CAPSTONE TURBINE Corp
Form 10-K
June 15, 2015

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended March 31, 2015

or

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

For the transition period from to
Commission file number 001-15957

CAPSTONE TURBINE CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**95-4180883**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
21211 Nordhoff Street, Chatsworth, California	**91311**
(Address of principal executive offices)	(Zip Code)

(818) 734-5300
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of exchange on which registered**
Common Stock, par value $.001 per share	NASDAQ Global Market
Series A Preferred Stock Purchase Rights	

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No ý

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No ý

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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 o	Accelerated filer ý	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No ý

The aggregate market value of the shares of Common Stock of the registrant held by non-affiliates on September 30, 2014 was approximately $353.3 million.

As of June 8, 2015, there were 330,689,556 shares of the registrant's Common Stock issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement relating to the registrant's 2015 annual meeting of stockholders are incorporated by reference into Part III of this report to the extent described therein.

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CAPSTONE TURBINE CORPORATION

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PART I

Item 1. Business.

Overview

Capstone Turbine Corporation ("Capstone" or the "Company") develops, manufactures, markets and services microturbine technology solutions for use in stationary distributed power generation applications, including cogeneration (combined heat and power ("CHP"), integrated combined heat and power ("ICHP"), and combined cooling, heat and power ("CCHP")), renewable energy, natural resources and critical power supply. In addition, our microturbines can be used as battery charging generators for hybrid electric vehicle applications. Microturbines allow customers to produce power on-site in parallel with the electric grid or stand alone when no utility grid is available. Several technologies are used to provide "on-site power generation" (also called "distributed generation") such as reciprocating engines, solar power, wind powered systems and fuel cells. For customers who do not have access to the electric utility grid, microturbines provide clean, on-site power with fewer scheduled maintenance intervals and greater fuel flexibility than competing technologies. For customers with access to the electric grid, microturbines provide an additional source of continuous duty power, thereby providing additional reliability and potential cost savings. With our stand-alone feature, customers can produce their own energy in the event of a power outage and can use microturbines as their primary source of power for extended periods. Because our microturbines also produce clean, usable heat energy, they provide economic advantages to customers who can benefit from the use of hot water, chilled water, air conditioning and heating. Our microturbines are sold, installed and serviced primarily through our global distribution network. Together we offer new and remanufactured parts as well as a comprehensive Factory Protection Plan ("FPP"). Successful implementation of microturbines relies on the quality of the microturbine, marketability for appropriate applications, and the quality of the installation and support.

We believe we were the first company to offer a commercially available power source using microturbine technology. Capstone offers microturbines designed for commercial, industrial and utility users with product offerings ranging from 30 kilowatts ("kW") to one megawatt in electric power output. Our 30 kW ("C30") microturbine can produce enough electricity to power a small convenience store. The 65 kW ("C65") microturbine can produce enough heat to provide hot water to a 100-room hotel while also providing about one-third of its electrical requirements. Our 200 kW ("C200") microturbine is well suited for larger hotels, office buildings and wastewater treatment plants, among others. By packaging the C200 microturbine power modules into an International Organization for Standardization ("ISO") sized container, Capstone has created a family of microturbine offerings from 600 kW up to one megawatt in a compact footprint. Our 1000 kW ("C1000 Series") microturbines are well suited for utility substations, larger commercial and industrial facilities and remote oil and gas applications. Our microturbines combine patented air-bearing technology, advanced combustion technology and sophisticated power electronics to form efficient and ultra-low emission electricity and cooling and heat production systems. Because of our air-bearing technology, our microturbines do not require liquid lubricants. This means they do not require routine maintenance to change and dispose of oil or other liquid lubricants, as do the most common competing products. Capstone microturbines can be fueled by various sources, including natural gas, propane, sour gas, renewable fuels such as landfill or digester gas, kerosene, diesel and biodiesel. The C65 and C200 microturbines are available with integrated heat exchangers, making them easy to engineer and install in applications where hot water is used. Our products produce exceptionally clean power. Our natural gas-fueled C65 and C200 microturbines were certified by the California Air Resources Board ("CARB") as meeting its stringent 2007 emissions requirements the same emissions standard used to certify fuel cells and the same emissions levels as a state-of-the-art central power plant. Our C65 Landfill and Digester Gas systems were certified in January 2008 by CARB as meeting 2008 waste gas emissions requirements for landfill and digester gas applications. Our C200 Landfill and Digester Gas systems were certified in

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November 2010 by CARB as meeting 2008 waste gas emissions requirements for landfill and digester gas applications.

On February 1, 2010, we acquired the 100 kW ("TA100") microturbine product line from Calnetix Power Solutions, Inc. ("CPS"). The TA100 microturbine is most similar to the Capstone product design compared to other microturbine products in the industry.

We sell complete microturbine units, subassemblies, components and various accessories. We also remanufacture microturbine engines and provide after-market parts and services. Our microturbines are sold primarily through distributors and Original Equipment Manufacturers ("OEMs"). Distributors purchase our products for sale to end users and also provide application engineering and installation support. Distributors are also required to provide a variety of additional services, including engineering the applications in which the microturbines will be used, installation support of the products at the end users' sites, commissioning the installed applications and providing post-commissioning service. Our distributors perform as value-added resellers. OEMs integrate Capstone's products into their own product solutions.

To assure proper installation of Capstone microturbine systems, we have instituted a Factory Trained Installer ("FTI") training and certification program. Personnel from our distributors and OEMs, as well as design engineering firms, contractors and end users attend this FTI training. We offer to assist all customers by reviewing their installation designs to confirm that the technical requirements for proper operation have been met, such as electrical interconnections, load requirements, fuel type and pressure, cooling air flow and turbine exhaust routing. As part of the microturbine commissioning process, we also receive a checklist to confirm that the final installation adheres to Capstone technical requirements before we accept any warranty obligations. This is aimed at providing the end user with a proper installation that will operate as expected for the life of the equipment.

Through our global distribution network, we offer a comprehensive FPP for a fixed annual fee to perform regularly scheduled and unscheduled maintenance as needed. Capstone provides factory and on-site training to certify all personnel that are allowed to perform service on our microturbines. Individuals who are certified are called Authorized Service Providers ("ASPs"), and must be employed by a distributor in order to perform work pursuant to a Capstone FPP. The majority of our distributors provide these services.

This Annual Report on Form 10-K (this "Form 10-K") refers to Capstone's fiscal years ending March 31 as its "Fiscal" years.

Our Products

We began commercial sales of our C30 products in 1998, targeting the emerging distributed generation industry that was being driven by fundamental changes in power requirements. In September 2000, we shipped the first commercial unit of our 60 kW microturbine ("C60"), which was replaced by the C65 model during the quarter ended March 31, 2006. We began shipping the C60 ICHP solution in 2003. The first commercial C200 microturbine was shipped on August 28, 2008. Our C1000 Series product was developed based on Capstone's C200 microturbine engine. The C1000 Series product can be configured into 1,000 kW, 800 kW and 600 kW solutions in a single ISO-sized container. The first commercial shipment of our C1000 Series product was on December 29, 2008. We began shipping TA100 microturbines in March 2010.

During Fiscal 2015, we booked total orders of $84.5 million for 587 units, or 86.0 megawatts, compared to $131.5 million for 675 units, or 135.3 megawatts, during Fiscal 2014. We shipped 620 units with an aggregate of 91.4 megawatts, generating revenue of $90.4 million compared to 671 units with an aggregate of 109.9 megawatts, generating revenue of $108.8 million during Fiscal 2014. Total backlog as of March 31, 2015 decreased $5.9 million, or 3%, to $165.7 million from $171.6 million at March 31,

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2014. As of March 31, 2015, we had 787 units, or 182.8 megawatts, in total backlog compared to 820 units, or 188.2 megawatts, at the same date last year. The decrease in backlog was primarily the result of the downturn of the oil markets, a substantially stronger U.S. dollar making our products more expensive overseas and on-going geopolitical tensions in Russia, North Africa and the Middle East. The timing of the backlog is based on the requirement date indicated by our customers. However, based on historical experience, management expects that a significant portion of our backlog may not be shipped within the next twelve months. The timing of shipments is subject to change based on several variables (including customer deposits, payments, availability of credit and customer delivery schedule changes), most of which are not in our control and can affect the timing of our revenue.

The following table summarizes our backlog:

	As of March 31,			
	2015		2014	
	Megawatts	Units	Megawatts	Units
C30	2.9	97	3.0	101
C65	32.6	502	33.8	520
TA100	1.9	19	1.9	19
C200	2.4	12	3.4	17
C600	7.2	12	9.0	15
C800	9.8	12	8.8	11
C1000	125.0	125	127.0	127
Waste heat recovery generator	1.0	8	1.3	10
Total Backlog	182.8	787	188.2	820

Capstone microturbines are compact, lightweight and environmentally friendly generators of electricity and heat compared to competing technologies. They operate on the same principle as a jet engine with the added capability of using a variety of commercially available fuels. For example, our microturbines can operate on low British Thermal Unit ("BTU") gas, which is gas with lower energy content, and can also operate on gas with a high amount of sulfur, known in the industry as sour gas. Examples of these fuel sources include methane from facilities such as wastewater treatment plants, landfills and anaerobic digesters.

Our microturbines incorporate four major design features:

- advanced combustion technology;
- patented air-bearing technology;
- digital power electronics; and
- remote monitoring capability.

Our advanced combustion technology allows Capstone microturbines to achieve low emissions with a design geared towards manufacturability. These low emission levels not only provide an environmentally friendly product, but also eliminate permitting requirements in several municipalities for continuously operated onsite power generation. The air-bearing system allows the microturbine's single moving assembly to produce power without the need for typical petroleum-based lubrication. Air-bearings use a high-pressure field of air rather than petroleum lubricants. This improves reliability and reduces maintenance such as oil changes. The electronic controls manage critical functions and monitor operations of the microturbine. For instance, our electronics control the microturbine's speed, temperature and fuel flow and communicate with external networks and building management systems. The power electronics coordinate with the grid when the units are operated in a grid-connect mode and with the onboard battery when equipped for stand-alone mode. All control functions are

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performed digitally. Performance is optimized, resulting in lower emissions, higher reliability and high efficiency over a variable power range.

The electrical output of our units can be paralleled in multiple unit configurations through our Advanced Power Server product and a digital communications cable to serve larger installations requiring electrical loads up to ten megawatts.

Our products can operate:

- connected to the electric utility grid as a current source;
- on a stand-alone basis as a voltage source;
- multipacked to support larger loads as a "virtual single" unit; and
- in dual mode, where the microturbine operates connected to the electric utility grid or operates independently.

We also offer C65 and C200 ICHP systems. These systems combine the standard C65 and C200 microturbine unit with a heat recovery module that provides electricity and heats water.

Our family of products is offered in the following configurations:

	C30		C65		TA100		C200		C1000 Series	
Fuel Types	**Grid Connect**	**Dual Mode**	**Grid Connect**	**Dual Mode**	**Grid Connect**	**Dual Mode**	**Grid Connect**	**Dual Mode**	**Grid Connect**	**Dual Mode**
Low pressure natural gas	X	X	X	X	X	X	X	X	X	X
High pressure natural gas	X	X	X	X	X	X	X	X	X	X
Compressed natural gas	X	X	X	X	X	X	X	X	X	X
Landfill gas	X		X				X		X	
Digester gas	X		X				X		X	
Gaseous propane	X	X	X	X			X	X	X	X
High pressure sour gas	X	X	X	X			X	X	X	X
Diesel	X	X	X	X			X	X	X	X
Kerosene	X	X	X	X						

We offer various accessories for our products including rotary gas compressors with digital controls, heat recovery modules for CHP applications, dual mode controllers that allow automatic transition between grid connect and stand-alone modes, batteries with digital controls for stand-alone or dual-mode operations, power servers for large multipacked installations, protocol converters for Internet access, packaging options and miscellaneous parts such as frames, exhaust ducting and installation hardware. We also sell microturbine components and subassemblies.

Our electronic controls manage microturbines using Capstone's proprietary software and advanced algorithms. The controls:

- start the turbogenerator and manage its load;
- coordinate the functioning of the microturbine with the grid;
- manage the speed, fuel flow and exhaust temperature of the microturbine;

convert the variable frequency, up to a maximum of 1,600 Hertz and variable voltage power produced by the generator into a usable output of either 50 or 60 Hertz AC for stationary applications or DC for hybrid electric vehicle applications; and

provide digital communications to externally maintain and control the equipment.

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In addition, our proprietary Capstone Remote Monitoring Software ("CRMS") allows end users to remotely operate and manage the microturbine. Unlike the technology of other power sources that require on-site monitoring and maintenance, the CRMS allows end users to remotely and efficiently monitor their microturbine systems. This remote capability can provide end users with power generation flexibility and cost savings.

The C30 microturbines were initially designed to operate connected to an electric utility grid and to use a high pressure natural gas fuel source. We have expanded our microturbine's functionality to operate with different fuels. The combustor system remains the same for all fuels except for the fuel injectors, which currently vary between liquid and gaseous fuels. The Capstone microturbine's multi-fuel capability provides significant competitive advantages with respect to some of our selected vertical markets.

Our C65 grid-connect and stand-alone microturbine power systems are listed by Underwriters Laboratories ("UL") as meeting the UL 2200 stationary engine generator standards and the UL 1741 utility interconnection requirements. Our products are manufactured by processes that are ISO 9001:2008 and ISO 14001:2004 certified.

In 2002, the California Energy Commission certified our C30 and C60 microturbines as the first products to comply with the requirements of its "Rule 21" grid interconnection standard. This standard streamlines the process for connecting distributed generation systems to the grid in California. The benefits of achieving this standard include avoiding both costly external equipment procurement requirements and extensive site-by-site and utility-by-utility analysis. Our protective relay functionality has also been recognized by the State of New York, which has pre-cleared our microturbines for connection to New York's electric utility grid.

Our C60 microturbine was the first combustion power generation product to be certified by the CARB as meeting its stringent distributed generation emissions standards that went into effect in 2003. Our C65 microturbine now meets the even more stringent CARB 2007 standard for natural gas.

The TA100 microturbine offers a digital communication interface which can be connected to an external controller (not sold by Capstone) to provide multiple unit and dual mode dispatching functionality. An external synchronization board is provided to parallel the electrical output in multiple unit configurations for stand-alone operation.

We are the first microturbine manufacturer to achieve UL Class I, Division 2 certification for operation in hazardous-area oil and gas applications. These specially packaged systems are applied in oil and gas production areas with potentially explosive environments. In September 2009, we received UL certification for our C200 grid-connect and stand-alone microturbine as meeting the UL 2200 stationary engine generator standards and the UL 1741 utility interconnection requirements. In June 2010, we received UL certification for our C1000 Series grid-connect and stand-alone microturbine as meeting the UL 2200 stationary engine generator standards and the UL 1741 utility interconnection requirements.

Applications

Worldwide, stationary power generation applications vary from huge central stationary generating facilities up to 1,000 MW to back-up generators as small as 2 kW. Historically, power generation in most developed countries such as the United States has been part of a regulated utility system. A number of developments related primarily to the deregulation of the utility industry as well as significant technology advances have broadened the range of power supply choices available to all types of customers.

Capstone products serve multiple vertical markets worldwide. Within the markets served, we focus on vertical markets that we have identified as having the greatest near-term potential. In the markets

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we are focusing on, which are energy efficiency, renewable energy, natural resources, critical power supply, transportation and marine, we have identified specific targeted vertical market segments.

