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

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**FORM 10-Q**

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

For the Quarterly Period Ended September 30, 2012

OR

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

Commission file number 001-33887

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**Orion Energy Systems, Inc.**

(Exact name of Registrant as specified in its charter)

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**Wisconsin**  
(State or other jurisdiction of  
incorporation or organization)

**39-1847269**  
(I.R.S. Employer  
Identification number)

**2210 Woodland Drive, Manitowoc, Wisconsin**  
(Address of principal executive offices)

**54220**  
(Zip code)

**Registrant's telephone number, including area code: (920) 892-9340**

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

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

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

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

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

There were 20,135,623 shares of the Registrant's common stock outstanding on November 7, 2012.

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Orion Energy Systems, Inc.  
Quarterly Report On Form 10-Q  
For The Quarter Ended September 30, 2012

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

	March 31, 2012	September 30, 2012
<b>Assets</b>		
Cash and cash equivalents	\$ 23,011	\$ 13,214
Short-term investments	1,016	1,019
Accounts receivable, net of allowances of \$947 and \$834	19,167	19,447
Inventories, net	18,132	18,411
Deferred contract costs	2,193	4,764
Deferred tax assets	1,549	—
Prepaid expenses and other current assets	2,174	1,727
Total current assets	67,242	58,582
Property and equipment, net	30,225	29,769
Long-term inventory	12,328	12,273
Patents and licenses, net	1,689	1,698
Deferred tax assets	2,609	213
Long-term accounts receivable	7,555	6,735
Other long-term assets	4,002	3,962
Total assets	<u>\$ 125,650</u>	<u>\$ 113,232</u>
<b>Liabilities and Shareholders' Equity</b>		
Accounts payable	\$ 14,300	\$ 15,166
Accrued expenses	3,018	6,485
Deferred revenue	2,614	3,756
Current maturities of long-term debt	2,791	2,871
Total current liabilities	22,723	28,278
Long-term debt, less current maturities	6,704	5,365
Deferred revenue	3,048	3,128
Other long-term liabilities	406	401
Total liabilities	32,881	37,172
Commitments and contingencies (See Note F)		
Shareholders' equity:		
Common stock, no par value: Shares authorized: 200,000,000 at March 31, 2012 and September 30, 2012; shares issued: 30,445,479 and 30,482,026 at March 31, 2012 and September 30, 2012; shares outstanding: 22,785,258 and 20,753,923 at March 31, 2012 and September 30, 2012	—	—
Additional paid-in capital	126,753	126,148
Treasury stock: 7,660,221 and 9,728,103 common shares at March 31, 2012 and September 30, 2012	(32,470)	(36,913)
Shareholder notes receivable	(221)	(283)
Retained deficit	(1,293)	(12,892)
Total shareholders' equity	92,769	76,060
Total liabilities and shareholders' equity	<u>\$ 125,650</u>	<u>\$ 113,232</u>

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

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2011	2012	2011	2012
Product revenue	\$ 30,111	\$ 16,931	\$ 47,472	\$ 30,511
Service revenue	3,364	2,477	4,224	4,207
Total revenue	33,475	19,408	51,696	34,718
Cost of product revenue	21,447	11,867	33,039	21,464
Cost of service revenue	2,647	1,736	3,269	3,076
Total cost of revenue	24,094	13,603	36,308	24,540
Gross profit	9,381	5,805	15,388	10,178
Operating expenses:				
General and administrative	2,725	4,638	5,800	7,940
Sales and marketing	3,729	4,561	7,504	8,513
Research and development	593	710	1,215	1,407
Total operating expenses	7,047	9,909	14,519	17,860
Income (loss) from operations	2,334	(4,104)	869	(7,682)
Other income (expense):				
Interest expense	(150)	(142)	(237)	(303)
Interest income	214	218	368	443
Total other income	64	76	131	140
Income (loss) before income tax	2,398	(4,028)	1,000	(7,542)
Income tax expense	1,040	5,631	434	4,057
Net income (loss)	\$ 1,358	\$ (9,659)	\$ 566	\$ (11,599)
Basic net income (loss) per share attributable to common shareholders	\$ 0.06	\$ (0.46)	\$ 0.02	\$ (0.53)
Weighted-average common shares outstanding	22,989,502	21,075,624	22,955,655	21,814,321
Diluted net income (loss) per share attributable to common shareholders	\$ 0.06	\$ (0.46)	\$ 0.02	\$ (0.53)
Weighted-average common shares outstanding	23,369,520	21,075,624	23,380,375	21,814,321

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

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

	Six Months Ended September 30,	
	2011	2012
<b>Operating activities</b>		
Net income (loss)	\$ 566	\$ (11,599)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,890	2,230
Stock-based compensation expense	657	770
Deferred income tax (benefit) expense	(538)	3,945
(Gain) Loss on sale of property and equipment	(1)	30
Provision for bad debts	159	100
Other	38	34
Changes in operating assets and liabilities:		
Accounts receivable, current and long-term	3,157	440
Inventories, current and long-term	(3,227)	(224)
Deferred contract costs	6,682	(2,571)
Prepaid expenses and other assets	(2,330)	445
Accounts payable	(2,099)	866
Accrued expenses	370	1,985
Deferred revenue	(3,940)	1,222
<b>Net cash provided by (used in) operating activities</b>	<b>1,384</b>	<b>(2,327)</b>
<b>Investing activities</b>		
Purchase of property and equipment	(2,003)	(1,715)
Purchase of property and equipment held under operating leases	(3)	—
Purchase of short-term investments	(3)	(3)
Additions to patents and licenses	(125)	(75)
Proceeds from sales of property, plant and equipment	1	19
<b>Net cash used in investing activities</b>	<b>(2,133)</b>	<b>(1,774)</b>
<b>Financing activities</b>		
Payment of long-term debt	(664)	(1,415)
Proceeds from long-term debt	4,583	156
Proceeds from repayment of shareholder notes	13	6
Repurchase of common stock into treasury	—	(4,523)
Excess tax benefits from stock-based compensation	811	21
Deferred financing costs	(113)	—
Proceeds from issuance of common stock	118	59
<b>Net cash provided by (used in) financing activities</b>	<b>4,748</b>	<b>(5,696)</b>
Net increase (decrease) in cash and cash equivalents	3,999	(9,797)
Cash and cash equivalents at beginning of period	11,560	23,011
Cash and cash equivalents at end of period	<u>\$ 15,559</u>	<u>\$ 13,214</u>
<b>Supplemental cash flow information:</b>		
Cash paid for interest	\$ 201	\$ 279
Cash paid for income taxes	\$ 63	\$ 37
<b>Supplemental disclosure of non-cash investing and financing activities:</b>		
Shares issued from treasury for shareholder note receivable	\$ 64	\$ 68

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

**ORION ENERGY SYSTEMS, INC. AND SUBSIDIARIES**  
**UNAUDITED NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE A — DESCRIPTION OF BUSINESS**

***Organization***

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

See Note I “Segment Reporting” of these financial statements for further discussion of our reportable segments.

The Company’s corporate offices and manufacturing operations are located in Manitowoc, Wisconsin and an operations facility occupied by Orion Engineered Systems is located in Plymouth, Wisconsin.

**NOTE B — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***Principles of Consolidation***

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

***Reclassifications***

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

***Basis of Presentation***

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation have been included. Interim results are not necessarily indicative of results that may be expected for the year ending March 31, 2013 or other interim periods.

The condensed consolidated balance sheet at March 31, 2012 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, 2012 filed with the Securities and Exchange Commission on June 14, 2012.

***Use of Estimates***

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

The Company’s valuation allowance for deferred tax assets is based upon estimates of future taxable income.

***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.

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### **Short-Term Investments**

The amortized cost and fair value of short-term investments, with gross unrealized gains and losses, as of March 31, 2012 and September 30, 2012 were as follows (in thousands):

	March 31, 2012			Fair Value	Cash and Cash Equivalents	Short-Term Investments
	Amortized Cost	Unrealized Gains	Unrealized Losses			
Money market funds	\$ 486	\$ —	\$ —	\$ 486	\$ 486	\$ —
Bank certificate of deposit	1,016	—	—	1,016	—	1,016
Total	<u>\$ 1,502</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1,502</u>	<u>\$ 486</u>	<u>\$ 1,016</u>

  

	September 30, 2012			Fair Value	Cash and Cash Equivalents	Short-Term Investments
	Amortized Cost	Unrealized Gains	Unrealized Losses			
Money market funds	\$ 486	\$ —	\$ —	\$ 486	\$ 486	\$ —
Bank certificate of deposit	1,019	—	—	1,019	—	1,019
Total	<u>\$ 1,505</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1,505</u>	<u>\$ 486</u>	<u>\$ 1,019</u>

As of March 31, 2012 and September 30, 2012, the Company's financial assets described in the table above were measured at cost which approximates fair value due to the short-term nature of the investment (level 1 inputs).

### **Fair Value of Financial Instruments**

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

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

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

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

### **Accounts Receivable**

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

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### **Financing Receivables**

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

*Aging Analysis as of September 30, 2012 (in thousands):*

	Not past due	1-90 days past due	Greater than 90 days past due	Total past due	Total sales-type leases
Lease balances included in consolidated accounts receivable - current	\$ 3,060	\$ 125	\$ 45	\$ 170	\$ 3,230
Lease balances included in consolidated accounts receivable - long-term	5,126	—	—	—	5,126
Total gross sales-type leases	8,186	125	45	170	8,356
Allowance	—	(3)	(33)	(36)	(36)
Total net sales-type leases	<u>\$ 8,186</u>	<u>\$ 122</u>	<u>\$ 12</u>	<u>\$ 134</u>	<u>\$ 8,320</u>

### *Allowance for Credit Losses on Financing Receivables*

The Company's allowance for credit losses is based on management's assessment of the collectability of customer accounts. A considerable amount of judgment is required in order to make this assessment, including a detailed analysis of the aging of the lease receivables and the current credit worthiness of the Company's customers and an analysis of historical bad debts and other adjustments. If there is a deterioration of a major customer's credit worthiness or if actual defaults are higher than historical experience, the estimate of the recoverability of amounts due could be adversely affected. The Company reviews in detail the allowance for doubtful accounts on a quarterly basis and adjusts the allowance estimate to reflect actual portfolio performance and any changes in future portfolio performance expectations. The Company believes that there is no impairment of the receivables for the sales-type leases. The Company incurred \$59,000 and \$0 of write-offs or credit losses against its OTA sales-type lease receivable balances in fiscal 2012 and for the six months ended September 30, 2012, respectively.

### **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 and systems, and wireless energy management 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, 2012 and September 30, 2012, the Company had inventory obsolescence reserves of \$1.5 million and \$1.8 million, respectively.

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

Inventories were comprised of the following (in thousands):

	March 31, 2012	September 30, 2012
Raw materials and components	\$ 10,466	\$ 10,909
Work in process	969	934
Finished goods	6,697	6,568
	<u>\$ 18,132</u>	<u>\$ 18,411</u>



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### **Deferred Contract Costs**

Deferred contract costs consist primarily of the costs of products delivered, and services performed, that are subject to additional performance obligations or customer acceptance. These deferred contract costs are expensed at the time the related revenue is recognized. Current deferred costs amounted to \$2.2 million and \$4.8 million as of March 31, 2012 and September 30, 2012, respectively.

### **Prepaid Expenses and Other Current Assets**

Prepaid expenses and other current assets consist primarily of prepaid insurance premiums, prepaid license fees, purchase deposits, advance payments to contractors, unbilled revenue, prepaid taxes and miscellaneous receivables.

### **Property and Equipment**

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

	March 31, 2012	September 30, 2012
Land and land improvements	\$ 1,545	\$ 1,562
Buildings and building improvements	14,717	15,601
Furniture, fixtures and office equipment	11,000	11,819
Leasehold improvements	54	58
Equipment leased to customers under Power Purchase Agreements	4,997	4,997
Plant equipment	9,990	10,182
Construction in progress	1,080	772
	43,383	44,991
Less: accumulated depreciation and amortization	(13,158)	(15,222)
Net property and equipment	<u>\$ 30,225</u>	<u>\$ 29,769</u>

Depreciation is provided over the estimated useful lives of the respective assets, using the straight-line method. Depreciable lives by asset category are as follows:

Land improvements	10 - 15 years
Buildings and building improvements	3 - 39 years
Leasehold improvements	Shorter of asset life or life of lease
Furniture, fixtures and office equipment	2 - 10 years
Plant equipment	3 - 10 years

### **Patents and Licenses**

Patents and licenses are amortized over their estimated useful life, ranging from 7 to 17 years, using the straight line method.

### **Long-Term Receivables**

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

Also included in other long-term receivables are amounts due from a third party finance company to which the Company has sold, without recourse, the future cash flows from OTAs entered into with customers. Such receivables are recorded at the present value of the future cash flows discounted between 8.8% and 11%. As of September 30, 2012, the following amounts were due from the third party finance company in future periods (in thousands):

Fiscal 2013	\$ 616
Fiscal 2014	1,011
Fiscal 2015	955
Fiscal 2016	309
Fiscal 2017	9
Total gross long-term receivable	2,900
Less: amount representing interest	(402)
Net long-term receivable	<u>\$2,498</u>

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### **Long-Term Inventories**

The Company records long-term inventory for the non-current portion of its wireless controls inventory. All inventories are stated at the lower of cost or market value with cost determined using the FIFO method.

### **Other Long-Term Assets**

Other long-term assets include long-term security deposits, prepaid licensing costs, a note receivable, deferred costs for a long-term contract, and deferred financing costs. Other long-term assets include \$87,000 and \$73,000 of deferred financing costs as of March 31, 2012 and September 30, 2012. Deferred financing costs related to debt issuances are amortized to interest expense over the life of the related debt issue (5 to 10 years).

### **Accrued Expenses**

Accrued expenses include warranty accruals, accrued wages and benefits, accrued vacation, sales tax payable and other various unpaid expenses. Accrued expenses include \$31,000 and \$1.8 million of accrued reorganization costs and contractual commitments as of March 31, 2012 and September 30, 2012.

