

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, 2008

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

(State or other jurisdiction of incorporation or organization)

39-1847269

(I.R.S. Employer Identification number)

2001 Mirro Drive, Manitowoc, Wisconsin

(Address of principal executive offices)

54220

(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 is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definition 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

Smaller reporting company

(Do not check if a 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 22,648,887 shares of the Registrant's common stock outstanding on February 4, 2009.

Orion Energy Systems, Inc.
Quarterly Report On Form 10-Q
For The Quarter Ended December 31, 2008
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PART I — FINANCIAL INFORMATION**Item 1: Financial Statements**

ORION ENERGY SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share amounts)
(Unaudited)

	<u>March 31,</u> <u>2008</u>	<u>(Unaudited)</u> <u>December 31,</u> <u>2008</u>
Assets		
Cash and cash equivalents	\$ 78,312	\$ 24,175
Short-term investments	2,404	24,692
Accounts receivable, net of allowances of \$79 and \$111	17,666	19,144
Inventories, net	16,789	18,592
Deferred tax assets	286	472
Prepaid expenses and other current assets	1,439	2,616
Total current assets	116,896	89,691
Property and equipment, net	11,539	20,949
Patents and licenses, net	388	1,400
Investment	794	—
Deferred tax assets	1,000	888
Other long-term assets	85	360
Total assets	<u>\$ 130,702</u>	<u>\$ 113,288</u>
Liabilities and Shareholders' Equity		
Accounts payable	\$ 7,521	\$ 8,963
Accrued expenses	4,242	2,614
Current maturities of long-term debt	843	868
Total current liabilities	12,606	12,445
Long-term debt, less current maturities	4,473	3,813
Other long-term liabilities	433	429
Total liabilities	17,512	16,687
Commitments and contingencies (See Note F)		
Shareholders' equity:		
Preferred stock, \$0.01 par value: Shares authorized: 30,000,000 shares at March 31, 2008 and December 31, 2008		
Common stock, no par value: Shares authorized: 200,000,000 at March 31, 2008 and December 31, 2008; shares issued: 27,339,414 and 28,253,773 at March 31, 2008 and December 31, 2008; shares outstanding: 26,963,408 and 22,618,553 at March 31, 2008 and December 31, 2008	—	—
Additional paid-in capital	114,090	118,282
Treasury stock: 376,006 common shares at March 31, 2008 and 5,635,220 at December 31, 2008	(1,739)	(24,180)
Accumulated other comprehensive (loss) income	(6)	13
Retained earnings	845	2,486
Total shareholders' equity	113,190	96,601
Total liabilities and shareholders' equity	<u>\$ 130,702</u>	<u>\$ 113,288</u>

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

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2007	2008	2007	2008
Product revenue	\$ 18,934	\$ 20,671	\$ 47,686	\$ 50,840
Service revenue	4,377	1,704	10,751	6,401
Total revenue	23,311	22,375	58,437	57,241
Cost of product revenue	12,224	13,644	31,044	33,724
Cost of service revenue	2,833	1,311	7,214	4,565
Total cost of revenue	15,057	14,955	38,258	38,289
Gross profit	8,254	7,420	20,179	18,952
Operating expenses:				
General and administrative	3,288	2,438	6,766	7,946
Sales and marketing	2,260	2,741	6,309	8,164
Research and development	454	347	1,334	1,138
Total operating expenses	6,002	5,526	14,409	17,248
Income from operations	2,252	1,894	5,770	1,704
Other income (expense):				
Interest expense	(648)	(33)	(1,272)	(141)
Dividend and interest income	286	325	480	1,492
Total other income (expense)	(362)	292	(792)	1,351
Income before income tax	1,890	2,186	4,978	3,055
Income tax expense	737	1,032	2,023	1,414
Net income	1,153	1,154	2,955	1,641
Accretion of redeemable preferred stock and preferred stock dividends	(75)	—	(225)	—
Participation rights of preferred stock in undistributed earnings	(264)	—	(775)	—
Net income attributable to common shareholders	\$ 814	\$ 1,154	\$ 1,955	\$ 1,641
Basic net income per share attributable to common shareholders	\$ 0.06	\$ 0.05	\$ 0.17	\$ 0.06
Weighted-average common shares outstanding	13,889,162	25,203,827	11,774,702	26,398,338
Diluted net income per share attributable to common shareholders	\$ 0.05	\$ 0.04	\$ 0.14	\$ 0.06
Weighted-average common shares and share equivalents outstanding	22,858,230	26,414,750	20,752,432	28,710,765

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

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

	Nine Months Ended December 31,	
	2007	2008
Operating activities		
Net income	\$ 2,955	\$ 1,641
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	1,089	1,337
Stock-based compensation expense	929	1,204
Deferred income tax benefit	565	1,340
Other	38	78
Changes in operating assets and liabilities:		
Accounts receivable	(3,130)	(1,484)
Inventories	(7,822)	(1,804)
Prepaid expenses and other current assets	(785)	(2,473)
Accounts payable	2,032	1,442
Accrued expenses	2,014	(1,749)
Net cash used in operating activities	(2,115)	(468)
Investing activities		
Purchase of property and equipment	(1,876)	(10,630)
Purchase of short-term investments	—	(22,270)
Additions to patents and licenses	(132)	(1,090)
Proceeds from sales of long term assets	—	860
Gain on sale of long term investment	—	(361)
Net decrease in amount due from shareholder	187	—
Net cash used in investing activities	(1,821)	(33,491)
Financing activities		
Proceeds from issuance of long-term debt	11,302	—
Payment of long-term debt	(531)	(633)
Repurchase of common stock into treasury	—	(22,441)
Proceeds from shareholder notes receivable, net	750	—
Net activity in revolving line of credit	(6,064)	—
Excess benefit for deferred taxes on stock-based compensation	1,230	1,453
Deferred financing costs and offering costs	(256)	7
Proceeds from initial public offering, net of issuance costs	78,627	—
Proceeds from exercise of stock options and warrants	1,888	1,436
Net cash provided by (used in) financing activities	86,946	(20,178)
Net increase (decrease) in cash and cash equivalents	83,010	(54,137)
Cash and cash equivalents at beginning of period	285	78,312
Cash and cash equivalents at end of period	<u>\$ 83,295</u>	<u>\$ 24,175</u>
Supplemental cash flow information:		
Cash paid for interest	\$ 914	\$ 272
Cash paid for income taxes	379	121
Supplemental disclosure of non-cash investing and financing activities		
Long term note receivable received on sale of investment	\$ —	\$ 298
Shares surrendered for payment of stock note receivable	1,378	—
Conversion of debt to common stock	10,762	—
Conversion of redeemable preferred stock and accrued dividends to common stock	10,714	—
Preferred stock accretion	225	—

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

ORION ENERGY SYSTEMS, INC. AND SUBSIDIARIES
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. The corporate offices and manufacturing operations are located in Manitowoc, Wisconsin and operations facilities are located in Plymouth, Wisconsin.

Initial Public Offering

In December 2007, the Company completed its initial public offering (IPO) of common stock in which a total of 8,846,154 shares were sold, including 1,997,062 shares sold by selling shareholders, at an issuance price of \$13.00 per share. The Company raised a total of \$89.0 million in gross proceeds from the IPO, or approximately \$78.6 in net proceeds after deducting underwriting discounts and commissions of \$6.2 million and offering costs of approximately \$4.2 million. Concurrent with the closing of the IPO on December 24, 2007, all of the Company's then outstanding Series B preferred stock and Series C preferred stock converted on a one share to one share basis to common stock. The numbers of shares converted were 2,989,830 and 1,818,182 of Series B preferred stock and Series C preferred stock, respectively. On December 24, 2007, the holders of convertible debt converted \$10.8 million of such debt and accreted interest into 2,360,802 shares of the Company's common stock.

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.

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 instructions to Form 10-Q and Article 10 of Regulation S-X. 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, 2009 or other interim periods.

The condensed consolidated balance sheet at March 31, 2008 has been derived from the audited 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, 2008 filed with the Securities and Exchange Commission on June 27, 2008.

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, bad debt reserves, accruals for warranty expenses, income taxes and certain equity transactions. Accordingly, actual results could differ from those estimates.

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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.

Short-term investments available for sale

The amortized cost and fair value of marketable securities, with gross unrealized gains and losses, as of December 31, 2008 and March 31, 2008 were as follows (in thousands):

	December 31, 2008					
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Short Term Investments
Money market funds	\$ 17,318	\$ —	\$ —	\$ 17,318	\$ 17,318	\$ —
Bank certificate of deposit	7,000	—	—	7,000	700	6,300
Commercial paper	6,596	83	—	6,679	3,000	3,679
Corporate obligations	2,257	—	(11)	2,246	—	2,246
Government agency obligations	14,501	24	—	14,525	2,058	12,467
Total	<u>\$ 47,672</u>	<u>\$ 107</u>	<u>\$ (11)</u>	<u>\$ 47,768</u>	<u>\$ 23,076</u>	<u>\$ 24,692</u>

	March 31, 2008					
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Short Term Investments
Money market funds	\$ 63,356	\$ —	\$ —	\$ 63,356	\$ 63,356	\$ —
Commercial paper	14,466	7	—	14,473	14,473	—
Government agency obligations	2,410	—	(6)	2,404	—	2,404
Total	<u>\$ 80,232</u>	<u>\$ 7</u>	<u>\$ (6)</u>	<u>\$ 80,233</u>	<u>\$ 77,829</u>	<u>\$ 2,404</u>

Effective April 1, 2008, the Company adopted Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS No. 157). In February 2008, The Financial Accounting Standards Board (FASB) issued FASB Staff Position No. 157-2, *Effective Date of FASB Statement No. 157*, which provides a one year deferral of the effective date of SFAS 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. Therefore, the Company has adopted the provisions of SFAS No. 157 with respect to its financial assets and liabilities only. SFAS No. 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and enhances disclosures about fair value measurements. Fair value is defined under SFAS No. 157 as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value under SFAS No. 157 must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

Level 1 — Quoted prices in active markets for identical assets or liabilities.

Level 2 — Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The adoption of SFAS No. 157 did not have a material impact on the Company's results of operations or financial position. As of December 31, 2008, the Company's financial assets were measured at fair value in accordance with SFAS No. 157 employing level 1 inputs.

Fair value of financial instruments

The carrying amounts of the Company's financial instruments, which include cash and cash equivalents, short-term investments,

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accounts receivable, and accounts payable, approximate their respective fair values due to the relatively short-term nature of these instruments. Based upon interest rates currently available to the Company for debt with similar terms, the carrying value of the Company's long-term debt is also approximately equal to its fair value.

Accounts receivable

The majority of the Company's accounts receivable are due from companies in the commercial, industrial and agricultural industries, and 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. Accounts receivable are 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.

Included in accounts receivable are amounts due from a third party finance company to which the Company has sold, without recourse, the future cash flows from lease arrangements entered into with customers. Such receivables are recorded at the present value of the future cash flows discounted at 10.25%. As of December 31, 2008 the following amounts were due from the third party finance company in future periods (in thousands):

2009	\$ 140
2010	33
Total gross receivable	<u>173</u>
Less: amount representing interest	<u>(9)</u>
Net contracts receivable	<u>\$ 164</u>

Inventories

Inventories consist of raw materials and components, such as ballasts, metal sheet and coil stock and molded parts; work in process inventories, such as frames and reflectors; and finished goods, including completed fixtures or systems and accessories, such as lamps, meters 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 12 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, 2008 and December 31, 2008, the Company had inventory obsolescence reserves of \$530,000 and \$617,000.

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 (in thousands):

	<u>March 31, 2008</u>	<u>December 31, 2008</u>
Raw materials and components	\$ 9,948	\$ 10,630
Work in process	680	1,024
Finished goods	6,161	6,938
	<u>\$ 16,789</u>	<u>\$ 18,592</u>

Property and Equipment

Property and equipment were comprised of the following (in thousands):

	<u>March 31, 2008</u>	<u>December 31, 2008</u>
Land and land improvements	\$ 703	\$ 822
Buildings	4,803	5,390
Furniture, fixtures and office equipment	2,256	2,591
Plant equipment	4,543	6,568
Construction in progress	2,918	10,104
	<u>15,223</u>	<u>25,475</u>
Less: accumulated depreciation and amortization	<u>(3,684)</u>	<u>(4,526)</u>
Net property and equipment	<u>\$ 11,539</u>	<u>\$ 20,949</u>

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

	March 31, 2008	December 31, 2008
Equipment	\$ 1,206	\$ 1,154
Less: accumulated amortization	(433)	(493)
Net equipment	<u>\$ 773</u>	<u>\$ 661</u>

The Company capitalized \$90,000 and \$186,000 of interest for construction in progress for the three and nine months ended December 31, 2008. There was no interest capitalized for the three and nine months ended December 31, 2007.

Patents and Licenses

In April 2008, the Company entered into a new employment agreement with the Company's CEO, Neal Verfuert, which superceded and terminated Mr. Verfuert's former employment agreement with the Company. Under the former agreement, Mr. Verfuert was entitled to initial ownership of any intellectual work product he made or developed, subject to the Company's option to acquire, for a fee, any such intellectual work product. The Company made payments to Mr. Verfuert totaling \$144,000 per year in exchange for the rights to eight issued and pending patents. Pursuant to the new employment agreement, in exchange for a lump sum payment of \$950,000, Mr. Verfuert terminated the former agreement and irrevocably transferred ownership of his current and future intellectual property rights to the Company as the Company's exclusive property. This amount was capitalized in fiscal 2009 and is being amortized over the estimated future useful lives (ranging from 10 to 17 years) of the property rights.

Investment

In June 2008, the Company sold its long-term investment consisting of 77,000 shares of preferred stock of a manufacturer of specialty aluminum products. The investment was originally acquired in July 2006 by exchanging products with a fair value of \$794,000. The Company received cash proceeds from the sale in the amount of \$986,000, which included accrued dividends of \$128,000, and also received a promissory note in the amount of \$298,000.

Other Long-Term Assets

Other long-term assets include \$62,000 and \$34,000 of deferred financing costs as of March 31, 2008 and December 31, 2008 and \$298,000 of a note receivable as of December 31, 2008. Upon the sales of the long-term investment noted above, the Company received a promissory note. The note provides for interest only payments at 7% for the first year and 15% for the second year and thereafter. The full principal amount of the note is due in June 2011. The note is secured by a personal guarantee from the CEO of the specialty aluminum products company.

Accrued Expenses

Accrued expenses include warranty accruals, accrued wages, accrued vacation, sales tax payable and other various unpaid expenses. Accrued subcontractor fees were \$916,000 and accrued bonus costs were \$968,000 as of March 31, 2008. No accrued costs exceeded 5% of current liabilities as of December 31, 2008.

The Company generally offers a limited warranty of one year on its products in addition to those standard warranties offered by major original equipment component manufacturers. The manufacturers' warranties cover lamps and ballasts, which are significant components in the Company's products.

