March 31, 2010, we had outstanding employee options to purchase a total of 6,120,883 shares of common stock at exercise prices ranging from \$1.00 to \$5.97 per share, with a weighted average exercise price of \$1.56. As of March 31, 2010, we had outstanding non-employee options to purchase a total of 740,000 shares of common stock at an exercise price of \$1.00 per share. As of March 31, 2010, we had warrants outstanding to purchase a total of 12,158,941 shares of common stock at exercise prices ranging from \$0.33 to \$4.17 per share, with a weighted average exercise price of \$1.60. The exercise of outstanding options and warrants and the sale in the public market of the shares purchased upon such exercise will be dilutive to existing stockholders and could adversely affect the market price of our common stock.

Risks Related to Our Business

The industry within which we operate is intensely competitive and rapidly evolving.

We operate in a highly competitive, quickly changing environment, and our future success will depend on our ability to develop and introduce new products and product enhancements that achieve broad market acceptance in the markets within which we compete. We will also need to respond effectively to new product announcements by our competitors by quickly introducing competitive products.

Delays in product development and introduction could result in:

- loss of or delay in revenue and loss of market share;
- negative publicity and damage to our reputation and the reputation of our product offerings; and
- decline in the average selling price of our products.

Government regulation of our products could impair our ability to sell such products in certain markets.

The rules of the Federal Communications Commission, or FCC, permit the operation of unlicensed digital devices that radiate radio frequency emissions if the manufacturer complies with certain equipment authorization procedures, technical requirements, marketing restrictions and product labeling requirements. Differing technical requirements apply to “Class A” devices intended for use in commercial settings, and “Class B” devices intended for residential use to which more stringent standards apply. An independent, FCC-certified testing lab has verified that our iWire System product suite complies with the FCC technical requirements for Class A and Class B digital devices. No further testing of these devices is required, and the devices may be manufactured and marketed for commercial and residential use. Additional devices designed by us for commercial and residential use will be subject to the FCC rules for unlicensed digital devices. Moreover, if in the future, the FCC changes its technical requirements for unlicensed digital devices, further testing and/or modifications of devices may be necessary. Failure to comply with any FCC technical requirements could impair our ability to sell our products in certain markets and could have a negative impact on our business and results of operations.

Products sold by our competitors could become more popular than our products or render our products obsolete.

The market for our products and services is highly competitive. Some of our competitors have longer operating histories, greater name recognition and substantially greater financial, technical, sales, marketing and other resources. These competitors may, among other things, undertake more extensive marketing campaigns, adopt more

aggressive pricing policies, obtain more favorable pricing from suppliers and manufacturers and exert more influence on the sales channel than we can. As a result, we may not be able to compete successfully with these competitors, and these competitors may develop or market technologies and products that are more widely accepted than those being developed by us or that would render our products obsolete or noncompetitive. We anticipate that competitors will also intensify their efforts to penetrate our target markets. These competitors may have more advanced technology, more extensive distribution channels, stronger brand names, bigger promotional budgets and larger customer bases than we do. These companies could devote more capital resources to develop, manufacture and market competing products than we could. If any of these companies are successful in competing against us, our sales could decline, our margins could be negatively impacted, and we could lose market share, any of which could seriously harm our business, results of operations, and prospects.

We may not be able to obtain patents, which could have a material adverse effect on our business.

Our ability to compete effectively in the powerline technology industry will depend on our success in acquiring suitable patent protection. We currently have several patents pending. We also intend to file additional patent applications that we deem to be economically beneficial. If we are not successful in obtaining patents, we will have limited protection against those who might copy our technology. As a result, the failure to obtain patents could negatively impact our business, results of operations, and prospects.

Infringement by third parties on our proprietary technology and development of substantially equivalent proprietary technology by our competitors could negatively impact our business.

Our success depends partly on our ability to maintain patent and trade secret protection, to obtain future patents and licenses and to operate without infringing on the proprietary rights of third parties. There can be no assurance that the measures we have taken to protect our intellectual property rights, including intellectual property rights of third parties integrated into our Telkonet iWire System product suite and Telkonet SmartEnergy products, will prevent misappropriation or circumvention. In addition, there can be no assurance that any patent application, when filed, will result in an issued patent, or that our existing patents, or any patents that may be issued in the future, will provide us with significant protection against competitors. Moreover, there can be no assurance that any patents issued to, or licensed by, us will not be infringed upon or circumvented by others. Infringement by third parties on our proprietary technology could negatively impact our business. Moreover, litigation to establish the validity of patents, to assert infringement claims against others, and to defend against patent infringement claims can be expensive and time-consuming, even if the outcome is in our favor. We also rely to a lesser extent on unpatented proprietary technology, and no assurance can be given that others will not independently develop substantially equivalent proprietary information, techniques or processes or that we can meaningfully protect our rights to such unpatented proprietary technology. If our competitors develop substantially equivalent technology, and we are unable to enforce any intellectual property rights with respect to such technology in a cost-effective manner or at all, our business and operations would suffer significant harm.

We may incur substantial damages due to litigation.

We cannot be certain that our products do not and will not infringe issued patents or other intellectual property rights of others. We are currently a defendant (and have assumed the obligation to defend another defendant) in an action in which it is alleged that we have infringed the intellectual property rights of another party and we have an obligation to defend another defendant in that litigation. Although we are vigorously defending the claims made in such action and believe that we have meritorious defenses, if it were determined that our products infringe the intellectual property rights of the plaintiff in that action, we could be required to pay substantial damages or be enjoined from licensing or using the infringing products or technology. Additionally, if it were determined that our products infringe the intellectual property rights of others, we would need to obtain licenses from these parties or substantially re-engineer our products in order to avoid infringement. We might not be able to obtain the necessary licenses on acceptable terms or at all, or to re-engineer our products successfully. Any of the foregoing could cause us to incur significant costs and prevent us from selling our products.

We are also currently defending an action alleging that we are in breach of an obligation to make severance and other payments to a former executive. Although we are vigorously defending the claims made in such action and believe that we have meritorious defenses, if it is determined that we are in breach of any such obligation, we could be required to pay substantial damages to our former executive.

In March 2010 we suffered a judgment against us in the amount of \$64,966 for our default in payment of rent for our former executive offices. Although we voluntarily vacated the premises on May 3, 2010, we remain liable for the judgment and post-judgment interest.

We depend on a small team of senior management, and it may have difficulty attracting and retaining additional personnel.