The Company generally offers a limited warranty of one year on its own manufactured 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 September 30,		Six Months Ended September 30,	
	2011	2012	2011	2012
Beginning of period	\$ 59	\$ 90	\$ 59	\$ 84
Provision to product cost of revenue	28	126	59	141
Charges	(22)	(129)	(53)	(138)
End of period	<u>\$ 65</u>	<u>\$ 87</u>	<u>\$ 65</u>	<u>\$ 87</u>

### **Revenue Recognition**

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

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

For sales of solar photovoltaic systems, which are governed by customer contracts that require the Company to deliver functioning solar power systems and are generally completed within three to 15 months, the Company recognizes revenue from fixed price construction contracts using the percentage-of-completion method in accordance with ASC 605-35, Construction-Type and

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

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

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

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

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

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

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

Deferred revenue relates to advance customer billings, investment tax grants received related to PPAs and a separate obligation to provide maintenance on OTAs, and is classified as a liability on the Consolidated Balance Sheet. The fair value of the maintenance is readily determinable based upon pricing from third-party vendors. Deferred revenue related to maintenance services is recognized when the services are delivered, which occurs in excess of a year after the original OTA is executed.

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### **Income Taxes**

The Company recognizes deferred tax assets and liabilities for the future tax consequences of temporary differences between financial reporting and income tax basis of assets and liabilities, measured using the enacted tax rates and laws expected to be in effect when the temporary differences reverse. Deferred income taxes also arise from the future tax benefits of operating loss and tax credit carryforwards. A valuation allowance is established when management determines that it is more likely than not that all or a portion of a deferred tax asset will not be realized. For the three months ended September 30, 2012, the Company recorded a full valuation allowance of \$5.6 million against its deferred tax assets.

ASC 740, *Income Taxes*, also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination. The Company has classified the amounts recorded for uncertain tax benefits in the balance sheet as other liabilities (non-current) to the extent that payment is not anticipated within one year. The Company recognizes penalties and interest related to uncertain tax liabilities in income tax expense. Penalties and interest are immaterial and are included in the unrecognized tax benefits.

Deferred tax benefits have not been recognized for income tax effects resulting from the exercise of non-qualified stock options. These benefits will be recognized in the period in which the benefits are realized as a reduction in taxes payable and an increase in additional paid-in capital. For the six months ended September 30, 2011 and 2012, realized tax benefits from the exercise of stock options were \$0.8 million and \$27,000, respectively.

### **Stock Option Plans**

The fair value of each option grant for the three and six months ended September 30, 2011 and 2012 was determined using the assumptions in the following table:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2011	2012	2011	2012
Weighted average expected term	6.8 years	6.0 years	5.7 years	5.6 years
Risk-free interest rate	1.64%	0.9%	1.83%	0.8%
Expected volatility	70%	73%	70%	74.2%
Expected forfeiture rate	11.4%	15.1%	11.4%	15.1%

### **Net Income (Loss) per Common Share**

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

Diluted net income (loss) per common share reflects the dilution that would occur if warrants and employee stock options were exercised. In the computation of diluted net income (loss) per common share, the Company uses the "treasury stock" method for outstanding options and warrants. Diluted net income (loss) per common share is the same as basic net income (loss) per common share for the periods ended September 30, 2012, because the effects of potentially dilutive securities are anti-dilutive. The effect of net income (loss) per common share is calculated based upon the following shares (in thousands except share amounts):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2011	2012	2011	2012
<b>Numerator:</b>				
Net income (loss) (in thousands)	\$ 1,358	\$ (9,659)	\$ 566	\$ (11,599)
<b>Denominator:</b>				
Weighted-average common shares outstanding	22,989,502	21,075,624	22,955,655	21,814,321
Weighted-average effect of assumed conversion of stock options and warrants	380,018	—	424,720	—
Weighted-average common shares and common share equivalents outstanding	<u>23,369,520</u>	<u>21,075,624</u>	<u>23,380,375</u>	<u>21,814,321</u>
<b>Net income (loss) per common share:</b>				
Basic	\$ 0.06	\$ (0.46)	\$ 0.02	\$ (0.53)
Diluted	\$ 0.06	\$ (0.46)	\$ 0.02	\$ (0.53)

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

	September 30, 2011	September 30, 2012
Common stock options	4,018,917	4,321,571
Restricted shares	—	163,750
Common stock warrants	38,980	38,980
Total	<u>4,057,897</u>	<u>4,524,301</u>

### **Concentration of Credit Risk and Other Risks and Uncertainties**

The Company previously depended on one supplier for a number of components necessary for its products, including ballasts and lamps. Purchases from this supplier accounted for 10% and 12% of total cost of revenue for the three and six months ended September 30, 2011, respectively. Currently, the Company has been able to obtain these components from multiple suppliers. For the three months ended September 30, 2012, purchases from two suppliers accounted for 11% and 12% of total cost of revenue. For the six months ended September 30, 2012, no supplier accounted for more than 10% of total cost of revenue.

The Company previously purchased a majority of its solar panels from one supplier for its sales of solar generating systems through its Orion Engineered Systems Division. Purchases from this supplier accounted for 15% and 25% of total cost of revenue for the three and six months ended September 30, 2011, respectively. Currently, the Company has been able to obtain panels from multiple suppliers. For the three and six months ended September 30, 2012, panel purchases from one supplier accounted for 11% and 6% of total cost of revenue, respectively.

For the three and six months ended September 30, 2011, two customers accounted for 21% of revenue and two customers accounted for 15% and 14% of revenue, respectively. For the three and six months ended September 30, 2012, no customer accounted for more than 10% of revenue.

As of March 31, 2012, one customer accounted for 11% of accounts receivable. As of September 30, 2012, one customer accounted for 15% of accounts receivable.

### **Recent Accounting Pronouncements**

In May 2011, the FASB issued ASU No. 2011-04 *Fair Value Measurements (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in US GAAP and International Financial Reporting Standards (“IFRS”)* (“ASU 2011-04”). ASU 2011-04 represents the converged guidance of the FASB and the IASB (the “Boards”) on fair value measurements. The collective efforts of the Boards and their staffs, reflected in ASU 2011-04, have resulted in common requirements for measuring fair value and for disclosing information about fair value measurements, including a consistent meaning of the term “fair value.” The Boards have concluded the common requirements will result in greater comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with GAAP and IFRSs. The amendments in this ASU are required to be applied prospectively, and are effective for interim and annual periods beginning after December 15, 2011. The adoption of ASU 2011-04 did not have a significant impact on the Company’s consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, “*Comprehensive Income (ASC Topic 220): Presentation of Comprehensive Income,*” (“ASU 2011-05”) which amends current comprehensive income guidance. This accounting update eliminates the option to present the components of other comprehensive income as part of the statement of shareholders’ equity. Instead, the Company must report comprehensive income in either a single continuous statement of comprehensive income which contains two sections, net income and other comprehensive income, or in two separate but consecutive statements. ASU 2011-05 will be effective for public companies during the interim and annual periods beginning after December 15, 2011 with early adoption permitted. However, in December 2011, the FASB issued ASU No. 2011-12, “*Deferral of the Effective Date for Amendments to the Presentation of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*” (“ASU 2011-12”), which deferred the guidance on whether to require entities to present reclassification adjustments out of accumulated other comprehensive income by

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component in both the statement where net income is presented and the statement where other comprehensive income is presented for both interim and annual financial statements. ASU 2011-12 reinstated the requirements for the presentation of reclassifications that were in place prior to the issuance of ASU 2011-05 and did not change the effective date for ASU 2011-05. For public entities, the amendments in ASU 2011-05 and ASU 2011-12 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, and should be applied retrospectively. The adoption of ASU 2011-05 and ASU 2011-12 did not have a significant impact on the Company's consolidated statements as it only requires a change in the format of the current presentation.

In December 2011, the FASB issued ASU No. 2011-11, "Balance Sheet: Disclosures about Offsetting Assets and Liabilities." ASU 2011-11 requires entities to disclose information about offsetting and related arrangements of financial instruments and derivative instruments and will be applied retrospectively for all comparative periods presented. ASU 2011-11 is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The Company is currently evaluating the impact of ASU 2011-11.

### **NOTE C — RELATED PARTY TRANSACTIONS**

During the six months ended September 30, 2011 and 2012, the Company purchased goods and services from an entity in the amounts of \$23,000 and \$0, respectively, for which a director of the Company serves as a member of the board of directors. 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 — DEBT**

Long-term debt as of March 31, 2012 and September 30, 2012 consisted of the following (in thousands):

	<u>March 31,</u> <u>2012</u>	<u>September 30,</u> <u>2012</u>
Term note	\$ 532	\$ 400
Customer equipment finance notes payable	6,568	5,483
First mortgage note payable	776	736
Debenture payable	765	743
Other long-term debt	854	874
Total long-term debt	9,495	8,236
Less current maturities	(2,791)	(2,871)
Long-term debt, less current maturities	<u>\$ 6,704</u>	<u>\$ 5,365</u>

#### ***New Debt Arrangement***

In September 2012, the Company entered into a combination note and security agreement with First Business Equipment Finance, LLC (First Business) to finance the remaining payments on one of its operating leases with First Business. The note matures on February 15, 2013 and bears interest at 4.5%. The note is secured by the equipment originally leased.

#### ***Revolving Credit Agreement***

The Company has a credit agreement (Credit Agreement) with JP Morgan Chase Bank, N.A. (JP Morgan). The Credit Agreement provides for a revolving credit facility (Credit Facility) that matures on June 30, 2013. Borrowings under the Credit Facility are limited to (i) \$15.0 million or (ii) during periods in which the outstanding principal balance of outstanding loans under the Credit Facility is greater than \$5.0 million, the lesser of (A) \$15.0 million or (B) the sum of 75% of the outstanding principal balance of certain accounts receivable of the Company and 45% of certain inventory of the Company. The Credit Agreement contains certain financial covenants, including minimum unencumbered liquidity requirements and requirements that the Company maintain a total liabilities to tangible net worth ratio not to exceed 0.50 to 1.00 as of the last day of any fiscal quarter. 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. The Company also may cause JP Morgan to issue letters of credit for the Company's account in the aggregate principal amount of up to \$2.0 million, with the dollar

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amount of each issued letter of credit counting against the overall limit on borrowings under the Credit Facility. As of September 30, 2012, the Company had outstanding letters of credit totaling \$1.7 million, primarily for securing collateral requirements under equipment operating leases. There were no borrowings by the Company under the Credit Agreement as of March 31, 2012 or September 30, 2012. We were not in compliance with all covenants in the credit agreement as of September 30, 2012 and expect to receive a waiver from our bank for the covenant defaults.

The Credit Agreement is secured by a first lien security interest in the Company's accounts receivable, inventory and general intangibles, and a second lien priority in the Company's equipment and fixtures. All OTAs, PPAs, leases, supply agreements and/or similar agreements relating to solar PV and wind turbine systems or facilities, as well as all accounts receivable and assets of the Company related to the foregoing, are excluded from these liens.

The Credit Agreement provides that the Company has the option to select whether borrowings under the Credit Facility will bear interest at either (i) a daily borrowing LIBOR rate tied to a one-month maturity or (ii) a LIBOR rate tied to a maturity corresponding to an interest period selected by the Company plus, in the case of either (i) or (ii), a per annum rate spread of 2.00%, 2.50% or 3.00%, depending on the ratio of (A) earnings before interest, taxes, depreciation and amortization less income taxes paid in cash less 50% of depreciation expense to (B) the sum of interest expense paid in cash in respect of indebtedness for borrowed money plus scheduled principal payments made with respect to indebtedness for borrowed money, all as determined for the 12-month period ending as of the end of the applicable fiscal quarter.

The Company must pay a fee of 0.25% on the average daily unused amount of the Credit Facility and a fee of 2.00% on the daily average face amount of undrawn issued letters of credit. The fee on unused amounts is waived if the Company or its affiliates maintain funds on deposit with JP Morgan or its affiliates above a specified amount. The deposit threshold requirement was met as of September 30, 2012.

### NOTE E — INCOME TAXES

The income tax provision for the six months ended September 30, 2012 was determined by applying an estimated annual effective tax rate of 53.8% to income (loss) before taxes. For the three months ended September 30, 2012, the Company has recorded a valuation allowance of \$5.6 million, equaling the net deferred tax asset due to the uncertainty of its realization value in the future. ASC 740, *Income Taxes*, requires that a deferred tax asset be reduced by a valuation allowance if there is less than a 50% chance that it will be realized. The determination of the realization of deferred tax assets requires considerable judgment. ASC 740 prescribes the consideration of both positive and negative evidence in evaluating the need for a valuation allowance. Negative evidence for the Company includes a cumulative three year operating loss and limited visibility into future earnings. While the Company has positive evidence with a strong backlog of orders, the Company has determined that the current negative evidence outweighs the current positive evidence and has concluded that the conservative approach is to record a valuation allowance. The estimated effective income tax rate was determined by applying statutory tax rates to pretax income (loss) 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:

	Six Months Ended September 30,	
	2011	2012
Statutory federal tax rate	34.0%	(34.0)%
State taxes, net	9.2%	(2.4)%
Federal tax credit	(11.6)%	(2.0)%
State tax credit	(5.9)%	0.4%
Change in valuation reserve	5.9%	92.7%
Permanent items	10.0%	1.2%
Change in tax contingency reserve	0.8%	(0.1)%
Other, net	1.0%	(2.0)%
Effective income tax rate	<u>43.4%</u>	<u>53.8%</u>

The Company is eligible for tax benefits associated with the excess of the tax deduction available for exercises of non-qualified stock options, or NQSOs, over the amount recorded at grant. The amount of the benefit is based on the ultimate deduction reflected in

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the applicable income tax return. Benefits of \$1.0 million were recorded in fiscal 2012 as a reduction in taxes payable and a credit to additional paid in capital based on the amount that was utilized during the year. Benefits of \$21,000 were recorded for the six months ended September 30, 2012.

As of September 30, 2012, the Company had federal net operating loss carryforwards of approximately \$11.5 million, of which \$3.2 million are associated with the exercise of NQSOs that have not yet been recognized by the Company in its financial statements. The Company also has state net operating loss carryforwards of approximately \$6.7 million, of which \$2.1 million are associated with the exercise of NQSOs. The Company also has federal tax credit carryforwards of approximately \$1.3 million and state tax credits of \$0.5 million. For the three months ended September 30, 2012, the Company has recorded a valuation allowance of \$5.6 million, equaling the net deferred tax asset due to the uncertainty of its realization value in the future. The Company considers future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance. In the event that the Company determines that the deferred tax assets are able to be realized, an adjustment to the deferred tax asset would increase income in the period such determination is made.

