

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the fiscal year ended March 31, 2012**

or

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

**For the transition period from** \_\_\_\_\_ **to** \_\_\_\_\_

**Commission File Number: 001-33887**

**Orion Energy Systems, Inc.**

(Exact name of Registrant as specified in its charter)

**Wisconsin**

(State or other jurisdiction of  
incorporation or organization)

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

**39-1847269**  
(I.R.S. Employer  
Identification No.)

**54220**  
(Zip Code)

**(920) 892-9340**

(Registrant's telephone number, including area code)

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

<u>Title of Each Class</u>	<u>Name of Each Exchange on Which Registered</u>
Common stock, no par value	NYSE MKT LLC
Common stock purchase rights	NYSE MKT LLC

**Securities registered pursuant to Section 12(g) of the act:**

**None**

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

The aggregate market value of shares of the Registrant's common stock held by non-affiliates as of September 30, 2011, the last business day of the Registrant's most recently completed second fiscal quarter, was approximately \$ 60,978,230.

As of June 6, 2012, there were 22,562,258 shares of the Registrant's common stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Not applicable.

## FORWARD-LOOKING STATEMENTS

This Form 10-K includes forward-looking statements that are based on our beliefs and assumptions and on information currently available to us. When used in this Form 10-K, the words “anticipate,” “believe,” “could,” “estimate,” “expect,” “intend,” “may,” “plan,” “potential,” “predict,” “project,” “should,” “will,” “would” and similar expressions identify forward-looking statements. Although we believe that our plans, intentions, and expectations reflected in any forward-looking statements are reasonable, these plans, intentions or expectations are based on assumptions, are subject to risks and uncertainties, and may not be achieved. These statements are based on assumptions made by us based on our experience and perception of historical trends, current conditions, expected future developments and other factors that we believe are appropriate under the current circumstances. Such statements are subject to a number of risks and uncertainties, many of which are beyond our control. Our actual results, performance or achievements could differ materially from those contemplated, expressed or implied by the forward-looking statements contained in this Form 10-K. Important factors could cause actual results to differ materially from our forward-looking statements. Given these uncertainties, you should not place undue reliance on these forward-looking statements. Also, forward-looking statements represent our beliefs and assumptions only as of the date of this Form 10-K, including particularly the Risk Factors described under Part I. Item 1A of this Form 10-K. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements set forth in this Form 10-K. Actual events, results and outcomes may differ materially from our expectations due to a variety of factors. Although it is not possible to identify all of these factors, they include, among others, the following:

- deterioration of market conditions, including customer capital expenditure budgets;
- our ability to compete and execute our growth strategy in a highly competitive market and our ability to respond successfully to market competition;
- increasing duration of customer sales cycles;
- dependence on customers’ capital budgets for sales of products and services;
- the market acceptance of our products and services, including increasing customer preference to purchase our products through our Orion Throughput Agreements, or OTAs, rather than through cash purchases;
- our ability to effectively manage the credit risk associated with our increasing reliance on OTA contracts;
- price fluctuations, shortages or interruptions of component supplies and raw materials used to manufacture our products;
- loss of one or more key employees, customers or suppliers, including key contacts at such customers;
- our ability to effectively manage our product inventory to provide our products to customers on a timely basis;
- the increasing relative volume of our product sales through our wholesale channel;
- a reduction in the price of electricity;
- the cost to comply with, and the effects of, any current and future government regulations, laws and policies;
- our development of, and participation in, new product and technology offerings or applications;
- increased competition from government subsidies and utility incentive programs;
- the availability of additional debt financing and/or equity capital;
- our failure to maintain effective internal controls over financial reporting;
- legal proceedings; and
- potential warranty claims.

You are urged to carefully consider these factors and the other factors described under Part I. Item 1A. “Risk Factors” when evaluating any forward-looking statements, and you should not place undue reliance on these forward-looking statements.

Except as required by applicable law, we assume no obligation to update any forward-looking statements publicly or to update the reasons why actual results could differ materially from those anticipated in any forward-looking statements, even if new information becomes available in the future.

**ORION ENERGY SYSTEMS, INC.**  
**ANNUAL REPORT ON FORM 10-K**  
**FOR THE YEAR ENDED MARCH 31, 2012**

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## ITEM 1. BUSINESS

*As used herein, unless otherwise expressly stated or the context otherwise requires, all references to “Orion,” “we,” “us,” “our,” “Company” and similar references are to Orion Energy Systems, Inc. and its consolidated subsidiaries.*

### Overview

We are a leading power technology enterprise. We research, develop, design, manufacture, market and implement energy management systems consisting primarily of high-performance, energy efficient commercial interior and exterior lighting systems, controls, power data management and cloud-based data storage and related services. We also market and implement renewable energy systems consisting primarily of solar generating photovoltaic systems and wind turbines. We operate in two business segments, which we refer to as our energy management division and our engineered systems division.

### Energy Management Division

Our energy management division develops, manufactures, sells and provides technical services for the sale of our commercial high intensity fluorescent, or HIF, and light emitting diode, or LED, lighting systems and energy management systems. Our energy management systems deliver energy savings and efficiency gains to our commercial and industrial customers without compromising their quantity or quality of light. The core of our energy management system is our HIF lighting system that we estimate reduces our customers’ lighting-related electricity costs by approximately 50%, while increasing their quantity of light by approximately 50% and improving lighting quality when replacing traditional high intensity discharge, or HID, fixtures. Our customers typically realize a two-to-three-year payback period from electricity cost savings generated by our HIF and LED lighting systems without considering utility incentives or government subsidies. We have sold and installed our HIF and LED fixtures in over 7,900 facilities across North America, representing over 1.1 billion square feet of commercial and industrial building space, including for many Fortune 500 companies.