Our future success will depend in large part upon the continued services and performance of senior management and other key personnel. If we lose the services of any member of our senior management team, our overall operations could be materially and adversely affected. In addition, our future success will depend on our ability to identify,

attract, hire, train, retain and motivate other highly skilled technical, managerial, marketing, purchasing and customer service personnel when they are needed. Competition for these individuals is intense. We cannot ensure that we will be able to successfully attract, integrate or retain sufficiently qualified personnel when the need arises. Any failure to attract and retain the necessary technical, managerial, marketing, purchasing and customer service personnel could have a negative effect on our financial condition and results of operations. On December 21, 2009, we announced a restructuring which includes the relocation of our offices from Germantown, Maryland to Milwaukee, Wisconsin, consolidating our business operations into a single location. Also as part of the corporate restructuring, we announced that our Chief Financial Officer, Rick Leimbach, will be leaving our company to pursue other opportunities in the near future, although a departure date has yet to be established. Until his departure date, Mr. Leimbach will continue to perform the duties and responsibilities customary and consistent with his position and will assist us in our transition. If we are unable to satisfactorily replace Mr. Leimbach upon his departure, our overall operations could be materially and adversely affected.

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 complementary businesses in our current or ancillary markets. 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.

Our inability to obtain capital, use internally generated cash or debt, or use shares of our common stock to finance future acquisitions could impair the growth and expansion of our business.

Reliance on internally generated cash or debt to finance our operations or complete acquisitions could substantially limit our operational and financial flexibility. The extent to which we will be able or willing to use shares of our common stock to consummate acquisitions will depend on the market value of our common stock which will vary, and our liquidity. Using shares of our common stock for this purpose also may result in significant dilution to our then existing stockholders. To the extent that we are unable to use our common stock to make future acquisitions, our ability to grow through acquisitions may be limited by the extent to which we are able to raise capital through debt or additional equity financings. No assurance can be given that we will be able to obtain the necessary capital to finance any acquisitions or our other cash needs. If we are unable to obtain additional capital on acceptable terms, we may be required to reduce the scope of any expansion or redirect resources committed to internal purposes. In addition to requiring funding for acquisitions, we may need additional funds to implement our internal growth and operating strategies or to finance other aspects of our operations. Our failure to: (i) obtain additional capital on acceptable terms; (ii) use internally generated cash or debt to complete acquisitions because it significantly limits our operational or financial flexibility; or (iii) use shares of our common stock to make future acquisitions, may hinder our ability to actively pursue any acquisitions.

The restrictive covenants contained in the Securities Purchase Agreement pursuant to which the convertible debentures were sold contain restrictions that could limit our financing options.

The Securities Purchase Agreement pursuant to which the convertible debentures were sold contains limitations on our ability to engage in certain financing activities without the prior consent of the holders of the convertible debentures. As a result of these restrictions, we may be unable to obtain the financing necessary to fund working capital, operating losses, capital expenditures or acquisitions. The failure to obtain such financing could have a material adverse effect on our business and results of operations.

Potential fluctuations in operating results could have a negative effect on the price of our common stock.

Our operating results may fluctuate significantly in the future as a result of a variety of factors, most of which are outside our control, including:

- the level of use of the Internet;

- the demand for high-tech goods;

- the amount and timing of capital expenditures and other costs relating to the expansion of our operations;

- price competition or pricing changes in the industry;

- technical difficulties or system downtime;

- economic conditions specific to the internet and communications industry; and

general economic conditions.

Our quarterly results may also be significantly impacted by certain accounting treatment of acquisitions, financing transactions or other matters. Such accounting treatment could have a material impact on our results of operations and have a negative impact on the price of our common stock.

We rely on a small number of customers and cannot be certain they will consistently purchase our products in the future.

One customer accounted for more than 10% of our revenues for the quarters ended March 31, 2010 and 2009, respectively. No customer accounted for more than 10% of our revenue for the year end December 31, 2009. Two customers accounted for 39% of our revenues for the year ended December 31, 2008. No other customer accounted for more than 10% of our revenues during those periods. In the future, a small number of customers may continue to represent a significant portion of our total revenues in any given period. We cannot be certain that such customers will consistently purchase our products at any particular rate over any subsequent period. A loss of any of these customers could adversely affect our financial performance.

We rely on a limited number of third party suppliers. If these companies fail to perform or experience delays, shortages, or increased demand for their products or services, we may face shortages, increased costs, and may be required to suspend deployment of our products and services.

We depend on a limited number of third party suppliers to provide the components and the equipment required to deliver our solutions. If these providers fail to perform their obligations under our agreements with them or we are unable to renew these agreements, we may be forced to suspend the sale and deployment of our products and services and enrollment of new customers, which would have an adverse effect on our business, prospects, financial condition and operating results.

Our management and operational systems might be inadequate to handle our potential growth.

We may experience growth that could place a significant strain upon our management and operational systems and resources. Failure to manage our growth effectively could have a material adverse effect upon our business, results of operations and financial condition. Our ability to compete effectively and to manage future growth will require us to continue to improve our operational systems, organization and financial and management controls, reporting systems and procedures. We may fail to make these improvements effectively. Additionally, our efforts to make these improvements may divert the focus of our personnel. We must integrate our key executives into a cohesive management team to expand our business. If new hires perform poorly, or if we are unsuccessful in hiring, training and integrating these new employees, or if we are not successful in retaining our existing employees, our business may be harmed. To manage the growth we will need to increase our operational and financial systems, procedures and controls. Our current and planned personnel, systems, procedures and controls may not be adequate to support our future operations. We may not be able to effectively manage such growth, and failure to do so could have a material adverse effect on our business, financial condition and results of operations.

We are exposed to risks relating to evaluations of controls required by Section 404 of the Sarbanes-Oxley Act of 2002.

We are required to comply with Section 404 of the Sarbanes-Oxley Act of 2002. We concluded that, as of December 31, 2009, there were material weaknesses in our internal control over financial reporting relating to the lack of segregation of duties and the need for a stronger internal control environment, attributable to the small size of our accounting staff and continued integration of our 2007 acquisitions of Smart Systems International and EthoStream LLC. We retained additional personnel and worked to remediate these deficiencies during fiscal 2009. Notwithstanding those efforts we continue to have material weaknesses in our internal control over financial reporting. A material weakness is a control deficiency, or a combination of control deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of annual or interim financial statements would not be prevented or detected. Until this deficiency in our internal control over financial reporting is remediated, there is reasonable possibility that a material misstatement to our annual or interim consolidated financial statements could occur and not be prevented or detected by our internal controls in a timely manner.