### **Uncertain Tax Positions**

As of September 30, 2012, the balance of gross unrecognized tax benefits was approximately \$0.4 million, all of which would reduce the Company's effective tax rate if recognized. The Company does not expect this amount to change during fiscal 2013 as none of the issues are currently under examination, the statutes of limitations do not expire within the period, and the Company is not aware of any pending litigation. Due to the existence of net operating loss and credit carryforwards, all years since 2002 are open to examination by tax authorities.

The Company has classified the amounts recorded for uncertain tax benefits in the balance sheet as other liabilities (non-current) to the extent that payment is not anticipated within one year. The Company recognizes penalties and interest related to uncertain tax liabilities in income tax expense. Penalties and interest are immaterial as of the date of adoption and are included in the unrecognized tax benefits. For the six months ended September 30, 2011 and 2012, the Company had the following unrecognized tax benefit activity (in thousands):

	<u>Six Months Ended September 30, 2011</u>	<u>Six Months Ended September 30, 2012</u>
Unrecognized tax benefits as of beginning of period	\$ 399	\$ 401
Additions based on tax positions related to the current period positions	1	—
Unrecognized tax benefits as of end of period	<u>\$ 400</u>	<u>\$ 401</u>

## **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 \$0.5 million and \$0.4 million for the three months ended September 30, 2011 and 2012, respectively; and \$1.0 million and \$0.9 million for the six months ended September 30, 2011 and 2012, respectively. The Company enters into non-cancellable purchase commitments for certain inventory items in order to secure better pricing and ensure materials are on hand to meet anticipated order volume and customer expectations, as well as for capital expenditures. As of September 30, 2012, the Company had entered into \$11.6 million of purchase commitments related to fiscal 2013, including \$1.2 million for operating lease commitments and \$10.4 million for inventory purchase commitments. As of September 30, 2012, the Company had entered into an agreement to repurchase \$1.5 million of its outstanding common stock.

## **NOTE G — SHAREHOLDERS' EQUITY**

### ***Shareholder Rights Plan***

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



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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 (a "Shares Acquisition Date") or 10 business days after the commencement of, or the announcement of an intention to make, a tender offer or exchange offer that would result in any such person or group of persons acquiring such beneficial ownership.

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

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

### **Employee Stock Purchase Plan**

In August 2010, the Company's board of directors approved a non-compensatory employee stock purchase plan, or ESPP. The ESPP authorizes 2,500,000 shares to be issued from treasury or authorized shares to satisfy employee share purchases under the ESPP. All full-time employees of the Company are eligible to be granted a non-transferable purchase right each calendar quarter to purchase directly from the Company up to \$20,000 of the Company's common stock at a purchase price equal to 100% of the closing sale price of the Company's common stock on the NYSE MKT exchange on the last trading day of each quarter. The ESPP allows for employee loans from the Company, except for Section 16 officers, limited to 20% of an individual's annual income and no more than \$250,000 outstanding at any one time. Interest on the loans is charged at the 10-year loan IRS rate and is payable at the end of each calendar year or upon loan maturity. The loans are secured by a pledge of any and all the Company's shares purchased by the participant under the ESPP and the Company has full recourse against the employee, including offset against compensation payable. The Company had the following shares issued from treasury as of March 31, 2012 and for the six months ended September 30, 2012:

	<u>Shares Issued Under ESPP Plan</u>	<u>Closing Market Price</u>	<u>Shares Issued Under Loan Program</u>	<u>Dollar Value of Loans Issued</u>	<u>Repayment of Loans</u>
Cumulative through March 31, 2012	102,810	\$2.38 - 4.04	86,148	\$ 279,350	\$ 58,876
Quarter Ended June 30, 2012	9,232	\$2.20	7,955	17,500	1,600
Quarter Ended September 30, 2012	27,467	\$1.98	25,606	50,700	4,060
Total as of September 30, 2012	<u>139,509</u>	<u>\$1.98 - 4.04</u>	<u>119,709</u>	<u>\$ 347,550</u>	<u>\$ 64,536</u>

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

### **Share Repurchase Program**

In October 2011, the Company's Board of Directors approved a share repurchase program authorizing the Company to repurchase in aggregate up to a maximum of \$1.0 million of the Company's outstanding common stock. In November 2011, the Company's Board of Directors approved an increase to the share repurchase program authorizing the Company to repurchase in aggregate up to a maximum of \$2.5 million of the Company's outstanding common stock. In April 2012, the Company's Board approved another increase to the share repurchase program authorizing the Company to repurchase in aggregate up to a maximum of \$7.5 million of the Company's outstanding common stock. As of September 30, 2012, the Company had repurchased a total of 2.4 million shares of common stock at a total cost of \$5.3 million under the program.

**NOTE H — STOCK OPTIONS, RESTRICTED SHARES AND WARRANTS**

The Company grants stock options under its 2003 Stock Option and 2004 Stock and Incentive Awards Plans (the Plans). Under the terms of the Plans, the Company has reserved 13,500,000 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 and shorter 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 10 years. In the past, the Company has granted both ISOs and NQSOs, although in July 2008, the Company adopted a policy of thereafter only granting NQSOs. Certain non-employee directors have elected to receive stock awards in lieu of cash compensation pursuant to elections made under the Company's non-employee director compensation program. The Plans also provide to certain employees accelerated vesting in the event of certain changes of control of the Company as well as under other special circumstances.

In fiscal 2011, the Company converted all of its existing ISO awards to NQSO awards. No consideration was given to the employees for their voluntary conversion of ISO awards.

In June 2012, the Compensation Committee of the Board of Directors approved the issuance of restricted shares under the Plans to key employees to provide an opportunity for such employees to earn long-term equity incentive awards. The restricted shares are settled in Company stock when the restriction period ends. Compensation cost for restricted shares granted to employees is recognized ratably over the vesting term, which is between three to five years. Settlement of the shares is contingent on the employees' continued employment and non-vested shares are subject to forfeiture if employment terminates for any reason. An aggregate of 138,750 of restricted shares were granted on June 18, 2012 valued at a price per share of \$2.00, which was the closing market price as of the grant date. Additionally, 25,000 restricted shares were granted on September 27, 2012 valued at a price per share of \$1.80, which was the closing market price as of the grant date.

For the three and six months ended September 30, 2012, the Company issued zero and 13,547 shares under the 2004 Stock and Incentive Awards Plan to certain non-employee directors who elected to receive stock awards in lieu of cash compensation. The shares were valued at \$2.03 per share, the closing market price as of the issuance date. Additionally, during the three and six months ended September 30, 2012, the Company issued zero and 3,000 shares to a consultant as part of a consulting compensation agreement. The shares were valued at \$2.03 per share, the closing market price as of the issuance date.

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2011	2012	2011	2012
Cost of product revenue	\$ 35	\$ 26	\$ 77	\$ 57
General and administrative	140	269	296	419
Sales and marketing	124	102	272	279
Research and development	7	7	12	15
<b>Total</b>	<b>\$ 306</b>	<b>\$ 404</b>	<b>\$ 657</b>	<b>\$ 770</b>

As of September 30, 2012, compensation cost related to non-vested common stock-based compensation, excluding restricted share awards, amounted to \$3.9 million over a remaining weighted average expected term of 6.8 years.

The following table summarizes information with respect to the Plans:

	Equity Awards Outstanding				
	Shares Available for Grant	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Balance at March 31, 2012	1,406,090	3,697,633	\$ 3.76	6.64	
Granted stock options	(795,876)	795,876	2.04		
Granted shares	(16,547)	—	—		
Restricted shares	(163,750)	—	—		
Forfeited	151,938	(151,938)	3.80		
Exercised	—	(20,000)	2.25	—	
<b>Balance at September 30, 2012</b>	<b>581,855</b>	<b>4,321,571</b>	<b>\$ 3.45</b>	<b>6.82</b>	<b>\$ 22,140</b>
<b>Exercisable at September 30, 2012</b>		<b>2,077,991</b>	<b>\$ 3.97</b>	<b>4.98</b>	<b>\$ 22,140</b>

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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 \$1.98 as of September 30, 2012.

A summary of the status of the Company's outstanding non-vested stock options as of September 30, 2012 was as follows:

Non-vested at March 31, 2012	1,810,249
Granted	795,876
Vested	(210,607)
Forfeited	(151,938)
Non-vested at September 30, 2012	<u>2,243,580</u>

During the first half of fiscal 2013, the Company granted restricted shares to key employees as follows (which are included in the above stock plan activity tables):

Shares issued	163,750
Per share price on grant date	\$ 1.80 - 2.00
Compensation expense	\$ 16,000

As of September 30, 2012, the amount of deferred stock-based compensation related to grants of restricted shares, to be recognized over a remaining period of 4.75 years, was approximately \$0.3 million.

The Company has previously issued warrants in connection with various private placement stock offerings and services rendered. The warrants granted the holder the option to purchase common stock at specified prices for a specified period of time. No warrants were issued in fiscal 2012 or during the six months ended September 30, 2012.

A summary of outstanding warrants at September 30, 2012 follows:

	<u>Number of Shares</u>	<u>Exercise Price</u>	<u>Expiration</u>
Balance at March 31, 2012	38,980	\$ 2.25	Fiscal 2015
Balance at September 30, 2012	38,980	\$ 2.25	Fiscal 2015

## NOTE I — SEGMENTS

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

### ***Energy Management***

The Energy Management Division develops, manufactures, integrates and sells commercial HIF and other lighting systems and energy management systems.

### ***Engineered Systems***

The Engineered Systems Division sells and integrates alternative renewable energy systems, such as solar and wind systems.

[Table of Contents](#)**Corporate and Other**

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

(dollars in thousands)	Revenues		Operating Income (Loss)	
	For the Three Months Ended September 30, 2011	For the Three Months Ended September 30, 2012	For the Three Months Ended September 30, 2011	For the Three Months Ended September 30, 2012
Segments:				
Energy Management	\$ 17,503	\$ 16,652	\$ 1,944	\$ (453)
Engineered Systems	15,972	2,756	1,590	(661)
Corporate and Other	—	—	(1,200)	(2,990)
	<u>\$ 33,475</u>	<u>\$ 19,408</u>	<u>\$ 2,334</u>	<u>\$ (4,104)</u>

(dollars in thousands)	Revenues		Operating Income (Loss)	
	For the Six Months Ended September 30, 2011	For the Six Months Ended September 30, 2012	For the Six Months Ended September 30, 2011	For the Six Months Ended September 30, 2012
Segments:				
Energy Management	\$ 34,517	\$ 29,252	\$ 2,601	\$ (2,211)
Engineered Systems	17,179	5,466	795	(1,057)
Corporate and Other	—	—	(2,527)	(4,414)
	<u>\$ 51,696</u>	<u>\$ 34,718</u>	<u>\$ 869</u>	<u>\$ (7,682)</u>

(dollars in thousands)	Total Assets		Deferred Revenue	
	March 31, 2012	September 30, 2012	March 31, 2012	September 30, 2012
Segments:				
Energy Management	\$ 61,873	\$ 61,754	\$ 734	\$ 590
Engineered Systems	13,424	16,239	4,928	6,294
Corporate and Other	50,353	35,239	—	—
	<u>\$ 125,650</u>	<u>\$ 113,232</u>	<u>\$ 5,662</u>	<u>\$ 6,884</u>

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

## 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 this Form 10-Q as well as our audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2012.*

### 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 fiscal 2012 Annual Report filed on Form 10-K for the fiscal year ended March 31, 2012 and elsewhere in this Quarterly Report. We urge you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. We do not undertake any obligation to release publicly any revisions to such forward-looking statements to reflect events or uncertainties after the date hereof or to reflect the occurrence of unanticipated events.

### Recent Management Change and Strategic Refocus

In September 2012, our Board of Directors elected John H. Scribante as our new Chief Executive Officer. Prior to his appointment, Mr. Scribante was the President of our Orion Engineered Systems division and had also served in executive sales management positions. As a result of this management change, we are refocusing our strategic initiatives to include: (i) enhancing and refocusing our sales organization with an emphasis on expanding our direct sales efforts; (ii) streamlining our product development initiatives with a focus on activities that will deliver the greatest return on our investment and disciplined product control releases versus a process of continuous development; and (iii) cost reduction initiatives to deliver profitability.

During the fiscal 2013 second quarter, we recorded operating expenses related to reorganization costs and contractual commitments of \$2.1 million, which included \$1.7 million to general and administrative expenses and \$0.4 million to sales and marketing expenses. Additionally, we recorded a \$5.6 million non-cash income tax expense to establish a valuation allowance against our deferred tax assets.

As part of our cost reduction initiatives, we recently identified additional cost containment initiatives which we believe will result in annualized cost reductions of \$4.0 million. These initiatives include headcount reductions, material and component cost savings in our HIF lighting products and reductions in consulting and other discretionary spending. We intend to implement these cost reductions during the second half of fiscal 2013.

### Overview

We design, manufacture, market and implement energy management systems consisting primarily of high-performance, energy efficient lighting systems, controls and related services and market and implement renewable energy systems consisting primarily of solar generating photovoltaic, or PV, systems and wind turbines. We operate in two business segments, which we refer to as our Energy Management Division and our Engineered Systems Division.

We typically generate the 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.

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We have more recently increased our product development activities surrounding light emitting diode, or LED, lighting and energy management systems. We believe that we have taken a responsible approach to this emerging technology. Based upon recent improvements, including drastic reduction of chip prices, availability of name-brand drivers and the integration with our Intelite controls offerings, we believe that LED will become a larger part of our overall interior lighting strategy in the future.

We have sold and installed more than 2,391,000 of our HIF lighting systems in over 8,477 facilities from December 1, 2001 through September 30, 2012. We have sold our products to 145 Fortune 500 companies, many of which have installed our HIF lighting systems in multiple facilities. Our top direct customers by revenue in fiscal 2012 included Coca-Cola Enterprises, Inc., International Paper Company, U.S. Foodservice, SYSCO Corp., and United Stationers, Inc.

Our fiscal year ends on March 31. We call our prior fiscal year which ended on March 31, 2012, "fiscal 2012". We call our current fiscal year, which will end on March 31, 2013, "fiscal 2013." Our fiscal first quarter ended on June 30, our fiscal second quarter ended on September 30, our fiscal third quarter ends on December 31 and our fiscal fourth quarter ends on March 31.