Energy Efficiency CHP/CCHP

Energy efficiency maximizes the use of energy produced by the microturbines, reduces emissions compared with traditional power generation and enhances the economic advantage to customers. Energy efficiency uses both the heat and electric energy produced in the power generation process. Using the heat and electricity created from a single combustion process increases the efficiency of the system from approximately 30% to 75% or more. The increased operating efficiency reduces overall greenhouse gas emissions compared with traditional independent sources such as power generation and local thermal generation and, through displacement of other separate systems, can reduce operating costs. Our microturbines' emissions of commonly found air pollutants ("criteria pollutants"), such as nitrogen oxides ("NOx"), carbon monoxide ("CO") and volatile organic compounds ("VOCs"), are lower than those from the on-site boilers that our CHP system displaces, meaning that local emissions of these pollutants are actually reduced when a Capstone energy efficiency CHP system is installed. This high CHP efficiency also means more efficient use of fuel and can reduce net utility costs for end users. The most common uses of heat energy include space heating and air conditioning, heating and cooling water, as well as drying and other applications. For example, we have used the heat generated by the microturbines to supply hot water solutions for hotels, office buildings and retail, commercial and industrial customers. When our microturbine exhaust drives an absorption chiller, the chiller produces chilled water for air conditioning and other uses.

There are energy efficiency markets for CHP and CCHP applications worldwide. A U.S. Department of Energy ("DOE") report cited the total technical potential for the energy efficiency CHP at commercial, institutional and industrial sites in the United States to be over 130 gigawatts. Many governments have encouraged more efficient use of the power generation process to reduce pollution, lower dependence on fossil fuels and control the cost of locally produced goods. To access these markets, we have entered into agreements with distributors which have engineered energy efficiency CHP packages that utilize the hot exhaust air of the microturbine for heating water and also use the hot exhaust to run an absorption chiller for air conditioning. We also offer our own integrated energy efficiency CHP and CCHP product for the C65, C200 and C1000 Series products.

Renewable Energy

Our microturbines can use renewable methane gases from landfills, wastewater treatment facilities and other biogas applications such as food processing and agricultural waste, referred to as green waste, and cow, pig and chicken manure. They can burn these renewable waste gases with minimal emissions, thereby, in some cases, avoiding the imposition of penalties incurred for pollution while simultaneously producing electricity from this "free" renewable fuel for use at the site or in the surrounding areas. The microturbines have demonstrated effectiveness in these applications and outperform conventional combustion engines in a number of situations, including when the gas contains a high amount of sulfur.

Capstone released for sale the C65 stand-alone digester product in the renewable energy market segment in 2007. This product is targeted at remote villages in third-world countries with wastewater treatment facilities that offer a valuable source of fuel which can be converted to electricity. A joint applications and engineering team evaluated the performance of the existing C65 digester gas system to ensure that the combustion system would be stable from 0 to 100% power output. Minor controls changes were implemented to increase stability at low power levels. The ability to convert this low BTU fuel to electricity along with the high reliability and low maintenance features of this product make it well suited for this market.

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Natural Resources Oil, Natural Gas, Shale Gas & Mining

On a worldwide basis, there are thousands of locations where the drilling, production, compression and transportation of natural resources and other extraction and production processes create fuel byproducts, which traditionally have been released or burned into the atmosphere. Our microturbines are installed in the natural resource market to be used in oil and gas exploration, production, compression and transmission sites both onshore and offshore as a highly reliable critical source of power generation. In addition, our microturbines can use flare gas as a fuel to provide prime power. Typically these oil and gas or mining operations have no electric utility grid and rely solely on Capstone's microturbine for reliable low emission power supply.

Many major oil and gas companies are exploring large shale reserves, or plays, in the United States. In mid-2010 Capstone sold its first microturbines into the U.S. shale gas market in the Eagle Ford and Marcellus shale plays. The addressable market for Capstone microturbines in this industry is significant. The shale gas market for microturbines is expected to grow substantially as demand for natural gas continues to rise and the U.S. Environmental Protection Agency ("EPA"), the Department of the Interior and other federal and state agencies work to reduce emissions of methane, volatile organic compounds and hazardous air pollutants associated with natural gas development. Capstone has been invited to participate in numerous Natural Gas STAR workshops in the United States and foreign markets to demonstrate the emissions reductions our technology can provide.

The C200 product is offered for sale configured to meet Class 1 Zone 2 hazardous location requirements for the oil and gas market. Hazardous location requirements are met through package ventilation changes for purging and pressurizing package air to avoid potential flammable mixtures as well as controls for emergency disconnect of fuel and electrical sources. The package is upgraded to stainless steel construction to withstand the corrosive offshore environments where these units are installed. Oil and gas customers prefer the low maintenance and high reliability attributes offered by our turbines to ensure continued production. Capstone also offers C30 and C65 microturbine products in similar configurations.

Critical Power Supply

Because of the potentially catastrophic consequences of even momentary system failure, certain power users such as high technology, health care and information systems facilities require particularly high levels of reliability in their power service. To meet these customer requirements, traditional solutions utilize Uninterruptible Power Supplies ("UPS") to protect critical loads from momentary power disturbances along with backup diesel generators for extended outages. Capstone offers an alternative solution that can both meet customer reliability requirements and reduce operating costs.

Capstone has developed the world's only microturbine powered UPS solutions that offer clean, IT-grade power and can completely displace the need for traditional UPS and backup diesel generators. We offer two microturbine-powered UPS solutions. The Capstone UPSource microturbine-powered UPS solution provides prime or emergency power solutions. Capstone's Hybrid UPS microturbine powered solution provides power when dispatched in high efficiency, standard UPS and emergency power solutions. Both critical power supply products offer 99.999999% availability in an n+1 configuration when the product has at least one independent backup. Our microturbine-powered UPS solutions are UL listed. These integrated solutions are ideal for new construction or facility expansion and are typically installed with absorption chillers or other heat recovery systems to obtain high efficiency and reduce operating costs compared with traditional solutions.

Dual mode units operating in a prime power configuration can support a 150% overload for 10 seconds during transient conditions. Dual mode units operating in grid parallel mode can provide customers a back-up power system with an economic return. These systems offer high onsite energy efficiency when combined with a heat exchanger (CHP) to create hot water or with a chiller (CCHP)

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for air conditioning at these facilities. This configuration, when combined with the Capstone Dual Mode Controller, can transition from the grid parallel mode to prime power mode in less than ten seconds. Capstone microturbines can also be installed along with a rotary UPS to provide a complete line-interactive continuous power solution. In this case, the microturbines remain in grid connect mode while the rotary UPS stabilizes the utility voltage and provides a seamless transfer from operation connected to the grid to operation isolated from the grid.

Transportation

Our technology is also used in hybrid electric vehicle ("HEV") applications. Our customers have applied our products in hybrid electric vehicles such as transit buses and trucks. In these applications the microturbine acts as an onboard battery charger to recharge the battery system as needed. The benefits of microturbine hybrids include extended range, fuel economy gains, quieter operation, reduced emissions and higher reliability compared with traditional internal combustion engines. Internal combustion diesel engine manufacturers have been challenged for the last several years to develop technology improvements, prior to aftertreatment that reduce emissions to levels specified by the EPA and CARB 2007 and 2010 standards. Many manufacturers are incorporating aftertreatment that increases upfront equipment costs, vehicle weight and life cycle costs and may reduce overall engine efficiency.

Marine

Our technology is also used in marine applications. Our customers have applied our products in the commercial vessel and luxury yacht markets. The most immediate market for our marine products is for use as a ship auxiliary engine. In this application, the microturbines provide power to the vessel's electrical loads and, in some cases, the vessel is able to utilize the exhaust energy to increase the overall efficiency of the application, reducing overall fuel consumption and emissions. The other application is similar to our HEV application where the vessel is driven by an electric propulsion system and the microturbine serves as an on board range extender. Our marine customers use both our liquid fueled and natural gas products. Liquefied natural gas ("LNG") is in its early stages as a marine fuel, and the number of vessels powered by LNG is forecasted to double every two years over the next decade. Vessel owners can receive the same benefits as users of stationary Capstone products: low emissions with no aftertreatment, long maintenance intervals, high reliability, low noise and no vibration.

Sales, Marketing and Distribution

We primarily sell our microturbine product, parts and service through distributors. Our world-wide distribution network is our most valuable intangible asset that we have proudly developed from the ground up. Each one of our distributors is a strategically placed independent partner of Capstone marketing and selling the Capstone products and services on our behalf. Our typical terms of sale include shipment of the products with title, care, custody and control transferring at our dock, payment due anywhere from in advance of shipment to 90 days from shipment, and warranty periods of approximately 15 to 18 months from shipment. We typically do not have customer acceptance provisions in our agreements.

North America

We have distribution agreements with a number of companies throughout North America for the resale of our products. Many of these distributors serve multiple markets in their select geographic regions. The primary markets served in this region have been energy efficiency, renewable energy, natural resources, critical power and mobile products. The energy efficiency and natural resources vertical markets are expected to grow as a result of an increased domestic production of hydrocarbons, the low downstream price of natural gas and public and regulatory acceptance of distributed generation.

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Recent energy reform in Mexico has opened new market opportunities by allowing competition and enabling power generation companies to sell directly to consumers instead of only to the state-owned Federal Electricity Commission. Capstone's strategy in Mexico is to leverage our distribution network in Mexico across various market verticals.

In developing our sales opportunities we have identified the need to address various requirements present in our target localities. These requirements include electric grid interconnection standards, gas utility connection requirements, emissions standards, building and fire safety codes and various inspections and approvals. The costs and scheduling ramifications of these various approvals, in conjunction with normal bidding process requirements and construction delays, can be significant to the completion of an installation. Our goal is to work with the applicable regulating entities to establish compliant standards for the installation of our microturbines so that the costs and installation timelines are minimized for our customers. Management believes that we can create market advantages for our products through enhancing the ease of deploying our distributed generation solutions.

Asia and Australia

Our sales and marketing strategy in Asia and Australia has been to develop and strengthen distributor relationships throughout these continents.

Our target markets in Asia and Australia are energy efficiency, renewable energy and natural resources. Our historical sales in Southeast Asia and Australia have primarily been in the CHP, CCHP and the oil and gas market. Other areas in Asia and the Pacific Rim offer attractive opportunities as well. China is expected to see growth in the oil and gas market, while biogas recovery is showing signs of growth in Southeast Asia.

Middle East and Africa

Our target market in the Middle East and Africa is primarily oil and gas. Flare gas to power projects are a particularly attractive market opportunity given the volume of gas being flared and the acute and chronic need for stable power in the region. Management has targeted distributors and customers involved in the capture and use of flare gas in the oil and gas market. However, the geopolitical environment in this region is still volatile, which can impact our sales.

Europe and Russia

To address the European market, including Russia, we are strengthening our relationships with existing and new distributors and have increased Capstone local sales and service support. We have an office in Europe for the purpose of working with our distributors there on a daily basis to realize growth opportunities. We have established a spare parts distribution center in Europe to make parts readily available to our distributors. Europe has a history of extensive use of distributed generation technologies. During Fiscal 2015, the pace of economic recovery in Europe was slow and demand remained soft with a decrease in revenue of 30%, primarily from Russia, compared to Fiscal 2014. Further, the continuation or escalation of the current geopolitical instability in Russia and Ukraine could continue to negatively impact our operations, sales, and future growth prospects in that region. For more information, see "Risk Factors" beginning on Page 14 of this Form 10-K.

South America

South America constitutes a diverse group of markets that vary greatly in potential capture for Capstone based on a number of factors including availability of oil and gas production and transmission, energy pricing and political and investment climate. While Capstone has distributors in nearly all South American countries, management is focused on what we consider to be the top markets, such as Colombia, Brazil, Chile and Ecuador. Our target markets in South America are

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energy efficiency, renewable energy and natural resources. Our historical sales in South America have primarily been in the natural resources market.

Revenue

For geographic and segment revenue information, please see Note 2 Summary of Significant Accounting Policies Segment Reporting in the "Notes to Consolidated Financial Statements."

Customers

Sales to Horizon Power Systems ("Horizon"), one of the Company's domestic distributors, accounted for 17%, 12% and 27% of our revenue for the years ended March 31, 2015, 2014 and 2013, respectively. Sales to BPC Engineering ("BPC"), one of the Company's Russian distributors, accounted for 11%, 17% and 11% of our revenue for the years ended March 31, 2015, 2014 and 2013, respectively. Sales to E-Finity Distributed Generation, LLC ("E-Finity), one of the Company's domestic distributors, accounted for 19% of our revenue for the year ended March 31, 2014. Additionally, Optimal Group Australia Pty Ltd ("Optimal"), one of the Company's Australian distributors, accounted for 17% of net accounts receivable as of March 31, 2015. BPC, Electro Mecanique Industries ("EMI"), one of the Company's distributors in the Middle East and Africa, and E-Finity accounted for 26%, 18% and 16%, respectively, of net accounts receivable as of March 31, 2014.

During the three months ended March 31, 2015, we recorded approximately $7.1 million with respect to the accounts receivable allowance from BPC. We determined that the collectability of this accounts receivable balance was not reasonably assured based on BPC's recent payment history and because the impact of the steep decline of the Russian ruble could continue to negatively impact its ability to pay its outstanding accounts receivable balance. Also during the three months ended September 30, 2014, we recorded approximately $2.6 million with respect to the accounts receivable allowance from EMI. We determined that the collectability of this accounts receivable balance was not reasonably assured based on EMI's payment history. The Company recorded bad debt expense of approximately $10.1 million, $0.2 million and $0.3 million for the years ended March 31, 2015, 2014 and 2013, respectively.

Competition

The market for our products is highly competitive. Our microturbines compete with existing technologies such as reciprocating engines and may also compete with emerging distributed generation technologies, including solar power, wind-powered systems, fuel cells and other microturbines. Many potential customers rely on the utility grid for their electrical power. Many of our distributed generation competitors are large, well-established companies that derive competitive advantages from production economies of scale, worldwide presence, brand recognition and greater resources which they can devote to product development or promotion.

Generally, power purchased from the electric utility grid is less costly than power produced by distributed generation technologies. Utilities may also charge fees to interconnect to their power grids. However, we can provide economic benefits to end users in instances where the waste heat from our microturbine has value (CHP and CCHP), where fuel costs are low (renewable energy/renewable fuels), where the costs of connecting to the grid may be high or impractical (such as remote power applications), where reliability and power quality are of critical importance, or in situations where peak shaving could be economically advantageous because of highly variable electricity prices. Because Capstone microturbines can provide a reliable source of power and can operate on multiple fuel sources, management believes they offer a level of flexibility not currently offered by other technologies such as reciprocating engines.

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Our reciprocating engine competitors have products and markets that are well developed and technologies that have been proven for some time. A reciprocating engine, also known as an internal combustion engine, is similar to those used in automotive applications. Reciprocating engines are popular for primary and back-up power applications despite higher levels of emissions, noise and maintenance. These technologies, which typically have a lower up-front cost than microturbines, are currently produced by Caterpillar Inc., Cummins Inc., Deutz Corporation, GE Gas Engines (which now includes Waukesha and Jenbacher), MAN SE, Tecogen, Inc. and Wärtsilä Corporation, among others.

Our microturbines may also compete with other distributed generation technologies, including solar power, wind power systems and fuel cells. Solar and wind powered systems produce no emissions. The main drawbacks to solar and wind powered systems are their dependence on weather conditions, the utility grid and high capital costs that can often make these systems uneconomical without government subsidies depending upon geographic locale and application of the technology. Although the market for fuel cells is still developing, a number of companies are focused on markets similar to ours, including FuelCell Energy Inc., Bloom Energy Corporation, LG Fuel Cell Systems, a business unit of LG Electronics, Plug Power Inc. and Ballard Power Systems Inc. Fuel cells have lower levels of NOx, CO, VOCs and other criteria pollutant emissions than our microturbines. Fuel cells, like solar and wind powered systems, have received higher levels of incentives for the same type of applications as microturbines. Management believes that, absent these higher government incentives, microturbines provide a better value to end users in most applications. However, over the medium-to-long term, fuel cell technology companies may introduce products that compete more directly with our microturbines.