We may be affected if the United States participates in wars or military or other action or by international terrorism.

Involvement in a war or other military action or acts of terrorism may cause significant disruption to commerce throughout the world. To the extent that such disruptions result in (i) delays or cancellations of customer orders, (ii) a general decrease in consumer spending on information technology, (iii) our inability to effectively market and distribute our services or products or (iv) our inability to access capital markets, our business and results of operations could be materially and adversely affected. We are unable to predict whether the involvement in a war or other military action will result in any long-term commercial disruptions or if such involvement or responses will have any

long-term material adverse effect on our business, results of operations, or financial condition.

Our exposure to the credit risk of our customers and suppliers may adversely affect our financial results.

We sell our products to customers that have in the past, and may in the future, experience financial difficulties, particularly in light of the recent global economic downturn. If our customers experience financial difficulties, we could have difficulty recovering amounts owed to us from these customers. While we perform credit evaluations and adjust credit limits based upon each customer's payment history and credit worthiness, such programs may not be effective in reducing our exposure to credit risk. We evaluate the collectability of accounts receivable, and based on this evaluation make adjustments to the allowance for doubtful accounts for expected losses. Actual bad debt write-offs may differ from our estimates, which may have a material adverse effect on our financial condition, operating results and cash flows.

Our suppliers may also experience financial difficulties, which could result in our having difficulty sourcing the materials and components we use in producing our products and providing our services. If we encounter such difficulties, we may not be able to produce our products for our customers in a timely fashion which could have an adverse effect on our results of operations, financial condition and cash flows.

The recent deterioration of the economy and credit markets may adversely affect our future results of operations.

Our operations and performance depend to some degree on general economic conditions and their impact on our customers' finances and purchase decisions. As a result of recent economic events, potential customers may elect to defer purchases of capital equipment items, such as the products we manufacture and supply. Additionally, the credit markets and the financial services industry have been experiencing a period of upheaval characterized by the bankruptcy, failure, collapse or sale of various financial institutions and an unprecedented level of intervention from the United States government. While the ultimate outcome of these events cannot be predicted, it may have a material adverse effect on our customers' ability to fund their operations thus adversely impacting their ability to purchase our products or to pay for our products on a timely basis, if at all. These and other economic factors could have a material adverse effect on demand for our products, the collection of payments for our products and on our financial condition and operating results.

We may not be able to obtain to obtain payment and performance bonds, which could have a material adverse effect on our business.

Our ability to deploy our SmartEnergy platform into the energy management initiatives in military housing and deployments may rely on our ability to obtain payment and performance bonds which may be an essential element to work orders for the installation of our products and services. If we are unable to obtain payment and performance bonds in a timely fashion as required by an applicable work order, we may not be entitled to payment under the work order until such bonds have been provided or until such a requirement is expressly waived. And any delays due to a failure to furnish bonds may not entitle us to a price increase for the work or an extension of time to complete the work and may entitle the other party to terminate our work order without liability and to indemnify such party from damages suffered as a result of our failure to deliver the bonds and the termination of the work order. As a result, the failure to obtain bonds where required could negatively impact our business, results of operations, and prospects.

Risks Relating to Our Financial Results and Need for Financing

Our independent auditors have expressed substantial doubt about our ability to continue as a going concern, which may hinder our ability to obtain future financing.

In their report dated March 31, 2010, our independent auditors stated that our financial statements for the year ended December 31, 2009 were prepared assuming that we would continue as a going concern, and that they have substantial doubt about our ability to continue as a going concern. Our auditors' doubts are based on our net losses and deficits in cash flows from operations. We continue to experience net operating losses. Our ability to continue as a going concern is subject to our ability to generate a profit and/or obtain necessary funding from outside sources, including by the sale of our securities, or obtaining loans from financial institutions, where possible. Our continued net operating losses and our auditors' doubts increase the difficulty of our meeting such goals. If we are not successful in raising sufficient additional capital, we may not be able to continue as a going concern and our stockholders may lose their entire investment.

We have a history of operating losses and an accumulated deficit and expect to continue to incur losses for the foreseeable future.

Since inception through March 31, 2010, we have incurred cumulative losses of \$114,413,347 and have never generated enough funds through operations to support our business. Because of the numerous risks and uncertainties associated with our technology, the industry in which we operate, and other factors, we are unable to predict the extent of any future losses or when we will become profitable, if ever. If we are unable to generate sufficient revenues from our operations to meet our working capital requirements for the next twelve months, we expect to finance our future

cash needs through public or private equity offerings, debt financings and interest income earned on our cash balances. We cannot be certain that additional funding will be available on acceptable terms, or at all.

Our ability to use our net operating loss carryforwards may be subject to limitation.

Generally, a change of more than 50% in the ownership of a corporation's stock, by value, over a three-year period constitutes an ownership change for U.S. federal income tax purposes. An ownership change may limit a company's ability to use its net operating loss carryforwards attributable to the period prior to such change. Because we may have experienced "ownership changes" within the meaning of Section 382 of the Internal Revenue Code of 1986, as amended, or the Code, during 2005 and prior years and because the rights or shares of common stock that we ultimately issue in connection with this offering may be sufficient, taking into account prior or future shifts in our ownership over a three-year period, to cause us to undergo an ownership change, our ability to use net operating losses may be limited. As a result, if we earn net taxable income, our ability to use our pre-change net operating loss carryforwards to offset U.S. federal taxable income may become subject to limitations, which could potentially result in increased future tax liability.

Our business activities might require additional financing that might not be obtainable on acceptable terms, if at all, which could have a material adverse effect on our financial condition, liquidity and our ability to operate going forward.

We believe that the anticipated net proceeds from this offering and cash flow from operations will be sufficient to meet our working capital, capital expenditure and other cash needs indefinitely. However, if we do not meet our business plan targets, we might need to raise additional capital from public or private equity or debt sources in order to finance future growth, including the expansion of service within existing markets and to new markets, which can be capital intensive, as well as unanticipated working capital needs and capital expenditure requirements.