Because of the recessed state of the global economy since 2009, especially as it has impacted capital equipment manufacturers, our results for the first half of fiscal 2013 continued to be adversely affected by lengthened customer sales cycles and sluggish customer capital spending. To address these difficult economic conditions, we implemented several cost reduction initiatives. During the first quarter of fiscal 2010, we implemented \$3.2 million of annualized cost reductions. These cost containment initiatives included reductions related to headcount, work hours and discretionary spending and began to show results in the second half of fiscal 2010 and the first half of fiscal 2011. During the second quarter of fiscal 2011, we identified an additional \$1 million of annualized cost reductions related to decreased product costs, improved manufacturing efficiencies and reduced operating expenses. We realized these cost reductions beginning during the fiscal 2011 third quarter through reduction in general and administrative expenses and improved product margins for our HIF lighting systems. During fiscal 2012, in recognition of an improving economy compared to the previous year, we focused our efforts on activities to increase revenue. These investments included the creation of a telemarketing call center for the purpose of customer lead generation, the establishment of a sales office and hiring of personnel in Houston, Texas and headcount additions to our retail sales force and our Engineered Systems Division. Despite these recent investments into revenue generating activities, we have continued to experience a difficult capital spending environment during the first half of fiscal 2013.

In response to the constraints on our customers' capital spending budgets, we have been aggressively promoting the advantages to our customers of purchasing our energy management systems through our Orion Throughput Agreement, or OTA, financing program. Our OTA financing program provides for our customer's purchase of our energy management systems without an up-front capital outlay. During fiscal 2012, we entered into an arrangement with a national equipment finance company to provide immediate non-recourse funding of pre-credit approved OTA finance contracts upon project completion and customer acceptance. Additionally, we completed a \$5.0 million OTA line of credit, of which we borrowed \$3.2 million, for the purpose of funding OTA projects upon project completion and customer acceptance, for which we chose to hold the contracts internally. The OTA line of credit expired in September 2012 for new financing, but not for drawn amounts. We now have secured multiple funding sources for our OTA projects. In the future, we expect to use our external sources of funding for OTA projects that are available to us and reduce the number of projects funded internally or funded through bank debt. We expect that the number of customers who choose to purchase our systems by using our OTA financing program will increase in future periods. Additionally, we have provided a financing program to our alternative renewable energy system customers called a solar Power Purchase Agreement, or PPA, as an alternative to purchasing our systems for cash. The PPA is a supply side agreement for the generation of electricity and subsequent sale to the end user. We do not intend to use our own cash balances to fund future PPA opportunities and have been able to secure several external sources of funding for PPA's on behalf of our customers.

Despite these recent economic challenges, we remain optimistic about our long-term financial performance. Our long-term optimism is based upon the considerable size of the existing market opportunity for lighting retrofits, the continued development of our new products and product enhancements, the opportunity for additional revenue from sales of renewable technologies through our Orion Engineered Systems Division, our cost reduction initiatives and the opportunity to increase gross margins through the leverage of our under-utilized manufacturing capacity.

Our annual report on Form 10-K for the fiscal year ended March 31, 2012 provides additional information about our business and operations.

## Revenue and Expense Components

*Revenue.* We sell our energy management products and services directly to commercial and industrial customers, and indirectly to end users through wholesale sales to electrical contractors and value-added resellers. We currently generate the 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. Our service revenues are recognized when services are complete and customer acceptance has been received. In fiscal 2010 and 2011, we increased our efforts to expand our value-added reseller channels, including through developing a partner standard operating procedural kit, providing our partners with product marketing materials and providing training to channel partners on our sales methodologies. These wholesale channels accounted for approximately 64% of our total revenue in fiscal 2012, not taking into consideration our renewable technologies revenue generated through our Orion Engineered Systems Division. During the first half of fiscal 2013, wholesale revenues accounted for approximately 58% of our total revenue, not taking into consideration our renewable technologies revenue generated through our Orion Engineered Systems Division, compared to 62% for the first half of fiscal 2012. In fiscal 2012, we focused our expansion efforts on our direct retail sales channel through the creation of a telemarketing call center for the purpose of customer lead generation, the establishment of a sales office and personnel in Houston, Texas and headcount additions to our retail sales force and our Engineered Systems Division. In the future, we intend to continue to selectively build out our retail sales force, focusing on geographic markets where we do not have a strong wholesale presence and the market contains a larger number of commercial and industrial facilities.

Additionally, we offer our OTA sales-type financing program under which we finance the customer's purchase of our energy management systems. The OTA program was established to assist customers who are interested in purchasing our energy management systems but who have capital expenditure budget limitations. Our OTA contracts are capital leases under GAAP and we record revenue at the present value of the future payments at the time customer acceptance of the installed and operating system is complete. Our OTA contracts under this sales-type financing are either structured with a fixed term, typically 60 months, and a bargain purchase option at the end of term, or are one year in duration and, at the completion of the initial one-year term, provide for (i) one to four automatic one-year renewals at agreed upon pricing; (ii) an early buyout for cash; or (iii) the return of the equipment at the customer's expense. The revenue that we are entitled to receive from the sale of our lighting fixtures under our OTA financing program is fixed and is based on the cost of the lighting fixtures and applicable profit margin. Our revenue from agreements entered into under this program is not dependent upon our customers' actual energy savings. We recognize revenue from OTA contracts at the net present value of the future cash flows at the completion date of the installation of the energy management systems and the customer's acknowledgement that the system is operating as specified. Upon completion of the installation, we may choose to sell the future cash flows and residual rights to the equipment on a non-recourse basis to third party finance companies in exchange for cash and future payments.

In fiscal 2012, we recognized \$10.2 million of revenue from 139 completed OTA contracts. For the three months ended September 30, 2012, we recognized \$1.6 million of revenue from 33 completed contracts compared to \$3.6 million from 29 completed contracts during the three months ended September 30, 2011. For the six months ended September 30, 2012, we recognized \$3.4 million of revenue from 52 completed contracts compared to \$6.5 million from 82 completed contracts for the six months ended September 30, 2011. In the future, we expect an increase in the volume of OTA contracts as our customers take advantage of the value proposition without incurring any up-front capital cost.

Our PPA financing program provides for our customer's purchase of electricity from our renewable energy generating assets without an upfront capital outlay. Our PPA is a longer-term contract, typically in excess of 10 years, in which we receive monthly payments over the life of the contract. This program creates an ongoing recurring revenue stream, but reduces near-term revenue 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. In fiscal 2012, we recognized \$0.6 million of revenue from completed PPAs. In the first half of fiscal 2013, we recognized \$0.4 million of revenue from completed PPAs. As of September 30, 2012, we had signed one customer to two separate PPAs representing future potential discounted revenue streams of \$2.7 million. We discount the future revenue from PPAs due to the long-term nature of the contracts, typically in excess of 10 years. The timing of expected future discounted GAAP revenue recognition and the resulting operating cash inflows from PPAs, assuming the systems perform as designed, was as follows as of September 30, 2012 (in thousands):

Fiscal 2013	\$ 205
Fiscal 2014	465
Fiscal 2015	277
Fiscal 2016	277
Fiscal 2017	276
Beyond	1,217
Total expected future discounted revenue from PPAs	<u>\$2,717</u>

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

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

Our dependence on individual key customers can vary from period to period as a result of the significant size of some of our solar PV projects. Our top 10 customers accounted for approximately 35% and 30% of our total revenue for the first half of fiscal 2012 and fiscal 2013, respectively. Two customers, individually, accounted for 14% and 15% of our total revenue in the first half of fiscal 2012. No customer accounted for more than 10% of our total revenue in the first half of fiscal 2013. To the extent that large solar PV 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 OTA and PPA programs and any new products, applications and service that we may introduce through our Orion Engineered Systems Division; (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; (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 and budget 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.

*Backlog.* We define backlog as the total contractual value of all firm orders received for our lighting and solar products and services where delivery of product or completion of services has not yet occurred as of the end of any particular reporting period. Such orders must be evidenced by a signed proposal acceptance or purchase order from the customer. Our backlog does not include PPAs or national contracts that have been negotiated, but under which we have not yet received a purchase order for the specific location. As of September 30, 2012, we had a backlog of firm purchase orders of approximately \$46.7 million, which included \$41.6 million of solar PV orders, compared to \$50.5 million as of June 30, 2012, which included \$44.3 million of solar PV orders. We currently expect approximately \$18.0 million of our September 30, 2012 backlog to be recognized as revenue in the second half of fiscal 2013 and the remainder in future fiscal years. We typically expect the non-solar portion of our backlog to be recognized as revenue within 90 days from receipt of order. Our solar PV orders are typically longer-term construction type projects and we expect revenue to be recognized over a period of between three and 24 months from receipt of order, dependent upon the size and complexity of the project. As a result of the increased volume of our solar PV orders, the continued lengthening of our customer's purchasing decisions because of current recessed economic conditions and related factors, the continued shortening of our installation cycles and the number of projects sold through OTAs, a comparison of backlog from period to period is not necessarily meaningful and may not be indicative of actual revenue recognized in future periods.



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*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) materials for sales of solar PV systems through our Engineered Systems Division, including solar panels, inverters and wiring; (iv) wages and related personnel expenses, including stock-based compensation charges, for our fabricating, coating, assembly, logistics and project installation service organizations; (v) manufacturing facilities, including depreciation on our manufacturing facilities and equipment, taxes, insurance and utilities; (vi) warranty expenses; (vii) installation and integration; and (viii) 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. Previously, we purchased most of our ballast and lamp components from a single supplier. Purchases from this supplier accounted for 12% of total cost of revenue for the first half of fiscal 2012. Currently, we purchase these components from multiple suppliers. For the first half of fiscal 2013, purchases from two suppliers accounted for 16% of total cost of revenue. Previously, we purchased most of our solar panels from one supplier for sales of our solar generating systems. Purchases from this supplier accounted for 25% of total cost of revenue for the first half of fiscal 2012. Currently, we have been able to obtain panels from multiple suppliers. For the first half of fiscal 2013, panel purchases from one supplier accounted for 6% of total cost of revenue. Our cost of revenue from OTA projects is recorded upon customer acceptance and acknowledgement that the system is operating as specified. 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. During fiscal 2011 and fiscal 2012, we reduced headcounts and improved production product flow through the reengineering of our assembly stations.

*Gross Margin.* Our gross profit has been, and will continue to be, affected by the relative levels of our total revenue and our total cost of revenue, and as a result, our gross profit may be subject to quarterly variation. Our gross profit as a percentage of total revenue, or gross margin, is affected by a number of factors, including: (i) our level of solar PV sales which have greater margin volatility due to recent decreases in product costs versus our traditional energy management systems; (ii) our mix of large retrofit and multi-facility roll-out projects with national accounts; (iii) the level of our wholesale and partner sales (which generally have historically resulted in lower relative gross margins, but higher relative net margins, than our sales to direct customers); (iv) our realization rate on our billable services; (v) our project pricing; (vi) our level of warranty claims; (vii) our level of utilization of our manufacturing facilities and production equipment and related absorption of our manufacturing overhead costs; (viii) our level of efficiencies in our manufacturing operations; and (ix) 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. In fiscal 2012, we increased headcount in our sales areas for telemarketing and direct sales employees. In 2013, we expect to continue to selectively increase headcount in our sales areas.

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

Our research and development expenses consist primarily of costs for: (i) salaries and related personnel expenses, including stock-based compensation charges, related to our engineering 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.

In fiscal 2012, we invested in sales expansion initiatives, including the creation of a telemarketing call center for the purpose of customer lead generation, the establishment of a sales office and hiring of personnel in Houston, Texas and headcount additions to our

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retail sales force and our Engineered Systems Division. 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. In the future, we intend to continue to invest in headcount additions to our retail sales force dependent upon geographic market opportunities and availability of sales talent. We also intend to continue investing in our research and development of new and enhanced energy management products and services.

We recognize compensation expense for the fair value of our stock option and restricted stock awards granted over their related vesting period. We recognized \$0.7 million for both the first half of fiscal 2012 and fiscal 2013. As a result of prior option and restricted stock grants, we expect to recognize an additional \$4.2 million of stock-based compensation over a weighted average period of approximately seven years, including \$0.7 million in the last six months of fiscal 2013. 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 long-term debt obligations, including the amortization of previously incurred financing costs. We amortize deferred financing costs to interest expense over the life of the related debt instrument, ranging from five to ten years.

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

*Income Taxes.* As of September 30, 2012, we had net operating loss carryforwards of approximately \$11.5 million for federal tax purposes and \$6.7 million for state tax purposes. Included in these loss carryforwards were \$3.2 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 tax credit carryforwards of approximately \$1.3 million and state credit carryforwards of approximately \$0.5 million. A valuation allowance of \$5.6 million equaling the net deferred tax assets was established during the second quarter of fiscal 2013 due to the uncertainty of its realization value in the future. The determination of the realization of deferred tax assets requires considerable judgment including both positive and negative evidence in evaluating the need for a valuation allowance. Our negative evidence included a cumulative three year operating loss, an expected loss for fiscal year 2013 and limited visibility into future earnings. Our positive evidence included a strong backlog of orders; however, we determined that the current negative evidence outweighed the current positive evidence. We considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance. In the event that we determine that the deferred tax assets are able to be realized, an adjustment to the deferred tax asset would increase income in the period such determination is made. A valuation allowance of \$0.4 million had been previously set up for our state tax credits due to our state apportioned income and the potential expiration of the state tax credits due to the carryforward period. These federal and state net operating losses and credit carryforwards are available, subject to the discussion in the following paragraph, to offset future taxable income and, if not utilized, will begin to expire in varying amounts between 2019 and 2032.

Generally, a change of more than 50% in the ownership of a company's stock, by value, over a three-year period constitutes an ownership change for federal income tax purposes. An ownership change may limit a company's ability to use its net operating loss carryforwards attributable to the period prior to such change. There was no limitation that occurred for fiscal 2011 or fiscal 2012.

