

ORION ENERGY SYSTEMS, INC.

Form 10-Q

February 09, 2016

Table of Contents

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

FORM 10-Q

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

For the Quarterly Period Ended December 31, 2015

OR

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

Commission file number 001-33887

Orion Energy Systems, Inc.
(Exact name of Registrant as specified in its charter)

Wisconsin	39-1847269
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification number)
2210 Woodland Drive, Manitowoc, Wisconsin	54220
(Address of principal executive offices)	(Zip code)
Registrant's telephone number, including area code: (920) 892-9340	

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 No

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) during the preceding 12 months (or for shorter period that the registrant was required to submit and post such files). Yes No

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 "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer

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

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

There were 27,754,478 shares of the Registrant's common stock outstanding on February 5, 2016.

Table of Contents

Orion Energy Systems, Inc.
 Quarterly Report On Form 10-Q
 For The Quarter Ended December 31, 2015
 Table Of Contents

	Page(s)
<u>PART I FINANCIAL INFORMATION</u>	<u>3</u>
ITEM 1. <u>Financial Statements (unaudited)</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheets as of March 31, 2015 and December 31, 2015</u>	<u>3</u>
<u>Condensed Consolidated Statements of Operations for the Three and Nine Months Ended December 31, 2014 and 2015</u>	<u>4</u>
<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended December 31, 2014 and 2015</u>	<u>5</u>
<u>Notes to the Condensed Consolidated Financial Statements</u>	<u>6</u>
ITEM 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>24</u>
ITEM 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>36</u>
ITEM 4. <u>Controls and Procedures</u>	<u>36</u>
<u>PART II OTHER INFORMATION</u>	<u>37</u>
ITEM 1. <u>Legal Proceedings</u>	<u>37</u>
ITEM 1A. <u>Risk Factors</u>	<u>37</u>
ITEM 2. <u>Unregistered Sale of Equity Securities and Use of Proceeds</u>	<u>37</u>
ITEM 5. <u>Other Information</u>	<u>37</u>
ITEM 6. <u>Exhibits</u>	<u>38</u>
<u>SIGNATURES</u>	<u>39</u>
Exhibit 31.1	
Exhibit 31.2	
Exhibit 32.1	
Exhibit 32.2	
EX-101 INSTANCE DOCUMENT	
EX-101 SCHEMA DOCUMENT	
EX-101 CALCULATION LINKBASE DOCUMENT	
EX-101 LABELS LINKBASE DOCUMENT	
EX-101 PRESENTATION LINKBASE DOCUMENT	

Table of Contents

PART I – FINANCIAL INFORMATION

Item 1: Financial Statements

ORION ENERGY SYSTEMS, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share amounts)

	March 31, 2015	December 31, 2015
Assets		
Cash and cash equivalents	\$20,002	\$17,458
Accounts receivable, net of allowances of \$458 and \$180 at March 31, 2015 and December 31, 2015, respectively	18,263	14,632
Inventories, net	14,283	18,435
Deferred contract costs	90	46
Prepaid expenses and other current assets	2,407	528
Total current assets	55,045	51,099
Property and equipment, net	21,223	19,186
Goodwill	4,409	4,409
Other intangible assets, net	6,335	5,371
Long-term accounts receivable	426	150
Other long-term assets	367	214
Total assets	\$87,805	\$80,429
Liabilities and Shareholders' Equity		
Accounts payable	\$11,003	\$12,020
Accrued expenses and other	5,197	3,471
Deferred revenue, current	287	361
Current maturities of long-term debt and capital leases	1,832	1,164
Total current liabilities	18,319	17,016
Revolving credit facility	2,500	4,973
Long-term debt, less current maturities and capital leases	722	316
Deferred revenue, long-term	1,231	1,042
Other long-term liabilities	522	538
Total liabilities	23,294	23,885
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value: Shares authorized: 200,000,000 at March 31, 2015 and December 31, 2015; shares issued: 36,837,864 and 37,165,416 at March 31, 2015 and December 31, 2015; shares outstanding: 27,421,533 and 27,739,886 at March 31, 2015 and December 31, 2015	—	—
Additional paid-in capital	150,516	151,831
Treasury stock: 9,416,331 and 9,425,530 common shares at March 31, 2015 and December 31, 2015	(36,049)	(36,075)
Shareholder notes receivable	(4)	(4)
Retained deficit	(49,952)	(59,208)
Total shareholders' equity	64,511	56,544
Total liabilities and shareholders' equity	\$87,805	\$80,429

The accompanying notes are an integral part of these condensed consolidated statements.

Table of Contents

ORION ENERGY SYSTEMS, INC. AND SUBSIDIARIES
 UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 (in thousands, except share and per share amounts)

	Three Months Ended December		Nine Months Ended December	
	31,		31,	
	2014	2015	2014	2015
Product revenue	\$23,646	\$16,094	\$48,534	\$46,872
Service revenue	2,492	657	4,309	2,195
Total revenue	26,138	16,751	52,843	49,067
Cost of product revenue	20,293	11,574	53,512	35,988
Cost of service revenue	2,021	468	3,451	1,700
Total cost of revenue	22,314	12,042	56,963	37,688
Gross (loss) profit	3,824	4,709	(4,120)	) 11,379
Operating expenses:				
General and administrative	3,816	3,861	11,328	11,135
Sales and marketing	3,771	2,409	10,016	8,112
Research and development	889	381	1,874	1,244
Total operating expenses	8,476	6,651	23,218	20,491
Loss from operations	(4,652)	) (1,942)	) (27,338)	) (9,112)
Other income (expense):				
Interest expense	(62)	) (71)	) (235)	) (223)
Interest income	69	27	246	107
Total other income (expense)	7	(44)	) 11	(116)
Loss before income tax	(4,645)	) (1,986)	) (27,327)	) (9,228)
Income tax expense	18	18	41	28
Net loss	\$(4,663)	) \$(2,004)	) \$(27,368)	) \$(9,256)
Basic net loss per share attributable to common shareholders	\$(0.21)	) \$(0.07)	) \$(1.26)	) \$(0.34)
Weighted-average common shares outstanding	21,882,741	27,671,633	21,791,184	27,584,288
Diluted net loss per share	\$(0.21)	) \$(0.07)	) \$(1.26)	) \$(0.34)
Weighted-average common shares and share equivalents outstanding	21,882,741	27,671,633	21,791,184	27,584,288

The accompanying notes are an integral part of these condensed consolidated statements.

Table of Contents

ORION ENERGY SYSTEMS, INC. AND SUBSIDIARIES
 UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (in thousands)

	Nine Months Ended December	
	31,	2015
	2014	2015
Operating activities		
Net loss	\$(27,368	) \$(9,256
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	2,154	2,320
Amortization of long-term assets	1,106	1,055
Stock-based compensation expense	1,250	1,166
Impairment on assets	12,130	—
(Gain) loss on sale of property and equipment	(4	) 18
Provision for inventory reserves	224	41
Provision for bad debts	236	245
Other	108	56
Changes in operating assets and liabilities, net of effects of acquisition:		
Accounts receivable, current and long-term	(1,856	) 3,660
Inventories	(2,975	) (4,192
Deferred contract costs	(80	) 44
Prepaid expenses and other assets	(3,645	) 1,951
Accounts payable	8,090	1,017
Accrued expenses and other	721	(1,333
Deferred revenue	(308	) (117
Net cash used in operating activities	(10,217	) (3,325
Investing activities		
Purchase of property and equipment	(1,647	) (302
Purchase of short-term investments	(2) —
Additions to patents and licenses	(61	) (6
Proceeds from sales of property, plant and equipment	1,040	—
Net cash used in investing activities	(670	) (308
Financing activities		
Payment of long-term debt and capital leases	(2,692	) (1,450
Proceeds from long-term debt	446	—
Proceeds from revolving credit facility	—	47,996
Payment of revolving credit facility	—	(45,523
Proceeds from issuance of common stock, net of offering costs	—	(1
Proceeds from repayment of shareholder notes	11	—
Repurchase of common stock into treasury	—	(20
Deferred financing costs	(75) —
Net proceeds from the exercise of warrants and employee stock options	384	87
Net cash (used in) provided by financing activities	(1,926	) 1,089
Net decrease in cash and cash equivalents	(12,813	) (2,544
Cash and cash equivalents at beginning of period	17,568	20,002
Cash and cash equivalents at end of period	\$4,755	\$17,458
Supplemental cash flow information:		
Cash paid for interest	\$147	\$128

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Cash paid for income taxes	\$35	\$20
Supplemental disclosure of non-cash investing and financing activities:		
Vendor financed capital lease addition	\$—	\$377
The accompanying notes are an integral part of these condensed consolidated statements.		

Table of Contents

ORION ENERGY SYSTEMS, INC. AND SUBSIDIARIES

UNAUDITED NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE A — DESCRIPTION OF BUSINESS

Organization

The Company includes Orion Energy Systems, Inc., a Wisconsin corporation, and all consolidated subsidiaries. The Company is a developer, manufacturer and seller of lighting and energy management systems to commercial and industrial businesses, predominantly in North America.

See Note J “Segment Reporting” of these financial statements for further discussion of the Company's reportable segments.

The Company's corporate offices and primary manufacturing operations are located in Manitowoc, Wisconsin. The operations facility in Plymouth, Wisconsin was classified as an asset held for sale as of March 31, 2014 and was sold in May 2014. The Company leases office space in Jacksonville, Florida; Chicago, Illinois; and Houston, Texas.

NOTE B — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The condensed consolidated financial statements include the accounts of Orion Energy Systems, Inc. and its wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

Reclassifications

Where appropriate, certain reclassifications have been made to prior years' financial statements to conform to the current year presentation.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation have been included. Interim results are not necessarily indicative of results that may be expected for the year ending March 31, 2016 or other interim periods.

The condensed consolidated balance sheet at March 31, 2015 has been derived from the audited and adjusted consolidated financial statements at that date but does not include all of the information required by GAAP for complete financial statements.

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2015 filed with the Securities and Exchange Commission on June 12, 2015.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during that reporting period. Areas that require the use of significant management estimates include revenue recognition, inventory obsolescence and bad debt reserves, accruals for warranty expenses, income taxes and certain equity transactions. Accordingly, actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers all highly liquid, short-term investments with original maturities of three months or less to be cash equivalents.

Table of Contents

Fair Value of Financial Instruments

The Company's financial instruments consist of cash, accounts receivable, accounts payable, accrued expenses and other and long-term debt. The carrying amounts of the Company's financial instruments approximate their respective fair values due to the relatively short-term nature of these instruments, or in the case of long-term, because of the interest rates currently available to the Company for similar obligations. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. GAAP describes a fair value hierarchy based on the following three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value:

Level 1 — Valuations are based on unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 — Valuations are based on quoted prices for similar assets or liabilities in active markets, or quoted prices in markets that are not active for which significant inputs are observable, either directly or indirectly.

Level 3 — Valuations are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. Inputs reflect management's best estimate of what market participants would use in valuing the asset or liability at the measurement date.

Accounts Receivable

Substantially all of the Company's accounts receivable are due from companies in the commercial, industrial and agricultural industries, as well as wholesalers. Credit is extended based on an evaluation of a customer's financial condition. Generally, collateral is not required for end users; however, the payment of certain trade accounts receivable from wholesalers is secured by irrevocable standby letters of credit and/or guarantees. Accounts receivable are generally due within 30-60 days. Accounts receivable are stated at the amount the Company expects to collect from outstanding balances. The Company provides for probable uncollectible amounts through a charge to earnings and a credit to an allowance for doubtful accounts based on its assessment of the current status of individual accounts. Balances that are still outstanding after the Company has used reasonable collection efforts are written off through a charge to the allowance for doubtful accounts and a credit to accounts receivable.

Also included in current receivables are amounts due from a third party finance company to which the Company has sold, without recourse, the future cash flows from its Orion Throughput Agreements, or OTAs, entered into with customers. Such receivables are recorded at the present value of the future cash flows discounted between 8.8% and 11%. As of December 31, 2015, the following amounts were due from the third party finance company in future periods (in thousands):

Fiscal 2016	\$247
Fiscal 2017	9
Total gross financed receivable	\$256
Less: amount representing interest	(5)
Total net financed receivable	\$251

Financing Receivables

The Company considers its lease balances included in consolidated current and long-term accounts receivable from OTA sales-type leases to be financing receivables. Additional disclosures on the credit quality of the Company's financing receivables are as follows:

Aging Analysis as of December 31, 2015 (in thousands):

	Not Past Due	1-90 days past due	Greater than 90 days past due	Total past due	Total sales-type leases
Lease balances included in consolidated accounts receivable—current	\$542	\$18	\$2	\$20	\$562
Lease balances included in consolidated accounts receivable—long-term	141	—	—	—	141
Total gross sales-type leases	683	18	2	20	703

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Allowance	—	—	(1) (1) (1)
Total net sales-type leases	\$683	\$18	\$1	\$19	\$702	

7

Table of Contents**Allowance for Credit Losses on Financing Receivables**

The Company's allowance for credit losses is based on management's assessment of the collectability of customer accounts. A considerable amount of judgment is required in order to make this assessment, including a detailed analysis of the aging of the lease receivables and the current credit worthiness of the Company's customers and an analysis of historical bad debts and other adjustments. If there is a deterioration of a major customer's credit worthiness or if actual defaults are higher than historical experience, the estimate of the recoverability of amounts due could be adversely affected. The Company reviews, in detail, the allowance for doubtful accounts on a quarterly basis and adjusts the allowance estimate to reflect actual portfolio performance and any changes in future portfolio performance expectations. The Company believes that there is no impairment of the receivables for the sales-type leases. The Company incurred no write-offs against its OTA sales-type lease receivable balances in fiscal 2015 and \$177 thousand for the three and nine months ended December 31, 2015.

Inventories

Inventories consist of raw materials and components, such as ballasts and drivers, light emitting diode (LED) chips, metal sheet and coil stock and molded parts; work in process inventories, such as frames and reflectors; and finished goods, including completed fixtures and accessories, such as lamps, sensors and power supplies. All inventories are stated at the lower of cost or market value with cost determined using the first-in, first-out (FIFO) method. The Company reduces the carrying value of its inventories for differences between the cost and estimated net realizable value, taking into consideration usage in the preceding 9 to 24 months, expected demand, and other information indicating obsolescence. The Company records as a charge to cost of product revenue the amount required to reduce the carrying value of inventory to net realizable value. As of March 31, 2015 and December 31, 2015, the Company had inventory obsolescence reserves of \$1.6 million and \$1.9 million, respectively.