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2007	2008	2007	2008
Beginning of period	\$ 187	\$ 46	\$ 45	\$ 69
Provision to cost of revenue	2	10	233	35
Charges	(95)	(1)	(184)	(49)
End of period	<u>\$ 94</u>	<u>\$ 55</u>	<u>\$ 94</u>	<u>\$ 55</u>

Revenue Recognition

The Company recognizes revenue in accordance with Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition*. Based upon SAB 104, revenue is recognized 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

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 contracts 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 the relative fair values in accordance with Emerging Issues Task Force (EITF) No. 00-21, *Revenue Arrangements With Multiple Deliverables*.

Services other than installation and recycling that are completed prior to delivery of the product are recognized upon shipment and

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are included in product revenue as evidence of fair value does not exist. These services include comprehensive site assessment, site field verification, utility incentive and government subsidy management, engineering design, and project management.

Service revenue includes revenue earned from installation, which includes recycling services. Service revenue is recognized when services are complete and customer acceptance has been received. The Company primarily contracts with third-party vendors for the installation services provided to customers and, therefore, determines fair value based upon negotiated pricing with such third-party vendors. Recycling services provided in connection with installation entail disposal of the customer's legacy lighting fixtures.

In October 2008, the Company introduced a new financing program for a customer's purchase of the Company's energy management systems called the Orion Virtual Power Plant ("OVPP"). The OVPP is structured as a supply contract in which the Company delivers a defined amount of energy savings at a fixed rate over the life of the contract, typically 60 months. Revenue is recognized on a monthly basis over the life of the contract upon successful installation of the system and customer acknowledgement that the product is operating as specified.

Costs of products delivered, and services performed, that are subject to additional performance obligations or customer acceptance are deferred and recorded in Prepaid Expenses and Other Current Assets on the Consolidated Balance Sheet. These deferred costs are expensed at the time the related revenue is recognized. Deferred costs amounted to \$82,000 and \$567,000 as of March 31, 2008 and December 31, 2008.

Deferred revenue relates to an obligation to provide maintenance on certain sales and is classified as a liability on the Balance Sheet. The fair value of the maintenance is readily determinable based upon pricing from third-party vendors. Deferred revenue is recognized when the services are delivered, which occurs in excess of a year after the original contract.

Deferred revenue was comprised of the following (in thousands):

	<u>March 31,</u> <u>2008</u>	<u>December 31,</u> <u>2008</u>
Deferred revenue — current liability	\$ 134	\$ 116
Deferred revenue — long term liability	41	32
Total deferred revenue	<u>\$ 175</u>	<u>\$ 148</u>

Income Taxes

The Company accounts for income taxes in accordance with SFAS 109, *Accounting for Income Taxes* and FIN 48, *Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109*. SFAS 109 requires recognition of deferred tax assets and liabilities for the future tax consequences of temporary differences between financial reporting and income tax basis of assets and liabilities and are measured using the enacted tax rates and laws expected to be in effect when the temporary differences will 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.

FIN 48 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 as of the date of adoption and are included in the unrecognized tax benefits.

	<u>Nine Months Ended</u> <u>December 31, 2008</u>
Unrecognized tax benefits upon adoption on March 31, 2008	\$ 392
Decreases relating to settlements with tax authorities	(5)
Additions based on tax positions related to the current period positions	10
Unrecognized tax benefits as of December 31, 2008	<u>\$ 397</u>

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The income tax provision for the nine months ended December 31, 2008 was determined by applying an estimated annual effective tax rate of 46.30% to income before taxes. The estimated effective income tax rate was determined by applying statutory tax rates to pretax income adjusted for certain permanent book to tax differences and tax credits.

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

	Year Ended March 31, 2008	Nine Months Ended December 31, 2008
Statutory federal tax rate	34.00%	34.00%
State taxes, net	4.20%	5.89%
Incentive stock options	2.70%	6.05%
Federal tax credit	(1.50)%	(0.77)%
State tax credit	(1.00)%	0.00%
Other, net	(0.30)%	1.13%
Effective income tax rate	38.10%	46.30%

The Company is eligible for tax benefits associated with the excess of the tax deduction available for exercises of non-qualified stock options over the amount recorded at grant. The amount of the benefit is based on the ultimate deduction reflected in the applicable income tax return. The current benefit of \$3.1 million was recorded as a reduction in taxes payable and a credit to additional paid-in capital based on the amount that was utilized year to date. As of December 31, 2008, the Company has approximately \$2.8 million of net operating losses that resulted from the exercise of non-qualified stock options in the current and prior years that have not been recognized as a reduction to current income taxes payable.

The Company has issued incentive stock options for which stock compensation expense is not deductible currently for tax purposes. The non-deductible expense is considered permanent in nature. A disqualifying disposition occurs when a shareholder sells shares from an option exercise within 12 months of the exercise date or within 24 months of the option grant date. In the event of a disqualifying disposition, the option and related stock compensation expense take on the characteristics of a non-qualified stock option grant, and is deductible for income tax purposes. This deduction is a permanent tax rate differential. The Company could incur significant changes in its effective tax rate in future periods based upon incentive stock option compensation expense and disqualifying disposition events. Since July 30, 2008, all stock option grants have been issued as non-qualified stock options.

Stock Option Plans

The fair value of each option grant for the three and nine months ended December 31, 2007 and 2008 was determined using the assumptions in the following table:

	Three months Ended December 31,		Nine months Ended December 31,	
	2007	2008	2007	2008
Weighted average expected term	N/A	5.2 years	6.6 years	5.6 years
Risk-free interest rate	N/A	2.19%	4.66%	3.15%
Expected volatility	N/A	60%	60%	60%
Expected forfeiture rate	N/A	2%	6%	2%
Expected dividend yield	N/A	0%	0%	0%

Net Income per Common Share

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

Prior to the Company's IPO on December 24, 2007, all series of the Company's preferred stock participated in all undistributed earnings with the common stock. The Company allocated earnings to the common shareholders and participating preferred shareholders under the two-class method as required by EITF 03-6, *Participating Securities and the Two-Class Method under FASB Statement No. 128*. The two-class method is an earnings allocation method under which basic net income per share is calculated for the Company's common stock and participating preferred stock considering both accrued preferred stock dividends and participation rights in undistributed earnings as if all such earnings had been distributed during the year. Since the Company's participating preferred stock was not contractually required to share in the Company's losses, in applying the two-class method to compute basic net income per common share, no allocation was made to the preferred stock if a net loss existed or if an undistributed net loss resulted from reducing net income by the accrued preferred stock dividends. All preferred stock outstanding as of the IPO was automatically converted to common stock upon closing of the IPO.

Diluted net income per common share reflects the dilution that would have occurred if preferred stock was converted, warrants and

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employee stock options were exercised, and shares issued per exercise of stock options for which the exercise price was paid by a non-recourse loan from the Company were outstanding. In the computation of diluted net income per common share, the Company uses the “if converted” method for preferred stock and restricted stock, and the “treasury stock” method for outstanding options and warrants. In addition, in computing the dilutive effect of the convertible notes, the numerator is adjusted to add back the after-tax amount of interest recognized in the period.

The net income per share of common stock for the three and nine months ended December 31, 2007 and 2008 was as follows:

(in thousands except share amounts)	Three Months Ended December 31,		Nine Months Ended December 31,	
	2007	2008	2007	2008
Numerator:				
Net income	\$ 1,153	\$ 1,154	\$ 2,955	\$ 1,641
Accretion of redeemable preferred stock and preferred stock dividends	(75)	—	(225)	—
Participation rights of preferred stock in undistributed earnings	(264)	—	(775)	—
Numerator for basic net income per common share	814	1,154	1,955	1,641
Adjustment for interest, net of income tax effect	89	—	149	—
Preferred stock dividends and participation rights of preferred stock	334	—	1,000	—
Numerator for diluted net income per common share	<u>\$ 1,237</u>	<u>\$ 1,154</u>	<u>\$ 3,104</u>	<u>\$ 1,641</u>
Denominator:				
Weighted-average common shares outstanding	13,889,162	25,203,827	11,774,702	26,398,338
Weighted-average effect of preferred stock, restricted stock, convertible notes and assumed conversion of stock options and warrants	<u>8,969,068</u>	<u>1,210,923</u>	<u>8,977,730</u>	<u>2,312,427</u>
Weighted-average common shares and common share equivalents outstanding	<u>22,858,230</u>	<u>26,414,750</u>	<u>20,752,432</u>	<u>28,710,765</u>

Concentration of Credit Risk and Other Risks and Uncertainties

The Company’s cash is deposited with two financial institutions. At times, deposits in these institutions exceed the amount of insurance provided on such deposits. The Company has not experienced any losses in such accounts and believes that it is not exposed to any significant risk on these balances.

The Company currently depends on one supplier for a number of components necessary for its products, including ballasts and lamps. If the supply of these components were to be disrupted or terminated, or if this supplier were unable to supply the quantities of components required, the Company may have short-term difficulty in locating alternative suppliers at required volumes. Purchases from this supplier accounted for 17% and 19% of total cost of revenue for the three months ended December 31, 2007 and 2008 and 35% and 21% of total cost of revenue for nine months ended December 31, 2007 and 2008.

For the three and nine months ended December 31, 2007, one customer accounted for 12% and 17% of revenue. For the three and nine months ended December 31, 2008, no customers accounted for more than 10% of revenue.

One customer accounted for 19% of accounts receivable as of March 31, 2008. As of December 31, 2008, no customer accounted for more than 10% of the accounts receivable balance.

Segment Information

The Company has determined that it operates in only one segment in accordance with SFAS 131, *Disclosures about Segments of an Enterprise and Related Information*, as it does not disaggregate profit and loss information on a segment basis for internal management reporting purposes to its chief operating decision maker.

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

Recent Accounting Pronouncements

In February 2008, the FASB issued FASB Staff Position No. 157-2 (“FSP 157-2”), which delayed the effective date by which companies must adopt certain of the provisions of SFAS 157. FSP 157-2 defers the effective date of SFAS 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The adoption of this standard is not anticipated to have a material impact on our financial position, results of operations, or cash flows.

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In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements — An Amendment to ARB No. 51* (“SFAS 160”). The objective of this statement is to improve the relevance, comparability and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 requires reclassifying noncontrolling interests, also referred to as minority interest, to the equity section of the consolidated balance sheet presented upon adoption. This pronouncement is effective for fiscal years beginning after December 15, 2008. The Company has determined that there would be no current impact of adopting SFAS 160.

In April 2008, the FASB issued FASB Staff Position (“FSP”) FAS 142-3, *Determination of Useful Life of Intangible Assets* (“FSP FAS 142-3”), which amends the factors that should be considered in developing the renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS 142, “Goodwill and Other Intangible Assets.” FSP FAS 142-3 also requires expanded disclosure related to the determination of intangible asset useful lives. FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the potential impact, if any, of the adoption of FSP FAS 142-3 on its financial position and results of operations.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. SFAS No. 162 defines the order in which accounting principles that are generally accepted should be followed. SFAS No. 162 is effective 60 days following the SEC’s approval of the Public Company Accounting Oversight Board (“PCAOB”) amendments to AU Section 411, *The Meaning of Presented Fairly in Conformity with Generally Accepted Accounting Principles*. The Company does not expect the adoption of SFAS No. 162 to have a material impact on the consolidated financial statements.

In December 2008, the FASB issued FASB Staff Position (“FSP”) No. 140-4 and FIN 46R-8 (“FSP 140-4 and FIN 46R-8”), *Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities*. FSP 140-4 and FIN 46R-8 require additional disclosures about transfers of financial assets and involvement with variable interest entities. The requirements apply to transferors, sponsors, services, primary beneficiaries and holders of significant variable interests in a variable interest entity or qualifying special purpose entity. The FSP is effective for reporting periods that end after December 15, 2008. Because FSP 140-4 and FIN46R-8 only require additional disclosures, the adoption did not impact the Company’s consolidated financial results.

NOTE C — RELATED PARTY TRANSACTIONS

As of March 31, 2007, the Company had non-interest bearing advances of \$157,000 to a shareholder, and also held an unsecured, 1.46% note receivable due from the same shareholder in the amount of \$67,000, including interest receivable. These advances and this note were repaid on August 2, 2007. For the nine months ended December 31, 2007, the Company forgave \$37,000 of shareholder advances as part of a contractual employment relationship.

The Company incurred fees of \$24,000 for the nine months ended December 31, 2007 paid to a shareholder as consideration for guaranteeing notes payable and certain accounts payable. These guarantees were released in fiscal 2008.

The Company incurred fees of \$77,000 and \$12,000 for the nine months ended December 31, 2007 and 2008 respectively, which were for intellectual property fees paid to an executive pursuant to an employment agreement. In April 2008, the intellectual property rights were purchased from the executive for a cash payment of \$950,000. Please refer to “Patents and Licenses” under footnote B for additional disclosure.

The Company leases, on a month-to-month basis, an aircraft owned by an entity controlled by a former director. Amounts paid for the nine months ended December 31, 2007 and 2008 were \$36,000 and \$20,000. The terms and conditions of such relationship are believed to be not materially more favorable to the Company or the entity than could be obtained from an independent third party.

During the nine months ended December 31, 2007 and 2008, the Company recorded revenue of \$125,000 and \$24,000 for products and services sold to an entity for which the Company’s Chairman of the Board was the executive chairman. During the nine months ended December 31, 2007 and 2008, the Company purchased goods and services from the same entity in the amounts of \$0 and \$125,000. The terms and conditions of such relationship are believed to be not materially more favorable to the Company or the entity than could be obtained from an independent third party.

During the nine months ended December 31, 2007 and 2008, the Company recorded revenue of \$0 and \$57,000 for products and services sold to an entity for which a member of the board of directors serves as an executive vice president. The terms and conditions

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of such relationship are believed to be not materially more favorable to the Company or the entity than could be obtained from an independent third party.

During the nine months ended December 31, 2007 and 2008, the Company recorded revenue of \$289,000 and \$102,000 for products and services sold to an entity for which a member of the board of directors serves as the chief executive officer. During the nine months ended December 31, 2007 and 2008, the Company purchased goods and services from the same entity in the amounts of \$278,000 and \$79,000. The terms and conditions of such relationship are believed to be not materially more favorable to the Company or the entity than could be obtained from an independent third party.

NOTE D — LONG-TERM DEBT

Long-term debt as of March 31, 2008 and December 31, 2008 consisted of the following (in thousands):

	March 31, 2008	December 31, 2008
Term note	\$ 1,440	\$ 1,288
First mortgage note payable	1,045	1,007
Debenture payable	922	895
Lease obligations	536	302
Other long-term debt	1,373	1,189
Total long-term debt	5,316	4,681
Less current maturities	(843)	(868)
Long-term debt, less current maturities	<u>\$ 4,473</u>	<u>\$ 3,813</u>

Revolving Credit Agreement

On March 18, 2008, the Company entered into a credit agreement (“Credit Agreement”) to replace a previous agreement between the Company and Wells Fargo Bank, N.A. The Credit Agreement provides for a revolving credit facility (“Line of Credit”) that matures on August 31, 2010. The initial maximum aggregate amount of availability under the Line of Credit is \$25.0 million. The Company has a one-time option to increase the maximum aggregate amount of availability under the Line of Credit to up to \$50.0 million, although any advance from the Line of Credit over \$25.0 million is discretionary to Wells Fargo even if no event of default has occurred. Borrowings are limited to a percentage of eligible trade accounts receivables and inventories, less any borrowing base reserve that may be established from time to time. In December 2008, the Company briefly drew \$4.0 million on the line of credit due to the timing of treasury repurchases and funds available in the Company’s operating account. As of December 31, 2008, the borrowings had been repaid and there was no balance due on the Line of Credit. Borrowings allowed under the Line of Credit as of December 31, 2008 were \$20.2 million based upon available working capital, as defined.