## 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 September 30,			Six Months Ended September 30,			2012			
	2011		2012		2011		2012			
	Amount	% of Revenue	Amount	% of Revenue	% Change	Amount	% of Revenue	Amount	% of Revenue	% Change
Product revenue	\$30,111	90.0%	\$16,931	87.2%	(43.8)%	\$47,472	91.8%	\$30,511	87.9%	(35.7)%
Service revenue	3,364	10.0%	2,477	12.8%	(26.4)%	4,224	8.2%	4,207	12.1%	(0.4)%
Total revenue	33,475	100.0%	19,408	100.0%	(42.0)%	51,696	100.0%	34,718	100.0%	(32.8)%
Cost of product revenue	21,447	64.1%	11,867	61.1%	(44.7)%	33,039	63.9%	21,464	61.8%	(35.0)%
Cost of service revenue	2,647	7.9%	1,736	8.9%	(34.4)%	3,269	6.3%	3,076	8.9%	(5.9)%
Total cost of revenue	24,094	72.0%	13,603	70.1%	(43.5)%	36,308	70.2%	24,540	70.7%	(32.4)%
Gross profit	9,381	28.0%	5,805	29.9%	(38.1)%	15,388	29.8%	10,178	29.3%	(33.9)%
General and administrative expenses	2,725	8.1%	4,638	23.9%	70.2%	5,800	11.2%	7,940	22.9%	36.9%
Sales and marketing expenses	3,729	11.1%	4,561	23.5%	22.3%	7,504	14.5%	8,513	24.5%	13.4%
Research and development expenses	593	1.8%	710	3.7%	19.7%	1,215	2.4%	1,407	4.1%	15.8%
Income (loss) from operations	2,334	7.0%	(4,104)	(21.1)%	(275.8)%	869	1.7%	(7,682)	(22.1)%	(984.0)%
Interest expense	(150)	(0.4)%	(142)	(0.7)%	(5.3)%	(237)	(0.5)%	(303)	(0.9)%	27.8%
Dividend and interest income	214	0.6%	218	1.1%	1.9%	368	0.7%	443	1.3%	20.4%
Income (loss) before income tax	2,398	7.2%	(4,028)	(20.8)%	(268.0)%	1,000	1.9%	(7,542)	(21.7)%	(854.2)%
Income tax expense	1,040	3.1%	5,631	29.0%	441.4%	434	0.8%	4,057	11.7%	834.8%
Net income (loss)	\$1,358	4.1%	\$(9,659)	(49.8)%	(811.3)%	\$566	1.1%	\$(11,599)	(33.4)%	(2,149.3)%

**Revenue.** Product revenue decreased from \$30.1 million for the fiscal 2012 second quarter to \$16.9 million for the fiscal 2013 second quarter, a decrease of \$13.2 million, or 44%. The decrease in product revenue was a result of decreased sales of our renewable energy systems and HIF lighting systems. During the first half of fiscal 2012, we had two large solar PV projects under construction and did not have similar size projects under construction during the first half of fiscal 2013. Service revenue decreased from \$3.4 million for the fiscal 2012 second quarter to \$2.5 million for the fiscal 2013 second quarter, a decrease of \$0.9 million, or 26%. The decrease in service revenue was a result of the related service revenue from the decrease in sales of solar renewable energy systems. Total revenue from renewable energy systems was \$2.8 million for the fiscal 2013 second quarter compared to \$16.0 million for the fiscal 2012 second quarter, a decrease of \$13.2 million or 83%. Product revenue decreased from \$47.5 million for the first half of fiscal 2012 to \$30.5 million for the first half of fiscal 2013, a decrease of \$17.0 million, or 36%. Service revenue of \$4.2 million for the first half of fiscal 2012 was similar to service revenue for the first half of fiscal 2013. Total revenue from renewable energy systems was \$5.5 million for the first half of fiscal 2013 compared to \$17.2 million for the first half of fiscal 2012, a decrease of \$11.7 million, or 68%.

**Cost of Revenue and Gross Margin.** Our cost of product revenue decreased from \$21.4 million for the fiscal 2012 second quarter to \$11.9 million for the fiscal 2013 second quarter, a decrease of \$9.6 million, or 45%. Our cost of service revenue decreased from \$2.6 million for the fiscal 2012 second quarter to \$1.7 million for the fiscal 2013 second quarter, a decrease of \$0.9 million, or 34%. Gross margin increased from 28.0% for the fiscal 2012 second quarter to 29.9% for the fiscal 2013 second quarter. For the fiscal 2013 second quarter, our gross margin percentage increased due to improved margins on solar PV projects from our Orion Engineered Systems Division. Our gross margin percentage on renewable revenues from this division was 27.1% during the fiscal 2013 second quarter compared to 19.0% for the fiscal 2012 second quarter. Gross margin from our HIF integrated systems revenue for the 2013 second quarter was 30.4% compared to 36.3% for the fiscal 2012 second quarter. Our cost of product revenue decreased from \$33.0 million for the first half of fiscal 2012 to \$21.5 million for the first half of fiscal 2013, a decrease of \$11.6 million, or 35%. Our cost of service revenue decreased from \$3.3 million for the first half of fiscal 2012 to \$3.1 million for the first half of fiscal 2013, a decrease of \$0.2 million, or 6%. Total gross margin decreased from 29.8% for the first half of fiscal 2012 to 29.3% for the first half of fiscal 2013. For the first half of fiscal 2013, our decrease in total gross margin on product revenues versus the first half of fiscal 2012 was due to the reduced revenue from sales of our energy management systems and the impact of our fixed manufacturing costs on lower unit volumes of our HIF lighting energy management systems. Gross margins from the sale of our solar PV systems were 31.0% for the fiscal 2013 first half compared to 18.5% for the fiscal 2012 first half and our gross margins from the sale of our HIF energy management systems were 29.0% for the fiscal 2013 first half compared to 35.4% for the fiscal 2012 first half.

**General and Administrative.** Our general and administrative expenses increased from \$2.7 million for the fiscal 2012 second quarter to \$4.6 million for the fiscal 2013 second quarter, an increase of \$1.9 million, or 70%. The increase in expenses was due to reorganization costs of \$1.9 million related to management changes and cost reduction initiatives. Our general and administrative expenses increased from \$5.8 million for the first half of fiscal 2012 to \$7.9 million for the first half of fiscal 2013, an increase of \$2.1 million, or 37%. The increase for the first half was due to reorganization expenses resulting from cost reduction initiatives and increased legal and audit expenses of \$0.2 million related to the re-audit of our fiscal 2011 financial statements.

**Sales and Marketing.** Our sales and marketing expenses increased from \$3.7 million for the fiscal 2012 second quarter to \$4.6 million for the fiscal 2013 second quarter, an increase of \$0.9 million, or 24%. Our sales and marketing expenses increased from \$7.5 million for the first half of fiscal 2012 to \$8.5 million for the first half of fiscal 2013, an increase of \$1.0 million, or 13%. The increase was due to reorganization expenses of \$0.4 million and the full year impact of headcount additions from our prior year investment into the formation and staffing of our telemarketing function, the establishment and staffing of our Houston technology center, headcount additions for retail sales and sales and project management to support the increase in our solar PV backlog. Total sales and marketing headcount was 93 and 115 at September 30, 2011 and 2012, respectively.

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**Research and Development.** Our research and development expenses increased from \$0.6 million for the fiscal 2012 second quarter to \$0.7 for the fiscal 2013 second quarter, an increase of \$0.1 million, or 20%. Our research and development expenses increased from \$1.2 million for the first half of fiscal 2012 to \$1.4 million for the first half of fiscal 2013, an increase of \$0.2 million, or 16%. The increase was due to increased compensation expenses related to the development of new product offerings, including our light emitting diode, or LED, product and energy management controls initiatives.

**Interest Expense.** Our interest expense decreased from \$150,000 for the fiscal 2012 second quarter to \$142,000 for the fiscal 2013 second quarter, a decrease of \$8,000, or 5%. Our interest expense increased from \$237,000 for the first half of fiscal 2012 to \$303,000 for the first half of fiscal 2013, an increase of \$66,000, or 28%. The increase in our interest expense was due to the full year impact of additional debt funding completed during fiscal 2012 for the purpose of financing our OTA projects.

**Interest Income.** Interest income increased slightly from \$214,000 for the fiscal 2012 second quarter to \$218,000 for the fiscal 2013 second quarter, an increase of \$4,000 or 2%. Interest income increased from \$368,000 for the first half of fiscal 2012 to \$443,000 for the first half of fiscal 2013, an increase of \$75,000 or 20%. Interest income increased due to an increase in the number and dollar amount of completed OTA contracts and the related interest income under the financing terms.

**Income Taxes.** Our income tax expense increased from \$1.0 million for the fiscal 2012 second quarter to \$5.6 million for the fiscal 2013 second quarter, an increase of \$4.6 million or 441%. Our income tax expense increased from \$0.4 million for the first half of fiscal 2012 to \$4.1 million for the first half of fiscal 2013, an increase of \$3.6 million or 835%. During the fiscal 2013 second quarter, we recorded a valuation reserve against our deferred tax assets in the amount of \$5.6 million due to the amount of our operating loss from operations for the fiscal 2013 first half and uncertainty of the realization value of these assets in the future. Our effective income tax rate for the first half of fiscal 2012 was 43.4%, compared to 53.8% for the half of fiscal 2013.

### **Energy Management Segment**

The following table summarizes our Energy Management segment operating results:

(dollars in thousands)	For the Three Months Ended September 30,		For the Six Months Ended September 30,	
	2011	2012	2011	2012
Revenues	\$ 17,503	\$ 16,652	\$ 34,517	\$ 29,252
Operating income (loss)	\$ 1,944	\$ (453)	\$ 2,601	\$ (2,211)
Operating margin	11.1%	(2.7)%	7.5%	(7.6)%

Energy Management segment revenue decreased \$0.8 million, or 5%, from \$17.5 million for the fiscal 2012 second quarter to \$16.7 million for the fiscal 2013 second quarter. Energy Management segment revenue decreased \$5.3 million, or 15%, from \$34.5 million for the first half of fiscal 2012 to \$29.3 million for the first half of fiscal 2013. The decrease in revenue for both the fiscal 2013 second quarter and year-to-date was due to reduced sales of our HIF lighting systems to our national account and wholesale customers due to a difficult capital spending environment.

Energy Management segment operating income decreased \$2.4 million, or 123%, from operating income of \$1.9 million for the fiscal 2012 second quarter to operating loss of \$0.5 million for the fiscal 2013 second quarter. Energy Management segment operating income decreased \$4.8 million, or 185%, from operating income of \$2.6 million for the first half of fiscal 2012 to operating loss of \$2.2 million for the first half of fiscal 2013. The decrease in operating income for both the fiscal 2013 second quarter and year-to-date was a result of decreased revenue, the negative gross margin impact of fixed costs in our manufacturing facility on reduced production volumes and the increase in selling expenses for our telemarketing and retail sales headcount additions.

### **Engineered Systems Segment**

The following table summarizes our Engineered Systems segment operating results:

(dollars in thousands)	For the Three Months Ended September 30,		For the Six Months Ended September 30,	
	2011	2012	2011	2012
Revenues	\$ 15,972	\$ 2,756	\$ 17,179	\$ 5,466
Operating income (loss)	\$ 1,590	\$ (661)	\$ 795	\$ (1,057)
Operating margin	10.0%	(24.0)%	4.6%	(19.3)%

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Engineered Systems segment revenue decreased \$13.2 million, or 83%, from \$16.0 million for the fiscal 2012 second quarter to \$2.8 million for the fiscal 2013 second quarter. Engineered Systems segment revenue decreased \$11.7 million, or 68%, from \$17.2 million for the first half of fiscal 2012 to \$5.5 million for the first half of fiscal 2013. The decrease was due to decreased sales of solar renewable technologies for the fiscal 2013 second quarter and the first half of fiscal 2013. During the same periods of fiscal 2012, we had two large solar PV projects under construction.

Engineered Systems segment operating income decreased \$2.3 million, or 142%, from operating income of \$1.6 million for the fiscal 2012 second quarter to operating loss of \$0.7 million for the fiscal 2013 second quarter. Engineered Systems segment operating income decreased \$1.9 million, or 233%, from operating income of \$0.8 million for the first half of fiscal 2012 to operating loss of \$1.1 million for the first half of fiscal 2013. The increase in operating loss for both the quarter and year-to-date was a result of the decreased revenue volume and resulting contribution margin from sales of solar renewable energy systems.

## Liquidity and Capital Resources

### Overview

We had approximately \$13.2 million in cash and cash equivalents and \$1.0 million in short-term investments as of September 30, 2012, compared to \$23.0 million and \$1.0 million at March 31, 2012. Our cash equivalents are invested in money market accounts with maturities of less than 90 days and an average yield of 0.24%. Our short-term investment account consists of a bank certificate of deposit in the amount of \$1.0 million with an expiration date of December 2012 and a yield of 0.50%. Additionally, as of September 30, 2012, we had \$13.3 million of borrowing availability under our revolving credit agreement. Our OTA credit agreement expired September 30, 2012 for new borrowings, but not for amounts previously drawn. We did not borrow on the OTA credit agreement during the first half of fiscal 2013. During the first half of fiscal 2013, we repurchased \$4.5 million of our common stock and have a commitment to repurchase \$1.5 million of our common stock during our fiscal 2013 third quarter. We do not intend to continue to repurchase our common stock in the near-term. 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 next 12 months, dependent upon our growth opportunities with our cash and finance customers.

### Cash Flows

The following table summarizes our cash flows for the six months ended September 30, 2011 and 2012 (in thousands):

	Six Months Ended September 30,	
	2011	2012
Operating activities	\$ 1,384	\$ (2,327)
Investing activities	(2,133)	(1,774)
Financing activities	4,748	(5,696)
Increase (decrease) in cash and cash equivalents	\$ 3,999	\$ (9,797)

*Cash Flows Related to Operating Activities.* Cash used in operating activities for the first half of fiscal 2013 was \$2.3 million and consisted of net cash provided by changes in operating assets and liabilities of \$2.4 million and a net loss adjusted for non-cash expense items of \$4.7 million. Cash provided by changes in operating assets and liabilities consisted of a decrease of \$0.5 million in total accounts receivable due to customer collections and reduced revenue during the first half, an increase in accounts payable of \$0.9 million due to vendor payment terms, an increase in accrued expenses of \$2.0 million due to the timing of payments and a \$1.2 million increase in deferred revenue due to customer deposit payments received. Cash used from changes in operating assets and liabilities included a \$0.2 million increase in inventory for purchases of raw material components and a \$2.6 million increase in deferred contract costs for product costs incurred on projects where the performance criteria for revenue recognition has not yet occurred.