We also compete with other companies who have microturbine products, including FlexEnergy and Turbec S.p.A.

Overall, we compete with end users' other options for electrical power and heat generation on the basis of our microturbine's ability to:

provide power when a utility grid is not available or goes out of service;

reduce total cost of purchasing electricity and fuel;

improve electric power availability and provide high power quality;

operate on multiple fuel types;

reduce emissions (both criteria pollutants and greenhouse gases);

simplify operation; and

control maintenance costs and associated disposal of hazardous materials.

Governmental and Regulatory Impact

Our markets can be positively or negatively impacted by the effects of governmental and regulatory matters. We are affected not only by energy policy, laws, regulations and incentives of governments in the markets in which we sell, but also by rules, regulations and costs imposed by utilities. Utility companies or governmental entities may place barriers on the installation or interconnection of our product with the electric grid. Further, utility companies may charge additional fees to customers who install on-site power generation; thereby reducing the electricity they take from the utility, or for having the capacity to use power from the grid for back-up or standby purposes. These types of restrictions, fees or charges could hamper the ability to install or effectively use our product, or increase the cost to our potential customers for using our systems. This could make our systems less desirable, thereby adversely affecting our revenue and profitability. In addition, utility rate reductions can make our products less competitive which would have a material adverse effect on our operations. These costs, incentives and rules are not always the same as those faced by technologies with which we compete.

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However, rules, regulations, laws and incentives could also provide an advantage to our distributed generation solutions as compared with competing technologies if we are able to achieve required compliance in a lower cost, more efficient manner. Additionally, reduced emissions and higher fuel efficiency could help our customers combat the effects of global warming. Accordingly, we may benefit from increased government regulations that impose tighter emission and fuel efficiency standards.

Capstone continues to engage with federal and state policymakers to develop government programs to promote the deployment of Capstone's low emission and energy efficient products. Kevin Mullin, Speaker Pro Tempore and Assembly member for California's 22nd Assembly district, recently introduced A.B. 674 in the California legislature. This bill may stimulate the market in California for Capstone products by revising utility charges and standby rates that apply to distributed generation projects. We cannot provide assurance that any such legislation will be enacted, however. In the wake of numerous destructive storms, several state and local governments are putting greater value in resilient distributed generation resources, including CHP and microgrids, and even reassessing the traditional utility model. However, utilities in other states have asked public utility commissioners to revisit incentive programs and exemptions from grid usage charges for distributed generation technologies, arguing that these policies shift costs to other rate payers.

The United States Government is focused on promoting exports of American products with a specific emphasis on clean energy goods. Capstone participates in export promotion activities such as trade missions which help us enter new markets by facilitating interactions with foreign buyers and distributors. Government funding can impact the rate of development of new technologies. While we continue to receive development funding, committed amounts remaining are relatively low. Competing new technologies generally receive larger incentives and development funding than do microturbines. There are certain recent federal funding solicitations that may support microturbine development. We cannot provide any assurance that any proposal Capstone submits will be funded.

Sourcing and Manufacturing

We are focused on continuously improving our supply chain effectiveness, strengthening our manufacturing processes and increasing operational efficiencies within our organization. Our microturbines are designed to achieve high volume and low cost production objectives. Our manufacturing designs include the use of conventional technology, which has been proven in high volume automotive and turbocharger production for many years. Many components used in the manufacture of our products are readily fabricated from commonly available raw materials or off-the-shelf items available from multiple supply sources; however, certain items are custom made to meet our specifications. We believe that in most cases, adequate capacity exists at our suppliers and that alternative sources of supply are available or could be developed within a reasonable period of time. We have an on-going program to develop alternative back-up suppliers for sole source parts. We regularly reassess the adequacy and abilities of our suppliers to meet our needs. We continue to evaluate and implement new systems designed to provide improved quality, reliability, service, greater efficiency and lower supply chain costs. We have substantially increased our focus on process controls and validations, supplier controls, distribution controls and providing our operations teams with the training and tools necessary to drive continuous improvement in product quality. In addition, we remain focused on examining our operations and general business activities to identify cost-improvement opportunities in order to enhance our operational effectiveness. Our ability to leverage these capabilities may be affected by the current variability in our demand volumes and forecasting. Our strategy is to identify primary and secondary sources for critical components when available to minimize factory down time due to unavailability of such parts, which could affect our ability to meet manufacturing schedules.

We have a combined total of approximately 102,000 square foot manufacturing footprint running on a single shift in the San Fernando Valley area of Southern California. We assemble and test units as

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well as manufacture air-bearings and certain combustion system components at our facility in Chatsworth, California. Additionally, we assemble and test our C200 and C1000 Series products and manufacture recuperator cores at our facility in Van Nuys, California. Management believes our manufacturing facilities located in Chatsworth and Van Nuys, California have a combined production capacity of approximately 2,000 units per year, depending on product mix. Excluding working capital requirements, management believes we can expand our combined production capacity to approximately 4,000 units per year, depending on product mix, with approximately $10 to $15 million of capital expenditures. We have not committed to this expansion nor identified a source for its funding, if available.

Solar Turbines Incorporated ("Solar"), a wholly owned subsidiary of Caterpillar Inc., was our sole supplier of recuperator cores prior to 2001. In 2000, we exercised an option to license Solar's technology, which allows us to manufacture these cores ourselves and we began manufacturing them in June 2001. The cores are subject to a per-unit royalty fee. As of March 31, 2015, cumulative royalties of $0.6 million have been paid under the terms of the licensing agreement with Solar.

The Company is a party to a Development and License Agreement with Carrier Corporation ("Carrier") regarding the payment of royalties on the sale of each of the Company's 200 kilowatt ("C200") microturbines. During the three months ended September 30, 2013, we reached our repayment threshold level and the fixed rate royalty was reduced by 50% on future sale of each of our C200 microturbines. As of March 31, 2015, cumulative royalties of $15.2 million have been paid under the terms of the Development Agreement with Carrier.

Research and Development ("R&D")

For the fiscal years ended March 31, 2015, 2014 and 2013, R&D expenses were $9.7 million, $9.0 million and $9.0 million, respectively, which amounts are equivalent to 8%, 7% and 7% of total revenue, respectively, for these fiscal years. R&D expenses are reported net of benefits from cost-sharing programs, such as DOE grants and the Development Agreement with Carrier. Benefits from cost-sharing programs were $0.5 million, $1.4 million and $1.7 million for Fiscal 2015, 2014 and 2013, respectively. Our R&D activities enabled us to become one of the first companies to develop a commercially available microturbine that operates in parallel with the grid. We were the first company to successfully demonstrate a commercially available microturbine that operates on a stand-alone basis.

During Fiscal 2015 we made significant development in variants of the C1000 Series product line. A liquid fuel version of the C1000 Series was produced with the use of Capstone's lean premix combustion technology based on the development work done previously with the C200 liquid fuel system. Liquid fuel products are well suited for markets where customers do not have access to gaseous fuels but still demand the low emissions, low maintenance, and high reliability benefits offered by Capstone's microturbine products. Additionally, a dual-mode (grid connect & standalone capability) Digester gas C1000 was produced to run off the Palm Oil Milling Effluent (POME) biogas produced as a byproduct of the palm oil extraction process. Advancement realized in both of these products opens up new markets for Capstone and also allows for further development possibilities in the areas of liquid fuel and biogas.

During Fiscal 2014 we achieved compliance with the German low voltage requirements, which have been adopted throughout much of Europe. During Fiscal 2015 we continued to make improvements to all our microturbine products to be compliant with other widely adopted European low and medium voltage grid inter-connect requirements for decentralized power generation. Compliance with other widely adopted European requirements for both low and medium voltage are planned to be completed during Fiscal 2016. This work will prepare us for the expected expansion of distributed generation grid inter-connect requirements within the US market. In addition, we continue to work both cost reduction and performance enhancement activities to improve the value of our microturbine products for our

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customer base. Cost reduction activities are focused on leveraging the capabilities of our supply base and internal design lean manufacturing improvements. Product enhancements are focused on reducing the already very low maintenance requirements for our products, while at the same time improving operational efficiency; thereby reducing our customers' total cost of ownership.

We are continuing to work on product improvements to our C30 and C65 microturbine products targeted at the hybrid electric bus and truck market. Because of Capstone's single moving assembly, manufacturers believe there is also the opportunity to produce a lower cost product in larger automotive volumes. Our current focus is on a next generation product that would include existing components and a liquid-cooled set of electronics that are consistent with the size, cost and cooling strategies employed on vehicles today.

Capstone is working with the Kenworth Truck Company to demonstrate a Class 7 series hybrid delivery truck with funding support from the South Coast Air Quality Management District and the San Joaquin Valley Air Pollution Control District. This truck will be operated on actual customer delivery routes in both air districts to quantify the performance, emissions, fuel economy, and other benefits of a microturbine-based series hybrid solution. The Kenworth Class 7 hybrid truck is currently being retrofitted with a refrigerated box body and should be ready for track testing at Kenworth facilities later in the year. The truck will then be used in a demonstration phase to a large commercial customer within the San Joaquin Valley, California. Capstone expects to collect and utilize information from the Kenworth Class 7 hybrid truck's road testing and demonstration processes for future product developments and enhancements. A prototype or concept vehicle may take several years to go into commercial production following completion of rigorous testing.

Capstone also worked with Peterbilt Motors to develop a series hybrid drivetrain as part of a concept Class 8 tractor for Walmart. The Walmart Advanced Vehicle Experience ("WAVE") concept truck is the latest in Walmart's fleet efficiency program. The WAVE concept truck has advanced aerodynamics and is powered by a Capstone C30 range-extending microturbine in its hybrid powertrain. This futuristic concept truck was unveiled at the Mid America Trucking Show in March, 2014. Future development efforts will be based on the lessons learned from these programs. As such, Capstone is working with both Peterbilt and Walmart as they continue to showcase the WAVE truck at various expos and hybrid vehicle shows around the country.

Capstone liquid fuel microturbines have demonstrated emissions levels which meet the CARB 2010 standards for Heavy Duty Diesel Engines ("HDDE"). Capstone is able to meet these extremely low emissions requirements using its lean premix combustion technology with no exhaust aftertreatment. Competitive reciprocating engine technologies require aftertreatment components that increase system cost, require frequent maintenance, and impact engine efficiency. Capstone's compressed natural gas ("CNG") fueled microturbines also meet extremely low emission standards, including the U.S. Environmental Protection Agency and CARB 2010 emissions requirements for On-Road HDDE for Urban Bus. Test emissions from our Natural Gas microturbines measured dramatically less than the emissions levels set forth by the CARB standard including NOx at 75% and CO at 96% less than the required levels. These microturbines are now certified by CARB and available for production in Fiscal 2016.

Capstone is expanding into the marine sector through collaboration with vessel owners, shipyards, and its marine OEM partner, Microturbine Marine Energy. Capstone's marine products can be used to provide hybrid electric marine propulsion, "hotel power," CHP, or CCHP. They are especially ideal for small- and mid-size commercial ships that travel inland waterways and emissions controlled areas (ECAs). A notable case study is the Deen Shipping's Argonon, where LNG fuels two C30 microturbines. Both units have been in operation since 2011 and have saved 25 tons of diesel equivalents per year, compared to conventional accommodation heating and chilling. Capstone has also been working with major marine certifying bodies (Lloyd's Register and DNV-GL) on Type Approval

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for its marine products, which is expected in 2015. Type Approval provides independent product verification that the product conforms to recognized industry quality standards, International Conventions and/or Marine Classification Society Rules, through a process of independent design review, sample testing and verification of production controls.

Capstone continues to evolve our C65 Hybrid UPS product line. After having received the 2011 NOVA Award from the Construction Innovation Forum for the C65 Hybrid UPS Microturbine at Syracuse University's data center labeled one of the greenest data centers in the world, Capstone's C65 Hybrid UPS system has continued development and has recent installations at Sempra in Monterey Park, CA and Capstone's own Data Center in Chatsworth, CA. The product utilizes Capstone's inverter electronics and controls technology to provide continuous power quality to meet the customer's critical load. The load inverter is connected through a central power bus to provide power from one of three available power sources including the utility grid, battery storage system, or microturbine generator. Power to the critical load is synchronized to an available utility grid to allow direct bypass of the critical load to the utility grid. This redundant functionality is provided in a single integrated package that can be scaled to a larger seamless power unit through Capstone's multipack feature. These units can also be combined with a heat recovery module or an absorption chiller to provide higher total output efficiency. Unlike current UPS products combined with reciprocating engines for backup, the low emissions Capstone Hybrid UPS product allows for continuous operation year round allowing customers the ability to receive a payback on their capital equipment investment.

Capstone is working with the Department of Energy ("DOE") on two next generation technology roadmap programs, including a High Efficiency Microturbine with integral heat recovery and advanced AFA (Alumina Forming Austenitic) stainless steel material program in partnership with Oak Ridge National Laboratory (ORNL). The High Efficiency Microturbine with integral heat recovery is focused on improving microturbine electrical efficiency and overall system efficiency utilizing heat recovery. We are currently focusing efforts on the development of the C370 Dual Spool High Efficiency Microturbine with integral heat recovery system. In March 2013, Capstone successfully completed proof-of-concept testing of the low pressure spool also known as the C250 that produced >270 kW as part of the first phase of development. This allowed Capstone to successfully achieve Phase Gate 2 requirements of the DOE contract and proceed with high pressure spool development. Capstone also demonstrated and increased capability of the power electronics and electrical system required to support this higher power generator. The final phase of the program, which is expected to be completed during Fiscal 2016, will incorporate further engine efficiency improvements, resulting in a product design with a projected electrical efficiency of 42% and targeted power output of 370 kW. Improvements in efficiency are key to all markets as improved fuel efficiency benefits users through lower operating costs. AFA stainless steel is a material that offers superior oxidation and creep resistance to commercial heat-resistant steel alloys used in Capstone microturbines at a significantly reduced cost. In Fiscal 2015, we successfully completed the first of two long term endurance tests and have engaged industry partners on commercialization viability. In Fiscal 2017, we expect to complete the second endurance test, after which we will be positioned to make a commercialization decision.

Protecting our Intellectual Property Rights and Patents

We rely on a combination of patent, trade secret, copyright and trademark law and nondisclosure agreements to establish and protect our intellectual property rights in our products. In this regard, we have obtained 103 U.S. and 34 international patents (in certain cases covering the same technology in multiple jurisdictions). The patents we have obtained will expire between 2015 and 2027.

Management believes that a policy of protecting intellectual property is an important component of our strategy of being the leader in microturbine system technology and will provide us with a long-term competitive advantage. In addition, we implement security procedures at our plants and

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facilities and have confidentiality agreements with our suppliers, distributors, employees and certain visitors to our facilities.

Organization and Employees

We were organized in 1988. On June 22, 2000, we reincorporated as a Delaware corporation.

As of March 31, 2015, we had 236 employees. No employees are covered by collective bargaining arrangements. We consider relations with our employees to be good.

Available Information

This Form 10-K, as well as our quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") are made available free of charge on the Company's Internet website (http://www.capstoneturbine.com) as soon as reasonably practicable after such materials are electronically filed with or furnished to the Securities and Exchange Commission ("SEC").

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Item 1A. Risk Factors.