The Company must pay a fee of 0.20% on the average daily unused amount of the Line of Credit and fees upon the issuance of each letter of credit equal to 1.25% per annum of the principal amount thereof.

The Credit Agreement provides that the Company has the option to select the interest rate applicable to all or a portion of the outstanding principal balance of the Line of Credit either (i) at a fluctuating rate per annum one percent (1.00%) below the prime rate in effect from time to time, or (ii) at a fixed rate per annum determined by Wells Fargo to be one and one quarter percent (1.25%) above LIBOR. Interest is payable on the last day of each month.

The Credit Agreement is secured by a first lien security interest in all of the Company’s accounts receivable, general intangibles and inventory, and a second lien priority in all of the Company’s equipment and fixtures and contains certain financial covenants including minimum net income requirements and requirements that the Company maintain net worth and fixed charge coverage ratios at prescribed levels. The Credit Agreement also contains certain restrictions on the ability of the Company to make capital or lease expenditures over prescribed limits, incur additional indebtedness, consolidate or merge, guarantee obligations of third parties, make loans or advances, declare or pay any dividend or distribution on its stock, redeem or repurchase shares of its stock, or pledge assets. As of December 31, 2008 the Company was in compliance with all covenant provisions.

NOTE E — INCOME TAXES

As of December 31, 2008, the Company had Federal net operating loss carryforwards of approximately \$2.8 million that are

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associated with the exercise of non-qualified stock options that have not yet been recognized by the Company in its financial statements. The Company also has state net operating loss carryforwards of approximately \$3.0 million, of which \$2.1 million are associated with the exercise of non-qualified stock options. The Company also has federal and state tax credit carryforwards of approximately \$296,000 and \$472,000 as of March 31, 2008. Both the net operating losses and tax credit carryforwards expire between 2016 and 2027.

In fiscal 2007 and prior to its IPO, the Company's past issuances and transfers of stock caused an ownership change for certain tax purposes. When certain ownership changes occur, tax laws require that a calculation be made to establish a limitation on the use of net operating loss carryforwards created in periods prior to such ownership change. For the fiscal year ended March 31, 2008, utilization of the federal loss carryforwards was limited to \$3.0 million. For the fiscal year 2009, there is only \$1.8 million of net operating loss carryforward remaining from periods prior to the ownership change, however, if there were more net operating loss available from those time periods, the Company believes that utilization of the federal loss carryforwards would again be limited to \$3.0 million.

NOTE F — COMMITMENTS AND CONTINGENCIES

Operating Leases and Purchase Commitments

The Company leases vehicles and equipment under operating leases. Rent expense under operating leases was \$192,000 and \$263,000 for the three months ended December 31, 2007 and 2008; and \$635,000 and \$802,000 for the nine months ended December 31, 2007 and 2008. Total annual commitments under non-cancelable operating leases as of December 31, 2008 were \$1.1 million. In addition, the Company enters into non-cancellable purchase commitments for certain inventory items in order to secure better pricing and ensure materials on hand, as well as for capital expenditures. As of December 31, 2008, the Company had entered into \$5.5 million of purchase commitments related to fiscal 2009, including \$1.7 million related to the remaining capital committed for construction of its technology center and manufacturing and system improvements and \$3.8 million for inventory purchases.

Litigation

In February and March 2008, three class action lawsuits were filed in the United States District Court for the Southern District of New York against the Company, several of its officers, all members of the then existing board of directors, and certain underwriters relating to the Company's December 2007 IPO. The plaintiffs claim to represent those persons who purchased shares of the Company's common stock from December 18, 2007 through February 6, 2008. The plaintiffs allege, among other things, that the defendants made misstatements and failed to disclose material information in the Company's IPO registration statement and prospectus. The complaints allege various claims under the Securities Act of 1933, as amended. The complaints seek, among other relief, class certification, unspecified damages, fees, and such other relief as the court may deem just and proper.

On August 1, 2008, the court-appointed lead plaintiff filed a consolidated amended complaint in the United States District Court for the Southern District of New York. On September 15, 2008, the Company and the other director and officer defendants filed a brief in support of their motion to dismiss the consolidated complaint. On November 13, 2008, the lead plaintiff filed a brief in opposition to the motion to dismiss. On December 15, 2008, the Company and the other director and officer defendants, filed a reply brief in support of their motion to dismiss. Having been fully briefed, the motion to dismiss is awaiting the court's review and decision.

The Company believes that it and the other defendants have substantial legal and factual defenses to the claims and allegations contained in the consolidated complaint, and the Company intends to pursue these defenses vigorously. There can be no assurance, however, that the Company will be successful, and an adverse resolution of the lawsuit could have a material adverse effect on the Company's consolidated financial position; results of operations and cash flow. In addition, although the Company carries insurance for these types of claims, a judgment significantly in excess of the Company's insurance coverage or a judgment which is not covered by insurance, could materially and adversely affect the Company's financial condition, results of operations and cash flows. The Company is not presently able to reasonably estimate potential losses, if any, related to the lawsuit.

NOTE G — SHAREHOLDERS' EQUITY

Share Repurchase Program

In July 2008, the Company's board of directors approved a share repurchase program authorizing the Company to repurchase in the aggregate up to a maximum of \$20 million of the Company's outstanding common stock. In December 2008, the Company's board of directors supplemented the share repurchase program authorizing the Company to repurchase up to an additional \$10 million of the Company's outstanding common stock. As of December 31, 2008, the Company had repurchased 5,259,214 shares of common stock at a cost of \$22.4 million under the program.

NOTE H — STOCK OPTIONS AND WARRANTS

The Company grants stock options and restricted stock awards under its 2003 Stock Option and 2004 Stock and Incentive Awards Plans (the Plans). Under the terms of the Plans, the Company has reserved 9,000,000 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 vesting periods have been used in certain circumstances. Exercisability of the options granted to employees are contingent on the employees' continued employment and non-vested options are subject to forfeiture if employment terminates for any reason. Options under the Plans have a maximum life of ten years. In the past, the Company has granted both incentive stock options and non-qualified stock options, although in July 2008, the Company adopted a policy of only granting non-qualified stock options. Restricted stock awards have no vesting period and have been issued to certain non-employee directors pursuant to elections made under the non-employee director compensation plan, which became effective upon the closing of the Company's IPO. The Plans also provide to certain employees accelerated vesting in the event of certain changes of control of the Company. In December 2007, upon the closing of our IPO, an additional 1,500,000 shares were made available for grant under our 2004 Stock and Incentive Awards Plan.

Prior to the Company's IPO, certain non-employee directors elected to receive stock awards in lieu of cash compensation under the non-employee director compensation plan which became effective upon the closing of the Company's IPO. The Company granted 5,000 shares from the 2004 Stock Incentive Awards Plan to non-employee directors as compensation for the three months ended December 31, 2008. The shares were issued in November 2008 and valued at the market price as of the grant date of \$3.00 per share.

In accordance with SFAS 123(R), the following amounts of stock-based compensation were recorded (in thousands):

	Three months ended December 31,		Nine months ended December 31,	
	2007	2008	2007	2008
Cost of product revenue	\$ 24	\$ 68	\$ 68	\$ 198
General and administrative	185	121	565	546
Sales and marketing	157	157	267	428
Research and development	13	12	29	32
Total	\$ 379	\$ 358	\$ 929	\$ 1,204

As of December 31, 2008, compensation cost related to non-vested common stock-based compensation amounted to \$5.1 million over a remaining weighted average expected term of 6.4 years.

The following table summarizes information with respect to the Plans:

(In thousands, except per share amounts)	Shares Available for Grant	Number of Shares	Options Outstanding		
			Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic value
Balance at March 31, 2008	1,482	4,716	\$2.30		
Granted	(634)	634	\$8.04		
Cancelled or expired	290	(290)	\$6.17		
Exercised		(827)	\$1.53		
Balance at December 31, 2008	1,138	4,233	\$3.05	6.4	\$12,141
Exercisable at December 31, 2008		2,093	\$1.74	4.6	\$ 7,688

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 \$5.41 as of December 31, 2008.

A summary of the status of the Company's outstanding non-vested stock options as of December 31, 2008 is as follows (in thousands):

Non-vested at March 31, 2008	2,307
Granted	634
Vested	(528)
Forfeited	(273)
Non-vested at December 31, 2008	2,140

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Prior to the Company's IPO, the Company issued warrants in connection with various 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 2008 or for the nine months ended December 31, 2008.

Outstanding warrants are comprised of the following:

	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>
Balance at March 31, 2008	578,788	\$2.31
Issued	—	—
Exercised	(73,580)	2.33
Cancelled	—	—
Balance at December 31, 2008	<u>505,208</u>	<u>\$2.31</u>

A summary of outstanding warrants at December 31, 2008 follows:

<u>Exercise Price</u>	<u>Number of Warrants</u>	<u>Expiration</u>
\$2.25	38,980	Fiscal 2014
\$2.30	428,968	Fiscal 2010
\$2.50	<u>37,260</u>	Fiscal 2011
Total	505,208	

NOTE I — SUBSEQUENT EVENTS

Shareholder Rights Plan

On January 7, 2009, the Company's Board of Directors adopted a shareholder rights plan pursuant to which it declared and will pay a dividend of one common share purchase right (a "Right") for each outstanding share of the Company's common stock. The dividend will be paid on February 15, 2009 to shareholders of record on February 1, 2009. Each Right will entitle 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.

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 (an "Acquiring Person") has acquired beneficial ownership of 20% or more of the Company's outstanding common stock 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 will be entitled to purchase shares of the Company's common stock for one-half its then-current market price, as defined in the shareholder rights plan, and all Rights beneficially owned by an Acquiring Person, or by certain related parties or transferees, will be null and void. If, after there is an Acquiring Person, 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 shares of the acquiring company's common stock at a price of one-half the then-current market price of that stock.

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. The Rights will expire on January 7, 2019.

Wisconsin Department of Commerce loan and grant agreement

In January 2009, the Company entered into a grant and loan agreement with the State of Wisconsin Department of Commerce relating to the Company's investments and work in developing and implementing its integrated energy management systems at project locations within the State. The agreement provides for funding in the aggregate amount of \$420,000, comprised of a low-interest loan in the amount of \$200,000 and grant funding in the amount of \$220,000, with a match funding requirement on the part of the Company in the amount of \$420,000. The loan bears annual interest at a rate of 2%, with monthly payments of \$3,400 commencing in August 2010 and with the final balance due and payable not later than November 1, 2015. Grant funds must be drawn upon by December 31, 2009 based upon project costs incurred between April 1, 2008 and December 31, 2009. To date, no grant or loan funding has been disbursed.

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 elsewhere in the Form 10-Q. It should also be read in conjunction with our audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended March 31, 2008.

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", "projects", "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 2008 Annual Report filed on Form 10-K for the year ended March 31, 2008, our Form 10-Q for the quarter ended September 30, 2008 and elsewhere in this Quarterly Report. We urge you not to place undue reliance on these forward-looking statements, which speak only as 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.

Overview

We design, manufacture and implement energy management systems consisting primarily of high-performance, energy-efficient lighting systems, controls and related services.

We currently generate the substantial majority of our revenue from sales of high intensity fluorescent, or HIF, lighting systems and related services to commercial and industrial customers. We typically sell our HIF lighting systems in replacement of our customers' existing high intensity discharge, or HID, 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 HIF lighting systems on a wholesale basis, principally to electrical contractors and value-added resellers to sell to their own customer bases.

We have sold and installed more than 1,419,000 of our HIF lighting systems in over 4,300 facilities from December 1, 2001 through December 31, 2008. We have sold our products to 114 Fortune 500 companies, many of which have installed our HIF lighting systems in multiple facilities. Our top direct customers by revenue in fiscal 2008 included Coca-Cola Enterprises Inc., Kraft Foods Inc., Sherwin Williams Co., Kroger Co., SYSCO Corp. and Anheuser-Busch Companies, Inc. Our top direct customers by revenue for the nine months ended December 31, 2008 included Coca-Cola Enterprises Inc., Anheuser-Busch Companies, Inc., SYSCO Corp., Ben E. Keith Co., Kraft Foods Inc., and U.S. Foodservice.

Our fiscal year ends on March 31. We call our prior fiscal year which ended on March 31, 2008, "fiscal 2008". We call our current fiscal year, which will end on March 31, 2009, "fiscal 2009." Our fiscal first quarter 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.

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 and value-added resellers. We currently generate the substantial majority of our revenue from sales of HIF lighting systems and related services to commercial and industrial customers. 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. Except for our installation and recycling services, all other services historically have been completed prior to product shipment and revenue from such services was included in product revenue because evidence of fair value for these services did not exist. We are continuing to increase our selling efforts through our contractor and value-added reseller channels with increased marketing through mass mailings, participating in national trade organizations and providing training to channel partners on our sales methodologies. These wholesale channels accounted for approximately 25% of our total revenue volume in fiscal 2008 and 43% of our total revenue for the first nine months of fiscal 2009. The increase in wholesale revenue was due to our marketing and training efforts within this channel, and we expect that revenue from these channels will be approximately 40% of our total revenue in fiscal 2009.

In October 2008, we introduced to the market a new financing program for our customer's purchase of our energy management systems called the Orion Virtual Power Plant ("OVPP"). The OVPP is structured as a supply contract in which we commit to deliver a defined amount of energy savings at a fixed rate over the life of the contract, typically 60 months. We collect payments from our customer on a monthly basis across the delivery period. This program creates a revenue stream, but may lessen near-term revenues as the payments are recognized as revenue on a monthly basis over the life of the contract versus upfront upon product shipment or project completion. However, we do retain the option to sell the payment stream to a third party finance company, as we have done under the terms of our former financing program, in which case the revenue would be recognized at the net present value of the total future payments from the finance company upon completion of the project. The OVPP program was established to assist customers who are interested in purchasing our energy management systems but who have capital expenditure budget limitations. For the nine months ended December 31, 2008, we recognized \$3,000 of revenue from completed OVPP contracts. As of December 31, 2008, customers have signed OVPP supply agreements for net present value of \$0.8 million in revenues. In the future, we expect an increase in the volume of contracts that utilize the OVPP financing program.