Cash provided by operating activities for the first half of fiscal 2012, was \$1.4 million and consisted of net cash of \$1.3 million used for changes in operating assets and liabilities offset by net income adjusted for non-cash expense items of \$2.7 million. Cash

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provided by changes in operating assets and liabilities consisted of a decrease of \$3.3 million in total accounts receivable due to customer payments received during the quarter and a \$6.7 million decrease in deferred contract costs due to project completions and cost recognition on solar PV systems. Cash used for changes in operating assets and liabilities included a \$3.2 million increase in inventory for purchases of solar panel inventory and increases in our work-in-process and lighting fixture inventories for orders that are expected to ship during the fiscal 2012 third quarter, a \$2.3 million increase in prepaid and other expenses related to deferred customer billings, a \$3.9 million decrease in deferred revenue to project completions and a \$2.1 million decrease in accounts payable due to vendor payments.

*Cash Flows Related to Investing Activities.* For the first half of fiscal 2013, cash used in investing activities was \$1.8 million. This included \$1.7 million for capital improvements related to our product development, information technology systems, manufacturing improvements and facility investments and \$0.1 million for investment in patent activities.

For the first half of fiscal 2012, cash used in investing activities was \$2.1 million. This included \$2.0 million for capital improvements related to our information technology systems, manufacturing and tooling improvements and facility investments and \$0.1 million for investment in patent activities.

*Cash Flows Related to Financing Activities.* For the first half of fiscal 2013, cash flows used in financing activities were \$5.7 million. This included \$4.5 million used for common share repurchases and \$1.4 million for repayment of long-term debt. Cash flows provided by financing activities included \$0.2 million in debt proceeds and \$0.1 million received from stock option exercises and for excess tax benefits from stock-based compensation.

For the first half of fiscal 2012, cash flows provided by financing activities were \$4.7 million. This included \$4.6 million in new debt borrowings to fund OTAs, \$0.8 million for excess tax benefits from stock-based compensation and \$0.1 million received from stock option and warrant exercises. Cash flows used in financing activities included \$0.7 million for repayment of long-term debt and \$0.1 million for debt closing costs.

### **Working Capital**

Our net working capital as of September 30, 2012 was \$30.3 million, consisting of \$58.6 million in current assets and \$28.3 million in current liabilities. Our net working capital as of March 31, 2012 was \$44.5 million, consisting of \$67.2 million in current assets and \$22.7 million in current liabilities. Our current accounts receivables increased from fiscal 2012 year-end by \$0.3 million and our inventories increased from our fiscal 2012 year-end by \$0.3 million due to an increase in lighting raw material inventories. During fiscal 2012, we had increased our inventories of fluorescent lamps due to concerns over shortages of rare earth minerals used in the production of fluorescent lamps. We believe that these supply shortage concerns have stabilized, but we continue to monitor them through conversations with our key vendors. Our accounts payable increased from our fiscal 2012 year end by \$0.9 million due to increased inventory purchases and the timing of vendor payment terms.

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

For the second half of fiscal 2013, we intend to focus our efforts to preserve cash by reducing expenses and by implementing conservative inventory purchasing strategies and reducing our overall inventories.

### **Indebtedness**

#### **Revolving Credit Agreement**

We have a credit agreement (Credit Agreement) with JP Morgan Chase Bank, N.A. (JP Morgan). The Credit Agreement provides for a revolving credit facility (Credit Facility) that matures on June 30, 2013. Borrowings under the Credit Facility are limited to (i) \$15.0 million or (ii) during periods in which the outstanding principal balance of outstanding loans under the Credit Facility is greater than \$5.0 million, the lesser of (A) \$15.0 million or (B) the sum of 75% of the outstanding principal balance of certain accounts receivable and 45% of certain inventory. The Credit Facility contains certain financial covenants, including minimum unencumbered liquidity requirements and requirements that the Company maintain a total liabilities to tangible net worth ratio not to exceed 0.50 to 1.00 as of the last day of any fiscal quarter. The Credit Facility also contains certain restrictions on our ability to make capital or lease

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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 our stock, redeem or repurchase shares of our stock or pledge assets. We also may cause JP Morgan to issue letters of credit for our account in the aggregate principal amount of up to \$2.0 million, with the dollar amount of each issued letter of credit counting against the overall limit on borrowings under the Credit Facility. As of September 30, 2012, we had outstanding letters of credit totaling \$1.7 million, primarily for securing collateral requirements under equipment operating leases. We had no outstanding borrowings under the Credit Facility as of March 31, 2012 or September 30, 2012. We were not in compliance with all covenants in the credit agreement as of September 30, 2012 and expect to receive a waiver from our bank for the covenant defaults.

The Credit Agreement is secured by a first lien security interest in our accounts receivable, inventory and general intangibles, and a second lien priority in our equipment and fixtures. All OTAs, PPAs, leases, supply agreements and/or similar agreements relating to solar PV and wind turbine systems or facilities, as well as all of our accounts receivable and assets related to the foregoing, are excluded from these liens.

The Credit Agreement provides that we have the option to select whether borrowings under the Credit Facility will bear interest at either (i) a daily borrowing LIBOR rate tied to a one-month maturity or (ii) a LIBOR rate tied to a maturity corresponding to an interest period selected plus, in the case of either (i) or (ii), a per annum rate spread of 2.00%, 2.50% or 3.00%, depending on the ratio of (A) earnings before interest, taxes, depreciation and amortization less income taxes paid in cash less 50% of depreciation expense to (B) the sum of interest expense paid in cash in respect of indebtedness for borrowed money plus scheduled principal payments made with respect to indebtedness for borrowed money, all as determined for the 12-month period ending as of the end of the applicable fiscal quarter.

We must pay a fee of 0.25% on the average daily unused amount of the Credit Facility and a fee of 2.00% on the daily average face amount of undrawn issued letters of credit. The fee on unused amounts is waived if we maintain funds on deposit with JP Morgan or its affiliates above a specified amount. The deposit threshold requirement was met as of September 30, 2012.

### ***OTA Credit Agreement***

We have a credit agreement with JP Morgan that provides us with \$5.0 million immediately available to fund completed customer contracts under our OTA finance program. We had one-year from the date of the commitment to borrow under the credit agreement, which expired on September 30, 2012 for new borrowing. Through September 2012, we have \$2.4 million outstanding against the credit agreement. There were no new borrowings during the first half of fiscal 2013. The loan amount is collateralized by the OTA-related equipment and the expected future monthly payments under the supporting 39 individual OTA customer contracts. The current loan amount under the credit agreement bears interest at LIBOR plus 4% and matures in December 2016. The credit agreement includes certain financial covenants, including funded debt to EBITDA and debt service coverage ratios. We were not in compliance with all covenants in the credit agreement as of September 30, 2012 and expect to receive a waiver from our bank for the covenant defaults.

### ***Capital Spending***

Capital expenditures totaled \$1.7 million during the first half of fiscal 2013 due to investments in new product development, information technologies, training and research facility additions, as well as facility investments. We expect to incur approximately \$0.6 to \$0.8 million in capital expenditures during the remainder of fiscal 2013, excluding capital to support expected OTA growth. Our capital spending plans predominantly consist of further cost improvements in our manufacturing facility, new product development and investment in information technology systems. We expect to finance these capital expenditures primarily through our existing cash, equipment secured loans and leases, to the extent needed, long-term debt financing, or by using our available capacity under our credit facility.



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### **Contractual Obligations and Commitments**

The following table is a summary of our long-term contractual obligations as of September 30, 2012 (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	\$ 8,236	\$ 2,871	\$ 4,225	\$ 706	\$ 434
Cash interest payments on debt	984	388	340	62	194
Operating lease obligations	7,020	1,133	1,883	1,648	2,356
Purchase obligation(2)	1,477	1,477	—	—	—
Purchase order and cap-ex commitments(1)	12,642	10,422	2,220	—	—
Total	<u>\$30,359</u>	<u>\$16,291</u>	<u>\$ 8,668</u>	<u>\$ 2,416</u>	<u>\$ 2,984</u>

(1) Reflects non-cancellable purchase order commitments in the amount of \$12.6 million for certain inventory items entered into in order to secure better pricing and ensure materials on hand.

(2) Reflects \$1.5 million for contractual agreement to repurchase outstanding common stock.

### **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, 2012. There have been no material changes in any of our accounting policies since March 31, 2012.

### **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, 2012. There have been no material changes to such exposures since March 31, 2012.

### **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 September 30, 2012 pursuant to Rule 13a-15(b) of the Exchange Act of 1934 (the “Exchange Act”). Our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective as of September 30, 2012.

There was no change in our internal control over financial reporting that occurred during the quarter ended September 30, 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



**PART II — OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

As previously disclosed, in August 2012, the Company received a subpoena issued by the staff of the Securities and Exchange Commission ("SEC") requesting certain documents and information generally related to the Company's financial reporting of its sales of solar photovoltaic systems, among other matters. The Company continues to cooperate with the SEC regarding this non-public, fact-finding inquiry. The SEC has informed the Company that this inquiry should not be construed as an indication that any violations of law have occurred or that the SEC has any negative opinion of any person, entity or security.

**ITEM 1A. RISK FACTORS**

We operate in a rapidly changing environment that involves a number of risks that could materially affect our business, financial condition or future results, some of which are beyond our control. In addition to the other information set forth in this Quarterly Report on Form 10-Q, the risks and uncertainties that we believe are most important for you to consider are discussed in Part I — Item 1A under the heading "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended March 31, 2012, which we filed with the SEC on June 14, 2012. During the six months ended September 30, 2012, there were no material changes to the risk factors that were disclosed in Part I — Item 1A under the heading "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended March 31, 2012.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS****(c) Purchases of Equity Securities**

The table below summarizes stock repurchases for the three-month period ended September 30, 2012.

<u>Period</u>	<u>Total Number of Shares Purchased</u>	<u>Average Price Paid per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(1)</u>	<u>Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs(1)</u>
July 1 - July 31, 2012	333,402	\$ 2.24	333,402	\$ 3,551,000
August 1 - August 31, 2012	572,450	\$ 2.23	572,450	\$ 2,277,000
September 1 - September 30, 2012	19,000	\$ 1.81	19,000	\$ 2,242,000
	924,852		924,852	

- (1) On April 27, 2012, we announced that our board of directors had authorized the repurchase, in the aggregate, of a maximum of \$7.5 million of our outstanding common stock. We have a commitment to repurchase \$1.5 million of our common stock during our fiscal 2013 third quarter. Following the \$1.5 million repurchase, we do not intend to continue to repurchase our common stock in the near-term.

**ITEM 5. OTHER INFORMATION****Statistical Data**

The following table presents certain statistical data, cumulative from December 1, 2001 through September 30, 2012, 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.

	<b>Cumulative From December 1, 2001 Through September 30, 2012</b>
	<b>(in thousands, unaudited)</b>
HIF lighting systems sold (1)	2,391
Total units sold (including HIF lighting systems)	3,284
Customer kilowatt demand reduction (2)	758
Customer kilowatt hours saved (2)(3)	23,389,645
Customer electricity costs saved (4)	\$ 1,799,874
Indirect carbon dioxide emission reductions from customers' energy savings (tons) (5)	15,367
Square footage retrofitted (6)	1,241,271

- (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 3.3 million units).
- (3) We calculate the number of kilowatt hours saved on a cumulative basis by assuming the demand (kW) reduction for each fixture 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 2011, which is the most current full year for which this information is available, was \$0.1002 per kilowatt hour according to the United States Energy Information Administration.
- (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.
- (6) Based on 3.3 million total units sold, which contain a total of approximately 16.5 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.

**Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements of Certain Officers.***Executive Employment and Severance Agreements*

Effective November 9, 2012, Orion Energy Systems, Inc. (the "Company") entered into an Executive Employment and Severance Agreement (the "Employment Agreement") with Scott R. Jensen, the Company's Chief Financial Officer, Chief Accounting Officer and Treasurer.

The Employment Agreement is for an initial term through September 30, 2013, after which the Employment Agreement will be renewed for successive one-year periods unless the Company provides notice of non-renewal prior to the end of the applicable term. The Employment Agreement provides for an annual base salary of \$255,000 and for participation by Mr. Jensen in the Company's annual and/or long-term bonus plans as well as the Company's employee benefit plans made available to other senior executives.

The Employment Agreement also provides that Mr. Jensen is entitled to certain severance payments and other benefits upon a qualifying employment termination, including certain enhanced protections under such circumstances occurring after a "Change of Control" (as defined in the Employment Agreement) of the Company. If Mr. Jensen's employment is terminated without "Cause" (as defined in the Employment Agreement) or for "Good Reason" (as defined in the Employment Agreement) prior to the end of the employment period, Mr. Jensen will be entitled to a severance benefit payable over an 18-month period equal to the sum of his base salary plus the average of the prior three years' bonuses and COBRA premiums at the active employee rate for the duration of the executive's COBRA continuation coverage period. If Mr. Jensen is terminated without "Cause" or for "Good Reason" following a "Change of Control" prior to the end of the employment period, Mr. Jensen will be entitled to a severance benefit payable over an 18-month

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period equal to two times the sum of his base salary plus the average of the prior three years' bonuses and COBRA premiums at the active employee rate for the duration of the executive's COBRA continuation coverage period. To receive these benefits, Mr. Jensen must execute and deliver to the Company (and not revoke) a general release of claims. The Employment Agreement also requires Mr. Jensen not to, during the term of the employment and for following the termination of employment, (i) disclose any confidential information of the Company, (ii) compete with the Company (for a term of 18 months following termination of employment) or (iii) solicit the employees or other persons with business relationships with the Company (for a term of 18 months following termination of employment).

Also effective November 9, 2012, the Company entered into a letter agreement (the "Letter Agreement") with Michael J. Potts, the Company's President and Chief Operating Officer, amending the Executive Employment and Severance Agreement, dated February 21, 2008, between the Company and Mr. Potts. The Letter Agreement increased the base salary of Mr. Potts from \$275,000 to \$280,000, waived any prior or existing "Good Reason" termination right that Mr. Potts may have had under the Executive Employment and Severance Agreement and amended and restated the definition of "Good Reason" in the Executive Employment and Severance Agreement. Except as expressly modified by the Letter Agreement, the Executive Employment and Severance Agreement will continue in effect in accordance with its terms.