The actual amount of capital required to fund our operations and development may vary materially from our estimates. If our operations fail to generate the cash that we expect, we may have to seek additional capital to fund our business. If we are required to obtain additional funding in the future, we may have to sell assets, seek debt financing or obtain additional equity capital. In addition, any indebtedness we incur in the future could subject us to restrictive covenants limiting our flexibility in planning for, or reacting to changes in, our business. If we do not comply with such covenants, our lenders could accelerate repayment of our debt or restrict our access to further borrowings. If we raise funds by selling more stock, your ownership in us will be diluted, and we may grant future investors rights superior to those of the common stock that you are purchasing. If we are unable to obtain additional capital when needed, we may have to delay, modify or abandon some of our expansion plans. This could slow our growth, negatively affect our ability to compete in our industry and adversely affect our financial condition.

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 \$11.7 million at March 31, 2010 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.

Our failure to comply with restrictive covenants under our revolving credit facilities and other debt instruments could trigger prepayment obligations.

Our failure to comply with the restrictive covenants under our revolving credit facilities and other debt instruments could result in an event of default, which, if not cured or waived, could result in us being required to repay these borrowings before their due date. If we are forced to refinance these borrowings on less favorable terms, our results of operations and financial condition could be adversely affected by increased costs and rates.

If we fail to remain current on our reporting requirements, we could be removed from the OTC Bulletin Board, which would limit the ability of broker-dealers to sell our securities and the ability of stockholders to sell their securities in the secondary market.

Companies trading on the OTC Bulletin Board, such as us, must be reporting issuers under Section 12 of the Securities Exchange Act of 1934, as amended, or the Exchange Act, and must be current in their reports under Section 13 of the Exchange Act in order to maintain price quotation privileges on the OTC Bulletin Board. If we fail to remain current on our reporting requirements, we could be removed from the OTC Bulletin Board. As a result, the

market liquidity for our securities could be severely adversely affected by limiting the ability of broker-dealers to sell our securities and the ability of stockholders to sell their securities in the secondary market.

We have substantial debt, and our debt agreements contain certain events of default and are secured by all of our assets.

As of March 31, 2010, our indebtedness totaled approximately \$2.2 million, excluding advances on our factoring lines of approximately \$521,000. As a result, we incur significant interest expense. We had \$1.6 million of outstanding term debt that matures in May 2011, approximately \$305,000 of our outstanding revolver debt that matures in September 2010, and a \$300,000 loan that matures in December 2016 with monthly installments commencing on January 1, 2010.

Our debt agreements contain certain events of default, including, among other things, failure to pay, violation of covenants, and certain other expressly enumerated events. Additionally, we have granted to YA Global and Thermo Credit a first priority security interest in substantially all of our assets, while the State of Wisconsin holds a subordinated interest in our assets.

The degree to which we are leveraged could have important consequences, including the following:

our ability to obtain additional financing in the future for operations, capital expenditures, potential acquisitions, and other purposes may be limited, or financing may not be available on terms favorable to us or at all;

a substantial portion of our cash flows from operations must be used to pay our interest expense and repay our debt, which reduces the funds that would otherwise be available to us for our operations and future business opportunities; and

our ability to continue operations at the current level could be negatively affected if we cannot refinance our obligations before their due date.

A default under any of our debt agreements could result in acceleration of debt payments and permit the lender to foreclose on our assets. We cannot assure you that we will be able to maintain compliance with these covenants. Failure to maintain compliance could have a material adverse impact on our financial position, results of operations and cash flow.

The terms of our outstanding Debentures put significant restrictions on our ability to:

pay cash dividends to our stockholders;

incur additional indebtedness;

permit liens on assets or conduct sales of assets; and

engage in transactions with affiliates.

These significant restrictions could have negative consequences, such as:

we may be unable to obtain additional financing to fund working capital, operating losses, capital expenditures or acquisitions on terms acceptable to us, or at all;

we may be unable to refinance our indebtedness on terms acceptable to us, or at all; and

we may be more vulnerable to economic downturns, which would limit our ability to withstand competitive pressures.

Moreover, any additional debt financing pursued by us may contain terms that include more restrictive covenants, require repayment on an accelerated schedule or impose other obligations that limit the ability to grow our business, acquire needed assets, or take other actions we might otherwise consider appropriate or desirable.

We require a waiver under our line of credit facility, without which we will be in default of our line of credit facility.

In September 2008, we entered into a two-year line of credit facility with a third party financial institution. Among other things, we agreed with the lender that (i) for each monthly period subsequent to March 31, 2009, we will maintain a ratio of cash flow to scheduled principal payments plus all accrued interest and related fee on funded debt of not less than 1.00 to 1.00 as of the end of each fiscal quarter (which we refer to as the minimum cash flow to debt service ratio) and (ii) we will maintain a tangible net worth of not less than \$14,400,000 as of the last day of each

fiscal quarter (which we refer to as the tangible net worth requirement). On May 14, 2010, we received a notice of waiver of the “minimum cash flow to debt service ratio” and the “tangible net worth” requirements under the line of credit facility, as such terms are defined in items D(10)a and D(10)b, respectively, of the line of credit agreement. The waiver is in effect as of March 31, 2010 and continues for the 90 day period thereafter. The outstanding principal balance is subject to additional interest of three (3%) percent per annum until such debt covenant requirements are met. We have no assurance that we will be granted a further extension. In the event we are unable to obtain an extension of the waiver we will be in default of the minimum cash flow to debt service ratio and the tangible net worth requirement. A default could result in acceleration of debt payments and permit the lender to foreclose on our assets.

USE OF PROCEEDS

Assuming the maximum offering amount of \$[] is subscribed for in the rights offering, we estimate that the net proceeds from the rights offering will be approximately \$[], after deducting expenses related to this offering payable by us estimated at approximately \$[], including dealer-manager fees. Assuming that the maximum offering amount is subscribed for in the rights offering, and all of the related warrants are exercised, we would receive \$[] of proceeds from the exercise of all of the warrants for [] shares at the stated exercise price of \$[] per share. There can be no assurances that all of the subscription rights or warrants will be exercised in full.

We intend to use the proceeds of the rights offering for expanding our sales and marketing operations, general working capital purposes, potential acquisitions of complementary businesses, research and development and may use a portion thereof to pay the expenses of defending, settling and/or paying unfavorable judgments against us in litigation in which we are a defendant. See “Legal Proceedings”. Pending use of the net proceeds from this offering described above, we intend to invest the net proceeds in short- and intermediate-term interest-bearing obligations, investment-grade instruments, certificates of deposit or direct or guaranteed obligations of the U.S. government. Any proceeds received by us from exercises of the warrants will be used for the same purpose and in the same manner.