We recognize revenue on product only sales at the time of shipment. For projects consisting of multiple elements of revenue, such as a combination of product sales and services, we separate the project into separate units of accounting based on their relative fair values for revenue recognition purposes. Additionally, the deferral of revenue on a delivered element may be required if such revenue is contingent upon the delivery of the remaining undelivered elements. 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 fair value, 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 retrofit and multi-facility roll-out projects. Our top 10 customers accounted for approximately 48% and 36% of our total revenue for the first nine months of fiscal 2008 and fiscal 2009, respectively. One customer accounted for approximately 17% of our total revenue for the first nine months of fiscal 2008. No customers accounted for more than 10% of our total revenue for the nine months ended December 31, 2008. To the extent that large retrofit and roll-out 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 demand for our products and systems, including our OVPP program; (ii) the number and timing of large retrofit and multi-facility retrofit, or "roll-out," projects; (iii) the level of our wholesale sales; (iv) our ability to realize revenue from our services and our OVPP program, including whether we decide to either retain or resell the expected future cash flows under our OVPP program and the relative timing of the resultant revenue recognition; (v) market conditions; (vi) our execution of our sales process; (vii) our ability to compete in a highly competitive market and our ability to respond successfully to market competition; (viii) the selling price of our products and services; (ix) changes in capital investment levels by our customers and prospects; and (x) customer sales cycles. 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.

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Backlog. We define backlog as the total contractual value of all firm orders received for our lighting products and services. Such orders must be evidenced by a signed proposal acceptance or purchase order from the customer. Our backlog does not include OVPP contracts or national account contracts that have been negotiated, but for which we have not yet received a purchase order for the specific location. As of December 31, 2008, we had a backlog of firm purchase orders of approximately \$3.2 million. We generally expect this level of firm purchase order backlog to be converted into revenue within the following quarter. Principally as a result of the continued lengthening of our customer's purchasing decisions because of current economic conditions and related factors, the continued shortening of our installation cycles and the number of projects sold through national and OVPP contracts, 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 and lamps; (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. Our cost of aluminum can be subject to commodity price fluctuations, which we attempt to mitigate with forward fixed-price, minimum quantity purchase commitments with our suppliers. We also purchase many of our electrical components through forward purchase contracts. We buy most of our specialty reflective aluminum from a single supplier, and most of our ballast and lamp components from a single supplier, although we believe we could obtain sufficient quantities of these raw materials and components on a price and quality competitive basis from other suppliers if necessary. Purchases from our current primary supplier of ballast and lamp components constituted 20.9% of our total cost of revenue for the first nine months of fiscal 2009 and were 28% of total cost of revenue for fiscal 2008. Our production labor force is non-union and, as a result, our production labor costs have been relatively stable. We have been expanding our network of qualified third-party installers to realize efficiencies in the installation process. Toward the end of fiscal 2008, we began to vertically integrate some of our processes performed at outside suppliers to help us better manage delivery lead time, control process quality and inventory supply. We installed a coating line and acquired production fabrication equipment. In fiscal 2009, we installed a power cord assembly line. Each of these production items provide us with additional capacity to continue to support our potential future revenue growth. We expect that these processes will help to reduce overall unit costs as the equipment becomes more fully utilized.

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 mix of large retrofit and multi-facility roll-out projects with national accounts; (ii) the level of our wholesale sales (which generally have historically resulted in higher relative gross margins, but lower relative net margins, than our sales to direct customers); (iii) our realization rate on our billable services; (iv) our project pricing; (v) our level of warranty claims; (vi) our level of utilization of our manufacturing facilities and production equipment and related absorption of our manufacturing overhead costs; (vii) our level of efficiencies in our manufacturing operations; and (viii) our level of efficiencies from our subcontracted installation service providers.

Operating Expenses. Our operating expenses consist of: (i) general and administrative expenses; (ii) sales and marketing expenses; and (iii) research and development expenses. Personnel related costs are our largest operating expense and we expect our general and administrative personnel costs to stabilize or decline slightly for the remainder of fiscal 2009 due to personnel cost reduction efforts. While we have recently focused on reducing our personnel costs and headcount in certain functional areas, we do nonetheless believe that future opportunities within our business remain strong. As a result, we may choose to selectively add to our sales staff based upon opportunities in regional markets.

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 and audit; (iii) occupancy expenses; (iv) professional services fees; (v) technology related costs and amortization; and (vi) corporate-related travel.

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; and (vi) 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 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 have been incurring increased general and administrative expenses in connection with our being a public company, including increased accounting, audit, investor relations, legal and support services and Sarbanes-Oxley compliance fees and expenses. Additionally, we anticipate our operating expenses to increase towards the end of fiscal 2009 and into fiscal 2010 as a result of the completion of our new technology center and the related building occupancy costs. 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 also intend to continue to invest in our research and development of new and enhanced energy management products and services.

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We recognize compensation expense for the fair value of our stock option awards granted over their related vesting period using the modified prospective method of adoption under the provisions of the Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment*. We recognized \$1.4 million of stock-based compensation expense in fiscal 2008 and \$1.2 million in the first nine months of fiscal 2009. As a result of prior option grants, we expect to recognize an additional \$5.1 million of stock-based compensation over a weighted average period of approximately 6.4 years, including \$0.4 million in the last three months of fiscal 2009. 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 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 our revolving credit facility and our other long-term debt obligations described under “— Liquidity and Capital Resources — Indebtedness” below, 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 nine to 15 years.

Dividend and Interest Income. Our dividend income consists of dividends paid on preferred shares that we acquired in July 2006. The terms of these preferred shares provided for annual dividend payments to us of \$0.1 million. The preferred shares were sold back to the issuer in June 2008 and all dividends accrued were paid upon sale. We also report interest income earned on our cash and cash equivalents. Our interest income has increased in fiscal 2009 as a result of our investment of the net proceeds from our initial public offering in short-term, interest-bearing, money market funds, bank certificate of deposits and investment-grade securities.

Income Taxes. As of December 31, 2008, we had net operating loss carryforwards of approximately \$2.8 million for federal tax purposes and \$3.0 million for state tax purposes. Included in these loss carryforwards were \$2.8 million for federal and \$2.1 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 and state credit carryforwards of approximately \$0.3 million and \$0.5 million, respectively, as of March 31, 2008. 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 2016 and 2027. Our income before income tax in fiscal 2008 was \$7.2 million. If we maintain this level of income before income tax in future fiscal years, we would expect to utilize our federal net operating loss carryforwards in fiscal 2009. State net operating loss carryforwards would be utilized over approximately five fiscal years or a shorter period if our income before income taxes increases further.

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. In fiscal 2007 and prior to our IPO, past issuances and transfers of our stock caused an ownership change for certain tax purposes. When certain ownership changes occur, tax laws require that a calculation be made to establish a limitation on the use of net operating loss carryforwards created in periods prior to such ownership change. For fiscal year 2008, utilization of our federal loss carryforwards was limited to \$3.0 million. For fiscal 2009, there is only \$1.8 million of net operating loss carryforward remaining from periods prior to the ownership change, however, if there were more net operating loss available from those time periods, we believe that utilization of the federal loss carryforwards would again be limited to \$3.0 million.

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,				
	2007		2008		% Change	2007		2008		% Change
	Amount	% of Revenue	Amount	% of Revenue		Amount	% of Revenue	Amount	% of Revenue	
Product revenue	\$ 18,934	81.2%	\$ 20,671	92.4%	9.2%	\$ 47,686	81.6%	\$ 50,840	88.8%	6.6%
Service revenue	4,377	18.8%	1,704	7.6%	(61.1)%	10,751	18.4%	6,401	11.2%	(40.5)%
Total revenue	23,311	100.0%	22,375	100.0%	(4.0)%	58,437	100.0%	57,241	100.0%	(2.0)%
Cost of product revenue	12,224	52.4%	13,644	61.0%	11.6%	31,044	53.1%	33,724	58.9%	8.6%
Cost of service revenue	2,833	12.2%	1,311	5.9%	(53.7)%	7,214	12.3%	4,565	8.0%	(36.7)%
Total cost of revenue	15,057	64.6%	14,955	66.8%	(0.7)%	38,258	65.5%	38,289	66.9%	0.1%
Gross profit	8,254	35.4%	7,420	33.2%	(10.1)%	20,179	34.5%	18,952	33.1%	(6.1)%
General and administrative expenses	3,288	14.1%	2,438	10.9%	(25.9)%	6,766	11.6%	7,946	13.9%	17.4%
Sales and marketing expenses	2,260	9.7%	2,741	12.3%	21.3%	6,309	10.8%	8,164	14.3%	29.4%
Research and development expenses	454	1.9%	347	1.6%	(23.6)%	1,334	2.3%	1,138	2.0%	(14.7)%
Income from operations	2,252	9.7%	1,894	8.4%	(15.9)%	5,770	9.8%	1,704	2.9%	(70.5)%
Interest expense	648	2.8%	33	0.1%	(94.9)%	1,272	2.2%	141	0.2%	(88.9)%
Dividend and interest income	286	1.2%	325	1.5%	13.6%	480	.8%	1,492	2.6%	210.8%
Income before income tax	1,890	8.1%	2,186	9.8%	15.7%	4,978	8.4%	3,055	5.3%	(38.6)%
Income tax expense	737	3.2%	1,032	4.6%	40.0%	2,023	3.5%	1,414	2.5%	(30.1)%
Net income	1,153	4.9%	1,154	5.2%	0.1%	2,955	4.9%	1,641	2.8%	(44.4)%
Accretion of redeemable preferred stock and preferred stock dividends	(75)	(.3)%	—	0.0%	100.0%	(225)	(.4)%	—	0.0%	100.0%
Participation rights of preferred stock in undistributed earnings	(264)	(1.1)%	—	0.0%	100.0%	(775)	(1.3)%	—	0.0%	100.0%
Net income attributable to common shareholders	\$ 814	3.5%	\$ 1,154	5.2%	40.9%	\$ 1,955	3.2%	\$ 1,641	2.8%	(16.2)%

Revenue. Product revenue increased from \$18.9 million for the third quarter ended December 31, 2007 to \$20.7 million for the third quarter ended December 31, 2008, an increase of \$1.7 million, or 9%. Product revenue increased from \$47.7 million for the nine months ended December 31, 2007 to \$50.8 million for the nine months ended December 31, 2008, an increase of \$3.2 million, or 7%. The increase in product revenue was a result of increased sales of our HIF lighting systems through our wholesale channel. Service revenue decreased from \$4.4 million for the third quarter ended December 31, 2007 to \$1.7 million for the third quarter ended December 31, 2008, a decrease of \$2.7 million, or 61%. Service revenue decreased from \$10.8 million for the nine months ended December 31, 2007 to \$6.4 million for the nine months ended December 31, 2008, a decrease of \$4.4 million, or 40%. The decrease in service revenues was a result of the increased revenues to our wholesale channels where services are not provided. Additionally, our fiscal 2009 nine months revenue was impacted by a lengthening sales cycle in the marketplace. We attribute this to general conservatism in the marketplace concerning capital spending and purchase decisions due to adverse economic and credit market conditions. We expect these circumstances to continue in our fourth quarter.

Cost of Revenue and Gross Margin. Our cost of product revenue increased from \$12.2 million for the third quarter ended December 31, 2007 to \$13.6 million for the third quarter ended December 31, 2008, an increase of \$1.4 million, or 11%. Our cost of product revenue increased from \$31.0 million for the nine months ended December 31, 2007 to \$33.7 million for the nine months ended December 31, 2008, an increase of \$2.7 million, or 9%. Our cost of service revenues decreased from \$2.8 million for the third quarter ended December 31, 2007 to \$1.3 million for the third quarter ended December 31, 2008, a decrease of \$1.5 million, or 54%. Total gross margin decreased from 35.4% for the third quarter ended December 31, 2007 to 33.2% for the third quarter ended December 31, 2008 and decreased from 34.5% for the nine months ended December 31, 2007 to 33.1% for the nine months ended December 31, 2008. The decrease in gross margin was attributable to unabsorbed manufacturing capacity costs related to additions of new process capabilities added in the fiscal 2008 fourth quarter for product coating and fabrication equipment. Additionally, for the three months ended December 31, 2008, gross margin was negatively impacted by manufacturing costs incurred as a result of increasing volumes of our enclosure fixtures and recently launched wet rated fixtures. These product lines are more complicated to manufacture and require more production time for fabrication and assembly. Due to customer project timelines, we incurred an additional \$0.3 million in added personnel costs, overtime costs and inefficiencies resulting in a margin impact of 1.3 basis points for the quarter. Over the past several weeks, we have reengineered our assembly process for enclosure fixtures, eliminated the additional staffing and reduced material handling costs. As a result, we believe that we are now better positioned to improve our gross margin on these products in the future. Gross margin may increase slightly in our fourth quarter to the extent our production volumes increase to support our planned roll-out programs and proposal pipeline and to the extent that we reduce excess capacity in our new manufacturing process equipment.

Operating Expenses

General and Administrative. Our general and administrative expenses decreased from \$3.3 million for the third quarter ended December 31, 2007 to \$2.4 million for the third quarter ended December 31, 2008, a decrease of \$0.9 million, or 27%. The decrease was a result of \$1.4 million in decreased compensation costs as a result of \$0.8 million in one-time IPO bonuses paid in December

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2007 that did not recur, \$0.4 million in decreased compensation for executive bonuses and \$0.2 million in cancelled discretionary bonus awards. Additionally, our stock compensation expense decreased by \$0.1 million and discretionary spending decreased by \$0.1 million. These decreases were offset by: (i) \$0.2 million in increased compensation for base wage increases for existing employees and increased compensation costs related to hiring additional employees in our accounting, information technology and administration departments; (ii) additional legal expenses of \$0.2 million, including \$0.1 million incurred for costs related to the class action litigation; and (iii) \$0.4 million of public company costs related to audit and tax support, investor relations, compliance and SOX initiatives that were not incurred during the third quarter of fiscal 2008.

General and administrative expenses increased from \$6.7 million for the nine months ended December 31, 2007 to \$7.9 million for the nine months ended December 31, 2008, an increase of \$1.2 million, or 18%. Total headcount increased from the prior year as we added staff support in our accounting, information technology, human resources and administrative functions resulting in increased compensation costs. Legal expenses increased as a result of the class action litigation and public company reporting and compliance costs. Additionally, as a result of being a public company, we have incurred increased costs for audit and tax support, SOX compliance and other public company administrative costs. For the nine months ended December 31, 2008, we recorded a \$0.4 million gain on the sale of an asset which was reported as a reduction in our general and administrative expenses.

Sales and Marketing. Our sales and marketing expenses increased from \$2.3 million for the third quarter ended December 31, 2007 to \$2.7 million for the third quarter ended December 31, 2008, an increase of \$0.4 million, or 17%. The increase was a result of increased employee compensation and stock compensation costs of \$0.6 million from our hiring additional sales and marketing personnel during fiscal 2009. Our marketing costs increased by \$0.2 million as a result of our efforts to increase our brand awareness through direct mail campaigns into the wholesale channel and participation in national trade shows. Spending decreases were due to reduced variable compensation costs related to reduced commissions and bonuses of \$0.4 million.