A copy of the Employment Agreement and Letter Agreement are attached hereto as Exhibits 10.13 and 10.14, respectively, and are incorporated by reference herein.

### *Second Half of Fiscal 2013 Incentive Cash Bonus Program*

Effective November 9, 2012, the Company's Compensation Committee approved a new incentive cash bonus program for the second half of fiscal 2013 in replacement of the existing fiscal 2013 incentive bonus program. The new incentive cash bonus program provides a cash bonus opportunity to named executive officers and other key employees based on the Company's relative achievement, in the second half of fiscal 2013, of target operating income (before bonuses and other extraordinary or unusual items) and target cost containment initiatives.

Under the new program, 50% of the target bonus payments will be based on the Company's relative achievement of its cost containment target of \$1.48 million for the second half of fiscal 2013. For every \$1.00 of cost containment achieved, a bonus pool of \$0.167 will be earned, up to a maximum total bonus pool of \$247,000 for all employees. The other 50% of the target bonus payments will be based on the Company achieving operating income (before bonuses and other extraordinary or unusual items) of \$500,000 for the second half of fiscal 2013. For every \$1.00 of operating profit achieved, a bonus pool of \$0.50 will be earned, up to a maximum total bonus pool of \$247,000 for all employees. The Compensation Committee established a target maximum bonus for each of the Company's named executive officers as follows:

Name	Target Maximum Bonus	Cost Containment (50%)	Operating Income (50%)
John Scribante Chief Executive Officer	\$230,000	\$ 115,000	\$115,000
Mike Potts President and Chief Operating Officer	70,000	35,000	35,000
Scott Jensen Chief Financial Officer, Chief Accounting Officer and Treasurer	44,625	22,313	22,313
Other Key Performers (as determined by Chief Executive Officer)	150,000	75,000	75,000
<b>TOTAL</b>	<b>\$494,625</b>	<b>\$ 247,313</b>	<b>\$247,313</b>

The financial targets described above are not a prediction of how the Company will perform during fiscal year 2013. The purpose of the targets is to provide appropriate financial metrics to determine amounts of compensation under the Company's incentive compensation program. The targets are not intended to serve, and should not be relied upon, as guidance or any other indication of the Company's expected future performance.

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**ITEM 6. EXHIBITS**

**(a) Exhibits**

10.13	Executive Employment and Severance Agreement, effective November 9, 2012 between the Company and Scott R. Jensen.
10.14	Letter Agreement effective November 9, 2012, between the Company and Michael J. Potts.
31.1	Certification of Chief Executive Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(a) or Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.
31.2	Certification of Chief Financial Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(a) or Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.
32.1	Certification of Chief Executive Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	Taxonomy extension schema document
101.CAL	Taxonomy extension calculation linkbase document
101.LAB	Taxonomy extension label linkbase document
101.PRE	Taxonomy extension presentation linkbase document

**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 November 9, 2012.

ORION ENERGY SYSTEMS, INC.  
Registrant

By /s/ Scott R. Jensen  
Scott R. Jensen  
Chief Financial Officer  
(Principal Financial Officer and Authorized Signatory)

**Exhibit Index to Form 10-Q for the Period Ended September 30, 2012**

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Name of Executive:	<b>Scott Jensen</b>
Position:	Chief Financial Officer
Fiscal Year 2013 Base Salary:	\$255,000
Effective Date:	November 9, 2012
Initial Term:	Effective Date through September 30, 2013
Renewal Periods are:	1 Year
Post-Change of Control Renewal Period is:	2 Years
Severance Multiplier is:	1x
Post-Change of Control Severance Multiplier is:	2x

### EXECUTIVE EMPLOYMENT AND SEVERANCE AGREEMENT

This Agreement (“Agreement”) is between the individual named above (“Executive”), and Orion Energy Systems, Inc. (“Orion”) effective as of the date above.

**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 Orion; and

**WHEREAS**, Orion and Executive desire to specify the terms and conditions on which Executive will continue employment with Orion on and after the effective date set forth above (the “Effective Date”) and under which Executive will receive severance in the event that Executive separates from service with Orion.

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

1. **Effective Date; Term.** This Agreement shall become effective on the Effective Date and continue until the end of the initial term set forth above. The employment status of the Executive will be reviewed by Orion ninety (90) days prior to the end of the initial term as set forth above (and the end of any subsequent term thereafter). Upon such review, Orion may choose not to extend Executive’s employment under this Agreement for an additional renewal period term as set forth above and, upon such a determination, shall provide written notice to such effect to Executive prior to the end of the initial term (or the end of any subsequent term thereafter). If Orion does not provide Executive with such notice of non-renewal prior to the end of any term, then the term of this Agreement shall be extended for the renewal period set forth above. 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, as of the Termination Date, the sum of: (i) Executive’s Base Salary earned but not paid for the time period ending with the Termination Date; (ii) any other

earned but unpaid amounts as of the Termination Date, and (iii) any other payments or benefits to be provided to Executive by Orion pursuant to any employee benefit plans or arrangements adopted by Orion, to the extent such amounts are due from Orion.

(b) “**Base Salary**” shall mean the Executive’s annual base salary with Orion as in effect from time to time beginning with the initial Base Salary noted above.

(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 Orion that Executive has (i) failed, neglected, or refused to perform the lawful employment duties 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 Orion; (iii) violated or failed to comply in any material respect with Orion’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 Orion (whether or not such act constitutes 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 Orion.

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

(i) the acquisition by any “person” (as such term is used in Section 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended), other than (A) Orion or any of its subsidiaries, (B) a trustee or other fiduciary holding securities under any employee benefit plan of Orion or any of its subsidiaries, or (C) an underwriter temporarily holding securities pursuant to an offering of such securities, of the beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Securities Exchange Act of 1934, as amended) directly or indirectly, of securities of Orion by reason of having acquired such securities during the twelve month period ending on the date of the most recent acquisition representing 20% or more of the then outstanding shares of the common stock of Orion, or the combined voting power of Orion’s then outstanding securities entitled to vote generally in the election of directors (the “Company Voting Stock”); or

(ii) the majority of members of Orion’s Board is replaced during any twelve (12)-month period by directors whose appointment or election is not endorsed by a majority of the members of Orion’s Board before the date of the appointment or election; or

(iii) the consummation of a merger, consolidation, reorganization or share exchange of Orion with any other corporation or the issuance of Company Voting Stock in connection with a merger, consolidation, reorganization or share exchange of Orion which requires approval of the shareholders of Orion, other than (A) a merger, consolidation, reorganization or share exchange which would result in the Company Voting Stock outstanding immediately prior to such merger, consolidation, reorganization 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 Company Voting Stock or such surviving entity or any parent thereof outstanding immediately after such merger, consolidation, reorganization or share exchange, or (B) a merger, consolidation or share exchange effected to implement a recapitalization of Orion (or similar transaction) in which no "person" (defined above) is or becomes the beneficial owner (within the meaning of Rule 13d-3 promulgated under the Securities Exchange Act of 1934, as amended), directly or indirectly, of securities of Orion (not including in the securities beneficially owned by such "person" (defined above) any securities acquired directly from Orion or its affiliates (within the meaning of Rule 12b-2 promulgated under the Securities Exchange Act of 1934, as amended) pursuant to the 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 Orion or the Company Voting Stock; or

(iv) the consummation of a plan of complete liquidation or dissolution of Orion or a sale or disposition by Orion of all or substantially all of Orion'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 Orion, other than a sale or disposition by Orion of all or substantially all of Orion's assets to an entity at least seventy-five percent (75%) of the combined voting power of the outstanding voting securities of which are owned by "persons" (defined above) in substantially the same proportions as their ownership of Orion 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 Orion immediately prior to such transaction or series of transactions continue to own, directly or indirectly, in the same proportions as their ownership in Orion, an entity that owns all or substantially all of the assets or Company Voting Stock of Orion immediately following such transaction or series of transactions.

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

(f) "**Code**" shall mean the Internal Revenue Code of 1986, as amended, as interpreted by rules and regulations issued pursuant thereto, including any successor provisions thereto.

(g) "**Competing Product**" means any product or service which is sold or provided in competition with a product or service: (A) that Executive sold or provided on behalf of Orion at some time during the twenty-four (24) months immediately preceding the point when Executive is no longer employed by any of the Companies (such point being the "Termination of Executive's Employment"); (B) that one or more Orion Executives or business units managed, supervised or directed by Executive, sold or provided on behalf of Orion at some time during the twenty-four (24) months immediately preceding the Termination of Executive's Employment; (C) that was designed, developed, tested, distributed, marketed, provided or produced by Executive (individually or in collaboration with other Orion Executives) or one or more Orion Executives or business units managed, supervised or directed by Executive at some time during the twenty-four (24) months immediately preceding the Termination of Executive's Employment; or (D) that was designed, tested, developed, distributed, marketed, produced, sold or provided by Orion with management or executive support from Executive at some time during the twenty-four (24) months immediately preceding the Termination of Executive's Employment.

(h) “**Disability**” shall mean a total and permanent mental or physical disability precluding Executive from performing the material and substantial duties of his employment 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 and which makes Executive eligible to receive benefits under Orion’s long-term disability plan.

(i) “**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 change in the geographic location at which the Executive must perform services; or (iii) a material breach by Orion of any provisions of this Agreement or any option agreement with Orion to which the Executive is a party.

(j) “**Key Employee**” means any person who at the Termination of Executive’s Employment is employed or engaged by Orion and with whom Executive has had material contact in the course of employment during the twelve (12) months immediately preceding the Termination of Executive’s Employment, and (i) is a manager, officer or director of Orion; (ii) is in possession of Confidential Information and/or Trade Secrets of Orion; and/or (iii) is directly managed by or reports to Executive as of the Termination of Executive’s Employment.

(k) “**Restricted Customer**” means a customer of Orion to which Executive, or one or more individuals or Orion business units supervised, managed, or directed by Executive, sold or provided products or services on behalf of Orion during the twelve (12)-month period immediately preceding the Termination of Executive’s Employment.

(l) “**Restricted Territory**” means: (A) Territories (as the term “Territory” as defined below) in which Executive or one or more Orion employees or business units managed or directed by Executive provided products or services on behalf of Orion during the twelve (12)-month period immediately preceding the Termination of Executive’s Employment; (B) Territories in which one or more Orion employees or business units managed or directed by Executive sold or solicited the sale of products or services on behalf of Orion during the twelve (12)-month period immediately preceding the Termination of Executive’s Employment; (C) Territories in which Executive or one or more Orion employees or business units managed or directed by Executive or receiving management or executive support from Executive provided, sold or solicited the sale of products or services on behalf of Orion during the twelve (12)-month period immediately preceding the Termination of Executive’s Employment; or (D) Territories in which Orion sold or provided products or services designed, developed, tested, or produced by Executive (either individually or in collaboration with other Orion employees) or by Orion employees or business units working under Executive’s direction, management or control during the twelve (12)-month period immediately preceding the Termination of Executive’s Employment. Notwithstanding the foregoing, the term Restricted Territory is limited to Territories in which Orion sold or provided in excess of one hundred thousand dollars (US \$100,000) in the aggregate worth of products or services in the twelve (12)-month period immediately preceding the Termination of Executive’s Employment.

(i) “**Separation from Service**” shall have the meaning set forth in Code Section 409A and the related Treasury Regulations; *provided*, that for this purpose, a “separation from service” is deemed

to occur on the date that Orion and Executive reasonably anticipate that the level of bona fide services Executive would perform after that date (whether as an employee or independent contractor) would permanently decrease to no more than 50% of the average level of bona fide services provided in the immediately preceding thirty-six (36) months.

(m) “**Services**” means sales, financial, supervisory, management, engineering, scientific, and other services of the type performed for Orion by Executive or one or more Orion Executives managed, supervised or directed by Executive during the final twenty-four (24) months preceding the Termination of Executive’s Employment, but shall not include clerical, menial or manual labor.

(n) “**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 Orion preceding the year in which the Termination Date occurs (or such lesser number of fiscal years for which the Executive was employed by Orion, 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.

(o) “**Strategic Customer**” means a customer of Orion that purchased a product or service from the Orion during the twelve (12)-month period immediately preceding the Termination of Executive’s Employment, but is limited to individuals and entities concerning which Executive learned, created or reviewed Confidential Information or Trade Secrets on behalf of Orion during the twelve (12)-month period immediately preceding the Termination of Executive’s Employment.

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

(q) “**Territory**” means a state within the United States, the District of Columbia, a territory of the United States, and/or a foreign nation.

(r) “**Third Party Confidential Information**” means information received by Orion from others that Orion has an obligation to treat as confidential.

(s) “**Trade Secret**” means a Trade Secret as that term is defined under Wis. Stat. § 134.90, or its successor provision.

### **3. Employment of Executive.**

#### **(a) Position.**

(i) Executive shall serve in a full-time capacity in the position set forth above or in any other position and/or with such other duties as determined from time to time by Orion.

(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 Orion; *provided* that nothing herein shall preclude Executive, subject to the prior approval of Orion, from accepting appointment to or continuing 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 materially 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 annual rate set forth above, payable in regular installments in accordance with Orion'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 Orion.

(c) **Bonus Incentives.** Executive shall be entitled to participate in such annual and/or long-term cash plans and programs of Orion as are generally provided to the senior executives of Orion, as determined by the Board in its discretion. Any cash bonuses payable to Executive will be paid at the time Orion normally pays such bonuses to its senior executives and will be subject to the terms and conditions of the applicable annual cash incentive compensation arrangement, as determined by the Board in its discretion.

(d) **Equity Compensation.** Executive shall be eligible to receive equity compensation awards (which may consist of stock options or other types of awards), as determined by the Board in its discretion pursuant to Orion's equity compensation plans and programs in effect from time to time. These awards shall be granted in the discretion of the Board, and shall include such terms and conditions, including performance objectives, as the Board deems appropriate.

(e) **Employee Benefits.** Executive shall be entitled to participate in Orion's employee benefit plans (other than annual and/or long-term incentive programs, which are addressed in subsections (c) and (d)) as in effect from time to time on the same basis as those benefits are generally made available to other senior executives of Orion.

(f) **Business Expenses.** Executive shall have a right to be reimbursed for Executive's reasonable and appropriate business expenses which Executive actually incurs in connection with the performance of Executive's duties and responsibilities under this Agreement in accordance with Orion's expense reimbursement policies and procedures for its senior executives, subject to Orion's reasonable requirements with respect to reporting and documentation of such expenses.