Costs associated with the procurement and warehousing of inventories, such as inbound freight charges and purchasing and receiving costs, are also included in cost of product revenue.

Inventories were comprised of the following as of the dates set forth below (in thousands):

	March 31, 2015	December 31, 2015
Raw materials and components	\$8,474	\$10,265
Work in process	1,588	1,546
Finished goods	4,221	6,624
	\$14,283	\$18,435

Deferred Contract Costs

Deferred contract costs consist primarily of the costs of products delivered, and services performed, that are subject to additional performance obligations or customer acceptance. These deferred contract costs are expensed at the time the related revenue is recognized. Current deferred costs amounted to \$0.1 million and \$46 thousand as of March 31, 2015 and December 31, 2015, respectively.

Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist primarily of prepaid insurance premiums, prepaid license fees, purchase deposits, advance payments to contractors, unbilled revenue, prepaid taxes and miscellaneous receivables. Prepaid expenses and other current assets included \$1.7 million and \$55 thousand of unbilled revenue as of March 31, 2015 and December 31, 2015, respectively.

Long-Lived Assets

The Company evaluates the recoverability of long-lived assets with finite lives in accordance with Accounting Standards Codification, or ASC, Subtopic 360-10-35 which requires recognition of impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. When events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable based on estimated undiscounted cash flows, the impairment loss would be measured as the difference between the carrying amount of the assets and its fair value based on the present value of estimated future cash flows. The Company's long-lived assets include property, plant and equipment and intangible assets. For the three months ended December

31, 2015, the Company determined that events and circumstances indicated that the assets might be impaired due to the current period operating cash flow and a history of operating cash flow losses. The Company performed a quantitative assessment of these assets for all business units and its

8

Table of Contents

estimated undiscounted cash flows indicated that such carrying amounts were expected to be recovered. However, it is reasonably possible that the estimate of undiscounted cash flows may change in the near term resulting in the need to write down the long-lived assets to fair value.

Property and Equipment

The Company periodically reviews the carrying values of property and equipment for impairment in accordance with ASC 360, Property, Plant and Equipment, if events or changes in circumstances indicate that the assets may be impaired. The estimated future undiscounted cash flows expected to result from the use of the assets and their eventual disposition are compared to the assets' carrying amount to determine if a write down to market value is required.

Property and equipment were comprised of the following as of the dates set forth below (in thousands):

	March 31, 2015	December 31, 2015
Land and land improvements	\$ 1,511	\$ 1,515
Buildings	14,441	14,443
Furniture, fixtures and office equipment	8,600	8,676
Leasehold improvements	148	148
Equipment leased to customers under Power Purchase Agreements	4,997	4,997
Plant equipment	11,084	11,077
Construction in progress	379	118
	41,160	40,974
Less: accumulated depreciation and amortization	(19,937)	(21,788)
Net property and equipment	\$ 21,223	\$ 19,186

Equipment included above under capital leases was as follows (in thousands):

	March 31, 2015	December 31, 2015
Equipment	\$ —	\$ 389
Less: accumulated depreciation and amortization	—	(46)
Net Equipment	\$ —	\$ 343

Depreciation expense related to capital leased equipment was \$20 thousand and \$46 thousand for the three and nine months ended December 31, 2015, respectively.

Depreciation is provided over the estimated useful lives of the respective assets, using the straight-line method.

Depreciable lives by asset category are as follows:

Land improvements	10-15 years
Buildings and building improvements	3-39 years
Furniture, fixtures and office equipment	2-10 years
Leasehold improvements	Shorter of asset life or life of lease
Equipment leased to customers under Power Purchase Agreements	20 years
Plant equipment	3-10 years

Table of Contents

Goodwill and Other Intangible Assets

The costs of specifically identifiable intangible assets that do not have an indefinite life are amortized over their estimated useful lives. Goodwill and intangible assets with indefinite lives are not amortized and are reviewed for impairment annually, as of January 1, or more frequently if impairment indicators arise. During the quarter ended December 31, 2015, the Company determined that a triggering event occurred due to the decline in the Company's share price when compared to the share price as of March 31, 2015 and due to the Company's history of operating losses. The Company performed a qualitative assessment of Goodwill and determined that no impairment had occurred.

Amortizable intangible assets are amortized over their estimated economic useful life to reflect the pattern of economic benefits consumed based upon the following lives and methods:

Patents	10-17 years	Straight-line
Licenses	7-13 years	Straight-line
Customer relationships	5-8 years	Accelerated based upon the pattern of economic benefits consumed
Developed technology	8 years	Accelerated based upon the pattern of economic benefits consumed
Non-competition agreements	5 years	Straight-line

Indefinite lived intangible assets are evaluated for potential impairment whenever events or circumstances indicate that the carrying value may not be recoverable based primarily upon whether expected future undiscounted cash flows are sufficient to support the asset recovery. If the actual useful life of the asset is shorter than the estimated life estimated by us, the asset may be deemed to be impaired and accordingly a write-down of the value of the asset determined by a discounted cash flow analysis or shorter amortization period may be required.

There was no change in the carrying value of goodwill during fiscal 2015 or for the nine months ended December 31, 2015.

Goodwill is allocated to each operating segment during the nine months ended December 31, 2015 as follows (in thousands):

	U.S. Markets	Orion Engineered Systems	Orion Distribution Services	Corporate and Other	Total
Goodwill at December 31, 2015	\$2,371	\$2,038	\$—	\$—	\$4,409

The components of, and changes in, the carrying amount of other intangible assets were as follows as of the dates set forth below (in thousands):

	March 31, 2015		December 31, 2015	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Patents	\$2,447	\$(906)	\$2,456	\$(1,010)
Licenses	58	(58)	58	(58)
Trade name and trademarks	1,958	—	1,956	—
Customer relationships	3,600	(1,620)	3,600	(2,357)
Developed technology	900	(109)	900	(224)
Non-competition agreements	100	(35)	100	(50)
Total	\$9,063	\$(2,728)	\$9,070	\$(3,699)

As of December 31, 2015, the weighted average useful life of intangible assets was 6.35 years. The estimated amortization expense for each of the next five years is shown below (in thousands):

Table of Contents

Fiscal 2016	\$257
Fiscal 2017	883
Fiscal 2018	608
Fiscal 2019	432
Fiscal 2020	346
Fiscal 2021	271
Thereafter	618
Total	\$3,415

Long-Term Receivables

The Company records a long-term receivable for the non-current portion of its sales-type capital lease OTA contracts. The receivable is recorded at the net present value of the future cash flows from scheduled customer payments. The Company uses the implied cost of capital from each individual contract as the discount rate.

Other Long-Term Assets

Other long-term assets include long-term security deposits, deferred costs for a long-term contract and deferred financing costs. Deferred financing costs as of March 31, 2015 and December 31, 2015 were \$202 thousand and \$120 thousand, respectively. Deferred financing costs related to debt issuances are amortized to interest expense over the life of the related debt issue (1 to 3 years) using the effective interest rate method.

Accrued Expenses and Other

Accrued expenses include warranty accruals, accrued wages and benefits, accrued vacation, accrued legal costs, accrued commissions, customer deposits, accrued project costs, sales tax payable and other various unpaid expenses.

Accrued expenses include \$1.3 million and \$0.2 million of accrued project costs as of March 31, 2015 and December 31, 2015, respectively.

The Company generally offers a limited warranty of one year on its high intensity fluorescent (HIF) lighting products and a one-to ten-year limited warranty on its LED lighting products in addition to those standard warranties offered by major original equipment component manufacturers. The manufacturers' warranties cover lamps, ballasts, drivers and LED chips, which are significant components in the Company's lighting products. Included in other long-term liabilities is \$0.3 million for warranty reserves related to solar operating systems. These warranties vary in length, with the longest coverage extended until 2030. Due to the limited warranty data available for solar operating systems of this nature, actual warranty claims may differ from the Company's estimate of these warranties.

Changes in the Company's warranty accrual were as follows (in thousands):

	Three Months Ended December		Nine Months Ended December	
	31,		31,	
	2014	2015	2014	2015
Beginning of period	\$466	\$1,043	\$263	\$1,015
Provision to product cost of revenue	685	(1	) 718	88
Charges	(35	) (104	) 135	(165
End of period	\$1,116	\$938	\$1,116	\$938

Revenue Recognition

Revenue is recognized on the sales of our lighting and related energy efficiency systems and products when the following four criteria are met:

- persuasive evidence of an arrangement exists;
- delivery has occurred and title has passed to the customer;
- the sales price is fixed and determinable and no further obligation exists; and
- collectability is reasonably assured.

Table of Contents

These four criteria are met for the Company's product-only revenue upon delivery of the product and title passing to the customer. At that time, the Company provides for estimated costs that may be incurred for product warranties and sales returns. Revenues are presented net of sales tax and other sales related taxes.

For sales of the Company's lighting and energy management technologies, consisting of multiple elements of revenue, such as a combination of product sales and services, the Company determines revenue by allocating the total contract revenue to each element based on their relative selling prices in accordance with ASC 605-25, Revenue Recognition - Multiple Element Arrangements. In such circumstances, the Company uses a hierarchy to determine the selling price to be used for allocating revenue to deliverables: (1) vendor-specific objective evidence (VSOE) of fair value, if available, (2) third-party evidence (TPE) of selling price if VSOE is not available, and (3) best estimate of the selling price if neither VSOE nor TPE is available (a description as to how the Company determined estimated selling price is provided below).

The nature of the Company's multiple element arrangements for the sale of its lighting and energy management technologies is similar to a construction project, with materials being delivered and contracting and project management activities occurring according to an installation schedule. The significant deliverables include the shipment of products and related transfer of title and the installation.

To determine the selling price in multiple-element arrangements, the Company establishes the selling price for its lighting and energy management system products using management's best estimate of the selling price, as VSOE or TPE does not exist. Product revenue is recognized when products are shipped. For product revenue, management's best estimate of selling price is determined using a cost plus gross profit margin method. In addition, the Company records in service revenue the selling price for its installation and recycling services using management's best estimate of selling price, as VSOE or TPE does not exist. Service revenue is recognized when services are completed and customer acceptance has been received. Recycling services provided in connection with installation entail the disposal of the customer's legacy lighting fixtures. The Company's service revenues, other than for installation and recycling that are completed prior to delivery of the product, are included in product revenue using management's best estimate of selling price, as VSOE or TPE does not exist. These services include comprehensive site assessment, site field verification, utility incentive and government subsidy management, engineering design, and project management. For these services, along with the Company's installation and recycling services, under a multiple-element arrangement, management's best estimate of selling price is determined by considering several external and internal factors including, but not limited to, economic conditions and trends, customer demand, pricing practices, margin objectives, competition, geographies in which the Company offers its products and services and internal costs. The determination of estimated selling price is made through consultation with and approval by management, taking into account all of the preceding factors.

For sales of solar photovoltaic systems, which are governed by customer contracts that require the Company to deliver functioning solar power systems and are generally completed within three to 15 months from the start of construction, the Company recognizes revenue from fixed price construction contracts using the percentage-of-completion method in accordance with ASC 605-35, Construction-Type and Production-Type Contracts. Under this method, revenue arising from fixed price construction contracts is recognized as work is performed based upon the percentage of incurred costs to estimated total forecasted costs. The Company has determined that the appropriate method of measuring progress on these sales is measured by the percentage of costs incurred to date of the total estimated costs for each contract as materials are installed. The percentage-of-completion method requires revenue recognition from the delivery of products to be deferred and the cost of such products to be capitalized as a deferred cost and asset on the balance sheet. The Company performs periodic evaluations of the progress of the installation of the solar photovoltaic systems using actual costs incurred over total estimated costs to complete a project. Provisions for estimated losses on uncompleted contracts, if any, are recognized in the period in which the loss first becomes probable and reasonably estimable.

The Company offers a financing program, called an OTA, for a customer's lease of the Company's energy management systems. The OTA is structured as a sales-type lease and upon successful installation of the system and customer acknowledgment that the system is operating as specified, revenue is recognized at the Company's net investment in

the lease, which typically is the net present value of the future cash flows.

The Company offered a financing program, called a power purchase agreement, or PPA, for the Company's renewable energy product offerings. A PPA is a supply side agreement for the generation of electricity and subsequent sale to the end user. Upon the customer's acknowledgment that the system is operating as specified, product revenue is recognized on a monthly basis over the life of the PPA contract, which is typically in excess of 10 years.

Deferred revenue relates to advance customer billings, investment tax grants received related to PPAs and a separate obligation to provide maintenance on OTAs and is classified as a liability on the Consolidated Balance Sheet. The fair value of the maintenance is readily determinable based upon pricing from third-party vendors. Deferred revenue related to maintenance

Table of Contents

services is recognized when the services are delivered, which occurs in excess of a year after the original OTA contract is executed.

Income Taxes

The Company recognizes deferred tax assets and liabilities for the future tax consequences of temporary differences between financial reporting and income tax basis of assets and liabilities, measured using the enacted tax rates and laws expected to be in effect when the temporary differences reverse. Deferred income taxes also arise from the future tax benefits of operating loss and tax credit carryforwards. A valuation allowance is established when management determines that it is more likely than not that all or a portion of a deferred tax asset will not be realized. As of December 31, 2015, the Company had a valuation allowance of \$23.2 million against its deferred tax assets. ASC 740, Income Taxes, also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination. The Company has classified the amounts recorded for uncertain tax benefits in the balance sheet as other liabilities (non-current) to the extent that payment is not anticipated within one year. The Company recognizes penalties and interest related to uncertain tax liabilities in income tax expense. Penalties and interest are immaterial and are included in the unrecognized tax benefits.

Deferred tax benefits have not been recognized for income tax effects resulting from the exercise of non-qualified stock options. These benefits will be recognized in the period in which the benefits are realized as a reduction in taxes payable and an increase in additional paid-in capital. For the three and nine months ended December 31, 2014 and 2015, there were no realized tax benefits from the exercise of stock options.

Stock Based Compensation

The Company accounts for stock-based compensation in accordance with ASC 718, Compensation - Stock Compensation. Under the fair value recognition provisions of ASC 718, stock-based compensation is measured at the grant date based on the fair value of the award and is recognized as expense ratably over the requisite service period, net of estimated forfeitures. As more fully described in Note I, the Company awards restricted stock to employees, executive officers and directors. The Company did not issue any stock options during fiscal 2015 or for the nine months ended December 31, 2015.

Net Loss per Common Share

Basic net loss per common share is computed by dividing net loss attributable to common shareholders by the weighted-average number of common shares outstanding for the period and does not consider common stock equivalents.