Sales and marketing expenses increased from \$6.3 million for the nine months ended December 31, 2007 to \$8.2 million for the nine months ended December 31, 2008, an increase of \$1.9 million, or 30%. The increase was a result of increased employee compensation, recruiting and stock compensation costs of \$1.8 million from our hiring additional sales and marketing personnel during fiscal 2009. A majority of new sales and marketing hires were completed within our first fiscal quarter. Our marketing costs increased by \$0.6 million as a result of our efforts to increase our brand awareness through direct mail into the wholesale channel and through participation in national trade shows. Spending decreases were due to reduced variable commission plans of \$0.3 million and reduced discretionary bonus expense of \$0.3 million.

Research and Development. Our research and development expenses decreased for the third quarter and nine months ended December 31, 2008 from the third quarter and nine months ended December 31, 2007 on an absolute dollar basis and as a percentage of total revenue as a result of decreased research consulting expenses and a reduction in sample and material costs as our wireless control product transitioned into production stages.

Interest Expense. Our interest expense decreased by \$0.2 million for the third quarter and by \$0.5 million for the nine months ended December 31, 2008 from the third quarter and nine months ended December 31, 2007 due to the payoff of our revolving line of credit balance in December 2007. Additionally, for the nine months ended December 2007, we recorded \$0.5 million in interest expense from our then outstanding convertible debt. The debt converted into common shares as a result of the completion of our IPO. For the nine months ended December 31, 2008, we capitalized \$0.2 million of interest for construction in progress.

Dividend and Interest Income. Dividend and interest income increased for the three and nine months ended December 31, 2008 from the three and nine months ended December 31, 2007 due to interest income earned on the invested proceeds from our IPO completed in December 2007.

Income Taxes. Our income tax expense increased for the three months ended December 31, 2008 from the three months ended December 31, 2007 due to the increase in taxable income. Our income tax expense decreased for the nine months ended December 31, 2008 from the nine months ended December 31, 2007 due to the decrease in taxable income. Our effective income tax rate for the nine months ended December 31, 2008 was 46.3%, compared to 40.6% for the nine months ended December 31, 2007. The increase in our effective tax rate was due to an increase in non-deductible stock compensation expense, a mix change in state tax rates, and a reduction in federal tax credits due to a reduction in taxable income after stock option deductions.

Liquidity and Capital Resources

Overview

On December 24, 2007, we completed our initial public offering. Net proceeds to us from the offering were approximately \$82.8 million (net of underwriting discounts and commissions but before the deduction of offering expenses). We invested the net proceeds from the IPO in money market funds and short-term government agency bonds.

We had approximately \$24.2 million in cash and cash equivalents and \$24.7 million in short-term investments as of December 31, 2008. Our cash equivalents are invested in money market accounts, bank certificates of deposit and commercial paper with maturities of less than 90 days and an average yield of 2.1%. Our short-term investment account consists of high-grade government agency bonds, bank certificates of deposit and AAA-rated corporate debt with expiration dates ranging from February 2009 through November 2009 and an average yield of 2.8%.

Cash Flows

The following table summarizes our cash flows for the nine months ended December 31, 2007 and 2008 (in thousands):

	Nine Months Ended December 31,	
	2007	2008
Operating activities	\$ (2,115)	\$ (468)
Investing activities	(1,821)	(33,491)
Financing activities	86,946	(20,178)
Increase (decrease) in cash and cash equivalents	<u>\$ 83,010</u>	<u>\$ (54,137)</u>

Cash Flows Related to Operating Activities. Cash used in operating activities primarily consists of net income adjusted for certain non-cash items; including depreciation and amortization, stock-based compensation expenses, income taxes and the effect of changes in working capital and other activities.

Cash used in operating activities for the nine months ended December 31, 2008 was \$0.5 million and consisted of net cash of \$4.7 million used for working capital purposes partially offset by net income adjusted for non-cash expense items of \$4.2 million. Cash used for working capital consisted of an increase of \$1.8 million in inventory to provide safety stock inventories on key components, a \$1.5 million increase in trade receivables attributed to national account customers holding cash at calendar year-end, a \$0.7 million increase in prepaids due to advanced payments for income taxes and services, a \$0.4 million increase in deferred costs due to incomplete projects where revenue has not yet been recognized, a \$0.1 million increase for interest receivable on short-term investments, and a \$1.6 million decrease in accrued expenses due to \$0.8 million for payments to contractors for project services performed and a \$0.8 million decrease in compensation accruals for payments made and bonus accruals no longer required. This amount was offset by a \$1.4 million increase in accounts payable due to inventory purchases within the quarter that were still within payment terms.

Cash used in operating activities for the nine months ended December 31, 2007 was \$2.1 million and consisted of net income adjusted for non-cash expense items of \$5.6 million offset by cash used for working capital purposes of \$7.7 million. Cash used for working capital purposes consisted of an increase of \$3.1 million in trade receivables as result of increased revenues, an increase of \$7.8 million in inventory due to purchases of raw materials to support sales order backlogs and an increase of \$0.1 million in prepaids due to advanced payments for services. These amounts were offset by an increase of \$2.0 million in accounts payable as a result of increased inventories and services, and an increase in accrued expenses of \$2.0 million due to increased service contracting activities, increased legal costs for the public offering preparation, and an increase in sales tax accruals resulting from the revenue increase.

Cash Flows Related to Investing Activities. For the nine months ended December 31, 2008, cash used in investing activities was \$33.5 million. This included \$22.3 million for short-term investments with maturity dates ranging from 91 to 360 days, \$10.6 million for capital expenditures related to the technology center, operating software systems and processing equipment for capacity and cost improvement measures, and \$1.0 million for the purchase of intellectual property rights from an executive, partially offset by net proceeds from the sale of an investment of \$0.5 million.

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Cash used in investing activities for the nine months ended December 31, 2007 was \$1.8 million. This included \$1.9 million for capital expenditures for purchases of processing equipment for capacity and cost improvement measures and \$0.1 million for the continued development of intellectual property. Cash provided from investing activities included a \$0.2 million payment received on a shareholder advance.

Cash Flows Related to Financing Activities. For the nine months ended December 31, 2008, cash flows used in financing activities was \$20.2 million. This included \$22.4 million used for common share repurchases and \$0.6 million for repayment of long-term debt. Cash flows provided by financing activities included proceeds of \$1.4 million received from stock option and warrant exercises and \$1.5 million in deferred tax benefits from non-qualified stock option exercises.

Cash provided by financing activities for the nine months ended December 31, 2007 was \$86.9 million. In addition to the \$78.6 million of net proceeds from our initial public offering, financing activities included \$11.3 million in proceeds from our issuance of convertible debt, \$1.9 million for proceeds received from stock option and warrant exercises, \$0.8 million received in payments of shareholder note receivables and \$1.2 million in deferred tax benefits from non-qualified stock option exercises. These were offset by \$6.6 million for repayment of the revolving line of credit and long-term debt.

Working Capital

Our net working capital as of December 31, 2008 was \$77.3 million, consisting of \$89.7 million in current assets and \$12.4 million in current liabilities. Our net working capital as of March 31, 2008 was \$104.3 million, consisting of \$116.9 million in current assets and \$12.6 million in current liabilities. At December 31, 2008, our accounts receivable balance increased from our prior fiscal year-end. We attribute this to our direct retail account customers holding onto cash at calendar year-end. During the first seven business days of January, we received collections of \$3.8 million, or approximately 20% of our outstanding receivables balance at year-end. We believe that our receivables portfolio continues to remain sound and highly collectible. We are cognizant of the current liquidity and credit challenges in the economic environment and the high level of underwriting due diligence required as we review new customer opportunities. Our inventories have increased from our prior fiscal year-end as a result of our wireless Phase 2 initiative. The vast majorities of these components are assembled overseas and require longer delivery lead times. We attempt to maintain 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 receivables, inventory and payables may increase to the extent our revenue and order levels increase.

We believe that our existing cash and cash equivalents, our anticipated cash flows from operating activities and our borrowing capacity under our revolving credit facility will be sufficient to meet our anticipated cash needs for at least the remainder of fiscal 2009.

Indebtedness

On March 18, 2008, we entered into a credit agreement to replace a previous agreement between us and Wells Fargo Bank, N.A. The credit agreement provides for a revolving credit facility that matures on August 31, 2010. The initial maximum aggregate amount of availability under the line of credit is \$25.0 million. We have a one-time option to increase the maximum aggregate amount of availability under the line of credit to up to \$50.0 million, although any advance from the line of credit over \$25.0 million is discretionary to Wells Fargo even if no event of default has occurred. Borrowings are limited to a percentage of eligible trade accounts receivables and inventories, less any borrowing base reserve that may be established from time to time. Borrowings allowed under the line of credit as of December 31, 2008 were \$20.2 million based upon available working capital, as defined. In December 2008, we briefly drew \$4.0 million on the line due to the timing of treasury repurchases and funds available in our operating account. As of December 31, 2008, the borrowings had been repaid and there was no balance due on the line of credit.

We must pay a fee of 0.20% on the average daily unused amount of the line of credit and fees upon the issuance of each letter of credit equal to 1.25% per annum of the principal amount thereof.

We have the option to select the interest rate applicable to all or a portion of the outstanding principal balance under the line of credit either (i) at a fluctuating rate per annum one percent (1.00%) below the prime rate in effect from time to time, or (ii) at a fixed rate per annum determined by Wells Fargo to be one and one quarter percent (1.25%) above LIBOR.

In addition to our revolving credit facility, we also have other existing long-term indebtedness and obligations under various debt instruments and capital lease obligations, including pursuant to a bank term note, a bank first mortgage, a debenture to a community

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development organization, a federal block grant loan, two city industrial revolving loans and various capital leases and equipment purchase notes. As of December 31, 2008, the total amount of principal outstanding on these various obligations was \$4.7 million. These obligations have varying maturity dates between 2010 and 2024 and bear interest at annual rates of between 2.0% and 16.2%. The weighted average annual interest rate of such obligations as of December 31, 2008 was 5.6%. Based on interest rates in effect as of December 31, 2008, we expect that our total debt service payments on such remaining obligations for fiscal 2009, including scheduled principal, lease and interest payments, will approximate \$0.3 million. As of December 31, 2008, we were in compliance with all debt covenants, as amended.

Capital Spending

We expect to incur approximately \$1.2 million in capital expenditures during the remainder of fiscal 2009 to complete our new technology center and other improvements at our manufacturing facility. We also plan to incur \$0.5 million in capital expenditures to expand and improve our ERP systems. Our capital spending plans predominantly consist of the completion of projects that have been in place for several months and for which we have already invested significant capital. We consider the completion of our ERP systems critical to our long-term success and our ability to ensure a strong control environment over financial reporting and operations. We expect to finance the technology center and manufacturing improvement expenditures primarily through equipment secured loans and leases, long-term debt financing, using cash on hand or by using our available capacity under our revolving credit facility.

Contractual Obligations and Commitments

The following table is a summary of our long-term contractual obligations as of December 31, 2008 (dollars in thousands):

	<u>Total</u>	<u>Less than 1 Year</u>	<u>1-3 Years</u>	<u>3-5 Years</u>	<u>More than 5 Years</u>
Bank debt obligations	\$ 4,681	\$ 868	\$ 1,290	\$ 1,136	\$ 1,387
Cash interest payments on debt	1,198	241	366	236	355
Operating lease obligations	3,166	1,075	1,337	743	11
Purchase order and cap-ex commitments (1)	5,457	4,282	1,175	—	—
Total	\$ 14,502	\$ 6,466	\$ 4,168	\$ 2,115	\$ 1,753

- (1) Reflects non-cancellable purchase order commitment in the amount of \$3.8 million for certain inventory items entered into in order to secure better pricing and ensure materials on hand and capital expenditure commitments in the amount of \$1.7 million for construction of the new technology center at our Manitowoc facility, improvements to information technology systems and manufacturing equipment and tooling.

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

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, 2008. There have been no material changes in any of our accounting policies since March 31, 2008.

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, 2008. There have been no material changes to such exposures since March 31, 2008.

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, 2008 pursuant to Rule 13a-15(b) of the Securities Exchange Act of 1934 (the “Exchange Act”). Based upon their evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the quarter ended December 31, 2008 to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission’s rules and forms, and to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosures.

There was no change in our internal control over financial reporting that occurred during the quarter ended December 31, 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

This quarterly report does not include a report of management’s assessment regarding internal control over financial reporting or an attestation report of the Company’s registered public accounting firm due to a transition period established by rules of the Securities and Exchange Commission for newly public companies.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are subject to various claims and legal proceedings arising in the ordinary course of our business. In addition to ordinary-course litigation, we are a party to the litigation described below.

In February and March 2008, three class action lawsuits were filed in the United States District Court for the Southern District of New York against us, several of our officers, all members of our then existing board of directors, and certain underwriters from our December 2007 initial public offering. The plaintiffs claim to represent certain persons who purchased shares of our common stock from December 18, 2007 through February 6, 2008. The plaintiffs allege, among other things, that the defendants made misstatements and failed to disclose material information in our registration statement and prospectus for our initial public offering. The complaints allege various claims under the Securities Act of 1933, as amended. The complaints seek, among other relief, class certification, unspecified damages, fees, and such other relief as the court may deem just and proper.

On August 1, 2008, the court-appointed lead plaintiff filed a consolidated amended complaint in the United States District Court for the Southern District of New York. On September 15, 2008, we and the other director and officer defendants filed a brief in support of the motion to dismiss the consolidated complaint. On November 13, 2008, the lead plaintiff filed a brief in opposition to the motion to dismiss. On December 15, 2008, we and the other director and officer defendants, filed a reply brief in support of their motion to dismiss. Having been fully briefed, the motion to dismiss is awaiting the court’s review and decision.

We believe that we and the other defendants have substantial legal and factual defenses to the claims and allegations contained in the consolidated complaint, and we intend to pursue these defenses vigorously. There can be no assurance, however, that we will be successful, and an adverse resolution of the lawsuit could have a material adverse effect on our consolidated financial position, results of operations and cash flow. In addition, although we carry insurance for these types of claims, a judgment significantly in excess of our insurance coverage could materially and adversely affect our financial condition, results of operations and cash flows. We are not presently able to reasonably estimate potential losses, if any, related to the lawsuit.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**(b) Use of Proceeds**

Our IPO was declared effective by the SEC on December 18, 2007. The net offering proceeds received by us, after deducting underwriting discounts and commissions and expenses incurred in connection with the offering, were approximately \$78.6 million. Through December 31, 2008, approximately \$29.7 million of the proceeds from our IPO have been used to fund operations of our business and for general corporate purposes, including \$22.4 million used for the repurchase of common shares. The remainder of the net proceeds from the IPO are invested in short-term investment grade securities, bank certificate of deposits, commercial paper and money market accounts. Other than for our share repurchases, there has been no material change in the planned use of proceeds from our IPO as described in our final prospectus filed with the SEC on December 18, 2007 pursuant to Rule 424(b).