This document contains certain forward-looking statements (as such term is defined in Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the Exchange Act) pertaining to, among other things,

our results of operations;

profits and losses;

R&D activities;

sales expectations;

our ability to develop markets for our products;

sources for parts;

federal, state and local government regulations;

general business;

industry and economic conditions applicable to us;

the efficiency, reliability and environmental advantages of our products and their need for maintenance;

our ability to be cost-competitive and to outperform competition;

customer satisfaction;

the value of using our products;

our ability to achieve economies of scale;

market advantage;

return on investments;

issues with suppliers;

anticipation of product supply requirements;

listing requirements;

our microturbine technology;

the utilization of our products;

competition;

the introduction of new technologies;

our production capacity;

international markets;

protection of intellectual property;

the adequacy of our facilities;

dividends;

business strategy;

product development;

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capital resources;

capital expenditures;

liquidity;

amortization expense of intangibles;

cost of warranties;

stock-based compensation;

our stockholders rights plan;

purchase and lease commitments;

current liabilities;

recently issued accounting standards;

market risk;

the strength of the U.S. dollar;

interest rate sensitivity; and

growth of the shale gas market.

These statements are based largely on our current expectations, estimates and forecasts and are subject to a number of risks and uncertainties. Actual results could differ materially from those anticipated by these forward-looking statements. Factors that can cause actual results to differ materially include, but are not limited to, those discussed below. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The following factors should be considered in addition to the other information contained herein in evaluating Capstone and its business. We assume no obligation to update any of the forward-looking statements after the filing of this Annual Report to conform such statements to actual results or to changes in our expectations, except as may be required by law.

The following are risk factors that could affect our business, financial condition, results of operations, and cash flows. These risk factors should be considered in connection with evaluating the forward-looking statements contained in this Annual Report because these factors could cause actual results and conditions to differ materially from those projected in forward-looking statements. Before you invest in our publicly traded securities, you should know that making such an investment involves some risks, including the risks described below. Additional risks of which we may not be aware or that we currently believe are immaterial may also impair our business operations or our stock price. If any of the risks actually occur, our business, financial condition, results of operations or cash flow could be negatively affected. In that case, the trading price of our common stock could decline, and you may lose all or part of your investment. In assessing these risks, investors should also refer to the other information contained or incorporated by reference in this Annual Report, our quarterly reports on Form 10-Q and other documents filed by us from time to time.

Our operating history is characterized by net losses. We anticipate further losses and we may never become profitable.

Since inception, we have incurred annual operating losses. We expect this trend to continue until such time that we can sell a sufficient number of units and achieve a cost structure to become profitable. Our business is such that we have relatively few customers and limited repeat business. As a result, we may not maintain or increase revenue. We may not have adequate cash resources to reach the point of profitability, and we may never become profitable. Even if we do achieve profitability, we may be unable to increase our sales and sustain or increase our profitability in the future.

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We may be unable to fund our future operating requirements, which could force us to curtail our operations.

To the extent that the funds we now have on hand are insufficient to fund our future operating requirements, we would need to raise additional funds, through further public or private equity or debt financings depending upon prevailing market conditions. These financings may not be available or, if available, may be on terms that are not favorable to us and could result in dilution to our stockholders and reduction of the trading price of our stock. The state of worldwide capital markets could also impede our ability to raise additional capital on favorable terms or at all. If adequate capital were not available to us, we likely would be required to significantly curtail our operations or possibly even cease our operations.

We maintain two Credit and Security Agreements (the "Agreements"), with Wells Fargo Bank, National Association, ("Wells Fargo"), that provide us with a credit facility up to $15.0 million in the aggregate. At March 31, 2015, we had $13.0 million outstanding under this line of credit. Under this credit facility, we are required to satisfy specified financial and restrictive covenants. Failure to comply with these covenants could cause an event of default which, if not cured or waived, could require us to repay substantial indebtedness immediately or allow Wells Fargo to terminate the credit facility. In addition, we have pledged our accounts receivable, inventories, equipment, patents and other assets as collateral under the Agreements which would be subject to seizure by Wells Fargo if we were in default and unable to repay the indebtedness.

Several times since entering into the Agreements, we have not been in compliance with certain covenants under the Agreements. In connection with each event of noncompliance, Wells Fargo waived the event of default and, on several occasions, we amended the Agreements in response to the default. As of March 31, 2015, we were not in compliance with the annual net income financial covenant contained in the Agreements, as amended. On June 10, 2015, we received from Wells Fargo a waiver of such noncompliance. If we had not obtained the default waivers, or if we are ever again in noncompliance, we would not be able to draw additional funds under the credit facility. The Agreement also defines an event of default to include a material adverse effect on our business, as determined by Wells Fargo. An event of default for this or any other reason, if not waived, would have a material adverse effect on the Company.

Our obligations under the credit facility could have important consequences, including the following:

- We may have difficulty obtaining additional financing at favorable interest rates to meet our requirements for operations, capital expenditures, general corporate or other purposes.

- We will be required to dedicate a substantial portion of our cash flow to the payment of principal and interest on indebtedness, which will reduce the amount of funds available for operations, capital expenditures and future acquisitions.

- We may be required to repay our indebtedness immediately if we default on any of the numerous financial or other restrictive covenants contained in the Agreements. It is not certain whether we will have, or will be able to obtain, sufficient funds to make these accelerated payments. If any outstanding indebtedness under the credit facility is accelerated, our assets may not be sufficient to repay such indebtedness.

For more information, see the section below entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources."

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If we are unable to either substantially improve our operating results or obtain additional financing, we may be unable to continue as a going concern.

Should we be unable to execute our plans to build sales and margins while controlling costs, we may be unable to continue as a going concern on a longer term basis. In particular, we must generate positive cash flow from operations and net income and otherwise improve our results of operations substantially on a longer term basis. Our available cash and proceeds from future financings, if any, that we may be able to obtain, may not be sufficient to fund our operating expenses, capital expenditures and other cash requirements. Any such lack of funds would affect our ability to continue as a going concern. These events and circumstances could have a material adverse effect on our ability to raise additional capital and on the market value of our common stock and our ability to maintain a credit facility acceptable to the Company. Moreover, should we experience a cash shortage that requires us to curtail or cease our operations, or should we be unable to continue as a going concern, you could lose all or part of your investments in our securities.

Impairment charges on our long-lived assets, including intangible assets with finite lives would adversely affect our financial position and results of operations.

We evaluate the carrying value of long-lived assets, including intangible assets with finite lives, for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. To determine whether impairment has occurred, we compare the undiscounted cash flows of the long-lived asset group with its carrying value. The estimation of future cash flows requires significant estimates of factors that include future sales growth, gross margin performance, including our estimates of reductions in our direct material costs, and reductions in operating expenses. If our sales growth, gross margin performance or other estimated operating results are not achieved at or above our forecasted level, or inflation exceeds our forecast, the carrying value of our asset group may prove to be unrecoverable and we may incur impairment charges in the future. In addition, significant and unanticipated changes in circumstances, such as significant adverse changes in business climate, unanticipated competition, loss of key customers or changes in technology or markets, could require a charge for impairment that can materially and adversely affect our reported net loss and our stockholders' equity.

A sustainable market for microturbines may never develop or may take longer to develop than we anticipate which would adversely affect our results of operations.

Our products represent an emerging market, and we do not know whether our targeted customers will accept our technology or will purchase our products in sufficient quantities to allow our business to grow. To succeed, demand for our products must increase significantly in existing markets, and there must be strong demand for products that we introduce in the future. If a sustainable market fails to develop or develops more slowly than we anticipate, we may be unable to recover the losses we have incurred to develop our products, we may have further impairment of assets, and we may be unable to meet our operational expenses. The development of a sustainable market for our systems may be hindered by many factors, including some that are out of our control. Examples include:

- consumer reluctance to try a new product;
- regulatory requirements;
- the cost competitiveness of our microturbines;
- costs associated with the installation and commissioning of our microturbines;
- maintenance and repair costs associated with our microturbines;
- the future costs and availability of fuels used by our microturbines;

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economic downturns and reduction in capital spending;

consumer perceptions of our microturbines' safety and quality;

the emergence of newer, more competitive technologies and products; and

decrease in domestic and international incentives.

Our operating results are dependent, in large part, upon the successful commercialization of our products. Failure to produce our products as scheduled and budgeted would materially and adversely affect our business and financial condition.

We cannot be certain that we will deliver ordered products in a timely manner. Any reliability or quality issues that may arise with our products could prevent or delay scheduled deliveries or adversely impact the performance of our products. Any such delays or costs could significantly impact our business, financial condition and operating results.

We may not be able to produce our products on a timely basis if we fail to correctly anticipate product supply requirements or if we suffer delays in production resulting from issues with our suppliers. Our suppliers may not supply us with a sufficient amount of components or components of adequate quality, or they may provide components at significantly increased prices.

Some of our components are currently available only from a single source or limited sources. We may experience delays in production if we fail to identify alternative suppliers, or if any parts supply is interrupted, each of which could materially adversely affect our business and operations. In order to reduce manufacturing lead times and ensure adequate component supply, we enter into agreements with certain suppliers that allow them to procure inventories based upon criteria defined by us. If we fail to anticipate customer demand properly, an oversupply of parts could result in excess or obsolete inventories, which could adversely affect our business. Additionally, if we fail to correctly anticipate our internal supply requirements, an undersupply of parts could limit our production capacity. Our inability to meet volume commitments with suppliers could affect the availability or pricing of our parts and components. A reduction or interruption in supply, a significant increase in price of one or more components or a decrease in demand of products could materially adversely affect our business and operations and could materially damage our customer relationships. Financial problems of suppliers on whom we rely could limit our supply of components or increase our costs. Also, we cannot guarantee that any of the parts or components that we purchase will be of adequate quality or that the prices we pay for the parts or components will not increase. Inadequate quality of products from suppliers could interrupt our ability to supply quality products to our customers in a timely manner. Additionally, defects in materials or products supplied by our suppliers that are not identified before our products are placed in service by our customers could result in higher warranty costs and damage to our reputation. We also outsource certain of our components internationally. As a result of outsourcing internationally, we may be subject to delays in delivery because of regulations associated with the import/export process, delays in transportation or regional instability.

We may not be able to effectively manage our growth, expand our production capabilities or improve our operational, financial and management information systems, which would impair our results of operations.

If we are successful in executing our business plan, we will experience growth in our business that could place a significant strain on our business operations, management and other resources. Our ability to manage our growth will require us to expand our production capabilities, continue to improve our operational, financial and management information systems, and to motivate and effectively manage our employees. We cannot provide assurance that our systems, procedures and controls or financial resources will be adequate, or that our management will keep pace with this growth. We cannot provide assurance that our management will be able to manage this growth effectively.

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Adverse economic conditions may have an impact on our business and financial condition, including some effects we may not be able to predict.

Adverse economic conditions may prevent our customers from purchasing our products or delay their purchases, which would adversely affect our business, financial condition and results of operations. In addition, our ability to access the capital markets may be severely restricted or made very expensive at a time when we need, or would like, to do so, which could have a material adverse impact on our liquidity and financial resources. Certain industries in which our customers do business and certain geographic areas have been and could continue to be adversely affected by adverse economic conditions.

Product quality expectations may not be met, causing slower market acceptance or warranty cost exposure.

In order to achieve our goal of improving the quality and lowering the total costs of ownership of our products, we may require engineering changes. Such improvement initiatives may render existing inventories obsolete or excessive. Despite our continuous quality improvement initiatives, we may not meet customer expectations. Any significant quality issues with our products could have a material adverse effect on our rate of product adoption, results of operations, financial condition and cash flow. Moreover, as we develop new configurations for our microturbines and as our customers place existing configurations in commercial use, our products may perform below expectations. Any significant performance below expectations could adversely affect our operating results, financial condition and cash flow and affect the marketability of our products.

We sell our products with warranties. There can be no assurance that the provision for estimated product warranty will be sufficient to cover our warranty expenses in the future. We cannot ensure that our efforts to reduce our risk through warranty disclaimers will effectively limit our liability. Any significant incurrence of warranty expense in excess of estimates could have a material adverse effect on our operating results, financial condition and cash flow. Further, we have at times undertaken programs to enhance the performance of units previously sold. These enhancements have at times been provided at no cost or below our cost. If we choose to offer such programs again in the future, such actions could result in significant costs.

We operate in a highly competitive market among competitors who have significantly greater resources than we have and we may not be able to compete effectively.

Capstone microturbines compete with several technologies, including reciprocating engines, fuel cells and solar power. Competing technologies may receive certain benefits, like governmental subsidies or promotion, or be able to offer consumer rebates or other incentives that we cannot receive or offer to the same extent. This could enhance our competitors' abilities to fund research, penetrate markets or increase sales. We also compete with other manufacturers of microturbines.

Our competitors include several well-known companies with histories of providing power solutions. They have substantially greater resources than we do and have established worldwide presence. Because of greater resources, some of our competitors may be able to adapt more quickly to new or emerging technologies and changes in customer requirements, to devote greater resources to the promotion and sale of their products than we can or lobby for governmental regulations and policies to create competitive advantages vis-à-vis our products. We believe that developing and maintaining a competitive advantage will require continued investment by us in product development and quality, as well as attention to product performance, our product prices, our conformance to industry standards, manufacturing capability and sales and marketing. In addition, current and potential competitors have established or may in the future establish collaborative relationships among themselves or with third parties, including third parties with whom we have business relationships. Accordingly, new competitors or alliances may emerge and rapidly acquire significant market share.

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Overall, the market for our products is highly competitive and is changing rapidly. We believe that the primary competitive factors affecting the market for our products, including some that are outside of our control, include:

- name recognition, historical performance and market power of our competitors;
- product quality and performance;
- operating efficiency;
- product price;
- availability, price and compatibility of fuel;
- development of new products and features; and
- emissions levels.

There is no assurance that we will be able to successfully compete against either current or potential competitors or that competition will not have a material adverse effect on our business, operating results, financial condition and cash flow.

If we do not effectively implement our sales, marketing and service plans, our sales will not grow and our results of operations will suffer.

Our sales and marketing efforts may not achieve intended results and, therefore, may not generate the revenue we anticipate. As a result of our corporate strategies, we have decided to focus our resources on selected vertical markets. We may change our focus to other markets or applications in the future. There can be no assurance that our focus or our near term plans will be successful. If we are not able to address markets for our products successfully, we may not be able to grow our business, compete effectively or achieve profitability.

Our sales and results of operations could be materially and adversely impacted by risks inherent in international markets.

As we expand in international markets, customers may have difficulty or be unable to integrate our products into their existing systems or may have difficulty complying with foreign regulatory and commercial requirements. As a result, our products may require redesign. Any redesign of the product may delay sales or cause quality issues. In addition, we may be subject to a variety of other risks associated with international business, including import/export restrictions, fluctuations in currency exchange rates and economic or political instability.

The current geopolitical instability in Russia and Ukraine and related sanctions by the U.S. government against certain companies and individuals may hinder our ability to conduct business with potential or existing customers and vendors in these countries.

We derived approximately 11% and 17% of our revenue from Russia during Fiscal 2015 and Fiscal 2014, respectively. The continuation or escalation of the current geopolitical instability in Russia and Ukraine could negatively impact our operations, sales, and future growth prospects in that region. Recently, the U.S. government imposed sanctions through several executive orders restricting U.S. companies from conducting certain oil and gas production related business activities with specified Russian and Ukrainian individuals and companies and requiring export licenses for certain of such activities. While we believe that the executive orders currently do not preclude us from conducting business with our current customers in Russia, the sanctions imposed by the U.S. government could be expanded in the future to restrict us from engaging with them. If we are unable to conduct business with new or existing customers or pursue opportunities in Russia or Ukraine or elsewhere, our

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business, including revenue, profitability and cash flows, could be materially adversely affected. In addition, we are currently evaluating the impact of the executive orders on our relationships with vendors. If we are unable to conduct business with certain vendors, our operations in Russia and Ukraine could be materially adversely affected.