CAPITALIZATION

The following table describes our capitalization as of March 31, 2010, on an actual basis and on a pro forma, as-adjusted basis to give effect to the sale of all [] shares of our common stock offered in the rights offering (but excluding any issuance of shares of common stock upon exercise of related warrants), assuming a subscription price of \$[] per share, and our receipt of net proceeds from that sale after deducting estimated offering expenses payable by us of approximately \$[].

This table should be read in conjunction with our “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and the related notes included elsewhere in this prospectus.

	As of March 31, 2010 (1)	
	Actual	As Adjusted
Current and long-term debt	\$	2,210,523
Stockholders’ equity		
Preferred stock, par value \$.001 per share; 15,000,000 shares authorized; none issued and outstanding		
Common stock, \$.001 par value; 155,000,000 shares authorized; 96,563,771 shares issued and outstanding		96,674
Additional paid-in capital		120,157,645
Accumulated deficit		(114,413,347)
Total stockholders’ equity		5,840,972
Total capitalization	\$	8,051,495

(1)

Excludes 215 shares of Series A convertible redeemable preferred stock, which are convertible into an aggregate of 2,961,429 shares of our common stock, and warrants to purchase an aggregate of 1,628,800 shares of common stock issued in connection with a private placement completed on November 17, 2009. Also excludes 6,860,883 shares issuable upon the exercise of options granted pursuant to our Stock Option Plan, 4,783,379 shares reserved for issuance in connection with future grants under our Stock Option Plan and 12,158,941 shares reserved for issuance upon the exercise of warrants and conversion of our outstanding convertible debentures of which 4,621,212 shares reserved for issuance cannot be issued unless our stockholders remove the 20% limitation on the number of shares pursuant to the exercise of warrants and commission of debentures issued to YA Global.

DILUTION

Purchasers of our common stock in the rights offering (and upon exercise of the warrants issued pursuant to this rights offering) will experience an immediate dilution of the net tangible book value per share of our common stock. Our net tangible book value as of March 31, 2010 was approximately negative \$(6,049,000), or negative \$(.06) per share of our common stock (based upon 96,673,771 shares of our common stock outstanding). Net tangible book value per share is equal to our total net tangible book value, which is our total tangible assets less our total liabilities, divided by the number of shares of our outstanding common stock. Dilution per share equals the difference between the amount per share paid by purchasers of shares of common stock in the rights offering and the net tangible book value per share of our common stock immediately after the rights offering.

Based on the aggregate offering of a maximum of [] shares and after deducting estimated offering expenses payable by us of \$[], and the application of the estimated \$[] of net proceeds from the rights offering, our pro forma net tangible book value as of March 31, 2010 would have been approximately \$[], or \$[] per share. This represents an immediate increase in pro forma net tangible book value to existing shareholders of \$[] per share and an immediate dilution to purchasers in the rights offering of \$[] per share.

The following table illustrates this per-share dilution (assuming a fully subscribed for rights offering of [] shares at the subscription price of \$[] per share but excluding any issuance of shares of common stock upon exercise of warrants issued in the rights offering):

Post-offering net tangible book value per share	\$ [](1)
Pre-offering net tangible book value per share	\$ [](2)
Pro forma increase in book value per share attributable to new investors	\$ []
Offering price per share	\$ []
Post-offering net tangible book value per share	\$ [](1)
Pro forma decrease in book value per share experienced by new investors	\$ []

- (1) Determined by adding to our pre-offering net tangible assets of \$[] the amount of \$[] representing the net proceeds of the offering and dividing the sum of these amounts by the post-offering outstanding common stock totaling [] shares (including [] shares of common stock issuable upon conversion of outstanding preferred stock).
- (2) Determined by dividing our pre-offering net tangible assets of \$[] by our pre-offering outstanding common stock totaling [] shares (including [] shares of common stock issuable upon conversion of outstanding preferred stock).

DETERMINATION OF OFFERING PRICE

The anticipated subscription price of \$[] per share of common stock and warrant offered in the rights offering was determined by our board of directors and the purchasers in the private placement, in consultation with our dealer-manager, Source Capital Group, Inc. We did not seek or obtain an opinion of a financial advisor in establishing the subscription price. The subscription price will not necessarily be related to our book value, tangible book value, multiple of earnings or any other established criteria of fair value and may or may not be considered the fair value of our common stock to be offered in the rights offering. You should not assume or expect that, after the rights offering, our shares of common stock or warrants will trade at or above the subscription price in any given time period.

The market price of our common stock may decline during or after the rights offering, and you may not be able to sell the underlying shares of our common stock purchased during the rights offering at a price equal to or greater than the subscription price. You should obtain a current quote for our common stock before exercising your subscription rights and make your assessment of our business and financial condition, our prospects for the future and the terms of this rights offering.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the accompanying financial statements and related notes thereto.

Overview

Telkonet, Inc. was formed in 1999 and is incorporated under the laws of the state of Utah. We develop, manufacture and sell proprietary energy efficiency and smart grid networking technology products and platforms that have helped position us as a leading clean technology provider.

We began as a developer of powerline communications, or PLC, technology. Our proprietary, patented PLC products utilize a building's internal electrical wiring to form a data communications network, turning power outlets into data ports while leaving the electrical functionality unaffected. In 2003, we launched our PlugPlusInternet suite of products, designed to maximize the use of the existing electrical wiring in commercial buildings, such as hotels, schools, multi-dwelling units, government and military buildings and office buildings. Our PlugPlusInternet products provided high-speed Internet access throughout a building, utilizing the electrical wiring already in place, converting virtually every electrical outlet into a high-speed data network. The PlugPlusInternet product suite was comprised of the PlugPlus Gateway, the PlugPlus Coupler and the PlugPlus Modem, which together built an Internet delivery system throughout an entire building. We received our first order for our PlugPlusInternet products in October 2003.

In March 2007, we completed two strategic acquisitions. On March 15, 2007, we completed the acquisition of EthoStream, LLC, or EthoStream, a leading high-speed wireless Internet access, or HSIA, solutions and technology provider targeting the hospitality industry with a customer base then consisting of approximately 1,800 hotel and timeshare properties representing in excess of 180,000 guest rooms. We acquired 100% of the outstanding membership units of EthoStream for a purchase price of \$11,756,097, which was comprised of \$2.0 million in cash and 3,459,609 shares of our common stock. The entire stock portion of the purchase price was deposited into escrow upon closing 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.