Table of Contents

Diluted net loss per common share reflects the dilution that would occur if stock options were exercised and restricted shares vested. In the computation of diluted net loss per common share, the Company uses the "treasury stock" method for outstanding options and restricted shares. The effect of net loss per common share is calculated based upon the following shares (in thousands except share amounts):

	Three Months Ended December 31, 2014		Nine Months Ended December 31, 2015	
Numerator:				
Net loss (in thousands)	\$ (4,663	) \$ (2,004	) \$ (27,368	) \$ (9,256
Denominator:				
Weighted-average common shares outstanding	21,882,741	27,671,633	21,791,184	27,584,288
Weighted-average effect of assumed conversion of stock options and restricted shares	—	—	—	—
Weighted-average common shares and common share equivalents outstanding	21,882,741	27,671,633	21,791,184	27,584,288
Net loss per common share:				
Basic	\$ (0.21	) \$ (0.07	) \$ (1.26	) \$ (0.34
Diluted	\$ (0.21	) \$ (0.07	) \$ (1.26	) \$ (0.34

The following table indicates the number of potentially dilutive securities outstanding as of the end of each period:

	December 31, 2014	December 31, 2015
Common stock options	2,529,484	2,178,826
Restricted shares	718,684	1,005,539
Total	3,248,168	3,184,365

Concentration of Credit Risk and Other Risks and Uncertainties

The Company purchases components necessary for its lighting products, including ballasts, lamps and LED components, from multiple suppliers. For the three and nine months ended December 31, 2014, one supplier accounted for 16% and 9% of total cost of revenue, respectively. For the three months ended December 31, 2015, two suppliers accounted for 18.1% and 12.6% of total cost of revenue. For the nine months ended December 31, 2015, no supplier accounted for more than 10% of total cost of revenue.

For the three and nine months ended December 31, 2014, one customer accounted for 21% and 12% of revenue, respectively. For the three and nine months ended December 31, 2015, no customer accounted for more than 10% of revenue.

As of March 31, 2015 and December 31, 2015, no customer accounted for more than 10% of accounts receivable.

Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09"). This ASU is a comprehensive new revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. Companies may use either a full retrospective or modified retrospective approach to adopt this ASU and management is currently evaluating which transition approach to use. In August 2015, the FASB issued ASU 2015-14, "Deferral of the Effective date", which defers the required adoption date of ASU 2014-09 by one year. As a result of the deferred effective date, ASU 2014-09 will be effective for annual reporting periods beginning after December 15, 2018, and early adoption is permitted for annual reporting periods beginning after December 15, 2017. The Company is currently evaluating the impact of ASU 2014-09.

In June 2014, the FASB issued Accounting Standards Update No. 2014-12, "Compensation - Stock Compensation" ("ASU 2014-12"). ASU 2014-12 is intended to resolve diverse accounting treatment for share based awards in which

the terms of the award provide that a performance target that affects vesting could be achieved after the requisite service period. The standard is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015 and may be applied prospectively or retrospectively. The Company does not expect adoption of this standard will have a significant impact on the Company's consolidated financial statements.

Table of Contents

In August 2014, the FASB issued Accounting Standards Update No. 2014-15, "Presentation of Financial Statements - Going Concern" ("ASU 2014-15"). ASU 2014-15 requires an entity's management to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern and if those conditions exist, the required disclosures. The standard is effective for annual periods ending after December 15, 2016, and interim periods therein. The Company does not expect adoption of this standard will have a significant impact on the Company's consolidated financial statements.

In April 2015, the FASB issued Accounting Standards Update No. 2015-03, "Interest - Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs" ("ASU 2015-03"). ASU 2015-03 requires that debt issuance costs be reported in the balance sheet as a direct deduction from the face amount of the related liability, consistent with the presentation of debt discounts. Prior to the amendments, debt issuance costs were presented as a deferred charge on the balance sheet. The standard is effective for annual periods beginning after December 15, 2015 and interim periods within those fiscal years. The amendments must be applied retrospectively. The Company is currently evaluating the impact of ASU 2015-03.

In July 2015, the FASB issued Accounting Standards Update No. 2015-11, "Simplifying the Measurement of Inventory" ("ASU 2015-11"). ASU 2015-11 was issued to more closely align the measurement of inventory in U.S. GAAP with the measurement of inventory in International Financial Reporting Standards. The core principle of this updated guidance is that an entity should measure inventory at the lower of cost or net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The amendments in ASU 2015-11 apply to inventory that is measured using the first-in, first-out or average cost methods. ASU 2015-11 is effective for annual and interim reporting periods ending after December 15, 2016, including interim periods within those fiscal years and should be applied prospectively. Early adoption is permitted as of the beginning of an interim or annual reporting period. The Company does not expect adoption of this standard will have a significant impact on the Company's consolidated financial statements.

In November 2015, the FASB issued Accounting Standards Update No. 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes ("ASU 2015-17"), which requires management to classify all deferred tax liabilities and assets by jurisdiction as non-current on the balance sheet instead of separating deferred taxes into current and non-current amounts. The standard is effective for the Company beginning in fiscal 2018 and can be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. Early adoption is permitted as of the beginning of any interim or annual reporting period. The adoption of ASU 2015-17 is not expected to have a material impact on the Company's financial condition or financial statement disclosures.

NOTE C — ACQUISITION

On July 1, 2013, the Company completed the acquisition of Harris Manufacturing, Inc. and Harris LED, LLC (collectively, "Harris"). Harris was a Florida-based lighting company which engineered, designed, sourced and manufactured energy efficient lighting systems, including fluorescent and LED lighting solutions, and day-lighting products.

The acquisition of Harris expanded the Company's product lines, including a patent pending LED lighting product designed for commercial office buildings, increased its sales force and provided growth opportunities into markets where the Company had previously not had a strong presence, specifically, new construction, retail store fronts, commercial office and government.

The acquisition was consummated pursuant to a Stock and Unit Purchase Agreement, dated as of May 22, 2013 ("Purchase Agreement"), by and among Harris, the shareholders and members of Harris ("Harris Shareholders"), and the Company. The acquisition consideration paid to the Harris Shareholders was valued under the Purchase Agreement at an aggregate of \$10.0 million, plus an adjustment of approximately \$0.2 million to reflect the Company's acquisition of net working capital in excess of a targeted amount, plus an additional \$0.6 million for the contingent consideration earn-out value assigned to non-employee Harris shareholders. The aggregate acquisition

consideration was paid through a combination of \$5.0 million in cash, \$3.1 million in a three-year unsecured subordinated promissory note and the issuance of 856,997 shares of unregistered Company common stock. For purposes of the acquisition and the acquisition consideration, the shares of common stock issued in the acquisition of Harris were valued at \$2.33 per share, which was the average closing share price as reported on the NYSE MKT for the 45 trading days preceding and the 22 trading days following the execution of the Purchase Agreement. For purposes of applying the purchase accounting provisions of ASC 805, Business Combinations, the shares of common stock issued in the acquisition were valued at \$2.41 per share, which was the closing sale price of the Company's common stock as reported on the NYSE MKT on the July 1, 2013, date of acquisition.

Table of Contents

On October 21, 2013, the Company executed a letter agreement amending the Purchase Agreement. The letter agreement established a fixed future consideration of \$1.4 million for the previously existing earn-out component of the Purchase Agreement and eliminated the requirement that certain revenue targets must be achieved. Under the letter agreement, on January 2, 2014, the Company issued \$0.6 million, or 83,943 shares, of the Company's unregistered common stock. The fixed consideration was determined based upon the existing share calculation at a fair value of \$3.80 per common share. In December 2014, the Company amended the letter agreement to defer the January 2, 2015 payment of \$0.8 million in cash until February 13, 2015, to settle all outstanding obligations related to the earn-out component of the Purchase Agreement.

Prior to the amendment discussed above, the contingent consideration arrangement required the Company to pay the Harris Shareholders up to \$1.0 million in unregistered shares of the Company's common stock upon Harris' achievement of certain revenue milestones in calendar year 2013 and/or 2014, and, in the case of certain Harris Shareholders who became employees of the Company, their continued employment by the Company. The potential undiscounted amount of all future payments that the Company could have been required to make under the contingent consideration arrangement was between \$0 and \$1.0 million. The Company recorded \$0.6 million for the non-employee Harris Shareholder portion of the contingent consideration liability on the acquisition date. Total contingent consideration of \$0.5 million for employee Harris Shareholders was recorded as compensation expense through the end of calendar 2014. During the three and nine months ended December 31, 2014, the Company expensed \$49 thousand and \$0.1 million in compensation expense, respectively.

On December 31, 2014, Harris was merged with and into the Company.

NOTE D — RELATED PARTY TRANSACTIONS

During the three months ended December 31, 2014 and 2015, the Company purchased goods and services in the amount of \$10 thousand and \$9 thousand, respectively, from an entity for which a director of the Company serves as a minority owner and President. During the nine months ended December 31, 2014 and 2015, the Company purchased goods and services in the amount of \$26 thousand and \$15 thousand, respectively, from an entity for which a director of the Company serves as a minority owner and President.

NOTE E — LONG-TERM DEBT

Long-term debt as of March 31, 2015 and December 31, 2015 consisted of the following (in thousands):

	March 31, 2015	December 31, 2015
Revolving credit facility	2,500	4,973
Harris seller's note	1,607	816
Customer equipment finance notes payable	827	235
Equipment lease obligations	—	350
Other long-term debt	120	79
Total long-term debt	5,054	6,453
Less current maturities	(1,832	) (1,164
Long-term debt, less current maturities	\$3,222	\$5,289
Revolving Credit Agreement		

The Company has a revolving credit and security agreement (Credit Agreement) with Wells Fargo Bank, National Association. The Credit Agreement provides for a revolving credit facility (Credit Facility) that matures on February 6, 2018. Borrowings under the Credit Facility are initially limited to the lesser of (i) \$15.0 million or (ii) a borrowing base requirement based on eligible receivables and inventory, and currently less approximately \$10.3 million of reserves. Such limit may increase to \$20.0 million, subject to the borrowing base requirement, after July 31, 2016, if the Company satisfies certain conditions. The Credit Facility includes a \$2.0 million sublimit for the issuance of letters of credit.

From and after any increase in the Credit Facility limit from \$15.0 million to \$20.0 million, the Credit Agreement will require the Company to maintain as of the end of each month a minimum ratio for the trailing twelve-month period of (i) earnings before interest, taxes, depreciation and amortization, subject to certain adjustments, to (ii) the sum of cash

interest expense, certain principal payments on indebtedness and certain dividends, distributions and stock redemptions, equal to at least 1.10 to 1.00. The Credit Agreement also contains other customary covenants, including certain restrictions on the Company's ability to incur additional indebtedness, consolidate or merge, enter into acquisitions, guarantee obligations of third

Table of Contents

parties, make loans or advances, declare or pay any dividend or distribution on the Company's stock, redeem or repurchase shares of the Company's stock, or pledge or dispose of assets.

Each subsidiary of the Company is a joint and several co-borrower or guarantor under the Credit Agreement, and the Credit Agreement is secured by a security interest in substantially all of the Company's and each subsidiary's personal property (excluding various assets relating to customer OTAs) and a mortgage on certain real property.

Borrowings under the Credit Agreement bear interest at the daily three-month LIBOR plus 3.0% per annum, with a minimum interest charge for each year or portion of a year during the term of the Credit Agreement of \$130,000, regardless of usage. As of December 31, 2015, the interest rate was 3.60%. The Company must pay an unused line fee of 0.25% per annum of the daily average unused amount of the Credit Facility and a letter of credit fee at the rate of 3.0% per annum on the undrawn amount of letters of credit outstanding from time to time under the Credit Facility.

As of December 31, 2015, the Company had no outstanding letters of credit. Borrowings outstanding as of December 31, 2015, amounted to approximately \$5.0 million and are included in non-current liabilities in the accompanying Consolidated Balance Sheet. The Company estimates that as of December 31, 2015, it was eligible to borrow an additional \$0.3 million under the Credit Facility based upon current levels of eligible inventory and accounts receivable.

Equipment Lease Obligation

In June 2015, the Company entered into a lease agreement with De Lage Landen Financial Services, Inc in the principal amount of \$0.4 million to fund certain equipment. The lease amount is secured by the related equipment. The lease bears interest at a rate of 5.94% and matures in June 2020 with a \$1 buyout option.

NOTE F — INCOME TAXES

The income tax provision for the nine months ended December 31, 2015 was determined by applying an estimated annual effective tax rate of (0.3)% to loss before taxes. The estimated effective income tax rate was determined by applying statutory tax rates to pretax loss adjusted for certain permanent book to tax differences and tax credits. As of December 31, 2015, the Company had recorded a valuation allowance of \$23.2 million, equaling the net deferred tax asset due to the uncertainty of its realization value in the future. ASC 740, Income Taxes, requires that a deferred tax asset be reduced by a valuation allowance if there is less than a 50% chance that it will be realized. The determination of the realization of deferred tax assets requires considerable judgment. ASC 740 prescribes the consideration of both positive and negative evidence in evaluating the need for a valuation allowance. Negative evidence for the Company includes a four year operating loss and limited visibility into future earnings. Positive evidence includes the Company's recent new national account customer wins and the increase in revenue from new LED products. The Company has determined that the negative evidence outweighs the current positive evidence and has concluded to record a valuation allowance.

Below is a reconciliation of the statutory federal income tax rate and the effective income tax rate:

	Nine Months Ended December 31,			
	2014		2015	
Statutory federal tax rate	34.0	%	34.0	%
State taxes, net	3.0	%	3.5	%
Federal tax credit	0.3	%	0.8	%
State tax credit	0.1	%	0.3	%
Change in valuation reserve	(37.3	)%	(38.4)%
Permanent items	(0.1	)%	(0.3)%
Change in tax contingency reserve	—	%	(0.2)%
Other, net	(0.2)%	—	%
Effective income tax rate	(0.2	)%	(0.3)%

Table of Contents

The Company is eligible for tax benefits associated with the excess of the tax deduction available for exercises of non-qualified stock options, or NQSOs, over the amount recorded at grant. The amount of the benefit is based on the ultimate deduction reflected in the applicable income tax return. No benefits were recorded in fiscal 2015. No benefits were recorded for the nine months ended December 31, 2015 as a reduction in taxes payable and a credit to additional paid in capital based on the amount that was utilized during the year.