We cannot be certain of the future effectiveness of our internal controls over financial reporting. If we are unable to maintain effective internal controls over our financial reporting, investors may lose confidence in our ability to provide reliable and timely financial reports and the value of our common stock may decline.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we are required to include in our annual reports on Form 10-K our assessment of the effectiveness of our internal controls over financial reporting. This assessment includes disclosure of any material weaknesses identified by our management in our internal controls over financial reporting, as well as a statement that our independent registered public accounting firm has issued an attestation report on the effectiveness of our internal controls over financial reporting. Our management concluded that our internal controls over financial reporting were ineffective as of March 31, 2014 because a material weakness was detected which related to our risk assessment process. Management determined that this material weakness was remediated during Fiscal 2015. Refer to Item 9A, "Controls and Procedures" for additional information. We may in the future identify further material weaknesses in our internal controls over financial reporting that we have not discovered to date. If we cannot adequately maintain the effectiveness of our internal controls over financial reporting, we might be subject to sanctions or investigation by regulatory authorities, such as the SEC. Any such action could adversely affect our financial results and the market price of our securities.

We may not be able to retain or develop relationships with OEMs or distributors in our targeted markets, in which case our sales would not increase as expected.

In order to serve certain of our targeted markets, we believe that we must ally ourselves with companies that have particular expertise or better access to those markets. We believe that retaining or developing relationships with strong OEMs (which to date have typically resold our products under their own brands or packaged our products with other products as part of an integrated unit) or distributors in these targeted markets can improve the rate of adoption as well as reduce the direct financial burden of introducing a new technology and creating a new market. Because of OEMs' and distributors' relationships in their respective markets, the loss of an OEM or distributor could adversely impact the ability to penetrate our target markets. We offer our OEMs and distributors stated discounts from list price for the products they purchase. In the future, to attract and retain OEMs and distributors we may provide volume price discounts or otherwise incur significant costs that may reduce the potential revenues from these relationships. We may not be able to retain or develop appropriate OEMs and distributors on a timely basis, and we cannot provide assurance that the OEMs and distributors will focus adequate resources on selling our products or will be successful in selling them. In addition, some of the relationships may require that we grant exclusive distribution rights in defined territories. These exclusive distribution arrangements could result in our being unable to enter into other arrangements at a time when the OEM or distributor with whom we form a relationship is not successful in selling our products or has reduced its commitment to market our products. We cannot provide assurance that we will be able to negotiate collaborative relationships on favorable terms or at all. Our inability to have appropriate distribution in our target markets may adversely affect our financial condition, results of operations and cash flow.

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Activities necessary to integrate any future acquisitions may result in costs in excess of current expectations or be less successful than anticipated.

During Fiscal 2010, we completed the acquisition of certain assets relating to the microturbine business of CPS, and we may acquire other businesses in the future. The success of these transactions will depend on, among other things, our ability to develop productive relationships with the corresponding distributors and to integrate assets and personnel, if any, acquired in these transactions and to apply our internal controls processes to these acquired businesses. The integration of any acquired businesses or significant assets may require significant attention from our management, and the diversion of management's attention and resources could have a material adverse effect on our ability to manage our business. Furthermore, we may not realize the degree or timing of benefits we anticipated when we first enter into these transactions. If actual integration costs are higher than amounts assumed, if we are unable to integrate the assets and personnel acquired in an acquisition as anticipated, or if we are unable to fully benefit from anticipated synergies, our business, financial condition, results of operations, and cash flows could be materially adversely affected.

We have substantial accounts receivable, and increased bad debt expense or delays in collecting accounts receivable could have a material adverse effect on our cash flows and results of operations.

Our accounts receivable balance, net of allowances, was $13.1million and $28.0 million as of March 31, 2015 and March 31, 2014, respectively. Days sales outstanding in accounts receivable (DSO) at the end of Fiscal 2015 was 40 days, compared with 70 days at the end of Fiscal 2014. We recorded bad debt expense of $10.1 million and $0.2 million during Fiscal 2015 and Fiscal 2014, respectively. No assurances can be given that future bad debt expense will not increase above current operating levels. Increased bad debt expense or delays in collecting accounts receivable could have a material adverse effect on cash flows and results of operations.

Loss of a significant customer could have a material adverse effect on our results of operations.

Horizon and BPC accounted for approximately 17% and 11%, respectively, of our revenue for Fiscal 2015. Additionally, Optimal accounted for 17% of net accounts receivable as of March 31, 2015. The loss of Horizon, BPC or any other significant customers could adversely affect our results of operations.

We may not be able to develop sufficiently trained applications engineering, installation and service support to serve our targeted markets.

Our ability to identify and develop business relationships with companies who can provide quality, cost-effective application engineering, installation and service can significantly affect our success. The application engineering and proper installation of our microturbines, as well as proper maintenance and service, are critical to the performance of the units. Additionally, we need to reduce the total installed cost of our microturbines to enhance market opportunities. Our inability to improve the quality of applications, installation and service while reducing associated costs could affect the marketability of our products.

Changes in our product components may require us to replace parts held at distributors.

We have entered into agreements with some of our distributors requiring that if we render parts obsolete in inventories they own and hold in support of their obligations to serve fielded microturbines, we are required to replace the affected stock at no cost to the distributors. It is possible that future changes in our product technology could involve costs that have a material adverse effect on our results of operations, cash flow or financial position.

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We operate in a highly regulated business environment, and changes in regulation could impose significant costs on us or make our products less economical, thereby affecting demand for our microturbines.

Our products are subject to federal, state, local and foreign laws and regulations, governing, among other things, emissions and occupational health and safety. Regulatory agencies may impose special requirements for the implementation and operation of our products or that may significantly affect or even eliminate some of our target markets. We may incur material costs or liabilities in complying with government regulations. In addition, potentially significant expenditures could be required in order to comply with evolving environmental and health and safety laws, regulations and requirements that may be adopted or imposed in the future. Furthermore, our potential utility customers must comply with numerous laws and regulations. The deregulation of the utility industry may also create challenges for our marketing efforts. For example, as part of electric utility deregulation, federal, state and local governmental authorities may impose transitional charges or exit fees, which would make it less economical for some potential customers to switch to our products. We can provide no assurances that we will be able to obtain these approvals and changes in a timely manner, or at all. Non-compliance with applicable regulations could have a material adverse effect on our operating results.

The market for electricity and generation products is heavily influenced by federal and state government regulations and policies. The deregulation and restructuring of the electric industry in the United States and elsewhere may cause rule changes that may reduce or eliminate some of the advantages of such deregulation and restructuring. We cannot determine how any deregulation or restructuring of the electric utility industry may ultimately affect the market for our microturbines. Changes in regulatory standards or policies could reduce the level of investment in the research and development of alternative power sources, including microturbines. Any reduction or termination of such programs could increase the cost to our potential customers, making our systems less desirable, and thereby adversely affect our revenue and other operating results.

Utility companies or governmental entities could place barriers to our entry into the marketplace, and we may not be able to effectively sell our products.

Utility companies or governmental entities could place barriers on the installation of our products or the interconnection of the products with the electric grid. Further, they may charge additional fees to customers who install on-site generation or have the capacity to use power from the grid for back-up or standby purposes. These types of restrictions, fees or charges could hamper the ability to install or effectively use our products or increase the cost to our potential customers for using our systems. This could make our systems less desirable, thereby adversely affecting our revenue and other operating results. In addition, utility rate reductions can make our products less competitive which would have a material adverse effect on our operations. The cost of electric power generation bears a close relationship to natural gas and other fuels. However, changes to electric utility tariffs often require lengthy regulatory approval and include a mix of fuel types as well as customer categories. Potential customers may perceive the resulting swings in natural gas and electric pricing as an increased risk of investing in on-site generation.

We depend upon the development of new products and enhancements of existing products.

Our operating results depend on our ability to develop and introduce new products, enhance existing products and reduce the costs to produce our products. The success of our products is dependent on several factors, including proper product definition, product cost, timely completion and introduction of the products, differentiation of products from those of our competitors, meeting changing customer requirements, emerging industry standards and market acceptance of these products. The development of new, technologically advanced products and enhancements is a complex and uncertain process requiring high levels of innovation, as well as the accurate anticipation of technological and market trends. There can be no assurance that we will successfully identify new

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product opportunities, develop and bring new or enhanced products to market in a timely manner, successfully lower costs and achieve market acceptance of our products, or that products and technologies developed by others will not render our products or technologies obsolete or noncompetitive.

Operational restructuring may result in asset impairment or other unanticipated charges.

As a result of our corporate strategy, we have identified opportunities to outsource to third-party suppliers certain functions which we currently perform. We believe outsourcing can reduce product costs, improve product quality and increase operating efficiency. These actions may not yield the expected results, and outsourcing may result in production delays or lower quality products. Transitioning to outsourcing may cause certain of our affected employees to leave before the outsourcing is complete. This could result in a lack of the experienced in-house talent necessary to successfully implement the outsourcing. Further, depending on the nature of operations outsourced and the structure of agreements we reach with suppliers to perform these functions, we may experience impairment in the value of manufacturing assets related to the outsourced functions or other unanticipated charges, which could have a material adverse effect on our operating results.

We may not achieve production cost reductions necessary to competitively price our products, which would adversely affect our sales.

We believe that we will need to reduce the unit production cost of our products over time to maintain our ability to offer competitively priced products. Our ability to achieve cost reductions will depend on our ability to develop low cost design enhancements, to obtain necessary tooling and favorable supplier contracts and to increase sales volumes so we can achieve economies of scale. We cannot provide assurance that we will be able to achieve any such production cost reductions. Our failure to achieve such cost reductions could have a material adverse effect on our business and results of operations.

Commodity market factors impact our costs and availability of materials.

Our products contain a number of commodity materials from metals, which include steel, special high temperature alloys, copper, nickel and molybdenum, to computer components. The availability of these commodities could impact our ability to acquire the materials necessary to meet our production requirements. The cost of metals has historically fluctuated. The pricing could impact the costs to manufacture our products. If we are not able to acquire commodity materials at prices and on terms satisfactory to us or at all, our operating results may be materially adversely affected.

Our products involve a lengthy sales cycle and we may not anticipate sales levels appropriately, which could impair our results of operations.

The sale of our products typically involves a significant commitment of capital by customers, with the attendant delays frequently associated with large capital expenditures. For these and other reasons, the sales cycle associated with our products is typically lengthy and subject to a number of significant risks over which we have little or no control. We expect to plan our production and inventory levels based on internal forecasts of customer demand, which is highly unpredictable and can fluctuate substantially. If sales in any period fall significantly below anticipated levels, our financial condition, results of operations and cash flow would suffer. If demand in any period increases well above anticipated levels, we may have difficulties in responding, incur greater costs to respond, or be unable to fulfill the demand in sufficient time to retain the order, which would negatively impact our operations. In addition, our operating expenses are based on anticipated sales levels, and a high percentage of our expenses are generally fixed in the short term. As a result of these factors, a small fluctuation in timing of sales can cause operating results to vary materially from period to period.

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Potential litigation may adversely impact our business.

We may face litigation relating to labor matters or other matters. Any litigation could be costly, divert management attention or result in increased cost of doing business.

Our business could be negatively impacted if we fail to adequately protect our intellectual property rights or if third parties claim that we are in violation of their intellectual property rights.

We view our intellectual property rights as important assets. We seek to protect our intellectual property rights through a combination of patent, trademark, copyright and trade secret laws, as well as licensing and confidentiality agreements. These protections may not be adequate to prevent third parties from using our intellectual property without our authorization, breaching any confidentiality agreements with us, copying or reverse engineering our products, or developing and marketing products that are substantially equivalent to or superior to our own. The unauthorized use of our intellectual property by others could reduce our competitive advantage and harm our business. If it became necessary for us to litigate to protect these rights, any proceedings could be burdensome and costly and we may not prevail. We cannot guarantee that any patents, issued or pending, will provide us with any competitive advantage or will not be challenged by third parties. Moreover, the expiration of our patents may lead to increased competition with respect to certain products. In addition, we cannot be certain that we do not or will not infringe third parties' intellectual property rights. Any such claim, even if it is without merit, may be expensive and time-consuming to defend, subject us to damages, cause us to cease making, using or selling certain products that incorporate the disputed intellectual property, require us to redesign our products, divert management time and attention and/or require us to enter into costly royalty or licensing arrangements.

Our results of operations could be materially and adversely affected by risks related to cyber security threats.

As a manufacturer of high technology commercial products, we face cyber security threats, as well as the potential for business disruptions associated with information technology failures or cyber security attacks. We routinely experience cyber security threats, threats to our information technology infrastructure and attempts to gain access to our sensitive information. Because of the evolving nature of these security threats, the impact of any future incident cannot be predicted. The occurrence of any of these events could adversely affect our results of operations, the services we provide to customers, the competitive advantages derived from our R&D efforts, the usefulness of our products and services, our reputation or our stock price.

We may incur costs and liabilities as a result of product liability claims.

We face a risk of exposure to product liability claims in the event that the use of our products is alleged to have resulted in injury or other damage. Although we currently maintain product liability insurance coverage, we may not be able to obtain such insurance on acceptable terms in the future, if at all, or obtain insurance that will provide adequate coverage against potential claims. Product liability claims can be expensive to defend and can divert the attention of management and other personnel for long periods of time, regardless of the ultimate outcome. A significant unsuccessful product liability defense could have a material adverse effect on our financial condition and results of operations. In addition, we believe our business depends on the strong brand reputation we have developed. If our reputation is damaged, we may face difficulty in maintaining our market share and pricing with respect to some of our products, which could reduce our sales and profitability.

We have significant tax assets, usage of which may be subject to limitations in the future.

At March 31, 2015, we had federal and state net operating loss carryforwards of approximately $626 million and $203 million, respectively, which may be utilized to reduce future taxable income,

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subject to limitations under Section 382 of the Internal Revenue Code of 1986. These deferred tax assets have been fully offset by a valuation allowance. Any subsequent accumulations of common stock ownership leading to a change of control under Section 382 of the U.S. Internal Revenue Code of 1986, including through sales of stock by large stockholders, all of which are outside of our control, could limit and defer our ability to utilize our net operating loss carryforwards to offset future federal income tax liabilities.

Our success depends in significant part upon the continuing service of management and key employees.

Our success depends in significant part upon the continuing service of our executive officers, senior management and sales and technical personnel. The failure of our personnel to execute our strategy or our failure to retain management and personnel could have a material adverse effect on our business. Our success will be dependent on our continued ability to attract, retain and motivate highly skilled employees. There can be no assurance that we can do so.

Our internal control systems rely on people trained in the execution of the controls. Loss of these people or our inability to replace them with similarly skilled and trained individuals or new processes in a timely manner could adversely impact our internal control mechanisms.

Our operations are vulnerable to interruption by fire, earthquake and other events beyond our control.

Our operations are vulnerable to interruption by fire, earthquake and other events beyond our control. Our executive offices and manufacturing facilities are located in southern California. Because the southern California area is located in an earthquake-sensitive area, we are particularly susceptible to the risk of damage to, or total destruction of, our facilities in southern California and the surrounding transportation infrastructure, which could affect our ability to make and transport our products. If an earthquake, fire or other natural disaster occurs at or near our facilities, our business, financial condition, operating results and cash flow could be materially adversely affected.

If we continue to fail to meet all applicable Nasdaq Global Market requirements and Nasdaq determines to delist our common stock, the delisting could adversely affect the market liquidity of our common stock, impair the value of your investment and adversely affect our ability to raise needed funds.