ITEM 5. OTHER INFORMATION**Statistical Data**

The following table presents certain statistical data, cumulative from December 1, 2001 through December 31, 2008, regarding sales of our HIF lighting systems, total units sold (including HIF lighting systems), customer kilowatt demand reduction, customer kilowatt hours saved, customer electricity costs saved, indirect carbon dioxide emission reductions from customers' energy savings, and square footage we have retrofitted. The assumptions behind our calculations are described in the footnotes to the table below.

	Cumulative From December 1, 2001 Through December 31, 2008 (in thousands, unaudited)
HIF lighting systems sold(1)	1,419
Total units sold (including HIF lighting systems)	1,825
Customer kilowatt demand reduction(2)	423
Customer kilowatt hours saved(2)(3)	6,683,363
Customer electricity costs saved(4)	\$ 514,619
Indirect carbon dioxide emission reductions from customers' energy savings (tons)(5)	4,389
Square footage retrofitted(6)	725,679

(1) "HIF lighting systems" includes all HIF units sold under the brand name "Compact Modular" and its predecessor, "Illuminator."

(2) A substantial majority of our HIF lighting systems, which generally operate at approximately 224 watts per six-lamp fixture, are installed in replacement of HID fixtures, which generally operate at approximately 465 watts per fixture in commercial and industrial applications. We calculate that each six-lamp HIF lighting system we install in replacement of an HID fixture generally reduces electricity consumption by approximately 241 watts (the difference between 465 watts and 224 watts). In retrofit projects where we replace fixtures other than HID fixtures, or where we replace fixtures with products other than our HIF lighting systems (which other products generally consist of products with lamps similar to those used in our HIF systems, but with varying frames, ballasts or power packs), we generally achieve similar wattage reductions (based on an analysis of the operating wattages of each of our fixtures compared to the operating wattage of the fixtures they typically replace). We calculate the amount of kilowatt demand reduction by multiplying (i) 0.241 kilowatts per six-lamp equivalent unit we install by (ii) the number of units we have installed in the period presented, including products other than our HIF lighting systems (or a total of approximately 1.68 million units).

(3) We calculate the number of kilowatt hours saved on a cumulative basis by assuming the reduction of 0.241 kilowatts of electricity consumption per six-lamp equivalent unit we install and assuming that each such unit has averaged 7,500 annual operating hours since its installation.

(4) We calculate our customers' electricity costs saved by multiplying the cumulative total customer kilowatt hours saved indicated in the table by \$0.077 per kilowatt hour. The national average rate for 2007, which is the most current full year for which this information is available, was \$0.091 per kilowatt hour according to the United States Energy Information Administration.

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- (5) We calculate this figure by multiplying (i) the estimated amount of carbon dioxide emissions that result from the generation of one kilowatt hour of electricity (determined using the Emissions and Generation Resource Integration Database, or EGrid, prepared by the United States Environmental Protection Agency), by (ii) the number of customer kilowatt hours saved as indicated in the table. The calculation of indirect carbon dioxide emissions reductions reflects the most recent Environmental Protection Agency eGrid data.
- (5) Based on 1.825 million total units sold, which contain a total of approximately 9.1 million lamps. Each lamp illuminates approximately 75 square feet. The majority of our installed fixtures contain six lamps and typically illuminate approximately 450 square feet.

Executive Employment Agreement

On February 4, 2009, the Company entered into an Executive Employment and Severance Agreement (the "Employment Agreement"), the general content of which was previously disclosed by the Company in its Registration Statement on Form S-1 (Reg. No. 333-145569), with Patricia A. Verfueth. The terms and conditions of the Employment Agreement are the same as the terms and conditions of the employment agreements that that Company entered into with executive officers in February 2008, as disclosed in the Company's Current Report on Form 8-K dated February 15, 2008, except that (i) Ms. Verfueth's position will continue to be Vice President of Operations; (ii) her base salary for the Company's fiscal year ending March 31, 2009 will continue to be her existing base salary of \$175,000, subject to potential increase by the Board of Directors from time to time thereafter; (iii) her renewal period will be one year; and (iv) her severance multipliers will be one-half and one prior to and after, respectively, a "Change of Control" (as defined in the Employment Agreement).

The foregoing description of the Employment Agreement is qualified in its entirety by reference to the full text of the Employment Agreement, a copy of which is filed herewith as Exhibit 10.1 and incorporated herein by reference.

ITEM 6. EXHIBITS

(a) Exhibits

- 10.1 Executive Employment and Severance Agreement, dated February 4, 2009, by and between Orion Energy Systems, Inc. and Patricia A. Verfueth.
- 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.

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, 2009.

ORION ENERGY SYSTEMS, INC.
Registrant

By /s/ Scott R. Jensen

Scott R. Jensen
Chief Financial Officer

Exhibit Index to Form 10-Q for the Period Ended December 31, 2008

- 10.1 Executive Employment and Severance Agreement, dated February 4, 2009, by and between Orion Energy Systems, Inc. and Patricia A. Verfuert.
- 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.

Name of Executive:	Patricia A. Verfuert
Position:	Vice President of Operations
Fiscal Year 2009 Base Salary:	\$175,000
Initial Term:	Effective date through March 31, 2009
Renewal Periods are:	1 Year
Post-Change of Control Renewal Period is:	1 Year
Severance Multiplier is:	0.5x
Post-Change of Control Severance Multiplier is:	1x

EXECUTIVE EMPLOYMENT AND SEVERANCE AGREEMENT

This Agreement ("Agreement") is between the Executive named above ("Executive"), on the one hand, and Orion Energy Systems, Inc. ("Orion" and together with its subsidiaries, the "Company"), on the other.

WHEREAS, the Executive is employed by Orion in a key employee capacity and the Executive's services are valuable to the conduct of the business of the Company; and

WHEREAS, Orion and Executive desire to specify the terms and conditions on which Executive will continue employment on and after the date the Company's common stock is first sold to the public pursuant to an effective registration statement filed under the Securities Act of 1933, as amended (the "IPO"), and under which Executive will receive severance in the event that Executive separates from service with the Company;

NOW, THEREFORE, for good and valuable consideration, the parties agree as follows:

1. **Effective Date; Term.** This Agreement shall become effective on the date of the Company's IPO and continue until the end of the initial term set forth above. Thereafter, the Agreement shall renew automatically for successive renewal periods as set forth above unless and until either party provides written notice to the other party of the intent not to renew the Agreement at least ninety (90) days prior to the end of any term. Notwithstanding the foregoing, if a Change of Control occurs prior to the end of any term, the Agreement shall be automatically extended for the post- Change of Control renewal period set forth above beginning on the date of the Change of Control. Expiration of this Agreement will not affect the rights or obligations of the parties hereunder arising out of, or relating to, circumstances occurring prior to the expiration of this Agreement, which rights and obligations will survive the expiration of this Agreement.

2. **Definitions.** For purposes of this Agreement, the following terms shall have the meanings ascribed to them:

(a) "**Accrued Benefits**" shall mean the following amounts, payable as described herein: (i) all base salary for the time period ending with the Termination Date;

(ii) reimbursement for any and all monies advanced in connection with the Executive's employment for reasonable and necessary expenses incurred by the Executive on behalf of the Company for the time period ending with the Termination Date; (iii) any and all other cash earned through the Termination Date and deferred at the election of the Executive or pursuant to any deferred compensation plan then in effect; and (iv) all other payments and benefits to which the Executive (or in the event of the Executive's death, the Executive's surviving spouse or other beneficiary), including those provided pursuant to Exhibit A, is entitled on the Termination Date under the terms of any benefit plan of the Company, excluding severance payments under any Company severance policy, practice or agreement in effect on the Termination Date. Payment of Accrued Benefits shall be made promptly in accordance with the Company's prevailing practice with respect to clauses (i) and (ii) or, with respect to clauses (iii) and (iv), pursuant to the terms of the benefit plan or practice establishing such benefits.

(b) "**Base Salary**" shall mean the Executive's annual base salary with the Company as in effect from time to time.

(c) "**Board**" shall mean the board of directors of Orion or a committee of such Board authorized to act on its behalf in certain circumstances, including the Compensation Committee of the Board.

(d) "**Cause**" shall mean a good faith finding by the Board that Executive has (i) failed, neglected, or refused to perform the lawful employment duties related to his or her position or as from time to time assigned to him (other than due to Disability); (ii) committed any willful, intentional, or grossly negligent act having the effect of materially injuring the interest, business, or reputation of the Company; (iii) violated or failed to comply in any material respect with the Company's published rules, regulations, or policies, as in effect or amended from time to time; (iv) committed an act constituting a felony or misdemeanor involving moral turpitude, fraud, theft, or dishonesty; (v) misappropriated or embezzled any property of the Company (whether or not an act constituting a felony or misdemeanor); or (vi) breached any material provision of this Agreement or any other applicable confidentiality, non-compete, non-solicit, general release, covenant not-to-sue, or other agreement with the Company.

(e) "**Change of Control**" shall mean and be limited to any of the following:

(i) any Person (other than (A) the Company or any of its subsidiaries, (B) a trustee or other fiduciary holding securities under any employee benefit plan of the Company or any of its subsidiaries, (C) an underwriter temporarily holding securities pursuant to an offering of such securities or (D) a corporation owned, directly or indirectly, by the shareholders of the Company in substantially the same proportions as their ownership of stock in the Company ("Excluded Persons")) is or becomes the Beneficial Owner, directly or indirectly, of securities of the Company (not including in the securities beneficially owned by such Person any securities acquired directly from the Company or its Affiliates after the IPO Date, pursuant to express authorization by the Board that refers to this exception) representing twenty percent (20%) or more of either the then outstanding shares of common stock of the Company or the combined voting power of the Company's then outstanding voting securities; or

(ii) the following individuals cease for any reason to constitute a majority of the number of directors of the Company then serving: (A) individuals who, on the IPO Date, constituted the Board and (B) any new director (other than a director whose initial assumption of office is in connection with an actual or threatened election contest, including but not limited to a consent solicitation, relating to the election of directors of the Company, as such terms are used in Rule 14a-11 of Regulation 14A under the Act) whose appointment or election by the Board or nomination for election by the Company's shareholders was approved by a vote of at least two-thirds (2/3) of the directors then still in office who either were directors on the IPO Date, or whose appointment, election or nomination for election was previously so approved (collectively the "Continuing Directors"); *provided, however,* that individuals who are appointed to the Board pursuant to or in accordance with the terms of an agreement relating to a merger, consolidation, or share exchange involving the Company (or any direct or indirect subsidiary of the Company) shall not be Continuing Directors for purposes of this Agreement until after such individuals are first nominated for election by a vote of at least two-thirds (2/3) of the then Continuing Directors and are thereafter elected as directors by the shareholders of the Company at a meeting of shareholders held following consummation of such merger, consolidation, or share exchange; *and, provided further,* that in the event the failure of any such persons appointed to the Board to be Continuing Directors results in a Change of Control, the subsequent qualification of such persons as Continuing Directors shall not alter the fact that a Change of Control occurred; or

(iii) the consummation of a merger, consolidation or share exchange of the Company with any other corporation or the issuance of voting securities of the Company in connection with a merger, consolidation or share exchange of the Company (or any direct or indirect subsidiary of the Company), in each case, which requires approval of the shareholders of the Company, other than (A) a merger, consolidation or share exchange which would result in the voting securities of the Company outstanding immediately prior to such merger, consolidation or share exchange continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity or any parent thereof) at least fifty percent (50%) of the combined voting power of the voting securities of the Company or such surviving entity or any parent thereof outstanding immediately after such merger, consolidation or share exchange, or (B) a merger, consolidation or share exchange effected to implement a recapitalization of the Company (or similar transaction) in which no Person (other than an Excluded Person) is or becomes the Beneficial Owner, directly or indirectly, of securities of the Company (not including in the securities beneficially owned by such Person any securities acquired directly from the Company or its Affiliates after the IPO Date, pursuant to express authorization by the Board that refers to this exception) representing twenty percent (20%) or more of either the then outstanding shares of common stock of the Company or the combined voting power of the Company's then outstanding voting securities; or

(iv) the consummation of a plan of complete liquidation or dissolution of the Company or a sale or disposition by the Company of all or substantially all of the Company's assets (in one transaction or a series of related transactions within any period of 24 consecutive months), in each case, which requires

approval of the shareholders of the Company, other than a sale or disposition by the Company of all or substantially all of the Company's assets to an entity at least seventy-five percent (75%) of the combined voting power of the voting securities of which are owned by Persons in substantially the same proportions as their ownership of the Company immediately prior to such sale.

Notwithstanding the foregoing, no "Change of Control" shall be deemed to have occurred if there is consummated any transaction or series of integrated transactions immediately following which the record holders of the common stock of the Company immediately prior to such transaction or series of transactions continue to own, directly or indirectly, in the same proportions as their ownership in the Company, an entity that owns all or substantially all of the assets or voting securities of the Company immediately following such transaction or series of transactions.

For purposes of this Section 2(e):

(i) the term "Person" shall mean any individual, firm, partnership, corporation or other entity, including any successor (by merger or otherwise) of such entity, or a group of any of the foregoing acting in concert;

(ii) the terms "Affiliate" and "Associate" shall have the respective meanings ascribed to such terms in Rule 12b-2 of the General Rules and Regulations of the Act;

(iii) the term "Act" means the Securities Exchange Act of 1934, as amended; and

(iv) a Person shall be deemed to be the "Beneficial Owner" of any securities which:

a) such Person or any of such Person's Affiliates or Associates has the right to acquire (whether such right is exercisable immediately or only after the passage of time) pursuant to any agreement, arrangement or understanding, or upon the exercise of conversion rights, exchange rights, rights, warrants or options, or otherwise; *provided, however*, that a Person shall not be deemed the Beneficial Owner of, or to beneficially own, securities tendered pursuant to a tender or exchange offer made by or on behalf of such Person or any of such Person's Affiliates or Associates until such tendered securities are accepted for purchase;

b) such Person or any of such Person's Affiliates or Associates, directly or indirectly, has the right to vote or dispose of or has "beneficial ownership" of (as determined pursuant to Rule 13d-3 of the General Rules and Regulations under the Act), including pursuant to any agreement, arrangement or understanding; *provided, however*, that a Person shall not be deemed the Beneficial Owner of, or to beneficially own, any security under this clause b) as a result of an agreement, arrangement or understanding to vote such security if the agreement, arrangement or understanding: (A) arises solely from a revocable proxy or consent given to such Person in response to a public proxy or consent solicitation made pursuant to, and in accordance with, the applicable rules and regulations

under the Act and (B) is not also then reportable on a Schedule 13D under the Act (or any comparable or successor report); or

c) are beneficially owned, directly or indirectly, by any other Person with which such Person or any of such Person's Affiliates or Associates has any agreement, arrangement or understanding for the purpose of acquiring, holding, voting (except pursuant to a revocable proxy as described in clause b) above) or disposing of any voting securities of the Company.