As of December 31, 2015, the Company had federal net operating loss carryforwards of approximately \$50.6 million, of which \$3.6 million are associated with the exercise of NQSOs that have not yet been recognized by the Company. The Company also has state net operating loss carryforwards of approximately \$36.9 million, of which \$4.3 million are associated with the exercise of NQSOs. The Company also has federal tax credit carryforwards of approximately \$1.5 million and state tax credits of \$0.5 million. As of December 31, 2015, the Company has recorded a valuation allowance of \$23.2 million due to the uncertainty of its realization value in the future. The Company considers future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance. In the event that the Company determines that the deferred tax assets are able to be realized, an adjustment to the deferred tax asset would increase income in the period such determination is made.

Uncertain Tax Positions

As of December 31, 2015, the balance of gross unrecognized tax benefits was approximately \$0.2 million, all of which would reduce the Company's effective tax rate if recognized. The Company does not expect this amount to change during fiscal 2016 as none of the issues are currently under examination, the statutes of limitations do not expire within the period, and the Company is not aware of any pending litigation. Due to the existence of net operating loss and credit carryforwards, all years since 2002 are open to examination by tax authorities.

The Company has classified the amounts recorded for uncertain tax benefits in the balance sheet as other liabilities (non-current) to the extent that payment is not anticipated within one year. The Company recognizes penalties and interest related to uncertain tax liabilities in income tax expense. Penalties and interest are immaterial and are included in the unrecognized tax benefits. For the nine months ended December 31, 2014 and 2015, the Company had the following unrecognized tax benefit activity (in thousands):

	Nine Months Ended December 31,	
	2014	2015
Unrecognized tax benefits as of beginning of period	\$210	\$212
Additions based on tax positions related to the current period positions	2	16
Unrecognized tax benefits as of end of period	\$212	\$228

NOTE G — COMMITMENTS AND CONTINGENCIES**Operating Leases and Purchase Commitments**

The Company leases vehicles, equipment and facility space under operating leases expiring at various dates through 2018. Rent expense under operating leases was \$0.1 million for the three months ended December 31, 2014 and 2015; and \$0.3 million and \$0.4 million for the nine months ended December 31, 2014 and 2015, respectively. The Company enters into non-cancellable purchase commitments for certain inventory items in order to secure better pricing and ensure materials are on hand to meet anticipated order volume and customer expectations, as well as for capital expenditures. As of December 31, 2015, the Company had entered into \$5.3 million of purchase commitments for the next twelve months, including \$0.3 million for operating lease commitments and \$5.0 million for inventory purchase commitments.

Litigation

The Company is subject to various claims and legal proceedings arising in the ordinary course of business. As of the date hereof, the Company is unable to currently assess whether the final resolution of any of such claims or legal proceedings may have a material adverse effect on the Company. In addition to ordinary-course litigation, the Company is a party to the proceedings described below.

On March 27, 2014, the Company was named as a defendant in a civil lawsuit filed by Neal R. Verfuert, the Company's former chief executive officer who was terminated for cause in November 2012, in the United States District Court for the Eastern District of Wisconsin (Green Bay Division). The plaintiff alleges, among other things,

that the Company breached certain agreements entered into with the plaintiff, including the plaintiff's employment agreement, and violated certain laws. The complaint seeks, among other relief, unspecified pecuniary and compensatory damages, fees and such other relief as the court may deem just and proper. On November 4, 2014, the court granted the Company's motion to dismiss six of the plaintiff's claims. On January 9, 2015, the plaintiff filed an amended complaint re-alleging claims that were dismissed by the court,

Table of Contents

including, among other things, a retaliation claim and certain claims with respect to prior management agreements and certain intellectual property rights. On January 22, 2015, the Company filed a motion to dismiss and a motion to strike certain of the claims made in the amended complaint. On May 18, 2015, the court dismissed the intellectual property claims re-alleged in the January 9, 2015 amended complaint. The Company believes that it has substantial legal and factual defenses to the claims and allegations remaining in the case and that the Company will prevail in this proceeding. The Company intends to continue to defend against the claims vigorously. Based upon the current status of the lawsuit, the Company is currently unable to estimate any potential adverse impact on the Company from the plaintiff's claims and the Company does not believe the lawsuit will have a material adverse impact on its future continuing results of operations.

On May 29, 2014, the Equal Employment Opportunity Commission (EEOC) filed a claim against the Company alleging certain violations of the Americans with Disabilities Act (ADA) with regard to an employee. On August 3, 2015, the Company reached a settlement related to the allegations, which was entirely funded by the Company's insurance carrier. In addition, on August 20, 2014, the EEOC filed a claim against the Company alleging certain violations of the ADA with respect to the Company's wellness program. Based upon the current status of the lawsuit, the Company is currently unable to estimate any potential adverse impact on the Company from the plaintiff's claims and the Company does not believe the lawsuit will have a material adverse impact on its future continuing results of operations.

On December 10, 2015, a former employee filed a charge of discrimination against the Company alleging: (i) hostile work environment based on sexual harassment; (ii) sex discrimination during employment; and (iii) retaliation, and sex and age discrimination in terminating her employment. The former employee's complaint has been referred to the regional EEOC office. The Company believes that it has substantial legal and factual defenses to the claims and allegations and the Company intends to defend against the claims vigorously. Based upon the current status of the lawsuit, the Company is currently unable to estimate any potential adverse impact on the Company from the plaintiff's claims and the Company does not believe the lawsuit will have a material adverse impact on its future continuing results of operations.

State Tax Assessment

The Company is currently negotiating a settlement with the Wisconsin Department of Revenue with respect to an assessment regarding the proper classification of the Company's products for tax purposes under Wisconsin law. The issue under review is whether the installation of the Company's lighting systems is considered a real property construction activity under Wisconsin law. The Company currently expects to resolve this matter with the Wisconsin Department of Revenue in fiscal 2016 for an amount not in excess of the amount it has accrued.

NOTE H — SHAREHOLDERS' EQUITY

Common Stock Transactions

On February 20, 2015, the Company completed an underwritten public offering of 5.46 million shares of its common stock, at an offering price to the public of \$3.50 per share. Net proceeds of the offering approximated \$17.5 million.

Shareholder Rights Plan

On January 7, 2009, the Company's Board of Directors adopted a shareholder rights plan and declared a dividend distribution of one common share purchase right (Right) for each outstanding share of the Company's common stock. The issuance date for the distribution of the Rights was February 15, 2009 to shareholders of record on February 1, 2009. Each Right entitles the registered holder to purchase from the Company one share of the Company's common stock at a price of \$30.00 per share, subject to adjustment (Purchase Price).

The Rights will not be exercisable (and will be transferable only with the Company's common stock) until a "Distribution Date" occurs (or the Rights are earlier redeemed or expire). A Distribution Date generally will occur on the earlier of a public announcement that a person or group of affiliated or associated persons (Acquiring Person) has acquired beneficial ownership of 20% or more of the Company's outstanding common stock (Shares Acquisition Date) or 10 business days after the commencement of, or the announcement of an intention to make, a tender offer or exchange offer that would result in any such person or group of persons acquiring such beneficial ownership.

If a person becomes an Acquiring Person, holders of Rights (except as otherwise provided in the shareholder rights plan) will have the right to receive that number of shares of the Company's common stock having a market value of two times the then-current Purchase Price, and all Rights beneficially owned by an Acquiring Person, or by certain related parties or transferees, will be null and void. If, after a Shares Acquisition Date, the Company is acquired in a merger or other business combination transaction or 50% or more of its consolidated assets or earning power are sold, proper provision will be made so that each holder of a Right (except as otherwise provided in the shareholder rights plan) will thereafter have the right to receive that number of shares of the acquiring company's common stock which at the time of such transaction will have a market value of two times the then-current Purchase Price.

Table of Contents

Until a Right is exercised, the holder thereof, as such, will have no rights as a shareholder of the Company. At any time prior to a person becoming an Acquiring Person, the Board of Directors of the Company may redeem the Rights in whole, but not in part, at a price of \$0.001 per Right. Unless they are extended or earlier redeemed or exchanged, the Rights will expire on January 7, 2019.

Employee Stock Purchase Plan

In August 2010, the Company's Board of Directors approved a non-compensatory employee stock purchase plan, or ESPP. The ESPP authorizes 2.5 million shares to be issued from treasury or authorized shares to satisfy employee share purchases under the ESPP. All full-time employees of the Company are eligible to be granted a non-transferable purchase right each calendar quarter to purchase directly from the Company up to \$20 thousand of the Company's common stock at a purchase price equal to 100% of the closing sale price of the Company's common stock on The NASDAQ Capital Market exchange on the last trading day of each quarter. The ESPP allows for employee loans from the Company, except for Section 16 officers, limited to 20% of an individual's annual income and no more than \$0.25 million outstanding at any one time. Interest on the loans is charged at the 10-year loan IRS rate and is payable at the end of each calendar year or upon loan maturity. The loans are secured by a pledge of any and all the Company's shares purchased by the participant under the ESPP and the Company has full recourse against the employee, including offset against compensation payable. As of March 31, 2013, the Company had halted issuing new loans under the program. The Company had the following shares issued from treasury as of March 31, 2015 and for the three and nine months ended December 31, 2015:

	Shares Issued Under ESPP Plan	Closing Market Price	Shares Issued Under Loan Program	Dollar Value of Loans Issued	Repayment of Loans
Cumulative through March 31, 2015	154,269	\$1.66 - 7.25	128,143	\$361,550	\$357,550
Quarter Ended June 30, 2015	541	\$2.51	—	—	—
Quarter Ended September 30, 2015	779	\$1.80	—	—	—
Quarter Ended December 31, 2015	1,170	\$2.17	—	—	—
Total as of December 31, 2015	156,759	\$1.66 - 7.25	128,143	\$361,550	\$357,550

Loans issued to employees are reflected on the Company's balance sheet as a contra-equity account.

NOTE I — STOCK OPTIONS AND RESTRICTED SHARES

The Company has historically granted stock options and restricted stock awards under its 2003 Stock Option and 2004 Stock and Incentive Awards Plans (Plans). Under the terms of the Plans, the Company has reserved 13.5 million shares for issuance to key employees, consultants and directors. The options generally vest and become exercisable ratably between one month and five years although longer and shorter vesting periods have been used in certain circumstances. Exercisability of the options granted to employees are generally contingent on the employees' continued employment and non-vested options are subject to forfeiture if employment terminates for any reason. Options under the Plans are granted as non-qualified stock options (NQSO) and have a maximum life of 10 years. Certain non-employee directors have elected to receive stock awards in lieu of cash compensation pursuant to elections made under the Company's non-employee director compensation program. The Plans also provide to certain employees accelerated vesting in the event of certain changes of control of the Company as well as under other special circumstances.

In May 2013, the Compensation Committee of the Board of Directors changed the Company's long-term equity incentive grant policy so that only restricted shares are issued to all employees under the Plans instead of stock options. The restricted shares are settled in Company stock when the restriction period ends. Compensation cost for restricted shares granted to employees is recognized ratably over the vesting term, which is typically between three to five years, although on occasion, the vesting term may be one year or less. Settlement of the shares is contingent on the employees' continued employment and non-vested shares are subject to forfeiture if employment terminates for any reason. For the three months ended December 31, 2014, an aggregate of 22 thousand restricted shares were granted valued at a price per share of between \$4.79 and \$5.16, which was the closing market price as of each grant date. For

the nine months ended December 31, 2014, an aggregate of 393 thousand restricted shares were granted valued at a price per share of between \$4.20 and \$7.23, which was the closing market price as of each grant date. For the three months ended December 31, 2015, an aggregate of 154 thousand restricted shares were granted valued at a price per share of between \$1.76 and \$2.04, which was the closing market price as of each grant date. For the nine months ended December 31, 2015, an aggregate of 724 thousand restricted shares were granted valued at a price per share of between \$1.76 and \$2.62, which was the closing market price as of each grant date.

Table of Contents

For the three and nine months ended December 31, 2014, the Company issued 8 thousand and 22 thousand shares under the Plans to certain non-employee directors who elected to receive stock awards in lieu of cash compensation. The shares were valued at \$4.20 per share to \$5.23 per share, the closing market price as of the issuance dates. For the three and nine months ended December 31, 2015, the Company issued 11 thousand and 27 thousand shares under the Plans to certain non-employee directors who elected to receive stock awards in lieu of cash compensation. The shares were valued at \$1.76 per share to \$2.62 per share, the closing market price as of the issuance dates. Additionally, during the three and nine months ended December 31, 2015, the Company issued 2,500 shares to a consultant as part of a consulting compensation agreement. The shares were valued at \$2.00 per share, the closing market price as of the issuance date.

The following amounts of stock-based compensation were recorded (in thousands):

	Three Months Ended December		Nine Months Ended December	
	31, 2014	2015	31, 2014	2015
Cost of product revenue	\$16	\$9	\$40	\$29
General and administrative	300	327	910	902
Sales and marketing	139	74	281	210
Research and development	10	19	19	25
Total	\$465	\$429	\$1,250	\$1,166

As of December 31, 2015, compensation cost related to non-vested common stock-based compensation, excluding restricted share awards, amounted to \$0.3 million over a remaining weighted average expected term of 4.5 years.

The following table summarizes information with respect to the Plans:

	Outstanding Awards		Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
	Shares Available for Grant	Number of Shares			
Balance at March 31, 2015	1,078,600	2,426,836	\$3.50	5.38	
Granted stock options	—	—			
Granted shares	(29,457)	—	—		
Restricted shares	(723,815)	—	—		
Forfeited restricted shares	171,971	—	—		
Forfeited stock options	203,600	(203,600)	4.36		
Exercised	—	(44,410)	2.11		
Balance at December 31, 2015	700,899	2,178,826	\$3.45	4.51	\$135,447
Exercisable at December 31, 2015		1,937,426	\$3.58	4.41	\$103,095

The aggregate intrinsic value represents the total pre-tax intrinsic value, which is calculated as the difference between the exercise price of the underlying stock options and the fair value of the Company's closing common stock price of \$2.17 as of December 31, 2015.

A summary of the status of the Company's outstanding non-vested stock options as of December 31, 2015 was as follows:

Non-vested at March 31, 2015	581,842
Granted	—
Vested	(280,450)
Forfeited	(62,200)
Non-vested at December 31, 2015	239,192

Table of Contents

During the first nine months of fiscal 2016, the Company granted restricted shares as follows (which are included in the above stock plan activity tables):

Balance at March 31, 2015	704,688	
Shares issued	723,815	
Shares vested	(250,993)
Shares forfeited	(171,971)
Shares outstanding at December 31, 2015	1,005,539	
Per share price on grant date	\$1.76 - \$6.80	
Compensation expense for the nine months ended December 31, 2015	\$850,639	

For the nine months ended December 31, 2014, the Company recorded compensation expense related to granted restricted shares of \$0.8 million.