Our common stock is listed on the Nasdaq Global Market. In order to maintain that listing, we must satisfy minimum financial and other requirements. On December 19, 2014, we received a notice from the Nasdaq Listing Qualifications Department stating that, for 30 consecutive business days preceding the notice date, the closing bid price for our common stock had been below the minimum $1.00 per share requirement for continued listing on the Nasdaq Global Market as set forth in Nasdaq Listing Rule 5450(a)(1). In accordance with Nasdaq Listing Rule 5810(c)(3)(A), we have been provided 180 calendar days, or until June 17, 2015, to regain compliance with the minimum bid price requirement. In order to regain compliance, the bid price of our common stock must close at $1.00 per share or more for a minimum of ten consecutive business days, at which time Nasdaq Listing Qualifications Department would provide written confirmation of our compliance. In the event we do not meet the minimum bid price requirement during the initial 180-day grace period, we may be eligible for an additional 180-day grace period under the Nasdaq listing rules if we meet the listing standards for The Nasdaq Capital Market. We may need to implement a reverse stock split to regain compliance with the Nasdaq Listing Rules.

If we continue to fail to meet all applicable Nasdaq Global Market requirements in the future and Nasdaq determines to delist our common stock, the delisting could adversely affect the market liquidity of our common stock and adversely affect our ability to obtain financing for the continuation of our operations. This delisting could also impair the value of your investment.

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The market price of our common stock has been and may continue to be highly volatile and you could lose all or part of your investment in our securities.

An investment in our securities is risky, and stockholders could lose their investment in our securities or suffer significant losses and wide fluctuations in the market value of their investment. The market price of our common stock is highly volatile and is likely to continue to be highly volatile. Given the continued uncertainty surrounding many variables that may affect our business and the industry in which we operate, our ability to foresee results for future periods is limited. This variability could affect our operating results and thereby adversely affect our stock price. Many factors that contribute to this volatility are beyond our control and may cause the market price of our common stock to change, regardless of our operating performance. Factors that could cause fluctuation in our stock price may include, among other things:

actual or anticipated variations in quarterly operating results;

market sentiment toward alternative energy stocks in general or toward Capstone;

changes in financial estimates or recommendations by securities analysts;

conditions or trends in our industry or the overall economy;

loss of one or more of our significant customers;

errors, omissions or failures by third parties in meeting commitments to us;

changes in the market valuations or earnings of our competitors or other technology companies;

the trading of options on our common stock;

announcements by us or our competitors of significant acquisitions, strategic partnerships, divestitures, joint ventures or other strategic initiatives;

announcements of significant market events, such as power outages, regulatory changes or technology changes;

changes in the estimation of the future size and growth rate of our market;

future equity financings;

the failure to produce our products on a timely basis in accordance with customer expectations;

the inability to obtain necessary components on time and at a reasonable cost;

litigation or disputes with customers or business partners;

capital commitments;

additions or departures of key personnel;

sales or purchases of our common stock;

the trading volume of our common stock;

developments relating to litigation or governmental investigations; and

decreases in oil, natural gas and electricity prices.

In addition, the stock market in general, and the Nasdaq Global Market and the market for technology companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of particular companies affected. The market prices of securities of technology companies and companies servicing the technology industries have been particularly volatile. These broad market and industry factors may

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cause a material decline in the market price of our common stock, regardless of our operating performance. In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted against that company. This type of litigation, regardless of whether we prevail on the underlying claim, could result in substantial costs and a diversion of management's attention and resources, which could materially harm our financial condition, results of operations and cash flow.

Provisions in our certificate of incorporation, bylaws and our stockholder rights plan, as well as Delaware law, may discourage, delay or prevent a merger or acquisition at a premium price.

Provisions of our second amended and restated certificate of incorporation, amended and restated bylaws and our stockholder rights plan, as well as provisions of the General Corporation Law of the State of Delaware, could discourage, delay or prevent unsolicited proposals to merge with or acquire us, even though such proposals may be at a premium price or otherwise beneficial to you. These provisions include our board's authorization to issue shares of preferred stock, on terms the board determines in its discretion, without stockholder approval, and the following provisions of Delaware law that restrict many business combinations.

We are subject to the provisions of Section 203 of the General Corporation Law of the State of Delaware, which could prevent us from engaging in a business combination with a 15% or greater stockholder for a period of three years from the date such stockholder acquired such status unless appropriate board or stockholder approvals are obtained.

Our board of directors has adopted a stockholder rights plan, pursuant to which one preferred stock purchase right has been issued for each share of our common stock authorized and outstanding. Until the occurrence of certain prescribed events, the rights are not exercisable and are transferable along with, and only with, each share of our common stock and are evidenced by the common stock certificates. One preferred stock purchase right will also be issued with each share of our common stock we issue in the future until the rights plan expires or is terminated or we redeem or exchange the rights for other property in accordance with the terms of the rights plan or at such time, if any, as the rights separate from each share of our common stock and become exercisable. Each share of Series A Junior Participating Preferred Stock will be entitled to receive, when, as and if declared by our board of directors out of funds legally available for the purpose, dividends payable in cash in an amount per share (rounded to the nearest cent) equal to 100 times the aggregate per share amount of all dividends or other distributions, including non-cash dividends (payable in kind), declared on our common stock other than a dividend payable in shares of common stock or a subdivision of the outstanding shares of common stock. The rights plan prohibits the issuance of additional rights after the rights separate from our common stock. The rights plan is intended to protect our stockholders in the event of an unfair or coercive offer to acquire us. However, the existence of the rights plan may discourage, delay or prevent a merger or acquisition of us that is not supported by our board of directors.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

Our principal corporate offices, administrative, sales and marketing, R&D and support facilities consist of approximately 98,000 square feet of leased office space, warehouse space and assembly and test space located at 21211 Nordhoff Street in Chatsworth, California. Our lease for those premises expires in September 2019, and we have one five-year option to extend the term of this lease. We also lease an approximately 79,000 square foot facility at 16640 Stagg Street in Van Nuys, California as an engineering test and manufacturing facility for our recuperator cores. This lease will expire in December 2017. Management believes our facilities are adequate for our current needs.

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Item 3. Legal Proceedings.

From time to time, the Company may become subject to certain legal proceedings, claims and litigation arising in the ordinary course of business. In the opinion of management, we are not a party to any other material legal proceedings, nor are we aware of any other pending or threatened litigation that would have a material effect on our business, operating results, cash flows, financial position or results of operations should such litigation be resolved unfavorably.

Item 4. Mine Safety Disclosures.

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Price Range of Common Stock

Our common stock is publicly traded on the Nasdaq Global Market under the symbol "CPST". The following table sets forth the low and high sales prices for each period indicated.

	High	Low
Year Ended March 31, 2015:		
First Quarter	$ 2.32	$ 1.28
Second Quarter	$ 1.53	$ 1.03
Third Quarter	$ 1.08	$ 0.56
Fourth Quarter	$ 0.77	$ 0.59
Year Ended March 31, 2014:		
First Quarter	$ 1.34	$ 0.82
Second Quarter	$ 1.52	$ 1.07
Third Quarter	$ 1.45	$ 1.12
Fourth Quarter	$ 2.60	$ 1.26

As of June 8, 2015, the last reported sale price of our common stock on the Nasdaq Global Market was $0.55 per share.

Stockholders

As of June 8, 2015, there were 560 stockholders of record of our common stock. This does not include the number of persons whose stock is held in nominee or "street name" accounts through brokers.

Dividend Policy

We currently intend to retain any earnings for use in our business and, therefore, we do not anticipate paying any cash dividends in the foreseeable future. We have never declared or paid any cash dividends on our capital stock. In the future, the decision to pay any cash dividends will depend upon our results of operations, financial condition, cash flow and capital expenditure plans, as well as such other factors as our Board of Directors, in its sole discretion, may consider relevant. Additionally, the consent of Wells Fargo would be necessary in order for the Company to declare and pay a dividend in accordance with the terms of the Credit Agreements.

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Item 6. Selected Financial Data.

The selected financial data shown below have been derived from the audited financial statements of Capstone. The historical results are not necessarily indicative of the operating results to be expected in the future. The selected financial data should be read in conjunction with "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and related notes included elsewhere in this Annual Report.

	Year Ended March 31,				
(In thousands, except per share data)	**2015**	**2014**	**2013**	**2012**	**2011**
Statement of Operations:					
Revenue	$ 115,461	$ 133,105	$ 127,557	$ 109,371	$ 81,890
Cost of goods sold	97,174	111,409	113,172	103,944	82,427
Gross margin (loss)	18,287	21,696	14,385	5,427	(537)
Operating costs and expenses:					
Research and development	9,679	9,029	8,979	8,237	6,986
Selling, general and administrative(1)	39,517	27,981	27,364	28,927	26,203
Loss from operations	(30,909)	(15,314)	(21,958)	(31,737)	(33,726)
Net loss	$ (31,533)	$ (16,256)	$ (22,563)	$ (18,764)	$ (38,470)
Net loss per share of common stock basic and diluted	$ (0.10)	$ (0.05)	$ (0.07)	$ (0.07)	$ (0.16)

	As of March 31,				
	2015	**2014**	**2013**	**2012**	**2011**
Balance Sheet Data:					
Cash and cash equivalents	$ 32,221	$ 27,859	$ 38,817	$ 49,952	$ 33,456
Working capital	27,528	26,443	32,782	49,532	22,274
Total assets	78,927	84,118	87,338	99,792	87,019
Revolving credit facility	12,953	13,228	13,476	10,431	7,080
Capital lease/note payable obligations	496	645	594	433	297
Long-term liabilities	161	70	142	254	309
Stockholders' equity	$ 34,704	$ 34,093	$ 41,886	$ 58,617	$ 34,480

(1) The Company recorded bad debt expense of approximately $10.1 million, $0.2 million, $0.3 million, $2.3 million and $0.2 million for the years ended March 31, 2015, 2014, 2013, 2012 and 2011, respectively.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from the results discussed in the forward-looking statements. Factors that might cause a difference include, but are not limited to, those discussed under Item 1A (Risk Factors) in this Annual Report. The following section is qualified in its entirety by the more detailed information, including our financial statements and the notes thereto, which appears elsewhere in this Annual Report.

Overview

Capstone is the market leader in microturbines based on the number of microturbines sold. Generally, power purchased from the electric utility grid is less costly than power produced by distributed generation technologies. Utilities may also charge fees to interconnect to their power grids. However, we can provide economic benefits to end users in instances where the waste heat from our microturbine has value (combined heat and power ("CHP") and combined cooling, heat and power ("CCHP")), where fuel costs are low (renewable energy/renewable fuels), where the costs of connecting to the grid may be high or impractical (such as remote power applications), where reliability and power quality are of critical importance, or in situations where peak shaving could be economically advantageous because of highly variable electricity prices. Because Capstone microturbines can provide a reliable source of power and can operate on multiple fuel sources, management believes they offer a level of flexibility not currently offered by other technologies such as reciprocating engines.

During Fiscal 2015 our net loss increased by 93% to $31.5 million and our net loss per share increased by 100% to $0.10 compared to the same period last year. The increase in the net loss was primarily the result of lower revenue and accounts receivable allowance for two customers during Fiscal 2015 compared to the same period last year. Please see Results of Operations on page 34 for further discussion on the lower revenue and accounts receivable allowance. We continue to remain focused on improving our gross margin. Our gross margin was 16% for each of Fiscal 2015 and Fiscal 2014. While our year over year revenue decreased 13%, our gross margin rate remained flat compared to Fiscal 2014. During Fiscal 2015 we benefitted from our ongoing efforts in manufacturing cost reductions that were entirely offset by lower volume and lower average selling prices for our microturbines compared to the same period last year. Fiscal 2015 was characterized by lower revenue as our operational progress was eclipsed by challenging macroeconomic headwinds over the last year which included the dramatic downturn of the oil markets, a substantially stronger U.S. dollar making our products more expensive overseas and ongoing geopolitical tensions in Russia, North Africa and the Middle East; all of these factors negatively impacted our business.

Capstone products continue to gain interest in all six of the major vertical markets (energy efficiency, renewable energy, natural resources, critical power supply, marine and transportation). In the energy efficiency market, we continue to expand our market presence in hotels, office buildings, hospitals, retail and industrial applications globally. The renewable energy market is fueled by landfill gas, biodiesel, and biogas from sources such as food processing, agricultural waste and cow, pig and chicken manure. Our success in the oil and gas and other natural resources market, which continues to be a growing market worldwide is driven by our microturbines reliability, emissions profile and ease of installation. We have also seen increased interest in critical power supply solution applications as customers want solutions that can handle both primary and backup power. Capstone's transportation market, which utilizes microturbines for electric vehicle industries, is gaining interest as liquid natural gas becomes more readily available as a transportation fuel and emission regulations continue to be tightened on the diesel engine industry.

We continue to focus on improving our products based on customer input, building brand awareness and new channels to market by developing a diversified network of strategic distribution

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partners. Our focus is on products and solutions that provide near-term opportunities to drive repeatable business rather than discrete projects for niche markets. In addition, management closely manages operating expenses and strives to improve manufacturing efficiencies while simultaneously lowering direct material costs and increasing average selling prices. The key drivers to Capstone's success are revenue growth, higher average selling prices, lower direct material costs, positive new order flow and reduced cash usage.

To support our opportunities to grow in our targeted markets, we continue to enhance the reliability and performance of our products by regularly developing new processes and enhancing training to assist those who apply, install and use our products.

An overview of our direction, targets and key initiatives follows:

1)

Focus on Vertical Markets Within the distributed generation markets that we serve, we focus on vertical markets that we identify as having the greatest near-term potential. In our primary products and applications (energy efficiency, renewable energy, natural resources, critical power supply, marine and transportation products), we identify specific targeted vertical market segments. Within each of these segments, we identify what we believe to be the critical factors to success and base our plans on those factors.

During Fiscal 2015, we booked orders for 86.0 megawatts and shipped 91.4 megawatts of products, which combined with our backlog at March 31, 2014, resulted in 182.8 megawatts in backlog at the end of the fiscal year. Our product shipments in Fiscal 2015 were: 49% for use in natural resources applications, 44% for use in energy efficiency applications and 7% for use in renewable energy applications.

Energy Efficiency CHP/CCHP

Energy efficiency maximizes the use of energy produced by the microturbines, reduces emissions compared with traditional power generation and enhances the economic advantage to customers. Energy efficiency applications use both the heat and electric energy produced in the power generation process. Using the heat and electricity created from a single combustion process increases the efficiency of the system from approximately 30% to 75% or more. The increased operating efficiency reduces overall greenhouse gas emissions compared with traditional independent sources such as power generation and local thermal generation and, through displacement of other separate systems, can reduce variable production costs.

Renewable Energy

Our microturbines can use renewable methane gases from landfills, wastewater treatment facilities and biogas from sources such as food processing, agricultural waste and cow, pig and chicken manure. Capstone's microturbines can burn these renewable waste gases with minimal emissions, thereby, in some cases, avoiding the imposition of penalties incurred for pollution while simultaneously producing electricity from this "free" renewable fuel for use at the site or in the surrounding area. Capstone's microturbines have demonstrated effectiveness in these applications and outperform conventional combustion engines in a number of situations, including when the gas contains a high amount of sulfur.

Natural Resources Oil, Natural Gas, Shale Gas & Mining

On a worldwide basis, there are thousands of locations where the drilling, production, compression and transportation of natural resources and other extraction and production processes create fuel byproducts, which traditionally have been released or burned into the atmosphere. Our microturbines are installed in the natural resource market to be used in oil

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and gas exploration, production, compression and transmission sites both onshore and offshore as a highly reliable critical source of power generation. In addition, our microturbines can use flare gas as a fuel to provide prime power. Typically these oil and gas or mining operations have no access to an electric utility grid and rely solely on Capstone's microturbines for a reliable low emission power supply.