Our EthoStream Hospitality Network is now one of the largest hospitality HSIA service providers in the United States, with a customer base of approximately 2,350 properties representing over 205,000 hotel rooms. This network has created a ready opportunity for us to market our energy efficiency solutions. It also provides a marketing opportunity for our more traditional HSIA offerings, including the Telkonet iWire System. The iWire System offers a fast and cost effective way to deliver commercial high-speed broadband access using a building's existing electrical infrastructure to convert virtually every electrical outlet into a high-speed data port without the installation of additional wiring or major disruption of business activity. The EthoStream Hospitality Network represents a significant portion of our hospitality growth and market share. The EthoStream Hospitality Network is backed by a 24/7 U.S.-based in-house support center that uses integrated, web-based centralized management tools enabling proactive customer support.

While we continue to grow the EthoStream Hospitality Network, through our March 9, 2007 acquisition of Smart Systems International, or SSI, a leading manufacturer of in-room energy management systems for the hospitality industry with over 60,000 product installs as of the acquisition date, and the continued development of our PLC products, we have evolved into a "clean technology" company that develops, manufactures and sells proprietary energy efficiency and smart grid networking technology. We acquired substantially all of the assets of SSI for cash and shares of our 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 our common stock. Of the stock issued in the transaction, 1,090,909 shares were held

in an escrow account for a period of one year following the closing from which certain potential indemnification obligations under the purchase agreement could be satisfied. The aggregate number of shares held in escrow was subject to adjustment upward or downward depending upon the trading price of our common stock during the one year period following the closing date. On March 12, 2008, we released these shares from escrow, and on June 12, 2008 we issued an additional 1,882,225 shares pursuant to the adjustment provisions of the SSI asset purchase agreement.

Our Telkonet SmartEnergy, or TSE, and Networked Telkonet SmartEnergy, or NTSE, energy efficiency products incorporate our patented Recovery Time™ technology, allowing for the continuous monitoring of climate conditions to automatically adjust a room's temperature accounting for the presence or absence of an occupant. Our SmartEnergy products save energy while at the same time ensuring occupant comfort. This technology is particularly attractive to our customers in the hospitality area, as well as the education, healthcare and government/military markets, who are continually seeking ways to reduce costs without impacting building occupant comfort. By reducing energy usage automatically when a space is unoccupied, our customers are able to realize a significant cost savings without diminishing occupant comfort. The hospitality, education, healthcare and government/military markets represent a significant audience for the occupancy-based energy management controls offered by the SmartEnergy platform and provide a large footprint for utility-based consumption management. This platform may also be integrated with property management systems, automation systems and load shedding initiatives to increase the savings recognized. Working directly with management companies and utilities allows us to offer enhanced opportunities to our customers for savings and control. Our energy management systems are dynamically lowering HVAC costs in over 180,000 rooms and are an integral part of the numerous state and federal energy efficiency and rebate programs.

Our smart grid networking technology, including the Telkonet iWire System and the 200 Mbps Telkonet Series 5 PLC products, use PLC technology to quickly, economically and non-disruptively transform a site's existing internal electrical infrastructure into an internet protocol, or IP, network backbone. Our PLC systems offer the hard-wired security and reliability of a CAT-5 cabled network, but without the cost, physical disturbance and business disruption of wiring CAT-5 or the security issues inherent to wireless systems.

The development of an industrial PLC product for use within the utility space has introduced a competitive alternative to traditional local area network, or LAN, solutions. By capitalizing on the shortcomings of previously available offerings, we have gained traction and opened a new market opportunity. Our Series 5 SmartGrid networking technology provides a compelling solution for power substation automation, power generation, renewable facilities, manufacturing, and research environments by providing a rapidly-deployed, low cost alternative to structured cable, wireless and fiber. Operating at 200 Mbps, our PLC platform offers a secure new competitive alternative in grid communications, enabling LAN infrastructure for power substation command and control, monitoring and grid management, transforming a traditional power management system into a "smart grid" that delivers electricity in a manner that can save energy, reduce cost and increase reliability. By leveraging the existing electrical wiring within a facility to transport data, our PLC solutions enable facilities to deploy sensing and control systems to locations without the need for new network wiring, and without the security risks associated with wireless systems.

We employ direct and indirect sales channels in all areas of our business. With a growing value-added reseller network, we continue to broaden our reach throughout the industry. Utilizing key integrators and strategic OEM partners, we have been able to recognize significant success in each of our targeted markets. With an increasing share of our business originating outside of the hospitality industry, we have proven the versatility of our technology and the savings that can be derived through the use of our products.

Discontinued Operations

On January 31, 2006, we acquired a 90% interest in Microwave Satellite Technologies, Inc. from Frank Matarazzo, its sole stockholder, in exchange for \$1.8 million in cash and 1.6 million unregistered shares of our 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 held in escrow, 400,000 shares of which were paid at closing and the remaining 1,200,000 reserve shares, which shall be issued based on the achievement of 3,300 video and data subscribers over a three year period from the closing (later extended to July 2009 pursuant to a May 2008 agreement between the parties). The escrow agreement terminated on July 31, 2009. As of August 14, 2009, we had issued 800,000 of the reserve shares.

On April 22, 2009, we completed the deconsolidation of our subsidiary, MSTI Holdings, Inc., or MSTI. To effect the deconsolidation of MSTI, we were required to reduce our ownership percentage and board membership in MSTI. On February 26, 2009, we executed a Stock Purchase Agreement pursuant to which we sold 2.8 million shares of MSTI common stock and as a result of this transaction, we reduced our beneficial ownership in MSTI from 58% to 49% of the issued and outstanding shares of MSTI common stock. On April 22, 2009, Warren V. Musser and Thomas C. Lynch, members of our board of directors, submitted their resignations as directors of MSTI. Because of these resignations we no longer control a majority of MSTI's board of directors. As a result of the deconsolidation, the financial statements and accompanying footnotes included in this prospectus include disclosures of the results of operations of MSTI, for all periods presented, as discontinued operations.

Loss on Long-Term Investments

Geeks on Call America, Inc.