As of December 31, 2015, the weighted average grant-date fair value of restricted shares granted was \$2.14.

As of December 31, 2015, the amount of deferred stock-based compensation expense related to grants of restricted shares, to be recognized over a remaining period of 2.51 years, was approximately \$2.3 million.

The Company has previously issued warrants in connection with various private placement stock offerings and services rendered. The warrants granted the holder the option to purchase common stock at specified prices for a specified period of time. No warrants were issued in fiscal 2015 or during the nine months ended December 31, 2015. During fiscal 2015, all warrants outstanding for a total of 38,980 shares were exercised at \$2.25 per share and, as a result, none remain outstanding.

NOTE J — SEGMENTS

Beginning in fiscal 2015, the Company reorganized its business into the following business segments: U.S. markets, Orion engineered systems and Orion distribution services. The accounting policies are the same for each business segment as they are on a consolidated basis.

The descriptions of the Company's segments and their summary financial information are presented below.

U.S. Markets

The U.S. Markets Division sells lighting solutions into the wholesale markets.

Engineered Systems

The Engineered Systems Division sells lighting products and construction and engineering services direct to end users. The Engineered Systems Division also completes the construction management services related to existing contracted solar PV projects.

Distribution Services

The Distribution Services Division sells lighting products to a developing network of broad line distributors and internationally.

Corporate and Other

Corporate and Other is comprised of operating expenses not directly allocated to the Company's segments and adjustments to reconcile to consolidated results, which primarily include intercompany eliminations.

Table of Contents

	Revenues		Operating Income (Loss)	
	For the Three Months Ended December 31,		For the Three Months Ended December 31,	
	2014	2015	2014	2015
(dollars in thousands)				
Segments:				
U.S. Markets	\$12,078	\$9,569	\$(1,686)	) \$235
Engineered Systems	13,707	6,408	(1,143)	) (577)
Distribution Services	353	774	(152)	) 2
Corporate and Other	—	—	(1,671)	) (1,602)
	\$26,138	\$16,751	\$(4,652)	) \$(1,942)

	Revenues		Operating Income (Loss)	
	For the Nine Months Ended December 31,		For the Nine Months Ended December 31,	
	2014	2015	2014	2015
(dollars in thousands)				
Segments:				
U.S. Markets	\$27,503	\$31,075	\$(12,123)	) \$(593)
Engineered Systems	24,527	17,012	(9,973)	) (3,395)
Distribution Services	813	980	(318)	) (157)
Corporate and Other	—	—	(4,924)	) (4,967)
	\$52,843	\$49,067	\$(27,338)	) \$(9,112)

	Total Assets		Deferred Revenue	
	March 31, 2015	December 31, 2015	March 31, 2015	December 31, 2015
(dollars in thousands)				
Segments:				
U.S. Markets	\$27,769	\$26,786	\$157	\$285
Engineered Systems	27,435	23,195	1,361	1,118
Distribution Services	261	929	—	—
Corporate and Other	32,340	29,519	—	—
	\$87,805	\$80,429	\$1,518	\$1,403

The Company's revenue and long-lived assets outside the United States are insignificant.

NOTE K — SUBSEQUENT EVENTS

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transaction that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management has reviewed events occurring through the date the financial statements were issued and noted no subsequent event requiring accrual or disclosure.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read together with our unaudited condensed consolidated financial statements and related notes included in this Form 10-Q, as well as our audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2015.

Cautionary Note Regarding Forward-Looking Statements

Any statements in this Quarterly Report on Form 10-Q about our expectations, beliefs, plans, objectives, prospects, financial condition, assumptions or future events or performance are not historical facts and are "forward-looking statements" as that term is defined under the federal securities laws. These statements are often, but not always, made through the use of words or phrases such as "believe", "anticipate", "should", "intend", "plan", "will", "expects", "estimates", "positioned", "strategy", "outlook" and similar words. You should read the statements that contain these types of words carefully. Such forward-looking statements are subject to a number of risks, uncertainties and other factors that could cause actual results to differ materially from what is expressed or implied in such forward-looking statements. There may be events in the future that we are not able to predict accurately or over which we have no control. Potential risks and uncertainties include, but are not limited to, those discussed in "Part I, Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended March 31, 2015. We urge you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. We do not undertake any obligation to release publicly any revisions to such forward-looking statements to reflect events or uncertainties after the date hereof or to reflect the occurrence of unanticipated events.

Market Shift to Light Emitting Diode Products

The rapid market shift in the lighting industry from legacy lighting products to light emitting diode, or LED, lighting products has caused us to adopt new strategies, approaches and processes in order to respond proactively to this paradigm shift. These changing underlying business fundamentals in this paradigm shift include:

• Rapidly declining LED product end user customer pricing and related component costs, improving LED product performance and customer return on investment payback periods, all of which are driving increasing customer preferences for LED lighting products compared to legacy lighting products.

• Increasing LED lighting product customer sales compared to decreasing high intensity fluorescent, or HIF, product sales.

• Generally lower LED product gross margins than those typically realized on sales of legacy lighting products.

• A broader and more diverse customer base and market opportunities compared to our historical commercial and industrial facility customers.

• Increased importance of highly innovative product designs and features and faster speed to market product research and development capabilities.

• Significantly reduced product technology life cycles; significantly shorter product inventory shelf lives and the related increased risk of rapidly occurring product technology obsolescence.

• Increased reliance on international component sources.

• Less internal product fabrication and production capabilities needed to support LED product assembly.

• Different and broader types of components, fabrication and assembly processes needed to support LED product assembly compared to our legacy products.

• Significantly longer end user product warranty requirements for LED products compared to our legacy products.

As we continue to focus our business on selling our LED product lines to respond to the rapidly changing market dynamics in the lighting industry, we face intense competition from an increased number of other LED product companies, a number of which have substantially greater resources and more experience and history with LED lighting products than we do.

Fiscal 2016 Recent Developments

During the fourth quarter of fiscal 2014 and the first three quarters of fiscal 2015, we have experienced a reduction in the amount of new customer orders for our energy efficient HIF lighting systems within our industrial and exterior markets. We attribute this to an increasing awareness within the marketplace of emerging LED product offerings. We believe that customers continue to defer purchase decisions as they evaluate the cost and performance of these LED product offerings. During the fiscal 2015 third quarter, we began to see this deferral of purchasing decisions begin to abate as customer purchases of LED lighting systems during our fiscal 2015 back half increased compared to our fiscal 2014 back half. This trend continued during our first nine months of fiscal 2016 as LED lighting revenue increased by 57% compared to the first nine months of fiscal 2015.

Table of Contents

During the fiscal 2016 third quarter, we experienced a slowing of customer capital spending which we attribute to general macro-economic concerns and conservative cash allocation strategies within our manufacturing and industrial customer base. Additionally during fiscal 2016 third quarter, we began to further emphasize sales through our distribution channel by working through manufacturer representative agencies who represent lighting distributors throughout our addressable markets: commercial office and retail, area lighting and industrial high bay. While we expect this activity to generate long-term growth, in the near-term it may have a dampening impact on revenues. During the fiscal 2016 first nine months, we continued to see improvements in our gross margin related to LED products as a result of negotiated price decreases for lighting components and the benefits of our fiscal 2015 fourth quarter cost containment initiatives. During the fiscal 2016 second quarter, we experienced an increase in sales of our LED door retrofit, or LDR, product line which has lower gross margins as compared to our other LED product lines. This increase in volume negatively impacted our overall gross margins during the fiscal 2016 second quarter.

In October 2015, we introduced a series of new LED industrial high-bay products. These LED products have significant advantages in delivering lumens per watt and we believe, the lowest total cost of ownership versus other LED lighting products. Additionally, we expect that our gross margins will improve as we increase sales of these new products.

We expect that our gross margins from sales of lighting products will be in the mid 20% range during our fiscal 2016 fourth quarter due to an increase in revenue from lower margin national account projects; and that our gross margins will increase during fiscal 2017 as we continue to recognize the benefits of higher purchase volumes of LED components at lower costs, increasing sales volumes of our newly introduced and higher margin LED high-bay products and increased utilization of our manufacturing facility.

Marketing expenditures will increase in fiscal 2017 to primarily support more robust lead generations and further enhance our brand awareness with our agents in their efforts to sell Orion's products through our distribution channel.

Overview

We are a leading designer and manufacturer of high-performance, energy-efficient lighting platforms. We research, develop, design, manufacture, market, sell and implement energy management systems consisting primarily of high-performance, energy efficient commercial and industrial interior and exterior lighting systems and related services. Our products are targeted for applications in three primary market segments: commercial office and retail, area lighting and industrial high bay, although we do sell and install products into other markets. Virtually all of our sales occur within North America. We operate in three operating segments, which we refer to as U.S. Markets, Engineered Systems and Distribution Services. Our U.S. Markets division focuses on selling our lighting solutions into the wholesale markets with customers including domestic energy service companies, or ESCOs, and electrical contractors. Our Engineered Systems division focuses on selling lighting products and construction and engineering services direct to end users. Engineered Systems completes the construction management services related to existing contracted solar photovoltaic, or PV, projects. Its customers include national accounts, government, municipal and schools. Our Distribution Services division focuses on selling our lighting products to a developing network of broad line distributors and internationally.

Our lighting products consist primarily of LED and HIF lighting fixtures. Our principal customers include national accounts, ESCOs, electrical contractors and electrical distributors. Currently, substantially all of our products are manufactured at our production facility location in Wisconsin, although we are increasingly sourcing products and components from third parties as the LED market continues to evolve in order to have versatility in our product development.

While we continue to provide solutions using our legacy HIF technology, we believe the market for lighting products is currently in a significant technology shift to LED lighting systems. Compared to legacy lighting systems, we believe that LED lighting technology allows for better optical performance, significantly reduced maintenance costs due to performance longevity and reduced energy consumption. Due to their size and flexibility in application we also believe that LED lighting systems can address opportunities for retrofit applications that cannot be satisfied by fluorescent or other legacy technologies. We expect our LED lighting technologies to become the primary component

of our future revenue as we strive to be the leader in the industry transition to LED lighting technology. Based on a July 2015 United States Department of Energy report, we estimate the potential North American LED retrofit market within our key product categories to be approximately 1.1 billion lighting fixtures. For fiscal 2015, our LED lighting revenue totaled \$30.8 million, or 43.5% of our total lighting revenue, compared to \$4.8 million, or 7.2% of our total lighting revenue, for fiscal 2014. For the first nine months of fiscal 2016, our LED lighting revenue totaled \$32.1 million, or 66.1% of our total lighting revenue, compared to \$20.5 million, or 40% of our total lighting revenue for the first nine months of fiscal 2015. We plan to continue to primarily focus on developing and selling innovative LED products, although we will continue to market and sell legacy HIF solutions in circumstances in which LED solutions may not be our customers' best alternative.

Table of Contents

We typically generate substantially all of our revenue from sales of lighting systems and related services to commercial and industrial customers. We typically sell our lighting systems in replacement of our customers' existing fixtures. We call this replacement process a "retrofit." We frequently engage our customer's existing electrical contractor to provide installation and project management services. We also sell our lighting systems on a wholesale basis, principally to electrical contractors, ESCOs, and electrical distributors to sell to their own customer bases.

We have sold and installed approximately 4.6 million of our lighting systems in over 13,200 facilities from December 1, 2001 through December 31, 2015. We have sold our products to approximately 35% of the Fortune 500 companies, many of which have installed our HIF and LED lighting systems in multiple facilities. Our top direct customers by revenue in fiscal 2015 included Ford Motor Co., Dollar General Corporation, Sears Holding Corp., Coca-Cola Enterprises Inc., US Foodservice, and USF Holland Inc.

Despite recent economic challenges, we remain optimistic about our near-term and long-term financial performance. We believe that customer purchases of LED lighting systems will continue to increase in the near-term as expected improvements in LED performance and expected decreases in LED product costs are currently expected to make our LED products even more economically compelling to our customers. Our near-term optimism is based upon our efforts to expand our distribution services customer base, our intentions to continue to selectively expand our sales force, our investments into new high performance LED industrial lighting fixtures and the expected increase in revenue and gross margins as we increase sales of these product lines, our recent improvements in gross margin as a result of our cost containment initiatives and the increasing volume of unit sales of our new products, specifically our LED high-bay lighting fixtures, and additional cost containment opportunities. Our long-term optimism is based upon the considerable size of the existing market opportunity for lighting retrofits, including the market opportunities in commercial office, government and retail markets, the continued development of our new products and product enhancements, including our new LED product offerings, our efforts to expand our channels of distribution and our cost reduction initiatives. As we attempt to adapt our business organization to the quickly evolving lighting market, we are considering implementing significant changes to our manufacturing operations to increase our flexibility, remain competitive and lower our cost structure, including the potential sale and leaseback of our manufacturing facility. Implementing these initiatives may result in our incurring additional cost and expenses, including asset impairment or write-down charges and other repositioning expenses and charges, which would likely materially adversely affect our reported results of operations. As previously disclosed we are exploring various alternative sources of liquidity, including the potential sale and leaseback of our manufacturing facility.

Our fiscal year ends on March 31. We refer to our prior fiscal year which ended on March 31, 2015, as "fiscal 2015", and our current fiscal year, which will end on March 31, 2016, as "fiscal 2016." Our fiscal first quarter of each fiscal year ends on June 30, our fiscal second quarter ends on September 30, our fiscal third quarter ends on December 31 and our fiscal fourth quarter ends on March 31.

Our annual report on Form 10-K for the fiscal year ended March 31, 2015 provides additional information about our business and operations.

Revenue and Expense Components

Revenue. We sell our energy management products and services directly to commercial and industrial customers, and indirectly to end users through wholesale sales to electrical contractors, value-added resellers and electrical distributors. We currently generate the majority of our revenue from sales of LED and HIF lighting systems and related services to commercial and industrial customers, with sales of our LED systems becoming our primary emphasis. While our services include comprehensive site assessment, site field verification, utility incentive and government subsidy management, engineering design, project management, installation and recycling in connection with our retrofit installations, we separately recognize service revenue only for our installation and recycling services. Our installation and recycling service revenues are recognized when services are complete and customer acceptance has been received. Our wholesale channels, which include our value-added resellers, electrical contractors and electrical distributors, accounted for approximately 55% of our total revenue in fiscal 2015, not taking into consideration our renewable technologies revenue generated through our Engineered Systems Division. Wholesale revenues accounted for approximately 66% of our total revenue during the first nine months of fiscal 2016, not taking

into consideration our renewable technologies revenue generated through our Engineered Systems Division, compared to 55% for the first nine months of fiscal 2015. The increase in our wholesale revenue mix for the first nine months of fiscal 2016 was due to an increase in the number of key resellers selling our products in-market.