(f) "**COBRA**" shall mean the provisions of Code Section 4980B.

(g) "**Code**" shall mean the Internal Revenue Code of 1986, as amended, as interpreted by rules and regulations issued pursuant thereto, all as amended and in effect from time to time. Any reference to a specific provision of the Code shall be deemed to include reference to any successor provision thereto.

(h) "**Competitive Business Activity**" shall mean the design and manufacture of lighting systems and controls for industrial, commercial and agricultural facilities.

(i) "**Disability**" shall mean, subject to applicable law, a total and permanent disability consisting of a mental or physical disability which precludes the disabled Executive from performing the material and substantial duties of his employment. Payment of benefits for total disability under a disability insurance policy shall be conclusive as to the existence of total disability, although such payments are not required in order to establish total disability for purposes of this Agreement. The Executive has a "total and permanent disability" if he is precluded by mental or physical disability for 180 days during any twelve (12) month period. For purposes of this Agreement, an Executive shall be deemed totally and permanently disabled at the end of such 180th day. In case of a disagreement as to whether an Executive is totally and permanently disabled and, at the request of any party, the matter shall be submitted to arbitration as provided for herein, and judgment upon the award may be entered in any court having jurisdiction thereof. Any costs of such proceedings (including the reasonable legal fees of the prevailing party) shall be borne by the non-prevailing party to such arbitration.

(j) "**General Release**" shall mean a release of all claims that Executive, and anyone who may succeed to any claims of Executive, has or may have against Orion, its board of directors, any of its subsidiaries or affiliates, or any of their employees, directors, officers, employees, agents, plan sponsors, administrators, successors (including the Successor), fiduciaries, or attorneys, including but not limited to claims arising out of Executive's employment with, and termination of employment from, the Company, but excluding claims for (i) severance payments and benefits due pursuant to this Agreement and (ii) any salary, bonus, equity, accrued vacation, expense reimbursement and other ordinary payments or benefits earned or otherwise due with respect to the period prior to the date of any Separation from Service. The General Release shall be in a form that is reasonably acceptable to the Company or the Board.

(k) "**Good Reason**" shall mean the occurrence of any of the following without the consent of Executive: (i) a material diminution in the Executive's Base Salary; (ii) a material diminution in the Executive's authority, duties or responsibilities; (iii) a material diminution in the authority, duties or responsibilities of Neal Verfueth;

(iv) a material diminution in the budget over which the Executive retains authority; (v) a material change in the geographic location at which the Executive must perform services; or (vi) a material breach by Orion of any provisions of this Agreement or any option agreement with the Company to which the Executive is a party.

(l) **“Separation from Service”** shall mean Executive’s termination of employment from Orion and each entity that is required to be included in Orion’s controlled group of corporations within the meaning of Code Section 414(b), or that is under common control with Orion within the meaning of Code Section 414(c); *provided* that the phrase “at least 50 percent” shall be used in place of the phrase “ at least 80 percent” each place it appears therein or in the regulations thereunder (collectively, “409A affiliates”). Notwithstanding the foregoing:

(i) If Executive takes a leave of absence for purposes of military leave, sick leave or other bona fide leave of absence, Executive will not be deemed to have incurred a Separation from Service for the first six (6) months of the leave of absence, or if longer, for so long as Executive’s right to reemployment is provided either by statute or by contract.

(ii) Subject to paragraph (i), Executive shall incur a Separation from Service when the level of bona fide services provided by Executive to Orion and its 409A affiliates permanently decreases to a level of twenty percent (20%) or less of the level of services rendered by Executive, on average, during the immediately preceding 12 months of employment.

(iii) If, following Executive’s termination of employment, Executive continues to provide services to the Company or a 409A Affiliate in a capacity other than as an employee, Executive will not be deemed to have Separated from Service as long as Executive is providing bona fide services at a rate that is greater than twenty percent (20%) of the level of services rendered by Executive, on average, during the immediately preceding 12 months of service.

(m) **“Severance Payment”** shall mean the Executive’s Base Salary at the time of the Termination Date plus the average of the annual bonuses earned by the Executive with respect to each of the three completed fiscal years of the Company preceding the year in which the Termination Date occurs (or such lesser number of fiscal years for which the Executive was employed by the Company, with any partial year’s bonus being annualized with respect to such fiscal year) multiplied by the severance multiplier set forth above; *provided* that if Executive’s Termination Date occurs on or following a Change of Control, the multiplier described above shall be increased to the post-Change of Control severance multiplier set forth above and any reduction in Executive’s Base Salary since the date of the Change of Control shall be ignored.

(n) **“Successor”** shall mean the person to which this Agreement is assigned upon a Sale of Business within the meaning of Section 10.

(o) **“Termination Date”** shall mean the date of the Executive’s termination of employment from the Company, as further described in Section 4.

3. Employment of Executive

(a) Position.

(i) Executive shall serve in the position set forth above in a full-time capacity. In such position, Executive shall have such duties and authority as is customarily associated with such position and shall have such other titles and duties, consistent with Executive's position, as may be assigned from time to time by the Board.

(ii) Executive will devote Executive's full business time and best efforts to the performance of Executive's duties hereunder and will not engage in any other business, profession or occupation for compensation or otherwise which would conflict or interfere with the rendition of such services either directly or indirectly, without the prior written consent of the Board; *provided* that nothing herein shall preclude Executive, subject to the prior approval of the Board, from accepting appointment to or continue to serve on any board of directors or trustees of any business organization or any charitable organization; *further provided* in each case, and in the aggregate, that such activities do not conflict or interfere with the performance of Executive's duties hereunder or conflict with Section 7.

(b) **Base Salary.** Orion shall pay Executive a Base Salary at the respective annual rates set forth above for Fiscal Year 2008 and Fiscal Year 2009, payable in regular installments in accordance with the Company's usual payroll practices. Executive shall be entitled to such increases in Executive's base salary, if any, as may be determined from time to time by the Board.

(c) **Bonus Incentives.** Executive shall be entitled to participate in such annual and/or long-term cash and equity incentive plans and programs of Orion as are generally provided to the senior executives of Orion. On and after a Change of Control, to assure that Executive will have an opportunity to earn incentive compensation, the Executive shall be included in a bonus plan of the Employer which shall satisfy the standards described below (such plan, the "Bonus Plan"). Bonuses under the Bonus Plan shall be payable with respect to achieving such financial or other goals reasonably related to the business of the Company as the Company shall establish (the "Goals"), all of which Goals shall be attainable, prior to the end of the post-Change of Control renewal period (as set forth above), with approximately the same degree of probability as the most attainable goals under the Company's bonus plan or plans as in effect at any time during the 180-day period immediately prior to the Change of Control (whether one or more, the "Company Bonus Plan") and in view of the Company's existing and projected financial and business circumstances applicable at the time. The amount of the bonus (the "Bonus Amount") that Executive is eligible to earn under the Bonus Plan shall be no less than 100% of the Executive's target award provided in such Company Bonus Plan (such bonus amount herein referred to as the "Targeted Bonus"), and in the event the Goals are not achieved such that the entire Targeted Bonus is not payable, the Bonus Plan shall provide for a payment of a Bonus Amount equal to a portion of the Targeted Bonus reasonably related to that portion of the Goals which were achieved. Payment of the Bonus Amount shall not be affected by any circumstance occurring subsequent to the end of the post-Change of Control renewal period, including termination of Executive's employment.

(d) **Employee Benefits.** Executive shall be entitled to participate in the Company's employee benefit plans (other than annual and/or long-term incentive programs, which are addressed in subsection (c)) as in effect from time to time on the same basis as those benefits are generally made available to other senior executives of Orion. On and after a Change of Control, Executive shall be included: (i) to the extent eligible thereunder (which eligibility shall not be conditioned on Executive's salary grade or on any other requirement which excludes persons of comparable status to the Executive unless such exclusion was in effect for such plan or an equivalent plan immediately prior to the Change in Control of the Company), in any and all plans providing benefits for the Company's salaried employees in general (including but not limited to group life insurance, hospitalization, medical, dental, and long-term disability plans) and (ii) in plans provided to executives of the Company of comparable status and position to Executive (including but not limited to deferred compensation, split-dollar life insurance, supplemental retirement, stock option, stock appreciation, stock bonus, cash bonus and similar or comparable plans); provided, that, in no event shall the aggregate level of benefits under the plans described in clause (i) and the plans described in clause (ii), respectively, in which Executive is included be less than the aggregate level of benefits under plans of the Company of the type referred to in such clause, respectively, in which Executive was participating immediately prior to the Change in Control.

(e) **Business Expenses.** The reasonable business expenses incurred by Executive in the performance of Executive's duties hereunder shall be reimbursed by the Company in accordance with Company policies.

(f) **Other Perquisites.** Executive shall be entitled to receive the other benefits and perquisites set forth in Exhibit A.

4. **Termination of Employment.** Executive's employment with the Company will terminate during the term of the Agreement, and this Agreement will terminate on the date of such termination, as follows:

(a) Executive's employment will terminate upon Executive's death.

(b) If Executive is Disabled, and if within thirty (30) days after Orion notifies the Executive in writing that it intends to terminate the Executive's employment, the Executive shall not have returned to the performance of the Executive's duties hereunder on a full-time basis, Orion may terminate the Executive's employment, effective immediately following the end of such thirty-day period.

(c) Orion may terminate Executive's employment with or without Cause (other than as a result of Disability which is governed by subsection (b)) by providing written notice to Executive that indicates in reasonable detail the facts and circumstances alleged to provide a basis for such termination. If the termination is without Cause, Executive's employment will terminate on the date specified in the written notice of termination. If the termination is for Cause, the Executive shall have thirty (30) days from the date the written notice is provided, or such longer period as Orion may determine to be appropriate, to cure any conduct or act, if curable, alleged to provide grounds for termination of Executive's employment for Cause. If the alleged conduct or act constituting Cause is not curable, Executive's employment will terminate on the date specified in the written notice of termination. If the alleged conduct or act constituting

Cause is curable but Executive does not cure such conduct or act within the specified time period, Executive's employment will terminate on the date immediately following the end of the cure period. Notwithstanding the foregoing, a determination of Cause shall only be made in good faith by the Board, and after a Change of Control, by the Board of Directors of the Successor, which may terminate Executive for Cause only after providing Executive (i) written notice as set forth above, (ii) the opportunity to appear before such board and provide rebuttal to such proposed termination, and (iii) written notice following such appearance confirming such termination and certifying that the decision to terminate Executive for Cause was approved in good faith by at least sixty-six percent (66%) of the members of such board, excluding Executive. Unless otherwise directed by Orion, from and after the date of the written notice of proposed termination, Executive shall be relieved of his or her duties and responsibilities and shall be considered to be on a paid leave of absence pending any final action by the Board or the Board of Directors of the Successor confirming such proposed termination.

(d) Executive may terminate his or her employment for or without Good Reason by providing written notice of termination to Orion that indicates in reasonable detail the facts and circumstances alleged to provide a basis for such termination. If Executive is alleging a termination for Good Reason, Executive must provide written notice to Orion of the existence of the condition constituting Good Reason within ninety (90) days of the initial existence of such condition, and Orion must have a period of at least thirty (30) days following receipt of such notice to cure such condition. If such condition is not cured by Orion within such thirty-day period, Executive's termination of employment from the Company shall be effective on the date immediately following the end of such cure period.

5. Payments upon Termination.

(a) **Entitlement to Severance.** Subject to the other terms and conditions of this Agreement, Executive shall be entitled to the Accrued Benefits, and to the severance benefits described in subsection (c), in either of the following circumstances while this Agreement is in effect:

- (i) Executive's employment is terminated by Orion without Cause, except in the case of death or Disability; or
- (ii) Executive terminates his or her employment with the Company for Good Reason.

If Executive dies after receiving a notice by Orion that Executive is being terminated without Cause, or after providing notice of termination for Good Reason, the Executive's estate, heirs and beneficiaries shall be entitled to the Accrued Benefits and the severance benefits described in subsection (c) at the same time such amounts would have been paid or benefits provided to Executive had he or she lived.

(b) **General Release Requirement.** As an additional prerequisite for receipt of the severance benefits described in subsection (c), Executive must execute, deliver to Orion, and not revoke (to the extent Executive is allowed to do so) a General Release.

(c) **Severance Benefits; Timing and Form of Payment.** Subject to the limitations imposed by Section 6, if Executive is entitled to severance benefits, then:

(i) Company shall pay Executive the Severance Payment in a lump sum within ten (10) days following the Executive's Separation from Service, or if later, the date on which the General Release is no longer revocable, or if later, the date on which the amount payable under Section 6 is determined, but in no event may be payment be made more than 2½ months after the year in which Executive's Separation from Service occurs;

(ii) At the same time that the Severance Payment is made, Company shall pay Executive a lump sum amount equal to the Executive's annual target cash bonus opportunity (if any) as established by the Board or the Compensation Committee of the Board for the fiscal year in which the Separation from Service occurs, multiplied by a fraction, the numerator of which is the number of days that have elapsed during the annual performance period to the date of the Executive's Separation from Service and the denominator of which is 365; and

(iii) Executive shall be entitled to pay premiums for COBRA continuation coverage for the length of such coverage at the same rate as is being charged to active employees for similar coverage.

All payments shall be subject to payroll taxes and other withholdings in accordance with the Company's (or the applicable employer of record's) standard payroll practices and applicable law.

(d) **Other Termination of Employment.** If Executive's employment terminates for any reason other than those described in subsection (a), the Executive (or the Executive's estate in the event of his or her death), shall be entitled to receive only the Accrued Benefits. Executive must be terminated for Cause pursuant to and in accordance with Section 4(c) of this Agreement in order for the consequences of such a Cause termination to apply to Executive under any stock option or similar equity award agreement with the Company to which Executive is then a party. The Company's obligations under this Section 5 shall survive the termination of this Agreement.