Critical Power Supply

Because of the potentially catastrophic consequences of even momentary system failure, certain power users, such as high technology and information systems companies, require particularly high levels of reliability in their power service. Management believes that Capstone's critical power supply offerings are the world's only microturbine powered Uninterruptible Power Source solutions that can offer clean, IT-grade power produced from microturbines, the utility or a combination of both.

Transportation

Our technology is also used in hybrid electric vehicle ("HEV") applications. Our customers have applied our products in hybrid electric mobile applications, including transit buses and trucks. In these applications the microturbine acts as an onboard battery charger to recharge the battery system as needed. The benefits of microturbine hybrids include extended range, fuel economy gains, quieter operation, reduced emissions and higher reliability compared with traditional internal combustion engines.

Marine

Our technology is also used in marine applications. Our customers have applied our products in the commercial vessel and luxury yacht markets. The most immediate market for our marine products is for use as ship auxiliaries. In this application, the microturbines provide power to the vessel's electrical loads and, in some cases, the vessel is able to utilize the exhaust energy to increase the overall efficiency of the application, reducing overall fuel consumption and emissions. The other application is similar to our HEV application where the vessel is driven by an electric propulsion system and the microturbine serves as an on board range extender.

2)

Sales and Distribution Channels We seek out distributors that have business experience and capabilities to support our growth plans in our targeted markets. A significant portion of our revenue is derived from sales to distributors who resell our products to end users. We have a total of 97 distributors and Original Equipment Manufacturers ("OEMs"). In North America, we currently have 31 distributors and OEMs. Outside of North America, we currently have 66 distributors and OEMs. We continue to refine the distribution channels to address our specific targeted markets.

3)

Service We provide service primarily through our global distribution network. Together with our global distribution network we offer new and remanufactured parts as well as a comprehensive Factory Protection Plan ("FPP"). Through our global distribution network, we offer a comprehensive FPP for a fixed annual fee to perform regularly scheduled and unscheduled maintenance as needed. Capstone provides factory and onsite training to certify all personnel that are allowed to perform service on our microturbines. FPPs are generally paid quarterly in advance. Our FPP backlog at the end of Fiscal 2015 and Fiscal 2014 was $61.2 million and $47.2 million, respectively, which represents the value of the contractual agreement for FPP services that has not been earned and extends through Fiscal 2029. Service revenue in Fiscal 2015 was approximately 9% of total revenue.

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4) ***Product Robustness and Life Cycle Maintenance Costs*** We continue to invest in enhancements that relate to high performance and high reliability. An important element of our continued innovation and product strategy is to focus on the engineering of our product hardware and electronics to make them work together more effectively and deliver improved microturbine performance, reliability and low maintenance cost to our customers.

5) ***New Product Development*** Our new product development is targeted specifically to meet the needs of our selected vertical markets. We expect that our existing product platforms, the C30, C65, TA100, C200 and C1000 Series microturbines, will be our foundational product lines for the foreseeable future. Our research and development project portfolio is centered on enhancing the features of these base products. We are currently focusing efforts on enhancing our products to improve reliability, reduce direct material costs, and be compliant with the new European grid interconnect requirements. We are also developing a more efficient microturbine CHP system with the DOE. The first phase of the development program has successfully achieved 270 kW with a prototype C250 engine. Capstone plans to continue development of the engine as well as power electronics and software controls required for successful commercialization. The second phase of the program is expected to incorporate further engine efficiency improvements, resulting in a product with a projected electrical efficiency of 42% and targeted power output of 370 kW. The DOE awarded us a grant of $5.0 million in support of this development program of which $3.9 million has been used through March 31, 2015.

6) ***Cost and Core Competencies*** We believe that the core competencies of Capstone products are air-bearing technology, advanced combustion technology and sophisticated power electronics to form efficient and ultra-low emission electricity and cooling and heat production systems. Our core intellectual property is contained within our air-bearing technology. We continue to review avenues for cost reduction by sourcing to the best value supply chain option. In order to utilize manufacturing facilities and technology more effectively, we are focused on continuous improvements in manufacturing processes. Additionally, considerable effort is being directed to manufacturing cost reduction through process improvement, product design, advanced manufacturing technology, supply management and logistics. Management expects to be able to leverage our costs as product volumes increase.

Management believes that effective execution in each of these key areas will be necessary to leverage Capstone's promising technology and early market leadership into achieving positive cash flow with growing market presence and improving financial performance. Based on our recent progress and assuming achievement of targeted cost reductions, our financial model indicates that we will achieve positive cash flow when we ship approximately 200 units in a quarter, depending on an assumed product mix. Management believes our manufacturing facilities located in Chatsworth and Van Nuys, California have a combined production capacity of approximately 2,000 units per year, depending on product mix. Excluding working capital requirements, management believes we can expand our combined production capacity to approximately 4,000 units per year, depending on product mix, with approximately $10 to $15 million of capital expenditures. We have not committed to this expansion nor identified a source for its funding.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses and related disclosures of contingent liabilities. On an on-going basis, we evaluate our estimates, including but not limited to those related to long-lived assets,

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including finite-lived intangible assets and fixed assets, bad debts, inventories, warranty obligations, stock-based compensation, income taxes and contingencies. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Management believes that the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

We evaluate the carrying value of long-lived assets, including intangible assets with finite lives, for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. Factors that are considered important that could trigger an impairment review include a current-period operating or cash flow loss combined with a history of operating or cash flow losses and a projection or forecast that demonstrates continuing losses or insufficient income associated with the use of a long-lived asset or asset group. Other factors include a significant change in the manner of the use of the asset or a significant negative industry or economic trend. This evaluation is performed based on undiscounted estimated future cash flows compared with the carrying value of the related assets. If the undiscounted estimated future cash flows are less than the carrying value, an impairment loss is recognized and the loss is measured by the difference between the carrying value and the estimated fair value of the asset group. The estimated fair value of the assets are determined using the best information available. On a quarterly basis, we assess whether events or changes in circumstances have occurred that potentially indicate the carrying value of long-lived assets may not be recoverable. Intangible assets include a manufacturing license, technology, backlog and customer relationships. We reevaluate the useful life determinations for these intangible assets each reporting period to determine whether events and circumstances warrant a revision in their remaining useful lives. The Company performed an analysis as of March 31, 2015 and determined that no impairment was necessary. See Note 5 Intangible Assets in the "Notes to Consolidated Financial Statements."

Our inventories are valued on a first in first out ("FIFO") basis and at the lower of cost or market. We routinely evaluate the composition of our inventories and identify slow-moving, excess, obsolete or otherwise impaired inventories. Inventories identified as impaired are evaluated to determine if write-downs are required. Included in this assessment is a review for obsolescence as a result of engineering changes in our product. Future product enhancement and development may render certain inventories obsolete, resulting in additional write-downs of inventories. In addition, inventories are classified as current or long-term based on our sales forecast and also, in part, based on our projected usage for warranty claims and service. A change in forecast could impact the classification of inventories.

We provide for the estimated cost of warranties at the time revenue from sales is recognized. We also accrue the estimated costs to address reliability repairs on products no longer under warranty when, in our judgment, and in accordance with a specific plan developed by us, it is prudent to provide such repairs. We estimate warranty expenses based upon historical and projected product failure rates, estimated costs of parts, labor and shipping to repair or replace a unit and the number of units covered under the warranty period. While we engage in extensive quality programs and processes, our warranty obligation is affected by failure rates and service costs in correcting failures. As we have more units commissioned and longer periods of actual performance, additional data becomes available to assess future warranty costs. When we have sufficient evidence that product changes are altering the historical failure occurrence rates, the impact of such changes is then taken into account in estimating future warranty liabilities. Changes in estimates are recorded in the period that new information, such as design changes,

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cost of repair and product enhancements, becomes available. Should actual failure rates or service costs differ from our estimates, revisions to the warranty liability would be required and could be material to our financial condition, results of operations and cash flow.

Our revenue consists of sales of products, parts, accessories and service, which includes FPPs, net of discounts. Our distributors purchase products, parts and FPPs for sale to end users and are also required to provide a variety of additional services, including application engineering, installation, commissioning and post-commissioning service. Our standard terms of sales to distributors and direct end users include transfer of title, care, custody and control at the point of shipment, payment terms ranging from full payment in advance of shipment to payment in 90 days, no right of return or exchange, and no post-shipment performance obligations by us except for warranties provided on the products and parts sold. We recognize revenue when all of the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or service has been rendered, selling price is fixed or determinable and collectability is reasonably assured. Service revenue derived from time and materials contracts is recognized as the service is performed. FPP contracts are agreements to perform certain agreed-upon service to maintain a product for a specified period of time. Service revenue derived from FPP contracts is recognized on a straight-line basis over the contract period. We occasionally enter into agreements that contain multiple elements, such as equipment, installation, engineering and/or service.

Trade accounts receivable are recorded at the invoiced amount and typically non-interest bearing. We maintain allowances for estimated losses resulting from the inability of our customers to make required payments and other accounts receivable allowances. We evaluate all accounts aged over 60 days past payment terms. If the financial condition of our customers deteriorates or if other conditions arise that result in an impairment of their ability or intention to make payments, additional allowances may be required.

We have a history of unprofitable operations. These losses generated significant federal and state net operating loss ("NOL") carryforwards. We record a valuation allowance against the net deferred income tax assets associated with these NOLs if it is "more likely than not" that we will not be able to utilize them to offset future income taxes. Because of the uncertainty surrounding the timing of realizing the benefits of our favorable tax attributes in future income tax returns, a valuation allowance has been provided against all of our net deferred income tax assets. We currently provide for income taxes only to the extent that we expect to pay cash taxes, primarily foreign and state taxes. It is possible, however, that we could be profitable in the future at levels which could cause management to determine that it is more likely than not that we will realize all or a portion of the NOL carryforwards. Upon reaching such a conclusion, we would record the amount of net deferred tax assets that are expected to be realized. Such adjustment would increase income in the period that the determination was made.

We recognize stock-based compensation expense associated with stock options in the statement of operations. Determining the amount of stock-based compensation to be recorded requires us to develop estimates to be used in calculating the grant-date fair value of stock options. We calculate the grant-date fair values using the Black-Scholes valuation model. The use of Black-Scholes model requires us to make estimates of the following assumptions:

Expected volatility The estimated stock price volatility was derived based upon the Company's actual historic stock prices over the expected option life, which represents the Company's best estimate of expected volatility.

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Expected option life The expected life, or term, of options granted was derived from historical exercise behavior and represents the period of time that stock option awards are expected to be outstanding.

Risk-free interest rate We used the yield on zero-coupon U.S. Treasury securities for a period that is commensurate with the expected life assumption as the risk-free interest rate.

The amount of stock-based compensation recognized during a period is based on the value of the portion of the awards that are ultimately expected to vest. We estimate forfeitures at the time of grant and revise, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The term "forfeitures" is distinct from "cancellations" or "expirations" and represents only the unvested portion of the surrendered option. We review historical forfeiture data and determine the appropriate forfeiture rate based on that data. We re-evaluate this analysis periodically and adjust the forfeiture rate as necessary. Ultimately, we recognize the actual expense over the vesting period only for the shares that vest.

Results of Operations

Year Ended March 31, 2015 Compared to Year Ended March 31, 2014

Revenue Revenue for Fiscal 2015 decreased $17.6 million, or 13%, to $115.5 million from $133.1 million for Fiscal 2014. The change in revenue for Fiscal 2015 compared to Fiscal 2014 included decreases in revenue of $12.3 million from the European market, $4.3 million from the African market, $3.9 million from the North American market and $1.5 million from the Asian market. The decrease in the European market was primarily the result of the continuing geopolitical instability in Russia and Ukraine and the effects of a stronger U.S. dollar making our product more expensive overseas compared to Fiscal 2014. The revenue decline during Fiscal 2015 in the North American market was primarily the result of a drop in the oil and gas market which has affected the timing of customer demand for our products compared to the same period last year. Revenue from the Asian and African markets decreased during Fiscal 2015 because of the impact of a decline in the oil and gas market and stronger U.S. dollar. These overall decreases in revenue were offset by increases in revenue of $3.6 million from the Australian market and $0.8 million from the South American market. The increase in the Australian and South American markets was primarily the result of our continued efforts to improve distribution channels.

Megawatts shipped, microturbine units shipped and average revenue per unit decreased primarily as a result of lower sales volume and shift in product mix for our microturbines during Fiscal 2015 compared to the same period last year. Revenue from microturbine products during Fiscal 2015 decreased $19.4 million, or 18%, to $89.4 million from $108.8 million for Fiscal 2014. Microturbine megawatts shipped during Fiscal 2015 decreased 18.5 megawatts to 91.4 megawatts from 109.9 megawatts for Fiscal 2014. Microturbine units shipped during Fiscal 2015 decreased 51 units to 620 units from 671 units shipped during Fiscal 2014. Average revenue per unit shipped decreased for Fiscal 2015 to approximately $144,000 compared to approximately $162,000 per unit for Fiscal 2014. The decrease in average revenue per unit was primarily the result of a decrease in shipments of our C1000 Series systems partially offset by an increase in shipments of our C65 microturbines during Fiscal 2015 compared to the same period last year.

For Fiscal 2015, revenue from our accessories, parts and service increased $1.8 million, or 7%, to $26.1 million from $24.3 million for Fiscal 2014. The increase in revenue resulted primarily from higher FPP contract enrollment and sales of microturbine parts, partially offset by lower sales of microturbine service work.

The timing of shipments is subject to change based on several variables (including customer deposits, payments, availability of credit and delivery schedule changes), most of which are not within

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our control and can affect the timing of our revenue. Therefore, we evaluate historical revenue in conjunction with backlog to anticipate the growth trend of our revenue.

The following table summarizes our revenue (revenue amounts in millions):

	Years Ended March 31,					
	2015			2014		
	Revenue	Megawatts	Units	Revenue	Megawatts	Units
C30	$ 4.8	2.9	97	$ 5.6	3.7	124
C65	30.1	27.8	427	29.1	26.1	402
TA100	0.3	0.2	2	0.5	0.4	4
C200	7.1	6.6	33	14.8	12.6	63
C600	5.9	6.0	10	10.4	10.8	18
C800	8.3	8.8	11	10.1	11.2	14
C1000	32.7	39.0	39	38.1	45.0	45
Waste heat recovery generator	0.2	0.1	1	0.2	0.1	1
Unit upgrades						
Total from Microturbine Products	$ 89.4	91.4	620	$ 108.8	109.9	671
Accessories, Parts and Service	26.1			24.3		
Total	$ 115.5	91.4	620	$ 133.1	109.9	671

Sales to Horizon Power Systems ("Horizon"), one of the Company's domestic distributors, accounted for 17%, 12% and 27% of our revenue for the years ended March 31, 2015, 2014 and 2013, respectively. Sales to BPC Engineering ("BPC"), one of the Company's Russian distributors, accounted for 11%, 17% and 11% of our revenue for the years ended March 31, 2015, 2014 and 2013, respectively. Sales to E-Finity Distributed Generation, LLC ("E-Finity), one of the Company's domestic distributors, accounted for 19% of our revenue for the year ended March 31, 2014.