Table of Contents

We recognize revenue on product only sales of our lighting and energy management systems at the time of shipment. For lighting and energy management systems projects consisting of multiple elements of revenue, such as a combination of product sales and services, we recognize revenue by allocating the total contract revenue to each element based on their relative selling prices. We determine the selling price of each element based upon management's best estimate giving consideration to pricing practices, margin objectives, competition, scope and size of individual projects, geographies in which we offer our products and services and internal costs. We recognize revenue at the time of product shipment on product sales and on services completed prior to product shipment. We recognize revenue associated with services provided after product shipment, based on their relative selling price, when the services are completed and customer acceptance has been received. When other significant obligations or acceptance terms remain after products are delivered, revenue is recognized only after such obligations are fulfilled or acceptance by the customer has occurred.

Our dependence on individual key customers can vary from period to period as a result of the significant size of some of our past solar PV projects and new multi-facility roll-out projects. Our top 10 customers accounted for approximately 38% and 33% of our total revenue for the first nine months of fiscal 2015 and fiscal 2016, respectively. One customer accounted for more than 12% of our total revenue in the first nine months of fiscal 2015 and no customers accounted for more than 10% of our total revenue in the first nine months of fiscal 2016. To the extent that multi-facility roll-out projects and large retrofit projects become a greater component of our total revenue, we may experience more customer concentration in given periods. The loss of, or substantial reduction in sales volume to, any of our significant customers could have a material adverse effect on our total revenue in any given period and may result in significant annual and quarterly revenue variations.

Our level of total revenue for any given period is dependent upon a number of factors, including (i) the rate of performance improvement and cost decreases of our LED product offerings, particularly as we make our LED products our primary emphasis; (ii) the demand for our products and systems, particularly our LED products and any new products, applications and service that we may introduce; (iii) the selling price of our LED products compared to our other lighting alternatives; (iv) the level of our wholesale sales; (v) the number and timing of large retrofit and multi-facility retrofit, or "roll-out," projects; (vi) the rate at which we expand our number of key resellers; (vii) customer sales and budget cycles, including budget cycles for utility incentive programs; (viii) our ability to realize revenue from our services, particularly our ability to access job sites and manage our customer's control over their own installation labor workforce; (ix) market conditions; (x) our execution of our sales process; (xi) our ability to compete in a highly competitive market and our ability to respond successfully to market competition; (xii) the selling price of our products and services; (xiii) changes in capital investment levels by our customers and prospects; (xiv) the non-recurrence of our prior levels of PV revenue; and (xv) the rate of government spending on our products. As a result, our total revenue may be subject to quarterly variations and our total revenue for any particular fiscal quarter may not be indicative of future results. In particular, as we focus our marketing and sales efforts on our LED lighting products and decrease our emphasis on our HIF products, and given the rapidly changing market dynamics of the lighting market, we may experience significant and unpredictable variations in our quarterly results.

Backlog. We define backlog as the total contractual value of all firm orders and OTA contracts received for our lighting and solar products and services where delivery of product or completion of services has not yet occurred as of the end of any particular reporting period. Such orders must be evidenced by a signed proposal acceptance or purchase order from the customer. Our backlog does not include PPAs or national contracts that have been negotiated, but under which we have not yet received a purchase order for the specific location. As of December 31, 2015, we had a backlog of firm purchase orders of approximately \$7.5 million, which included an insignificant amount of solar PV orders, compared to \$5.7 million as of September 30, 2015, which included \$0.1 million of solar PV orders. We currently expect approximately \$3.2 million of our December 31, 2015 backlog to be recognized as revenue during the fourth quarter of 2016, with the remainder in fiscal 2017. We generally expect this level of firm purchase order backlog related to HIF and LED lighting systems to be recognized as revenue within the following quarter. As a result of the discontinuance of our solar PV orders, the increased volume of multi-facility roll-outs and large retrofit projects, the continued shortening of our installation cycles and the declining number of projects sold through OTAs, a

comparison of backlog from period to period is not necessarily meaningful and may not be indicative of actual revenue recognized in future periods.

Cost of Revenue. Our total cost of revenue consists of costs for: (i) raw materials, including sheet, coiled and specialty reflective aluminum; (ii) electrical components, including ballasts, power supplies, lamps and LED chips and components; (iii) (iii) wages and related personnel expenses, including stock-based compensation charges, for our fabricating, coating, assembly, logistics and project installation service organizations; (iv) manufacturing facilities, including depreciation on our manufacturing facilities and equipment, taxes, insurance and utilities; (v) warranty expenses; (vi) installation and integration; and (vii) shipping and handling. We also purchase many of our electrical components through forward purchase contracts. We buy most of our LED chips from a single supplier, although we believe we could obtain sufficient quantities of these raw materials on a price and quality competitive basis from other suppliers if necessary. We use multiple suppliers for our electronic component purchases, including ballasts, drivers and lamps. For the first nine months of fiscal 2015 and fiscal 2016, no supplier accounted for more than 10% of our total cost of revenue. Our production labor force is non-union and, as a result, our

Table of Contents

production labor costs have been relatively stable. During fiscal 2015, we reorganized our manufacturing production lines to increase our capacity to produce LED lighting products. Additionally, we continued to reduce product costs through a reduction in workforce and through negotiated material input price decreases with our vendors. During the fiscal 2015 second quarter, we recorded a non-cash impairment charge of \$12.1 million related to an assessment of the carrying cost of our long-term wireless control inventory and related development and intangible costs. The wireless controls inventory was deemed to be impaired based upon current market conditions, including a significant decline during the fiscal year in wireless controls unit volume sales, an increase in product sales in the commercial office and retail markets where the controls product offering is not saleable, limitations in alternative uses for the inventory and the increasing adoption of, and performance improvements in, LED lighting products. During fiscal 2016, we have been and expect to continue to generate efficiencies and cost decreases from our lean manufacturing initiatives that began during fiscal 2014 and from our focus on reducing component product costs through strategic sourcing began during fiscal 2015.

Gross Margin. Our gross profit has been, and will continue to be, affected by the relative levels of our total revenue and our total cost of revenue, and as a result, our gross profit may be subject to quarterly variation. Our gross profit as a percentage of total revenue, or gross margin, is affected by a number of factors, including: (i) our level of utilization of our manufacturing facilities and production equipment and related absorption of our manufacturing overhead costs; (ii) our mix of large retrofit and multi-facility roll-out projects with national accounts; (iii) our increasing sales mix of LED high-bay lighting products and their current higher margins compared to our other LED products; (iv) our project pricing; (v) our realization rate on our billable services; (vi) our level of warranty claims; (vii) our level of efficiencies from our subcontracted installation service providers; (viii) the seasonality of our sales mix; and (ix) any severance expenses that affect our cost of revenue. We expect that our gross margins from sales of lighting products will continue to improve into our fiscal 2017 as we continue to recognize the benefits of higher purchase volumes of LED components at lower costs, increasing sales volumes of our newly introduced and higher margin LED high-bay products and increased utilization of our manufacturing facility.

Operating Expenses. Our operating expenses consist of: (i) general and administrative expenses; (ii) acquisition-related expenses; (iii) sales and marketing expenses; and (iv) research and development expenses. Personnel-related costs are our largest operating expense. During the first quarter of fiscal 2015, we sold our facility in Plymouth. We intend to continue to invest in research and product development for new LED lighting products. During the fiscal 2015 fourth quarter, we identified potential annualized cost reductions of up to approximately \$4.0 million resulting from our ongoing business transition from our historical focus on our legacy fluorescent lighting products to our current focus on our new LED lighting products. These reductions included reduced compensation costs and other discretionary spending reductions in our operating expenses. Through the first nine months of fiscal 2016, we had recognized approximately \$3.4 million of these cost reductions.

Our general and administrative expenses consist primarily of costs for: (i) salaries and related personnel expenses, including stock-based compensation charges related to our executive, finance, human resource, information technology and operations organizations; (ii) public company costs, including investor relations, external audit and internal audit; (iii) occupancy expenses; (iv) professional services fees; (v) technology related costs and amortization; (vi) asset impairment charges; (vii) corporate-related travel; and (viii) acquisition related expenses consisting primarily of costs for legal and accounting.

Our sales and marketing expenses consist primarily of costs for: (i) salaries and related personnel expenses, including stock-based compensation charges related to our sales and marketing organization; (ii) internal and external sales commissions and bonuses; (iii) travel, lodging and other out-of-pocket expenses associated with our selling efforts; (iv) marketing programs; (v) pre-sales costs; (vi) bad debt; and (vii) other related overhead.

Our research and development expenses consist primarily of costs for: (i) salaries and related personnel expenses, including stock-based compensation charges, related to our engineering and product development organization; (ii) payments to consultants; (iii) the design and development of new energy management products and enhancements to our existing energy management system; (iv) quality assurance and testing; and (v) other related overhead. We expense research and development costs as incurred.

We expense all pre-sale costs incurred in connection with our sales process prior to obtaining a purchase order. These pre-sale costs may reduce our net income in a given period prior to recognizing any corresponding revenue. We recognize compensation expense for the fair value of our stock option and restricted stock awards granted over their related vesting period. We recognized \$1.3 million and \$1.2 million of compensation expense for the first nine months of fiscal 2015 and fiscal 2016, respectively. As a result of prior option and restricted stock grants, we expect to recognize an additional \$2.6 million of stock-based compensation over a weighted average period of approximately three years, including \$0.3 million in the last three months of fiscal 2016. These charges have been, and will continue to be, allocated to cost of product revenue, general and administrative expenses, sales and marketing expenses and research and development expenses based on the

Table of Contents

departments in which the personnel receiving such awards have primary responsibility. A substantial majority of these charges have been, and likely will continue to be, allocated to general and administrative expenses and sales and marketing expenses.

Interest Expense. Our interest expense is comprised primarily of interest expense on outstanding borrowings under long-term debt obligations, including the amortization of previously incurred financing costs. We amortize deferred financing costs to interest expense over the life of the related debt instrument, ranging from one to three years.

Interest Income. We report interest income earned from our financed OTA contracts and on our cash and cash equivalents and short term investments.

Income Taxes. As of December 31, 2015, we had net operating loss carryforwards of approximately \$50.6 million for federal tax purposes and \$36.9 million for state tax purposes. Included in these loss carryforwards were \$3.6 million for federal and \$4.3 million for state tax purposes of compensation expenses that were associated with the exercise of nonqualified stock options. The benefit from our net operating losses created from these compensation expenses has not yet been recognized in our financial statements and will be accounted for in our shareholders' equity as a credit to additional paid-in capital as the deduction reduces our income taxes payable. We also had federal tax credit carryforwards of approximately \$1.5 million and state credit carryforwards of approximately \$0.5 million. A valuation allowance has been set up to reserve for our net operating losses and our tax credits. A valuation allowance of \$23.2 million, equaling the net deferred tax asset due to the uncertainty of its realization in the future, has been set up to reserve for our net operating losses and our tax credits. It is possible that we may not be able to utilize the full benefit of our state tax credits due to our state apportioned income and the potential expiration of the state tax credits due to the carry forward period. These federal and state net operating losses and credit carryforwards are available, subject to the discussion in the following paragraph, to offset future taxable income and, if not utilized, will begin to expire in varying amounts between 2020 and 2035. Our valuation allowance for deferred tax assets is based upon our cumulative three year operating losses.

Generally, a change of more than 50% in the ownership of a company's stock, by value, over a three-year period constitutes an ownership change for federal income tax purposes. An ownership change may limit a company's ability to use its net operating loss carryforwards attributable to the period prior to such change. There was no limitation that occurred for fiscal 2014, fiscal 2015 or fiscal 2016 year-to-date.

Results of Operations

The following table sets forth the line items of our consolidated statements of operations on an absolute dollar basis and as a relative percentage of our total revenue for each applicable period, together with the relative percentage change in such line item between applicable comparable periods set forth below (dollars in thousands):

	Three Months Ended December 31,					Nine Months Ended December 31,				
	2014		2015		%	2014		2015		%
	Amount	% of Revenue	Amount	% of Revenue	Change	Amount	% of Revenue	Amount	% of Revenue	Change
Product revenue	\$23,646	90.5 %	\$16,094	96.1 %	(31.9)%	\$48,534	91.8 %	\$46,872	95.5 %	(3.4)%
Service revenue	2,492	9.5 %	657	3.9 %	(73.6)%	4,309	8.2 %	2,195	4.5 %	(49.1)%
Total revenue	26,138	100.0 %	16,751	100.0 %	(35.9)%	52,843	100.0 %	49,067	100.0 %	(7.1)%
Cost of product revenue	20,293	77.7 %	11,574	69.1 %	(43.0)%	53,512	101.3 %	35,988	73.3 %	(32.7)%
Cost of service revenue	2,021	7.7 %	468	2.8 %	(76.8)%	3,451	6.5 %	1,700	3.5 %	(50.7)%
Total cost of revenue	22,314	85.4 %	12,042	71.9 %	(46.0)%	56,963	107.8 %	37,688	76.8 %	(33.8)%
Gross (loss) profit	3,824	14.6 %	4,709	28.1 %	23.1 %	(4,120)	(7.8)%	11,379	23.2 %	376.2 %
	3,816	14.6 %	3,861	23.0 %	1.2 %	11,328	21.4 %	11,135	22.7 %	(1.7)%

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General and administrative expenses											
Sales and marketing expenses	3,771	14.4 %	2,409	14.4 %	(36.1)%	10,016	19.0 %	8,112	16.5 %	(19.0)%	
Research and development expenses	889	3.4 %	381	2.3 %	(57.1)%	1,874	3.5 %	1,244	2.5 %	(33.6)%	
Loss from operations	(4,652)	(17.8)%	(1,942)	(11.6)%	58.3 %	(27,338)	(51.7)%	(9,112)	(18.5)%	66.7 %	
Interest expense	(62)	(0.3)%	(71)	(0.4)%	(14.5)%	(235)	(0.5)%	(223)	(0.5)%	5.1 %	
Interest income	69	0.3 %	27	0.1 %	(60.9)%	246	0.5 %	107	0.2 %	(56.5)%	
Loss before income tax	(4,645)	(17.7)%	(1,986)	(11.9)%	57.2 %	(27,327)	(51.7)%	(9,228)	(18.8)%	66.2 %	
Income tax expense	18	0.1 %	18	0.1 %	— %	41	0.1 %	28	0.1 %	(31.7)%	
Net loss	\$(4,663)	(17.8)%	\$(2,004)	(12.0)%	57.0 %	\$(27,368)	(51.8)%	\$(9,256)	(18.9)%	66.2 %	