On October 19, 2007, we completed the acquisition of approximately 30% of the issued and outstanding shares of common stock of Geeks on Call America, Inc., or GOCA, a provider of on-site computer services. Under the terms of the stock purchase agreement, we acquired approximately 1,160,043 shares of GOCA common stock from several GOCA stockholders in exchange for 2,940,200 shares of our common stock for total consideration valued at approximately \$4.5 million. The number of shares issued in connection with this transaction was determined using a per share price equal to the average closing price of our common stock on the American Stock Exchange (AMEX) during the ten trading days immediately preceding the closing date. The number of shares was subject to adjustment on the date we filed a registration statement for the shares issued in this transaction, which occurred on April 25, 2008. The increase or decrease to the number of shares issued was determined using a per share price equal to the average closing price of our common stock on the AMEX during the ten trading days immediately preceding the date the registration statement was filed. We accounted for this investment under the cost method, as we do not have the ability to exercise significant influence over operating and financial policies of GOCA. On April 30, 2008, we issued an additional 3,046,425 shares of our common stock to the sellers of GOCA to satisfy the adjustment provision.

On February 8, 2008, Geeks on Call Acquisition Corp., a newly formed, wholly-owned subsidiary of Geeks On Call Holdings, Inc., (formerly Lightview, Inc.) merged with GOCA. As a result of the merger, our common stock in GOCA was exchanged for shares of common stock of Geeks on Call Holdings Inc., or Geeks Holdings. Immediately following the merger, Geeks Holdings completed a private placement of its common stock for aggregate gross proceeds of \$3,000,000. As a result of this transaction, our 30% interest in GOCA became an 18% interest in Geeks Holdings. We have determined that our investment in Geeks Holdings is impaired because we believe that the fair market value of Geeks Holdings has permanently declined. Accordingly, we wrote-off \$4,098,514 during the year ended December 31 2008. The remaining value of this investment amounted to \$367,653 as of December 31, 2008. Management has determined that the entire investment in GOCA is impaired and the remaining value of \$367,653 was written off during the year ended December 31 , 2009.

Multiband Corporation

On October 30, 2007, in lieu of a payment of \$75,000, we accepted 30,000 shares of common stock of Multiband Corporation, a Minnesota-based communication services provider to multiple dwelling units. We classify these securities as available for sale, and they are carried at fair market value. During the year ended December 31, 2008, we recorded a loss of \$6,500 on the sale of 5,000 shares of our investment in Multiband. In addition, we recorded an unrealized loss of \$32,750 due to a temporary decline in value of these securities. The remaining value of this investment amounted to \$29,750 as of December 31, 2008. We sold our remaining investment in Multiband and recorded a loss of \$29,371 in January 2009.

Private Placement

On November 19, 2009 we completed a private offering of our securities in which we sold 215 shares of our Series A convertible redeemable preferred stock, par value \$0.001 per share, at \$5,000 per share, and warrants to purchase an aggregate of 1,628,800 shares of our common stock at an exercise price of \$0.33 per share, the volume-weighted average price of a share of our common stock for the 30-day period immediately preceding November 12, 2009, and received gross proceeds of \$1,075,000. Each share of Series A convertible redeemable preferred stock is convertible into approximately 13,774 shares of our common stock at a conversion price of \$0.363 per share, 110% of the volume-weighted average price of our common stock for the 30-day period immediately preceding November 12, 2009. Except as specifically provided or as otherwise required by law, the Series A convertible redeemable preferred stock will vote together with the common stock shares on an as-if-converted basis and not as a separate class.

We are utilizing the net proceeds from the sale of the Series A convertible redeemable preferred stock shares and the warrants for general working capital needs and to repay certain outstanding indebtedness, and to pay expenses of the rights offering as well as other general corporate capital purposes.

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, we recognize revenue in accordance with FASB's Accounting Standards Codification, or ASC, 605-10, and ASC Topic 13 guidelines that require 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) collectability 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 collectability 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. We defer any revenue for which the product has not been delivered or is subject to refund until such time that we and the customer jointly determine that the product has been delivered or no refund will be required. The guidelines also address the 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 our 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 our 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.

Revenue from sales-type leases for our EthoStream Hospitality Network products is recognized at the time of lessee acceptance, which follows installation. We recognize revenue from sales-type leases at the net present value of future lease payments. Revenue from operating leases is recognized ratably over the lease period.

Fair Value of Financial Instruments

In January 2008, we adopted the provisions under FASB for Fair Value Measurements, which define fair value for accounting purposes, establishes a framework for measuring fair value and expands disclosure requirements regarding fair value measurements. Our adoption of these provisions did not have a material impact on our consolidated financial statements. Fair value is defined as an exit price, which is the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date. The degree of judgment utilized in measuring the fair value of assets and liabilities generally correlates to the level of pricing observability. Financial assets and liabilities with readily available, actively quoted prices or for which fair value can be measured from actively quoted prices in active markets generally have more pricing observability and require less judgment in measuring fair value. Conversely, financial assets and liabilities that are rarely traded or not quoted have less price observability and are generally measured at fair value using valuation models that require more judgment. These valuation techniques involve some level of management estimation and judgment, the degree of which is dependent on the price transparency of the asset, liability or market and the nature of the asset or liability. We have categorized our financial assets and liabilities measured at fair value into a three-level hierarchy in accordance with these provisions.

Stock Based Compensation

We account for our stock based awards in accordance with ASC 718 (formerly SFAS 123(R) "Share-Based Payment"), which requires a fair value measurement and recognition of compensation expense for all share-based payment awards made to our employees and directors, including employee stock options and restricted stock awards.

We estimate the fair value of stock options granted using the Black-Scholes valuation model. This model requires us to make estimates and assumptions including, among other things, estimates regarding the length of time an employee will retain vested stock options before exercising them, the estimated volatility of our common stock price and the number of options that will be forfeited prior to vesting. The fair value is then amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period. Changes in these estimates and assumptions can materially affect the determination of the fair value of stock-based compensation and consequently, the related amount recognized in our consolidated statements of operations.

Goodwill and Other Intangibles

Goodwill represents the excess of the cost of businesses acquired over fair value or net identifiable assets at the date of acquisition. Goodwill is subject to a periodic impairment assessment by applying a fair value test based upon a two-step method. The first step of the process compares the fair value of the reporting unit with the carrying value of the reporting unit, including any goodwill. We utilize a discounted cash flow valuation methodology to determine the fair value of the reporting unit. If the fair value of the reporting unit exceeds the carrying amount of the reporting

unit, goodwill is deemed not to be impaired in which case the second step in the process is unnecessary. If the carrying amount exceeds fair value, we perform the second step to measure the amount of impairment loss. Any impairment loss is measured by comparing the implied fair value of goodwill with the carrying amount of goodwill at the reporting unit, with the excess of the carrying amount over the fair value recognized as an impairment loss.