6. Limitations on Severance Payments and Benefits. Notwithstanding any other provision of this Agreement, if any portion of the Severance Payment or any other payment under this Agreement, or under any other agreement with or plan of the Company (in the aggregate "Total Payments"), would constitute an "excess parachute payment," then the Total Payments to be made to Executive shall be reduced such that the value of the aggregate Total Payments that Executive is entitled to receive shall be One Dollar (\$1) less than the maximum amount which Executive may receive without becoming subject to the tax imposed by Code Section 4999 or which the Company may pay without loss of deduction under Code Section 280G(a); *provided* that the foregoing reduction in the amount of Total Payments shall not apply if the After-Tax Value to Executive of the Total Payments prior to reduction in accordance herewith is greater than the After-Tax Value to Executive if Total Payments are reduced in accordance herewith. For purposes of this Agreement, the terms "excess parachute payment" and "parachute payments" shall have the meanings assigned to them in Code Section 280G, and such "parachute payments" shall be valued as provided therein. Present value for purposes of this Agreement shall be calculated in accordance with Code Section 1274(b)(2). Within twenty (20) business days following delivery of the notice of termination or notice by Orion to Executive of its belief that there is a payment or benefit due Executive that will result in an excess parachute payment as defined in Code Section 280G, Executive and Orion, at Orion's

expense, shall obtain the opinion (which need not be unqualified) of nationally recognized tax counsel selected by Orion's independent auditors and acceptable to Executive in Executive's sole discretion, which opinion sets forth: (A) the amount of the Base Period Income, (B) the amount and present value of Total Payments, (C) the amount and present value of any excess parachute payments without regard to the limitations of this Section 6, (D) the After-Tax Value of the Total Payments if the reduction in Total Payments contemplated under this Section 6 did not apply, and (E) the After-Tax Value of the Total Payments taking into account the reduction in Total Payments contemplated under this Section 6. As used in this Section 6, the term "Base Period Income" means an amount equal to Executive's "annualized includible compensation for the base period" as defined in Code Section 280G(d)(1). For purposes of such opinion, the value of any noncash benefits or any deferred payment or benefit shall be determined by Orion's independent auditors in accordance with the principles of Code Sections 280G(d)(3) and (4), which determination shall be evidenced in a certificate of such auditors addressed to Orion and Executive. For purposes of determining the After-Tax Value of Total Payments, Executive shall be deemed to pay federal income taxes and employment taxes at the highest marginal rate of federal income and employment taxation in the calendar year in which the Termination Payment is to be made and state and local income taxes at the highest marginal rates of taxation in the state and locality of Executive's domicile for income tax purposes on the date the Termination Payment is to be made, net of the maximum reduction in federal income taxes that may be obtained from deduction of such state and local taxes. Such opinion shall be dated as of the Termination Date and addressed to Orion and Executive and shall be binding upon the Company and Executive. If such opinion determines that there would be an excess parachute payment and that the After-Tax Value of the Total Payments taking into account the reduction contemplated under this Section is greater than the After-Tax Value of the Total Payments if the reduction in Total Payments contemplated under this Section did not apply, then the Termination Payment hereunder or any other payment determined by such counsel to be includible in Total Payments shall be reduced or eliminated as specified by Executive in writing delivered to Orion within five business days of Executive's receipt of such opinion or, if Executive fails to so notify Orion, then as Orion shall reasonably determine, so that under the bases of calculations set forth in such opinion there will be no excess parachute payment. If such legal counsel so requests in connection with the opinion required by this Section, Executive and Orion shall obtain, at Orion's expense, and the legal counsel may rely on in providing the opinion, the advice of a firm of recognized executive compensation consultants as to the reasonableness of any item of compensation to be received by Executive. Notwithstanding the foregoing, the provisions of this Section 6, including the calculations, notices and opinions provided for herein, shall be based upon the conclusive presumption that the following are reasonable: (1) the compensation and benefits provided for in Section 3 and (2) any other compensation, including but not limited to the Accrued Benefits, earned prior to the date of Executive's Separation from Service by the Executive pursuant to the Company's compensation programs if such payments would have been made in the future in any event, even though the timing of such payment is triggered by the Change in Control or the Executive's Separation from Service. If the provisions of Code Sections 280G and 4999 are repealed without succession, then this Section 6 shall be of no further force or effect.

7. Covenants by Executive.

(a) **Confidentiality and Non-Disclosure.** During Executive's employment with the Company and for a period of two years following Executive's Separation from Service, he or she agrees that he or she will not, except in furtherance of the business of the Company, disclose, furnish, or make available to any person or use for the benefit of

himself or herself or any other person any confidential or proprietary information or data of the Company including, but not limited to, trade secrets, customer and supplier lists, pricing policies, operational methods, marketing plans or strategies, product development techniques or plans, business acquisition or disposition plans, new personnel employment plans, methods of manufacture, technical process, and formulae, designs and design projects, inventions and research projects and financial budgets and forecasts except (i) information which at the time is available to others in the business or generally known to the public other than as a result of disclosure by Executive not permitted hereunder, and (ii) when required to do so by a court of competent jurisdiction, by any governmental agency or by any administrative, legislative or regulatory body; *provided* that in this instance Executive shall make reasonable efforts to inform the Company of any such request prior to any disclosure so as to permit the Company a meaningful opportunity to seek a protective order or similar adjudication. Upon termination of his or her employment with the Company, Executive will immediately return to the Company all written or electronically stored confidential or proprietary information in whatever format it is contained.

(b) Non-Competition/Non-Solicitation.

(i) During Executive's employment with the Company and for a period of two years following Executive's Separation from Service, Executive agrees not to directly or indirectly engage, or assist any business or entity, in Competitive Business Activity in any capacity, including without limitation as an employee, officer, or director of, or consultant or advisor to, any person or entity engaged directly or indirectly in a business which engages in Competitive Business Activity, in North America or anywhere that Orion or its Successor does business at the time of Executive's termination of employment, without the written consent of the Board.

(ii) During Executive's employment with the Company and for a period of two years following Executive's Separation from Service, Executive agrees not to, in any form or manner, directly or indirectly, on his or her own behalf or in combination with others (1) solicit, induce or influence any customer, supplier, lender, lessor or any other person with a business relationship with the Company to discontinue or reduce the extent of such business relationship, or (2) recruit, solicit or otherwise induce or influence any employee of the Company to discontinue their employment with the Company.

(c) Disclosure and Assignment to the Company of Inventions and Innovations.

(i) Executive agrees to disclose and assign to the Company as the Company's exclusive property, all inventions and technical or business innovations, including but not limited to all patentable and copyrightable subject matter (collectively, the "Innovations") developed, authored or conceived by Executive solely or jointly with others during the period of Executive's employment, including during Executive's employment prior to the date of this Agreement, (1) that are along the lines of the business, work or investigations of the Company to which Executive's employment relates or as to which Executive may receive information due to Executive's employment with the Company, or

(2) that result from or are suggested by any work which Executive may do for the Company or (3) that are otherwise made through the use of Company time, facilities or materials. To the extent any of the Innovations is copyrightable, each such Innovation shall be considered a “work for hire.”

(ii) Executive agrees to execute all necessary papers and otherwise provide proper assistance (at the Company’s expense), during and subsequent to Executive’s employment, to enable the Company to obtain for itself or its nominees, all right, title, and interest in and to patents, copyrights, trademarks or other legal protection for such Innovations in any and all countries.

(iii) Executive agrees to make and maintain for the Company adequate and current written records of all such Innovations;

(iv) Upon any termination of Executive’s employment, employee agrees to deliver to the Company promptly all items which belong to the Company or which by their nature are for the use of Company employees only, including, without limitation, all written and other materials which are of a secret or confidential nature relating to the business of the Company.

(v) In the event Company is unable for any reason whatsoever to secure Executive’s signature to any lawful and necessary documents required, including those necessary for the assignment of, application for, or prosecution of any United States or foreign application for letters patent or copyright for any Innovation, Executive hereby irrevocably designates and appoints Company and its duly authorized officers and agents as Executive’s agent and attorney-in-fact, to act for and in Executive’s behalf and stead to execute and file any such applications and to do all other lawfully permitted acts to further the assignment, prosecution, and issuance of letters patent or registration of copyright thereon with the same legal force and effect as if executed by Executive. Executive hereby waives and quitclaims to Company any and all claims, of any nature whatsoever, which Executive may now have or may hereafter have for infringement of any patent or copyright resulting from any such application.

(d) **Remedies Not Exclusive.** In the event that Executive breaches any terms of this Section 7, Executive acknowledges and agrees that said breach may result in the immediate and irreparable harm to the business and goodwill of the Company and that damages, if any, and remedies of law for such breach may be inadequate and indeterminable. The Company, upon Executive’s breach of this Section 7, shall therefore be entitled (in addition to and without limiting any other remedies that the Company may seek under this Agreement or otherwise at law or in equity) to (1) seek from any court of competent jurisdiction equitable relief by way of temporary or permanent injunction and without being required to post a bond, to restrain any violation of this Section 7, and for such further relief as the court may deem just or proper in law or equity, and (2) in the event that the Company shall prevail, its reasonable attorneys fees and costs and other expenses in enforcing its rights under this Section 7.

(e) **Severability of Provisions.** If any restriction, limitation, or provision of this Section 7 is deemed to be unreasonable, onerous, or unduly restrictive by a court of competent jurisdiction, it shall not be stricken in its entirety and held totally void and

unenforceable, but shall remain effective to the maximum extent possible within the bounds of the law. If any phrase, clause or provision of this Section 7 is declared invalid or unenforceable by a court of competent jurisdiction, such phrase, clause, or provision shall be deemed severed from this Section 7, but will not affect any other provision of this Section 7, which shall otherwise remain in full force and effect. The provisions of this Section 7 are each declared to be separate and distinct covenants by Executive.

8. **Notice.** Any notice, request, demand or other communication required or permitted herein will be deemed to be properly given when personally served in writing or when deposited in the United States mail, postage prepaid, addressed to Executive at the address appearing at the end of this Agreement and to the Company with attention to the Chief Executive Officer of Orion and the General Counsel of Orion. Either party may change its address by written notice in accordance with this paragraph.

9. **Set Off; Mitigation.** The Company's obligation to pay Executive the amounts and to provide the benefits hereunder shall be subject to set-off, counterclaim or recoupment of amounts owed by Executive to the Company. However, Executive shall not be required to mitigate the amount of any payment provided for pursuant to this Agreement by seeking other employment or otherwise.

10. **Benefit of Agreement.** This Agreement shall inure to the benefit of and be binding upon the parties hereto and their respective executors, administrators, successors and assigns. If Orion experiences a Change of Control, or otherwise sells, assigns or transfers all or substantially all of its business and assets to any person or if Orion merges into or consolidates or otherwise combines (where Orion does not survive such combination) with any person (any such event, a "Sale of Business"), then Orion shall assign all of its right, title and interest in this Agreement as of the date of such event to such person, and Orion shall cause such person, by written agreement in form and substance reasonably satisfactory to Executive, to expressly assume and agree to perform from and after the date of such assignment all of the terms, conditions and provisions imposed by this Agreement upon the Company. Failure of Orion to obtain such agreement prior to the effective date of such Sale of Business shall be a breach of this Agreement constituting "Good Reason" hereunder, except that for purposes of implementing the foregoing the date upon which such Sale of Business becomes effective shall be the Termination Date. In case of such assignment by Orion and of assumption and agreement by such person, as used in this Agreement, "Orion" shall thereafter mean the person which executes and delivers the agreement provided for in this Section 10 or which otherwise becomes bound by all the terms and provisions of this Agreement by operation of law, and this Agreement shall inure to the benefit of, and be enforceable by, such person. Executive shall, in his or her discretion, be entitled to proceed against any or all of such persons, any person which theretofore was such a successor to Orion, and Orion (as so defined) in any action to enforce any rights of Executive hereunder. Except as provided in this Section 10, this Agreement shall not be assignable by Orion. This Agreement shall not be terminated by the voluntary or involuntary dissolution of Orion.

11. **Arbitration.** Any controversy or claim arising out of or relating to this Agreement or the breach of this Agreement that cannot be mutually resolved by the Executive and the Company, including any dispute as to the calculation of the Executive's Benefits, Base Salary, Bonus Amount or any Severance Payment hereunder, shall be submitted to arbitration in Milwaukee, Wisconsin, in accordance with the procedures of the American Arbitration Association. The determination of the arbitrator shall be conclusive and binding on the

Company and the Executive, and judgment may be entered on the arbitrator's award in any court having jurisdiction.

12. **Applicable Law and Jurisdiction.** This Agreement is to be governed by and construed under the laws of the United States and of the State of Wisconsin without resort to Wisconsin's choice of law rules. Each party hereby agrees that the forum and venue for any legal or equitable action or proceeding arising out of, or in connection with, this Agreement will lie in the appropriate federal or state courts in the State of Wisconsin and specifically waives any and all objections to such jurisdiction and venue.

13. **Captions and Paragraph Headings.** Captions and paragraph headings used herein are for convenience only and are not a part of this Agreement and will not be used in construing it.

14. **Invalid Provisions.** Subject to Section 7(e), should any provision of this Agreement for any reason be declared invalid, void, or unenforceable by a court of competent jurisdiction, the validity and binding effect of any remaining portion will not be affected, and the remaining portions of this Agreement will remain in full force and effect as if this Agreement had been executed with said provision eliminated.

15. **No Waiver.** The failure of a party to insist upon strict adherence to any term of this Agreement on any occasion shall not be considered a waiver of such party's rights or deprive such party of the right thereafter to insist upon strict adherence to that term or any other term of this Agreement.

16. **Entire Agreement.** This Agreement contains the entire agreement of the parties with respect to the subject matter of this Agreement except where other agreements are specifically noted, adopted, or incorporated by reference. This Agreement otherwise supersedes any and all other agreements (including with respect to the definition of Cause and the process for Cause termination, any stock option or similar equity award agreements with the Company to which Executive may now or hereafter be a party), either oral or in writing, between the parties hereto with respect to the employment of Executive by Company, and all such agreements shall be void and of no effect. Each party to this Agreement acknowledges that no representations, inducements, promises, or agreements, oral or otherwise, have been made by any party, or anyone acting on behalf of any party, which are not embodied herein, and that no other agreement, statement, or promise not contained in this Agreement will be valid or binding.

17. **Modification.** This Agreement may not be modified or amended by oral agreement, but only by an agreement in writing signed by Orion and Executive.

18. **Counterparts.** This Agreement may be signed in counterparts, each of which shall be an original, with the same effect as if the signatures thereto and hereto were upon the same instrument..

EXECUTIVE

/s/ Patricia A Verfuert
Signature

Patricia A. Verfuert
Printed Name

February 4, 2009
Date

ORION ENERGY SYSTEMS, INC.

By: /s/ Thomas A. Quadracci
Name: Thomas A. Quadracci
Title: Chairman of the Board

Certification

I, Neal R. Verfuert, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for Orion Energy Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 9, 2009

/s/ Neal R. Verfuert
Neal R. Verfuert
President and Chief Executive Officer

Certification

I, Scott R. Jensen, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for Orion Energy Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 9, 2009

/s/ Scott R. Jensen

Scott R. Jensen
Chief Financial Officer

**Certification of CEO Pursuant To
18 U.S.C. Section 1350,
As Adopted Pursuant To
Section 906 Of The Sarbanes-Oxley Act Of 2002**

In connection with the Quarterly Report of Orion Energy Systems, Inc., a Wisconsin corporation (the "Company"), on Form 10-Q for the period ended December 31, 2008, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Neal R. Verfuerrth, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, based on my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 9, 2009

/s/ Neal R. Verfuerrth

Neal R. Verfuerrth

President and Chief Executive Officer

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

Certification of CFO Pursuant To**18 U.S.C. Section 1350,****As Adopted Pursuant To****Section 906 Of The Sarbanes-Oxley Act Of 2002**

In connection with the Quarterly Report of Orion Energy Systems, Inc., a Wisconsin corporation (the "Company"), on Form 10-Q for the period ended December 31, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Scott R. Jensen, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, based on my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 9, 2009

/s/ Scott R. Jensen

Scott R. Jensen

Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.