29

Table of Contents

Revenue. Product revenue decreased from \$23.6 million for the fiscal 2015 third quarter to \$16.1 million for the fiscal 2016 third quarter, a decrease of \$7.5 million, or 31.9%. The decrease in product revenue was a result of a decrease in order volume from our national account manufacturing and industrial customers as they deferred capital allocation decisions based upon concerns over a weakening economic environment. During the fiscal 2015 third quarter, two large national account customers accounted for \$7.0 million of revenue. These customers remain active, but have deferred capital allocation decisions and we recognized no significant revenue from either of these customers during the fiscal 2016 third quarter. Product sales of our LED fixtures decreased from \$12.7 million for the fiscal 2015 third quarter to \$12.0 million for the fiscal 2016 third quarter, a decrease of \$0.7 million, or 5.5%. Service revenue decreased from \$2.5 million for the fiscal 2015 third quarter to \$0.7 million for the fiscal 2016 third quarter, a decrease of \$1.8 million, or 73.6%. Total revenue decreased from \$26.1 million for the fiscal 2015 third quarter to \$16.8 million for the fiscal 2016 third quarter, a decrease of \$9.3 million, or 35.9%. Product revenue decreased from \$48.5 million for the fiscal 2015 first nine months to \$46.9 million for the fiscal 2016 first nine months, a decrease of \$1.6 million, or 3.4%. The decrease in product revenue was a result of the contraction of customer capital spending experienced during the fiscal 2016 third quarter which offset an increase in LED product revenue during the fiscal 2016 first half due to increasing sales of our new LED products which were launched during the back half of fiscal 2015 and from our initiative to increase the number our key resellers. Product sales of our LED fixtures increased from \$20.5 million for the fiscal 2015 first nine months to \$32.1 million for the fiscal 2016 first nine months, an increase of \$11.6 million, or 56.6%. As a result of our discontinuance of our sale of new PV systems, our product revenue from renewable energy systems was \$1.6 million for the fiscal 2015 first nine months compared to \$0.5 million for the fiscal 2016 first nine months. We currently expect our future revenue to increase significantly as we expand our distribution services customer base, as the manufacturing and industrial economic environment improves and customers resume allocating capital and as we begin to realize revenue from sales of our recently launched new high performance LED industrial lighting fixtures.

Cost of Revenue and Gross Margin. Our cost of product revenue decreased from \$20.3 million for the fiscal 2015 third quarter to \$11.6 million for the fiscal 2016 third quarter, a decrease of \$8.7 million, or 43.0%. The decrease in our cost of product revenue was due to the decline in sales volume during the third quarter. Our cost of service revenue decreased from \$2.0 million for the fiscal 2015 third quarter to \$0.5 million for the fiscal 2016 third quarter, a decrease of \$1.5 million, or 76.8%. Total gross margin was 14.6% for the fiscal 2015 third quarter compared to 28.1% for the fiscal 2016 third quarter. Our lighting gross margin was positively impacted by a favorable mix of higher priced and higher margin LED high-bay fixtures, negotiated price decreases for lighting component cost decreases and the benefits of our fiscal 2015 fourth quarter cost containment initiatives. Total cost of product revenue decreased from \$22.3 million for the fiscal 2015 third quarter to \$12.0 million for the fiscal 2016 first third quarter, a decrease of \$10.3 million, or 46.0%. Our cost of product revenue decreased from \$53.5 million for the fiscal 2015 first nine months to \$36.0 million for the fiscal 2016 first nine months, a decrease of \$17.5 million, or 32.7%. During the fiscal 2015 second quarter, we recorded a non-cash impairment charge of \$12.1 million related to an assessment of the carrying cost of our long-term wireless control inventory and related development and intangible costs. Our cost of product revenue decreased by \$12.1 million related to the aforementioned fiscal 2015 non-cash impairment charge, and by the contribution margin dollars from the decrease in product revenue. Gross margin, adjusted for the impact of the non-cash impairment charge, from sales of our integrated lighting systems for the fiscal 2015 first nine months was 15.2% compared to 23.2% for the fiscal 2016 first nine months. We expect that our gross margins from sales of lighting products will be in the mid 20% range during our fiscal 2016 fourth quarter due to an increase in revenue from lower margin national account projects; and that our gross margins will increase during fiscal 2017 as we continue to recognize the benefits of higher purchase volumes of LED components at lower costs, increasing sales volumes of our newly introduced and higher margin LED high-bay products and increased utilization of our manufacturing facility.

General and Administrative. Our general and administrative expenses increased from \$3.8 million for the fiscal 2015 third quarter to \$3.9 million for the fiscal 2016 third quarter, an increase of \$0.1 million, or 1.2%. The increase was due to an increase in legal expenses of \$0.1 million and an increase in compensation-related expenses of \$0.1 million,

partially offset by a decrease in insurance and discretionary related expenses of \$0.1 million. Our general and administrative expenses decreased from \$11.3 million for the fiscal 2015 first nine months to \$11.1 million for the fiscal 2016 first nine months, a decrease of \$0.2 million, or 1.7%. The decrease was due to decreased insurance expenses of \$0.2 million and decreased discretionary related expenses of \$0.1 million, partially offset by an increase in compensation-related expenses of \$0.1 million.

Sales and Marketing. Our sales and marketing expenses decreased from \$3.8 million for the fiscal 2015 third quarter to \$2.4 million for the fiscal 2016 third quarter, a decrease of \$1.4 million, or 36.1%. The decrease was due to a decrease in headcount related expenses for compensation and travel of \$1.0 million, a decrease in rebranding expenses related to our fiscal 2015 LED branding initiative of \$0.1 million, a decrease in commission expense of \$0.2 million due to the reduction in revenue and a decrease in other discretionary expenses of \$0.1 million. Our sales and marketing expenses decreased from \$10.0 million for the fiscal 2015 first nine months to \$8.1 million for the fiscal 2016 first nine months, a decrease of \$1.9 million, or 19.0%. The decrease was due to a decrease in headcount related expenses for compensation and travel of \$1.7 million and a decrease in

Table of Contents

rebranding expenses related to our fiscal 2015 LED branding initiative of \$0.4 million, partially offset by increased spending of \$0.2 million for trade show participation and advertising.

Total sales and marketing headcount was 89 and 62 at December 31, 2014 and 2015, respectively.

Research and Development. Our research and development expenses, or R&D, decreased from \$0.9 million for the fiscal 2015 third quarter to \$0.4 million for the fiscal 2016 third quarter, a decrease of \$0.5 million, or 57.1%. Our R&D expenses decreased from \$1.9 million for the fiscal 2015 first nine months to \$1.2 million for the fiscal 2016 first nine months, a decrease of \$0.7 million, or 33.6%. The decrease in our R&D expenses for both periods was due to a reduction in consulting and sample costs related to our new products as we continue to increase our cost effectiveness related to launching new products and decrease our reliance on higher cost third parties.

Interest Expense. Our interest expense increased from \$62 thousand for the fiscal 2015 third quarter to \$71 thousand for the fiscal 2016 third quarter. The increase in interest expense was due to the increase in borrowings on our revolving credit line. Our interest expense decreased slightly from \$235 thousand for the fiscal 2015 first nine months to \$223 thousand for the fiscal 2016 first nine months.

Interest Income. Our interest income decreased from \$69 thousand for the fiscal 2015 third quarter to \$27 thousand for the fiscal 2016 third quarter, a decrease of \$42 thousand, or 60.9%. Our interest income decreased from \$0.2 million for the fiscal 2015 first nine months to \$0.1 million for the fiscal 2016 first nine months, a decrease of \$0.1 million, or 56.5%. For both periods, our interest income decreased as we increased the utilization of third party finance providers for a majority of our financed projects. In the future, we expect our interest income to continue to decrease as we continue to utilize third party finance providers for our OTA projects.

Income Taxes. Our income tax expense was relatively unchanged at \$18 thousand for the fiscal 2015 third quarter and fiscal 2016 third quarter. Our income tax expense decreased from an income tax expense of \$41 thousand for the fiscal 2015 first nine months to an income tax expense of \$28 thousand for the fiscal 2016 first nine months. Our effective income tax rate for the 2016 first nine months was 0.3%, compared to 0.2% for the 2015 first nine months. Our income tax expense is due primarily to the changes in expected minimum state tax liabilities.

U.S. Markets Segment

Our U.S. Markets Division sells lighting solutions into the wholesale markets.

The following table summarizes our U.S. Markets segment operating results:

(dollars in thousands)	For the Three Months Ended December 31,			For the Nine Months Ended December 31,		
	2014	2015	% Change	2014	2015	% Change
Revenues	\$12,078	\$9,569	(20.8)%	\$27,503	\$31,075	13.0%
Operating (loss) income	\$(1,686)	\$235	113.9%	\$(12,123)	\$(593)	95.1%
Operating margin	(14.0)%	2.5%		(44.1)%	(1.9)%	

U.S. Markets segment revenue decreased \$2.5 million, or 20.8%, from \$12.1 million for the fiscal 2015 third quarter to \$9.6 million for the fiscal 2016 third quarter. The decrease in revenue during the fiscal 2016 third quarter was due to a customer contraction of capital spending within the manufacturing and industrial sector. U.S. Markets segment revenue increased \$3.6 million, or 13.0%, from \$27.5 million for the fiscal 2015 first nine months to \$31.1 million for the fiscal 2016 first nine months. The increase in revenue during the fiscal 2016 first nine months was primarily due to increased sales of our LED lighting products and our initiative to expand the number of our key resellers.

U.S. Markets segment operating loss decreased \$1.9 million, or 113.9%, from an operating loss of \$1.7 million for the fiscal 2015 third quarter to operating income of \$0.2 million for the fiscal 2016 third quarter. The decrease in operating loss for the fiscal 2016 third quarter was due to a greater mix of higher margin LED high-bay fixtures and a reduction in operating expenses related to compensation, commissions and discretionary spending. U.S. Markets segment operating loss decreased \$11.5 million, or 95.1%, from an operating loss of \$12.1 million for the fiscal 2015 first nine months to an operating loss of \$0.6 million for the fiscal 2016 first nine months. The decrease in operating loss in fiscal 2016 was due to \$7.5 million of expense related to the proportional long-term inventory controls impairment charge incurred during the fiscal 2015 second quarter and due to the increase in revenue, the related

increase in contribution margin dollars and the improvements to our gross margin related to cost decreases on LED components, and a reduction in our operating expenses related to compensation and discretionary spending.

31

Table of Contents**Engineered Systems Segment**

Our Engineered Systems Division sells lighting products and construction and engineering services direct to end users. Our Engineered Systems Division also completes the construction management services related to existing contracted solar PV projects.

The following table summarizes our Engineered Systems segment operating results:

(dollars in thousands)	For the Three Months Ended December 31,			For the Nine Months Ended December 31,		
	2014	2015	% Change	2014	2015	% Change
Revenues	\$13,707	\$6,408	(53.3)%	\$24,527	\$17,012	(30.6)%
Operating loss	\$(1,143)	\$(577)	49.5%	\$(9,973)	\$(3,395)	66.0%
Operating margin	(8.3)%	(9.0)%		(40.7)%	(20.0)%	

Engineered Systems segment revenue decreased \$7.3 million, or 53.3%, from \$13.7 million for the fiscal 2015 third quarter to \$6.4 million for the fiscal 2016 third quarter. During the fiscal 2015 third quarter, two large national account customers accounted for \$7.0 million of revenue. These customers remain active, but have deferred capital allocation decisions and we recognized no significant revenue from either of these customers during the fiscal 2016 third quarter. Engineered Systems segment revenue decreased \$7.5 million, or 30.6%, from \$24.5 million for the fiscal 2015 first nine months to \$17.0 million for the fiscal 2016 first nine months. The decrease in revenue for the fiscal 2016 first nine months was due to a decrease in lighting revenue due to customer contraction of capital spending within the manufacturing and industrial sector and a decrease of \$1.1 million related to a decrease in the number of solar projects under construction.

Engineered Systems segment operating loss decreased \$0.5 million, or 49.5%, from an operating loss of \$1.1 million for the fiscal 2015 third quarter to an operating loss of \$0.6 million for the fiscal 2016 third quarter. Engineered Systems segment operating loss decreased \$6.6 million, or 66.0%, from an operating loss of \$10.0 million for the fiscal 2015 first nine months to an operating loss of \$3.4 million for the fiscal 2016 first nine months. The decrease in operating loss for the first nine months of fiscal 2016 was due to \$4.6 million of expense related to the proportional long-term inventory controls impairment charge incurred during the fiscal 2015 second quarter, improvements to our gross margin related to cost decreases on LED components and a decrease in operating expenses for compensation and discretionary expenses resulting from our 2015 February cost containment initiative.

Distribution Services Segment

Our Distribution Services Division sells lighting products to a developing network of broad line distributors and internationally.

The following table summarizes our Distribution Services segment operating results:

(dollars in thousands)	For the Three Months Ended December 31,			For the Nine Months Ended December 31,		
	2014	2015	% Change	2014	2015	% Change
Revenues	353	774	119.3%	813	980	20.5%
Operating (loss) income	(152)	2	101.3%	(318)	(157)	50.6%
Operating margin	(43.1)%	0.3%		(39.1)%	(16.0)%	

Distribution Services segment revenue increased by \$0.4 million, or 119.3%, from \$0.4 million for the fiscal 2015 third quarter to \$0.8 million for the fiscal 2016 third quarter. Distribution Services segment revenue increased by \$0.2 million, or 20.5%, from \$0.8 million for the fiscal 2015 first nine months to \$1.0 million for the fiscal 2016 first nine months. The increase in revenue in fiscal 2016 was due to the relatively low base line of revenue following the April 2014 start-up of this business unit and to variability in the timing of customer orders as this business unit develops. Distribution Services operating income increased by \$0.2 million, or 101.3%, from an operating loss of \$0.2 million for the fiscal 2015 third quarter to operating income of break-even for the fiscal 2016 third quarter. Distribution Services operating loss decreased by \$0.2 million, or 50.6%, from an operating loss of \$0.3 million for the fiscal 2015

first nine months to an operating loss of \$0.2 million for the fiscal 2016 first nine months. The decrease in our operating loss was due to the increased contribution margin dollars earned from our increasing revenue and the leveraging of our investment in selling costs to start-up this business unit.