Gross Margin Cost of goods sold includes direct material costs, production and service center labor and overhead, inventory charges and provision for estimated product warranty expenses. The gross margin was $18.3 million, or 16% of revenue, for Fiscal 2015 compared to a gross margin of $21.7 million, or 16% of revenue, for Fiscal 2014. The change in the gross margin during Fiscal 2015 compared to Fiscal 2014 was driven by multiple factors including lower royalty expense of $1.2 million, lower production and service center labor and overhead expense of $1.0 million and lower warranty expense of $0.4 million. The positive impact of these factors was offset by the adverse impact of lower volume, lower average selling prices and a change in product mix for our microturbines of $5.0 million and higher inventory charges of $1.0 million. Management continues to implement initiatives to improve gross margin by further reducing manufacturing overhead fixed and direct material costs as we work to achieve profitability and improving product performance.

Royalty expense decreased $1.2 million during Fiscal 2015 compared to Fiscal 2014 as a result of a reduction in the predetermined fixed rate royalty. We pay a predetermined fixed rate royalty for each microturbine system covered by our Development and License Agreement with Carrier. The fixed rate royalty was reduced by 50% during the three months ended September 30, 2013 as a result of the contractual reduction.

Production and service center labor and overhead expense decreased approximately $1.0 million during Fiscal 2015 compared to Fiscal 2014 primarily as the result of decreases in service center travel expense of approximately $0.3 million, facilities expense of $0.3 million, salaries expense of $0.2 million and supplies expense of $0.2 million.

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Warranty expense is a combination of a standard warranty provision recorded at the time revenue is recognized and changes, if any, in estimates for reliability repair programs. Reliability repair programs are based upon estimates that are recorded in the period that new information becomes available, including design changes, cost of repair and product enhancements, which can include both in-warranty and out-of-warranty systems. The decrease in warranty expense of $0.4 million reflects a decrease in the standard warranty provision as a result of sales volume and a decrease in reliability repair programs during Fiscal 2015 compared to the prior year. Management expects warranty claim levels for C200 and C1000 Series systems to decline as reliability repair programs are completed and these products mature.

Inventory charges increased approximately $1.0 million during Fiscal 2015 compared to Fiscal 2014 primarily as a result of an allowance for slow-moving inventory related to our waste heat recovery generators.

During the three months ended March 31, 2015, we shipped approximately $0.7 million of product to BPC. Given the uncertainty as to the collectability of the sale, revenue recognition on this shipment was deferred. However, as we do not have title to the product or rights to receive the product back in the event we are not paid, such amounts were expensed through cost of goods sold for Fiscal 2015.

Research and Development Expenses R&D expenses include compensation, engineering department expenses, overhead allocations for administration and facilities and materials costs associated with development. R&D expenses for Fiscal 2015 increased $0.7 million, or 8%, to $9.7 million from $9.0 million for Fiscal 2014. R&D expenses are reported net of benefits from cost-sharing programs, such as DOE grants. During Fiscal 2015 cost sharing benefits decreased approximately $0.9 million offset by a decrease of approximately $0.2 million in professional services expense. There were approximately $0.5 million of cost-sharing benefits for Fiscal 2015 and $1.4 million of such benefits for Fiscal 2014. Cost-sharing programs vary from period to period depending on the phase of the programs. Management expects R&D expenses in Fiscal 2016 to be slightly higher than in Fiscal 2015 as we continue product robustness and direct material cost reduction initiatives.

Selling, General and Administrative ("SG&A") Expenses SG&A expenses for Fiscal 2015 increased $11.5 million, or 41%, to $39.5 million from $28.0 million for Fiscal 2014. The net increase in SG&A expenses was comprised of increases of $9.9 million in bad debt expense, $0.9 million in salaries expense, $0.6 million in professional services expense, which includes legal expense, $0.4 million in marketing expense and $0.1 million in business travel expense, offset by a decreases of $0.2 million in facilities expense and $0.2 million in supplies expense. The increase in the bad debt expense was primarily the result of accounts receivable allowances recorded for BPC and Electro Mecanique Industries ("EMI"), one of the Company's distributors in the Middle East and Africa, during Fiscal 2015. During the three months ended March 31, 2015, we recorded approximately $7.1 million with respect to the accounts receivable allowance from BPC. We determined that the collectability of this accounts receivable balance was not reasonably assured based on BPC's recent payment history and because the impact of the steep decline of the Russian ruble could continue to negatively impact its ability to pay its outstanding accounts receivable balance. Also during three months ended September 30, 2014, we recorded approximately $2.6 million with respect to EMI. We determined that the collectability of this accounts receivable balance was not reasonably assured based on EMI's payment history. Excluding bad debt expense, management expects SG&A expenses in Fiscal 2016 to be higher than in Fiscal 2015 primarily as a result of expanding our aftermarket services, which may require paying incentive-based compensation to certain key Capstone employees in the event that Capstone achieves its planned results of operations.

Interest Expense Interest expense decreased $0.2 million, or 29%, to $0.5 million during Fiscal 2015 from $0.7 million during Fiscal 2014. Interest expense is primarily from the average balances

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outstanding under the Credit Facility. As of March 31, 2015, we had total debt of $13.0 million outstanding under the Credit Facility.

Change in Fair Value of Warrant Liability Effective September 23, 2013, warrants issued in connection with the September 23, 2008 registered direct placement to purchase 4.0 million shares expired, and the liability associated with the warrants was reversed. The reversal of the warrant liability resulted in a benefit of approximately $10,000 for Fiscal 2014. This reversal of the warrant liability had no impact on our cash balances.

Income Tax Provision Income tax expense decreased $0.1 million, or 50%, to $0.1 million during Fiscal 2015 from $0.2 million during Fiscal 2014. Income tax expense incurred was related to state and foreign taxes. The effective income tax rate of 0.4% differs from the federal and state blended statutory rate of approximately 37% primarily as a result of recording taxable losses. At March 31, 2015, we had federal and state net operating loss carryforwards of approximately $626 million and $202 million, respectively, which may be utilized to reduce future taxable income, subject to limitations under Section 382 of the Internal Revenue Code of 1986. We provided a valuation allowance for 100% of our net deferred tax asset of $246.8 million at March 31, 2015 because the realization of the benefits of these favorable tax attributes in future income tax returns is not deemed more likely than not. Similarly, at March 31, 2014, the net deferred tax asset was fully reserved.

Year Ended March 31, 2014 Compared to Year Ended March 31, 2013

Revenue Revenue for Fiscal 2014 increased $5.5 million, or 4%, to $133.1 million from $127.6 million for Fiscal 2013. The change in revenue for Fiscal 2014 compared to Fiscal 2013 included increases in revenue of $15.2 million from the European market, $6.1 million from the African market and $2.3 million from the Asian market. The increase in the European market was primarily related to increased sales into the Russian natural resources vertical market. The increase in the African market was primarily the result of further market adoption of our products in this market. The increase in the Asian market was primarily because of an increase in average selling prices of microturbine units shipped in Asia during Fiscal 2014 compared to the same period last year. This overall increase in revenue was offset by decreases in revenue of $16.4 million from the North American market, $1.5 million from the South American market and $0.2 million from the Australian market. The decreases in the North American, South American and Australian markets were primarily the result of a shift in certain customers' project timelines compared to the same period last year.

Megawatts shipped and microturbine units shipped during Fiscal 2014 increased as a result of higher sales volume for our C65 microturbine and a change in product mix of the C1000 Series systems, offset by lower sales volume for our C30, TA100 and C200 microturbines. For Fiscal 2014, revenue from microturbine products increased $6.1 million, or 6%, to $108.8 million from $102.7 million for Fiscal 2013. Microturbine megawatts shipped during Fiscal 2014 increased 6.7 megawatts to 109.9 megawatts from 103.2 megawatts for Fiscal 2013. Microturbine units shipped during Fiscal 2014 increased 43 units to 671 units from 628 units for Fiscal 2013. Average revenue per unit decreased for Fiscal 2014 to approximately $162,000 compared to approximately $163,000 per unit for Fiscal 2013. The decrease in average revenue per unit was primarily the result of a change in mix of C1000 Series systems and more C65 microturbines shipped during Fiscal 2014 compared to the same period last year.

For Fiscal 2014, revenue from our accessories, parts and service decreased $0.6 million, or 2%, to $24.3 million from $24.9 million for Fiscal 2013. The decrease in revenue resulted primarily from lower sales of microturbine service work, partially offset by higher FPP contract enrollment, sales of microturbine parts and sales of accessories.

The timing of shipments is subject to change based on several variables (including customer deposits, payments, availability of credit and delivery schedule changes), most of which are not within our control and can affect the timing of our revenue. Therefore, we evaluate historical revenue in conjunction with backlog to anticipate the growth trend of our revenue.

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The following table summarizes our revenue (revenue amounts in millions):

	Years Ended March 31,					
	2014			2013		
	Revenue	Megawatts	Units	Revenue	Megawatts	Units
C30	$ 5.6	3.7	124	$ 6.8	4.4	147
C65	29.1	26.1	402	22.9	21.0	323
TA100	0.5	0.4	4	1.5	0.8	8
C200	14.8	12.6	63	18.1	15.6	78
C600	10.4	10.8	18	12.4	12.6	21
C800	10.1	11.2	14	5.3	5.6	7
C1000	38.1	45.0	45	35.6	43.0	43
Waste heat recovery generator	0.2	0.1	1			
Unit upgrades				0.1	0.2	1
Total from Microturbine Products	$ 108.8	109.9	671	$ 102.7	103.2	628
Accessories, Parts and Service	24.3			24.9		
Total	$ 133.1	109.9	671	$ 127.6	103.2	628

Sales to E-Finity accounted for 19% of our revenue for the year ended March 31, 2014. Sales to BPC accounted for 17%, 11% and 26% of our revenue for the years ended March 31, 2014, 2013 and 2012, respectively. Sales to Horizon accounted for 12%, 27% and 19% of our revenue for the years ended March 31, 2014, 2013 and 2012, respectively.

Gross Margin Cost of goods sold includes direct material costs, production and service center labor and overhead, inventory charges and provision for estimated product warranty expenses. The gross margin was $21.7 million, or 16% of revenue, for Fiscal 2014 compared to a gross margin of $14.4 million, or 11% of revenue, for Fiscal 2013. The increase of $7.3 million in gross margin was the result of a $4.4 million improvement realized from overall higher revenue as a result of higher sales volume of our microturbine products as discussed above, lower direct material costs primarily related to the C1000 Series, decreases in our royalty expense of $1.5 million, warranty expense of $1.2 million and production and service center labor and overhead expenses of $0.2 million during Fiscal 2014 compared to the prior year.

Royalty expense decreased $1.5 million during Fiscal 2014 compared to Fiscal 2013 as a result of a reduction in the predetermined fixed rate royalty offset by higher volume of covered microturbine systems. We pay a predetermined fixed rate royalty for each microturbine system covered by our Development and License Agreement with Carrier. The fixed rate royalty was reduced by 50% during the three months ended September 30, 2013 as a result of the contractual reduction.

Warranty expense is a combination of a standard warranty provision recorded at the time revenue is recognized and changes, if any, in estimates for reliability repair programs. Reliability repair programs are based upon estimates that are recorded in the period that new information becomes available, including design changes, cost of repair and product enhancements, which can include both in-warranty and out-of-warranty systems. The decrease in warranty expense of $1.2 million reflected a decrease in reliability repair programs, offset by an increase in the per unit standard warranty provision as a result of sales mix and higher volume of units under warranty during Fiscal 2014 compared to the prior year.

Production and service center labor and overhead expense decreased approximately $0.2 million during Fiscal 2014 compared to Fiscal 2013 primarily as the result of a decrease in service center travel expense of approximately $0.4 million, offset by an increase in facilities expense of approximately $0.2 million.

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Research and Development Expenses R&D expenses include compensation, engineering department expenses, overhead allocations for administration and facilities and materials costs associated with development. We had R&D expenses of approximately $9.0 million for each of Fiscal 2014 and Fiscal 2013. R&D expenses are reported net of benefits from cost-sharing programs, such as DOE grants. During Fiscal 2014 supplies expense decreased approximately $0.3 million, offset by a decrease in cost sharing benefits of approximately $0.3 million. There were approximately $1.4 million of cost-sharing benefits for Fiscal 2014 and $1.7 million of such benefits for Fiscal 2013. Cost-sharing programs vary from period to period depending on the phase of the programs.

Selling, General and Administrative ("SG&A") Expenses SG&A expenses for Fiscal 2014 increased $0.6 million, or 2%, to $28.0 million from $27.4 million for Fiscal 2013. The net increase in SG&A expenses was comprised of increases of approximately $0.7 million in salaries expense, $0.2 million in facilities expense $0.2 million in consulting expense and $0.2 million in supplies expense, offset by a decrease of approximately $0.7 million in marketing expense.

Interest Expense Interest expense for each of Fiscal 2014 and Fiscal 2013 was approximately $0.7 million. Interest expense is primarily from the average balances outstanding under the Credit Facility. As of March 31, 2014, we had total debt of $13.2 million outstanding under the Credit Facility.

Change in Fair Value of Warrant Liability Effective September 23, 2013, warrants to purchase approximately 4.0 million shares of common stock that were issued in connection with the September 23, 2008 registered direct placement expired, and the liability associated with the warrants was reversed. The reversal of the warrant liability resulted in a benefit of approximately $10,000 for Fiscal 2014. This reversal of the warrant liability had no impact on our cash balances. The change in fair value of the warrant liability resulted in a benefit of approximately $0.8 million for Fiscal 2013. This change in fair value of warrant liability was a result of warrant exercises and revaluing the warrant liability based on the Monte Carlo simulation valuation model which is based primarily upon the quoted price of the Company's common stock in an active market. This revaluation of the warrant liability had no impact on our cash balances.

Income Tax Provision Income tax expense decreased $0.5 million, or 71%, to $0.2 million during Fiscal 2014 from $0.7 million during Fiscal 2013. Income tax expense incurred was primarily related to foreign taxes of $0.2 million. The effective income tax rate of 1.4% differs from the federal and state blended statutory rate of 35% primarily as a result of recording taxable losses. At March 31, 2014, we had federal and state net operating loss carryforwards of approximately $606.2 million and $226.9 million, respectively, which may be utilized to reduce future taxable income, subject to limitations under Section 382 of the Internal Revenue Code of 1986. We provided a valuation allowance for 100% of our net deferred tax asset of $236.2 million at March 31, 2014 because the realization of the benefits of these favorable tax attributes in future income tax returns is not deemed more likely than not. Similarly, at March 31, 2013, the net deferred tax asset was fully reserved.

Quarterly Results of Operations

The following table presents unaudited quarterly financial information. This information was prepared in accordance with GAAP, and, in the opinion of management, contains all adjustments necessary for a fair presentation of such quarterly information when read in conjunction with the financial statements included elsewhere herein. Our operating results for any prior quarters may not necessarily indicate the results for any future periods.

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(In thousands, except per share data)

	Year Ended March 31, 2015				Year Ended March 31, 2014			
(Unaudited)	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Revenue	$ 29,869	$ 30,084	$ 32,248	$ 23,260	$ 36,438	$ 37,003	$ 35,291	$ 24,373
Cost of goods sold	26,347	23,978	27,005	19,844	30,292	29,668	30,399	21,050
Gross margin	3,522	6,106	5,243	3,416	6,146	7,335	4,892	3,323
Operating expenses:								
R&D	2,942	2,355	2,055	2,327	2,471	2,267	1,956	2,335
SG&A	14,702	7,508	9,543	7,764	6,781	6,991	6,641	7,568
Loss from operations	(14,122)	(3,757)	(6,355)	(6,675)	(3,106)	(1,923)	(3,705)	(6,580)
Net loss	$ (14,298)	$ (3,935)	$ (6,529)	$ (6,771)	$ (3,381)	$ (2,189)	$ (3,888)	$ (6,798)
Net loss per common share basic and diluted	$ (0.05)	$ (0.01)	$ (0.02)	$ (0.02)	$ (0.01)	$ (0.01)	$ (0.01)	$ (0.02)