Long-Lived Assets

We review long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with ASC 360-10 (formerly Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets). Recoverability is measured by comparison of the carrying amount to the future net cash flows which the assets are expected to generate. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the projected discounted future cash flows arising from the asset using a discount rate determined by management to be commensurate with the risk inherent to our current business model.

Results of Operations

Three Months Ended March 31, 2010 Compared to Three Months Ended March 31, 2009

Revenues

The table below outlines our product versus recurring revenues for comparable periods:

	March 31, 2010		Three Months Ended March 31, 2009		Variance	
Product	\$ 1,566,451	61%	\$ 1,918,427	66%	\$ (351,976)	-18%
Recurring	1,017,589	39%	979,525	34%	38,064	4%
Total	\$ 2,584,040	100%	\$ 2,897,952	100%	\$ (313,912)	-11%

Product revenue

Product revenue principally arises from the sale and installation of SmartGrid and broadband networking equipment, including SmartEnergy technology, Telkonet Series 5 and Telkonet iWire products. We market and sell to the hospitality, education, healthcare and government/military markets. The Telkonet Series 5 and the Telkonet iWire products consist of the Telkonet Gateways, Telkonet Extenders, the patented Telkonet Coupler, and Telkonet iBridges. The SmartEnergy product suite consists of thermostats, sensors, controllers, wireless networking products and a control platform.

For the three months ended March 31, 2010, product revenue decreased by 18% when compared to the prior year period. Product revenue in 2009 includes approximately \$1.1 million attributed to the sale and installation of energy management products, and approximately \$0.3 million for the sale and installation of HSIA products, and approximately \$0.2 million attributable to the Telkonet Series 5 products. The decrease in product sales compared to the prior year period is attributed to the economic downturn, however, the current quarter product revenue sales reflects positive anticipated trends in comparison to the second half of the prior year. We expect to see sales growth in 2010 from the addition and/or renewal of incentive based programs for energy efficiency, government stimulus funding through the American Reinvestment and Recovery Act of 2009, and energy savings initiatives in the commercial market.

Recurring Revenue

Recurring revenue includes approximately 2,350 hotels in our broadband network portfolio. We currently support over 205,000 HSIA rooms, with over 2.5 million monthly users. For the three months ended March 31, 2010, recurring revenue increased by 4% when compared to the prior year period. The increase of recurring revenue was primarily attributed to new HSIA customers.

Cost of Sales

	March 31, 2010		Three Months Ended March 31, 2009		Variance	
Product	\$ 899,782	57%	\$ 1,076,639	56%	\$ (176,857)	-16%
Recurring	305,845	30%	305,834	31%	11	0%
Total	\$ 1,205,627	47%	\$ 1,382,473	48%	\$ (176,846)	-13%

Product Costs

Product costs include equipment and installation labor related to the sale of Telkonet SmartEnergy™ products, Telkonet Series 5™ products and the Telkonet iWire System™. For the three months ended March 31, 2010, product costs were approximately \$0.9 million, and decreased by 16% when compared to the prior year period consist with the decreased sales when compared to the prior year period.

Recurring Costs

For the three months ended March 31, 2010, recurring costs were approximately \$0.3 million, and remained consistent when compared to the prior year, primarily due to the increase in efficiency in providing support services to our EthoStream Hospitality Network customers. As we continued to add new HSIA customers to our portfolio, we may need to hire additional support center staff which may affect our recurring product costs and margins.

Gross Profit

	March 31, 2009		Three Months Ended March 31, 2008		Variance	
Product	\$ 666,669	43%	\$ 841,788	44%	\$ (175,119)	-21%
Recurring	711,744	70%	673,691	69%	38,053	6%
Total	\$ 1,378,413	53%	\$ 1,515,479	52%	\$ (137,066)	-9%

Product Gross Profit

The gross profit on product revenue for the three months ended March 31, 2010 decreased by 21% compared to the prior year period as a result of decreased product sales and installations on energy management and HSIA sales.

Recurring Gross Profit

Our gross profit associated with recurring revenue increased by 6% for the three months ended March 31, 2010. The increase was a combination of additional recurring revenue and maintaining our support labor costs.

Operating Expenses

	March 31, 2010	Three Months Ended March 31, 2009		Variance
Total	\$ 2,037,000	\$ 2,076,398	\$ (39,398)	-2%

During the three months ended March 31, 2010 operating expenses decreased by 2% when compared to the prior year. Operating expenses have been contained for research and development and selling and administrative costs in comparison to the prior year period. The consolidation of offices has positioned us to maintain operating costs through 2010.

Research and Development

	March 31, 2010	Three Months Ended March 31, 2009		Variance
Total	\$ 265,851	\$ 275,962	\$ (10,111)	-4%

Our research and development costs related to both present and future products are expensed in the period incurred. Current research and development costs are associated with the continued development of Telkonet Series 5 products and next generation TSE and NTSE products. We anticipate modest growth of research and development costs in 2010.

Selling, General and Administrative Expenses

	March 31, 2010	Three Months Ended March 31, 2009	Variance	
Total	\$ 1,690,739	\$ 1,713,602	\$ (22,863)	-1%

Selling, general and administrative expenses decreased for the three months ended March 31, 2010 over the comparable prior year by 1%. This decrease was primarily the result of a reduction of stock based compensation of \$47,030 offset by an increase in legal costs related to current financings and legal matters in the current period. hawse have successfully maintained selling, general and administrative costs through costs reduction initiatives and corporate restructuring. In the current yearwe expect higher legal costs and plans to increase selling and marketing related initiatives in the growth and development of the current business markets.

Discontinued Operations

We had net loss from discontinued operations of \$(512,297) or (\$0.00) per share, for the period ended March 31, 2009.

Year Ended December 31, 2009 Compared to Year Ended December 31, 2008

Revenues

The table below outlines our product versus recurring revenues for comparable periods:

	2009		Year Ended December 31, 2008		Variance	
Product	\$ 6,521,906	62%	\$ 13,043,114	79%	\$ (6,521,208)	-50%
Recurring	3,996,147	38%	3,515,887	21%	480,260	14%
Total	\$ 10,518,053	100%	\$ 16,559,001	100%	\$ (6,040,948)	-36%

Product revenue

Product revenue principally arises from the sale and installation of SmartGrid and broadband networking equipment, including SmartEnergy technology, Telkonet Series 5 and Telkonet iWire products. We market and sell to the hospitality, education, healthcare and government/military markets. The Telkonet Series 5 and the Telkonet iWire products consist of the Telkonet