4. **Termination of Employment.** Executive's employment with Orion 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 suffers a Disability, and if within thirty (30) days after Orion notifies the Executive in writing that it intends to terminate Executive's employment, Executive shall not have returned to the performance of Executive's duties hereunder on a full-time basis, Orion may terminate 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 of

such termination, *provided however*, if Orion terminates Executive's employment for Cause, then such written notice shall indicate in reasonable detail the facts and circumstances alleged to provide a basis for such termination for Cause. 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 Orion, and after a Change of Control, Orion's successor, which may terminate Executive for Cause only after providing Executive (i) written notice as set forth above, (ii) the opportunity to appear before the Board and provide rebuttal to such proposed termination, and (iii) written notice following such appearance confirming such termination. Unless otherwise directed by Orion, from and after the date of the written notice of proposed termination, Executive shall be relieved of his duties and responsibilities and shall be considered to be on a paid leave of absence pending any final action by Orion or the successor confirming such proposed termination.

(d) Executive may terminate his 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 (30) day period, Executive's termination of employment from Orion 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 employment with Orion 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 lived. Any non-renewal by Orion pursuant to Section 1 shall not constitute a termination of Executive's employment under this Section 5(a) and Executive shall not be entitled to amounts set forth in Section 5(c). Any non-renewal by Executive of this Agreement pursuant to Section 1 shall constitute a resignation by Executive without Good Reason and Executive shall not be entitled to amounts set forth in Section 5(c).

(b) **General Release Requirement.** Executive will not be eligible to receive any payments or benefits under Section 5(c) until (i) Executive executes a general release of all claims arising out of his employment with, and termination of employment from, Orion in the form proscribed by and acceptable to Orion (“General Release”); and (ii) the revocation period specified in such General Release expires without such Executive exercising his right of revocation as set forth in the General Release.

(c) **Severance Benefits; Timing and Form of Payment.** Subject to Section 5(b) and the limitations imposed by Section 6, in lieu of any severance pay under any severance pay plans, programs or policies, if Executive is entitled to severance benefits, then:

(i) Orion shall pay Executive the Severance Payment on a ratable basis each month over the eighteen (18)-month period 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; and

(ii) Executive shall be entitled to receive premiums from Orion 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 Orion’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 Orion to which Executive is then a party. Orion’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 Orion (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 Orion 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.

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 Executive's "annualized includible compensation for the base period" as defined in Code Section 280G(d)(1), (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. 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 binding upon Orion and Executive.

Any reduction in payments and/or benefits required by this Section will occur in the following order: (I) reduction of cash payments; (II) reduction of vesting acceleration of equity awards; and (III) reduction of other benefits paid or provided to Executive. In the event that acceleration of vesting of equity awards is to be reduced, such acceleration of vesting will be cancelled in the reverse order of the date of grant for Executive's equity awards. If two or more equity awards are granted on the same date, each award will be reduced on a pro-rata basis. In no event will Executive exercise any discretion with respect to the ordering of any reductions of payments or benefits under this Section 6.

#### **7. Covenants by Executive.**

(a) **Nondisclosure of Third Party Confidential Information.** During Executive's employment with Orion and after Termination of Executive's Employment, Executive shall not use or disclose Third Party Confidential Information for as long as the relevant third party has required Orion to maintain its confidentiality, or for so long as required by applicable law, whichever period is longer. This prohibition does not prohibit Executive's use of general skills and know-how acquired during and prior to employment by Orion, as long as such use does not involve the use or disclosure of Third Party Confidential Information. This prohibition also does not prohibit the description by Executive of Executive's employment history and duties, for work search or other purposes, as long as such use does not involve the use or disclosure of Third Party Confidential Information.

(b) **Non-disclosure of Trade Secrets.** During employment and after Termination of Executive's Employment, Executive shall not use or disclose Orion's Trade Secrets so long as they remain Trade Secrets. Nothing in this Agreement shall limit either Executive's statutory and other duties not to use or disclose Orion's Trade Secrets, or Orion's remedies in the event Executive uses or discloses Orion's Trade Secrets.

(c) **Obligations Not to Disclose or Use Confidential Information.** Except as set forth herein or as expressly authorized in writing on behalf of Orion, Executive agrees that while Executive is employed by Orion and during the two (2) year period commencing at the Termination of Executive's

Employment, Executive will not use or disclose (except in discharging Executive's job duties with Orion) any Confidential Information, whether such Confidential Information is in Executive's memory or it is set forth electronically, in writing or other form. This prohibition does not prohibit Executive's disclosure of information after it ceases to meet the definition of "Confidential Information," or Executive's use of general skills and know-how acquired during and prior to employment by Orion, so long as such use does not involve the use or disclosure of Confidential Information; nor does this prohibition restrict Executive from providing prospective employers with an employment history or description of Executive's duties with Orion, so long as Executive does not use or disclose Confidential Information. Notwithstanding the foregoing, if Executive learns information in the course of employment with Orion which is subject to a law governing confidentiality or non-disclosure, Executive shall keep such information confidential for so long as required by law, or for two (2) years, whichever period is longer.

**(d) Return of Property; No Copying or Transfer of Documents.** All equipment, books, records, papers, notes, catalogs, compilations of information, data bases, correspondence, recordings, stored data (including data or files that exist on any personal computer or other electronic storage device), software, and any physical items, including copies and duplicates, that Executive generates or develops or which come into Executive's possession or control, which relate directly or indirectly to, or are a part of Orion's (or its customers') business matters, whether of a public nature or not, shall be and remain the property of Orion, and Executive shall deliver all such materials and items, and any and all copies of them, to Orion upon termination of employment. During employment or after Termination of Executive's Employment, Executive will not copy, duplicate, or otherwise reproduce, or permit copying, duplicating, or reproduction of Orion documents or writings, whether stored on paper, magnetic tape, CD, electronically, or otherwise, including but not limited to notes, notebooks, letters, blueprints, manuals, drawings, sketches, specifications, formulas, financial documents, business plans, and the like, or any other documentation owned or originated by Orion and relating to Orion's business which, from time to time, may have come into Executive's possession, custody, or control as a result of or in the course of Executive's employment with Orion, without the express written consent of Orion, or, as a part of Executive's duties performed hereunder for the benefit of Orion. Executive expressly covenants and warrants, upon termination of employment for any reason (or no reason), that Executive shall promptly deliver to Orion any and all originals and copies in Executive's possession, custody, or control of any and all said property, documents or writings, and that Executive shall not make, retain, or transfer to any third party any copies thereof. In the event any Confidential Information or Trade Secrets are stored or otherwise kept in or on a computer hard drive or other storage device owned by or otherwise in the possession or control of Executive (collectively, "Executive Storage Device"), upon Termination of Executive's Employment Executive will present to Orion for inspection and removal of all information regarding Orion (including but not limited to Confidential Information or Trade Secrets) stored on any Executive Storage Device.

**(e) Duty of Loyalty.** During employment with Orion, Executive shall owe Orion an undivided duty of loyalty, and shall take no action adverse to that duty of loyalty. Executive's duty of loyalty to Orion includes but is not limited to a duty to promptly disclose to Orion any information that might cause Orion to take or refrain from taking any action, or which otherwise might cause Orion to alter its behavior. Without limiting the generality of the foregoing, Executive shall promptly notify Orion at any time that Executive decides to terminate employment with Orion or enter into competition with Orion, as Orion may decide at such time to limit, suspend, or terminate Executive's employment or access to one or more Companies' Confidential Information, Trade Secrets, or customer relationships.



(f) **Limited Restriction on Misuse of Goodwill.** For eighteen (18) months following the Termination of Executive's Employment, for whatever reason, Executive shall not sell or solicit the sale of a Competing Product to a Restricted Customer.

(g) **Limited Restriction on Assisting Misuse of Goodwill.** For eighteen (18) months following the Termination of Executive's Employment, for whatever reason, Executive shall not perform Services as part of or in support of providing, selling or soliciting the sale of a Competing Product to a Restricted Customer.

(h) **Limited Restriction on Misuse of Information.** For eighteen (18) months following Termination of Executive's Employment, for whatever reason, Executive shall not sell or solicit the sale of a Competing Product to a Strategic Customer.

(i) **Limited Restriction on Assisting Misuse of Information.** For eighteen (18) months following Termination of Executive's Employment, for whatever reason, Executive shall not perform Services as part of or in support of providing, selling or soliciting the sale of a Competing Product to a Strategic Customer.

(j) **Limited Territorial Restriction.** For eighteen (18) months following Termination of Executive's Employment, for whatever reason, Executive shall not perform Services as part of or in support of the business of selling, soliciting the sale of or providing Competing Products in the Restricted Territory.

(k) **Limited Territorial Restriction — Design, Development, Production and Testing Activities.** For eighteen (18) months following the Termination of Executive's Employment, for whatever reason, Executive shall not perform Services as part of or in support of the business of designing, testing, developing or producing Competing Products for sale in the Restricted Territory.

(l) **Non-solicitation of Key Employees.** For eighteen (18) months following the Termination of Executive's Employment, for whatever reason, Executive shall not, without the prior written consent of Orion, solicit a Key Employee to engage in competition with Orion, unless such Key Employee has already ceased employment with Orion. This shall not bar any Employee of Orion from applying for or accepting employment with any person or entity.

(m) **Disclosure and Assignment to Orion of Inventions and Innovations.**

(i) Executive agrees to disclose and assign to Orion as Orion'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 Orion to which Executive's employment relates or as to which Executive may receive information due to Executive's employment with Orion, or (2) that result from or are suggested by any work which Executive may do for Orion or (3) that are otherwise made through the use of Orion 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 Orion's expense), during and subsequent to Executive's employment, to enable Orion 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 Orion adequate and current written records of all such Innovations;

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

(v) In the event Orion 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 Orion 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 Orion 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 Orion and that damages, if any, and remedies of law for such breach may be inadequate and indeterminable. Orion, upon Executive's breach of this Section 7, shall therefore be entitled (in addition to and without limiting any other remedies that Orion 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 Orion shall prevail, its reasonable attorney's 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 Orion 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.** Orion'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 Orion. 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. Orion will require any successor (whether direct or indirect, by purchase, merger, consolidation or otherwise) to all or substantially all of the business and/or assets of Orion to assume expressly and agree to perform this Agreement in the same manner and to the same extent that Orion would be required to perform it if no such succession had taken place. As used in this Agreement, "Orion" shall mean Orion as hereinbefore defined and any successor to its business and/or assets as aforesaid which assumes and agrees to perform this Agreement by operation of law, or otherwise.

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 Orion, 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 Orion and the Executive, and judgment may be entered on the arbitrator's award in any court having jurisdiction. Notwithstanding the foregoing, both Executive and Orion may seek to obtain injunctive relief in a Wisconsin court of competent jurisdiction pending arbitration.

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. **Section 409A Compliance.** This Agreement is intended to comply with, or otherwise be exempt from, Section 409A of the Code ("Section 409A"). Orion shall undertake to administer, interpret, and construe this Agreement in a manner that does not result in the imposition to the Executive of additional taxes or interest under Section 409A of the Code. If a payment obligation under this Agreement arises on account of the Executive's Separation from Service while the Executive is a "specified employee" (as defined under Section 409A of the Code and determined in good faith by the Board), any payment of "deferred compensation" (as defined under Treasury Regulation Section 1.409A-1(b)(1), after giving effect to the exemptions in Treasury Regulation Sections 1.409A-1(b)(3) through (b)(12)) that is scheduled to be paid within six (6) months after such Separation from Service shall accrue without interest and shall be paid within fifteen (15) days after the end of the six-month period beginning on the date of such separation from service or, if earlier, within fifteen (15) days after the appointment of the personal representative or executor of the Executive's estate following his death.

14. **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.

15. **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.

16. **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.

17. **Entire Agreement.** This Agreement contains the entire agreement of the parties with respect to the subject matter of this Agreement and supersedes any and all other agreements, either oral or in writing, between the parties hereto with respect to the employment of Executive by Orion. 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.

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

19. **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.

**WHEREAS**, this Agreement is effective as of the Effective Date set forth above.

#### EXECUTIVE

\_\_\_\_\_  
Name: Scott Jensen  
Address:

#### ORION ENERGY SYSTEMS, INC.

By: \_\_\_\_\_  
Michael Potts  
President and Chief Operating Officer

Michael J. Potts  
c/o Orion Energy Systems, Inc.  
2210 Woodland Drive  
Manitowoc, WI 54220

Dear Mike:

As a follow-up to our previous conversation, we have mutually agreed to increase your current annual base salary from \$275,000 to \$280,000 per year in consideration of your agreement to waive any prior or currently existing "Good Reason" termination rights you may have had or currently have under your executive employment and severance agreement, dated February 21, 2008 ("Employment Agreement") and to modify your Employment Agreement by amending and restating the definition of "Good Reason" set forth in Section 2(k) as follows:

"(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 change in the geographic location at which the Executive must perform services; or (iv) 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."

Please acknowledge your understanding and acceptance of this letter waiving any prior or currently existing "Good Reason" termination rights under your Employment Agreement and amending your Employment Agreement by signing and returning this letter. Except as otherwise specified in this letter, your existing Employment Agreement is not affected by this letter and by signing this letter you agree that your Employment Agreement, as modified hereby, will continue in full force and effect, that no event described in the definition of "Good Reason" in your Employment Agreement has occurred and that all terms and conditions of your Employment Agreement have been fully complied with and that you do not have any outstanding claims thereunder.

Best regards,

ORION ENERGY SYSTEMS, INC.

Accepted and Agreed:

By: \_\_\_\_\_  
John H. Scribante  
Chief Executive Officer

\_\_\_\_\_  
Michael J. Potts

Effective Date: November 9, 2012

*Certification*

I, John H. Scribante, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of 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 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. 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
  - d. 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: November 9, 2012

/s/ John H. Scribante

John H. Scribante  
Chief Executive Officer

*Certification*

I, Scott R. Jensen, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of 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 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. 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
  - d. 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: November 9, 2012

/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 September 30, 2012, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, John H. Scribante, 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: November 9, 2012

/s/ John H. Scribante

\_\_\_\_\_  
John H. Scribante

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 September 30, 2012, 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: November 9, 2012

/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.