Table of Contents

Liquidity and Capital Resources

Overview

We had approximately \$17.5 million in cash and cash equivalents as of December 31, 2015, compared to \$13.4 million at September 30, 2015 and \$20.0 million at March 31, 2015. In February 2015, we completed an underwritten public offering of 5.46 million shares of our common stock, at an offering price to the public of \$3.50 per share. Net proceeds of the offering approximated \$17.5 million.

In January 2014, we filed a universal shelf registration statement with the Securities and Exchange Commission.

Under our shelf registration statement, we have the flexibility to publicly offer and sell from time to time up to \$75 million of debt and/or equity securities, approximately \$55 million of which remains available following our February 2015 offering. The filing of the shelf registration statement may help facilitate our ability to raise public equity or debt capital to expand existing businesses, fund potential acquisitions, invest in other growth opportunities, repay existing debt, or for other general corporate purposes.

In February 2015, we entered into a new credit and security agreement with Wells Fargo Bank, National Association providing for a new three-year revolving credit facility replacing our prior agreements with JPMorgan Chase Bank.

Our new credit agreement provides for an initial credit limit equal to the lesser of (i) \$15.0 million or (ii) a borrowing base based on eligible receivables and inventory, and currently less approximately \$10.3 million of reserves. As of December 31, 2015, our borrowings under the credit agreement totaled approximately \$5.0 million, with approximately \$0.3 million of additional credit availability thereunder based on the credit availability formula described above. Borrowings under the agreement bear interest at the daily three-month LIBOR plus 3.0% per annum. Our future liquidity needs are dependent upon many factors, including our relative revenue, gross margins, cash management practices, capital expenditures, cost containment measures and future potential acquisition transactions. Based on our current expectations, while we anticipate realizing improved net income performance during the fourth quarter of fiscal 2016, we also currently believe that we will experience negative working capital cash flows during the fourth quarter of fiscal 2016. While we believe that we will have adequate available cash and equivalents and credit availability under our credit agreement to satisfy our currently anticipated working capital and liquidity requirements during the near-term, there can be no assurance to that effect. We are exploring various alternative sources of liquidity, including the potential sale and leaseback of our manufacturing facility to help ensure that we will have adequate available cash to satisfy our working capital needs. We are also implementing certain inventory management practices which should help to reduce our inventory levels and enhance our cash position.

Cash Flows

The following table summarizes our cash flows for the nine months ended December 31, 2014 and 2015 (in thousands):

	Nine Months Ended December 31,	
	2014	2015
Operating activities	\$(10,217)	\$(3,325)
Investing activities	(670)	(308)
Financing activities	(1,926)	1,089
Decrease in cash and cash equivalents	\$(12,813)	\$(2,544)

Cash Flows Related to Operating Activities. Cash used in operating activities for the first nine months of fiscal 2016 was \$3.3 million and consisted of a net loss adjusted for non-cash expense items of \$4.4 million and net cash provided by changes in operating assets and liabilities of \$1.1 million. Cash provided by changes in operating assets and liabilities included a decrease in accounts receivable of \$3.7 million due to cash collections and the reduction in revenue, an increase in accounts payable of \$1.0 million related to the timing of vendor payments and a decrease in prepaid and other assets of \$2.0 million due to a reduction in unbilled revenue related to the timing of customer billings. Cash used by changes in operating assets and liabilities included an increase in inventory of \$4.2 million due to the increasing mix of higher value LED component products and finished goods to support our anticipated fiscal 2016 fourth quarter sales, a decrease in accrued expenses and other of \$1.3 million related to the timing of accrued

project installation costs and the timing of payments on accrued sales taxes, and a decrease of \$0.1 million in deferred revenue related to the timing of project completions.

Cash used in operating activities for the first nine months of fiscal 2015 was \$10.2 million and consisted of net cash used by changes in operating assets and liabilities of \$0.1 million and a net loss adjusted for non-cash expense items of \$10.1 million. Cash used by changes in operating assets and liabilities consisted of an increase in accounts receivable of \$1.9 million

Table of Contents

due to the increase in lighting revenue, an increase in inventories of \$3.0 million to support expected revenue growth in LED products over the next several quarters, an increase in prepaid and other assets of \$3.6 million for unbilled revenue related to completed finance projects and an increase in deferred revenue of \$0.3 million. Cash provided by changes in operating assets and liabilities included an increase of \$8.1 million in accounts payable due to the increase in inventory purchases to support our growth in lighting product revenue and project installation costs and an increase in accrued expenses and other of \$0.7 million due to increased warranty reserves.

Cash Flows Related to Investing Activities. For the first nine months of fiscal 2016, cash used in investing activities was \$0.3 million, primarily for capital improvements related to information systems, the build out of our Chicago innovation hub, investments for marketing and trade show signage to reflect our new brand and new product tooling. For the first nine months of fiscal 2015, cash used in investing activities was \$0.7 million, which included \$1.0 million of proceeds from the sale of our facility in Plymouth, Wisconsin, offset by \$1.6 million for capital improvements related to new product tooling, information technology systems and infrastructure investments to improve response time to customers and generate business efficiencies, and \$0.1 million for investment in patents.

Cash Flows Related to Financing Activities. For the first nine months of fiscal 2016, cash flows provided by financing activities were \$1.1 million which included increased borrowing on our credit facility of \$2.5 million and \$0.1 million received from stock option exercises, partially offset by \$1.5 million related to the repayment of long-term debt. For the first nine months of fiscal 2015, cash flows used in financing activities were \$1.9 million which included \$2.7 million used for repayment of long-term debt and \$0.1 million for financing costs partially offset by \$0.4 million received from stock option exercises and stock note repayments and \$0.4 million for the refinancing of OTA debt.

Working Capital

Our net working capital as of December 31, 2015 was \$34.1 million, consisting of \$51.1 million in current assets and \$17.0 million in current liabilities. Our net working capital as of March 31, 2015 was \$36.7 million, consisting of \$55.0 million in current assets and \$18.3 million in current liabilities. Our current accounts receivable decreased from our fiscal 2015 year-end by \$3.6 million due to cash collections during the quarter of aged receivables and due to the reduction in revenue from our fiscal 2015 third quarter versus our fiscal 2016 third quarter. Our current inventories increased from our fiscal 2015 year-end by \$4.2 million primarily due to increases in finished goods levels to support expected revenue growth over the next several quarters and the higher unit dollar values of LED fixtures. Our prepaid expenses and other assets decreased from our fiscal 2015 year-end by \$1.9 million due to a decrease in unbilled revenue related to the timing of project billings and the period expensing of prepaid items. Our accounts payable increased from our fiscal 2015 year end by \$1.0 million due to the increase in inventory and negotiated payment terms with vendors. Our accrued expenses decreased from our fiscal 2015 year-end by \$1.7 million primarily due to a reduction of \$1.1 million in accrued subcontracted installation costs and \$0.5 million for the timing of sales tax payments.

We generally attempt to maintain at least a three-month supply of on-hand inventory of purchased components and raw materials to meet anticipated demand, as well as to reduce our risk of unexpected raw material or component shortages or supply interruptions. Our accounts receivable, inventory and payables are expected to increase in the back half of fiscal 2016 to the extent our revenue and order levels increase.

Indebtedness

Revolving Credit Agreement

Our February 6, 2015, we entered into a new three-year credit and security agreement (Credit Agreement) with Wells Fargo Bank, National Association. Borrowings under the Credit Facility are initially limited to the lesser of (i) \$15.0 million or (ii) a borrowing base based on eligible receivables and inventory, and currently less approximately \$10.3 million of reserves. As of December 31, 2015, our borrowings under the credit agreement totaled approximately \$5.0 million, with approximately \$0.3 million of additional credit availability thereunder based on the credit availability formula described above. Such limit may increase to \$20.0 million, subject to the borrowing base requirement, after July 31, 2016, if we satisfy certain conditions. The Credit Facility includes a \$2.0 million sublimit for the issuance of letters of credit.

From and after any increase in the Credit Facility limit from \$15.0 million to \$20.0 million, the Credit Agreement will require us to maintain as of the end of each month a minimum ratio for the trailing 12-month period of (i) earnings before interest, taxes, depreciation and amortization, subject to certain adjustments, to (ii) the sum of cash interest expense, certain principal payments on indebtedness and certain dividends, distributions and stock redemptions, equal to at least 1.10 to 1.00. The Credit Agreement also contains other customary covenants, including certain restrictions on our ability to incur additional

Table of Contents

indebtedness, consolidate or merge, enter into acquisitions, guarantee obligations of third parties, make loans or advances, declare or pay any dividend or distribution on our stock, redeem or repurchase shares of our stock, or pledge or dispose of assets.

Each of our subsidiaries is a joint and several co-borrower or guarantor under the Credit Agreement, and the Credit Agreement is secured by a security interest in substantially all of our and each of our subsidiary's personal property (excluding various assets relating to customer throughput agreements) and a mortgage on certain real property.

Borrowings under the Credit Agreement bear interest at the daily three-month LIBOR plus 3.0% per annum, with a minimum interest charge for each year or portion of a year during the term of the Credit Agreement of \$130,000, regardless of usage. We must pay an unused line fee of 0.25% per annum of the daily average unused amount of the Credit Facility and a letter of credit fee at the rate of 3.0% per annum on the undrawn amount of letters of credit outstanding from time to time under the Credit Facility.

Capital Spending

Capital expenditures totaled \$0.3 million during the first nine months of fiscal 2016 due to infrastructure investments for our Chicago innovation hub, investments for marketing and trade show signage to reflect our new brand and investments in new product tooling. We expect to incur approximately \$0.2 to \$0.3 million in capital expenditures during the fourth quarter of fiscal 2016. Our capital spending plans predominantly consist of investments related to new product development tooling and investments in information technology systems. We expect to finance these capital expenditures primarily through our existing cash, equipment secured loans and leases, to the extent needed, long-term debt financing, or by using our available capacity under our credit facility.

Contractual Obligations and Commitments

The following table is a summary of our long-term contractual obligations as of December 31, 2015 (dollars in thousands):

	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Debt obligations	\$6,100	\$1,096	\$5,004	\$—	\$—
Capital lease obligations	350	68	150	132	—
Cash interest payments on debt	72	41	25	6	—
Operating lease obligations	508	251	257	—	—
Purchase order and cap-ex commitments(1)	4,990	4,990	—	—	—
Total	\$12,020	\$6,446	\$5,436	\$138	\$—

(1) Reflects non-cancellable purchase order commitments in the amount of \$5.0 million for certain inventory items entered into in order to secure better pricing and ensure materials on hand.

State Tax Assessment

We are currently negotiating a settlement with the Wisconsin Department of Revenue with respect to an assessment regarding the proper classification of our products for tax purposes under Wisconsin law. The issue under review is whether the installation of our lighting systems is considered a real property construction activity under Wisconsin law. We currently expect to resolve this matter with the Wisconsin Department of Revenue in fiscal 2016 for an amount not in excess of the amount we have accrued.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

Inflation

Our results from operations have not been, and we do not expect them to be, materially affected by inflation.

Critical Accounting Policies and Estimates

Table of Contents

The 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. The preparation of our consolidated financial statements requires us to make certain estimates and judgments that affect our reported assets, liabilities, revenue and expenses, and our related disclosure of contingent assets and liabilities. We re-evaluate our estimates on an ongoing basis, including those related to revenue recognition, inventory valuation, the collectability of receivables, stock-based compensation, warranty reserves and income taxes. We base our estimates on historical experience and on various assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates. A summary of our critical accounting policies is set forth in the “Critical Accounting Policies and Estimates” section of our Management’s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended March 31, 2015. For the three months ended, December 31, 2015, there were no material changes in our accounting policies.

Recent Accounting Pronouncements

For a complete discussion of recent accounting pronouncements, refer to Note B in the condensed consolidated financial statements included elsewhere in this report.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to market risk was discussed in the “Quantitative and Qualitative Disclosures About Market Risk” section contained in our Annual Report on Form 10-K for the year ended March 31, 2015. There have been no material changes to such exposures since March 31, 2015.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain a system of disclosure controls and procedures designed to provide reasonable assurance as to the reliability of our published financial statements and other disclosures included in this report. Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the quarter ended December 31, 2015 pursuant to Rule 13a-15(b) of the Exchange Act of 1934. Our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2015.

There have been no changes in our internal controls over financial reporting that occurred during the quarter ended December 31, 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are subject to various claims and legal proceedings arising in the ordinary course of business. As of the date hereof, we are unable to currently assess whether the final resolution of any of such claims or legal proceedings may have a material adverse affect on us.

On May 29, 2014, the Equal Employment Opportunity Commission filed a claim against us alleging certain violations of the Americans with Disabilities Act with regard to an employee. On August 3, 2015, we reached a settlement related to the allegations, which was entirely funded by our insurance carrier.

On December 10, 2015, a former employee filed a charge of discrimination against us alleging: (i) hostile work environment based on sexual harassment; (ii) sex discrimination during employment; and (iii) retaliation, and sex and age discrimination in terminating her employment. The former employee's complaint has been referred to the regional Equal Employment Opportunity Commission office. We believe that we have substantial legal and factual defenses to the claims and allegations and we intend to defend against the claims vigorously.

There have been no additional material changes to the legal proceedings set forth in our Annual Report on Form 10-K for the fiscal year ended March 31, 2015, which we filed with the Securities and Exchange Commission (SEC) on June 12, 2015.

ITEM 1A. RISK FACTORS

We operate in a rapidly changing environment that involves a number of risks that could materially affect our business, financial condition or future results, some of which are beyond our control. In addition to the other information set forth in this Quarterly Report on Form 10-Q, the risks and uncertainties that we believe are most important for you to consider are discussed in Part I - Item 1A under the heading "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended March 31, 2015, which we filed with the SEC on June 12, 2015 and in Part 1 - Item 2 under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Form 10-Q.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 5. OTHER INFORMATION

None

Table of Contents

ITEM 6. EXHIBITS

(a) Exhibits

- 31.1 Certification of Chief Executive Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(a) or Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.
- 31.2 Certification of Chief Financial Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(a) or Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.
- 32.1 Certification of Chief Executive Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document
- 101.SCH Taxonomy extension schema document
- 101.CAL Taxonomy extension calculation linkbase document
- 101.LAB Taxonomy extension label linkbase document
- 101.PRE Taxonomy extension presentation linkbase document

Table of Contents

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on February 9, 2016.

ORION ENERGY SYSTEMS, INC.

Registrant

By /s/ William T. Hull
William T. Hull
Chief Financial Officer
(Principal Financial Officer and Authorized Signatory)

Table of Contents

Exhibit Index to Form 10-Q for the Period Ended December 31, 2015

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