Our core energy management system is comprised of: our HIF lighting system; our Intelite wireless lighting controls; our Apollo Solar Light Pipe, which collects and redistributes renewable sunlight and consumes no electricity; and our integrated energy management services. Our technology is designed around managing thermal and optical performance and we are agnostic as it relates to the actual light source. We believe that the implementation of our complete energy management system enables our customers to reduce electricity costs, while permanently reducing base and peak load demand from the electrical grid. From December 1, 2001 through March 31, 2012, we installed more than 2.3 million HIF lighting systems for our commercial and industrial customers. We are focused on leveraging this installed base to expand our customer relationships from single-site implementations of our HIF and LED lighting systems to enterprise-wide roll-outs of our complete energy management system.

We generally have focused on selling retrofit projects whereby we replace inefficient HID, fluorescent or incandescent systems. In fiscal 2012, we generated approximately 36% of our revenue in this segment through direct sales relationships with end users, compared to 46% in fiscal 2011 and 58% in fiscal 2010. We continue to develop resellers and partner relationships that utilize our systematic sales process to increase overall market coverage and awareness in regional and local markets along with electrical contractors who provide installation services for these projects. Reflecting our increased emphasis on expanding this sales channel, approximately 64% of our revenues in this segment in fiscal 2012 were generated from such indirect sales, compared to 54% in fiscal 2011 and 43% in fiscal 2010.

We estimate that the use of our HIF and LED fixtures and controls has resulted in cumulative electricity cost savings for our customers of approximately \$1.6 billion and has reduced base and peak load electricity demand by approximately 724 megawatts, or MW, through March 31, 2012. We estimate that this reduced electricity consumption has reduced associated indirect carbon dioxide emissions by approximately 13.7 million tons over the same period.

For a description of the assumptions behind our calculations of customer kilowatt demand reduction, customer kilowatt hours and electricity costs saved and reductions in indirect carbon dioxide emissions associated with our products used throughout this Annual Report on Form 10-K, see the following table and notes:

	<u>Cumulative From December 1, 2001</u> <u>Through March 31, 2012</u> <u>(in thousands, unaudited)</u>
HIF lighting systems sold (1)	2,304
Total units sold (including HIF lighting systems)	3,122
Customer kilowatt demand reduction (2)	724
Customer kilowatt hours saved (2)(3)	20,606,469
Customer electricity costs saved (4)	\$ 1,586,698
Indirect carbon dioxide emission reductions from customers' energy savings (tons) (5)	13,674
Square footage retrofitted (6)	1,195,491

- (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 when we replace fixtures other than HID fixtures, or when we replace fixtures with products other than our HIF lighting systems (which 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 3.1 million units).
- (3) We calculate the number of kilowatt hours saved on a cumulative basis by assuming the demand kilowatt (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 kW hour. The national average rate for 2011, which is the most current full year for which this information is available, was \$0.1002 per kW 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 kW hour of electricity (determined using the Emissions and Generation Resource Integration Database, or EGrid, prepared by the United States Environmental Protection Agency, or EPA), by (ii) the number of customer kW hours saved as indicated in the table.
- (6) Based on 3.1 million total units sold, which contain a total of approximately 15.5 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.

## Engineered Systems Division

In August 2009, we created our engineered systems division, which operates out of our Plymouth, Wisconsin facility and sells and integrates alternative renewable energy systems, such as solar and wind. Our engineered systems division offers solar photovoltaic, or PV, systems to allow our customers to convert sunlight into electricity. We are a distributor, not a manufacturer, of solar PV systems; however, we do manufacture certain wiring assemblies used to connect the individual solar modules to the electrical panel. Our fully integrated solar power services include (i) project development, (ii) engineering, procurement, and construction (EPC) services, (iii) operating and maintenance (O&M) services, and (iv) project finance expertise. We provide EPC services for projects developed directly to our end customers and to projects developed by independent solar power project developers. EPC services include engineering design and related services, advanced development of grid integration solutions, and construction contracting and management. The procurement component of our EPC services includes recommendation and deployment of solar modules and components that we procure from third parties. We provide O&M services which can include all or a combination of the following scopes of work: warranty, preventative and scheduled maintenance, spare parts inventory, monitoring and reporting of plant performance and diagnosing performance to assist customers in maximizing energy production. We began to report the results of our engineered systems division as a separate operating segment in the third quarter of fiscal 2011. Through March 31, 2012, we have contracted with customers to provide systems for 24.0 MW of electricity generation.

## Our Industry

As a company focused on providing and implementing energy management systems, our market opportunity is created by growing electricity capacity shortages, underinvestment in transmission and distribution, or T&D infrastructure, high electricity costs and the high financial and environmental costs associated with adding generation capacity and upgrading the T&D infrastructure. The United States electricity market is generally characterized by rising demand, increasing electricity costs and power reliability issues due to continued constraints on generation and T&D capacity. Electricity demand is expected to grow steadily over the coming decades and significant challenges exist in meeting this increase in demand, including the environmental concerns associated with generation assets using fossil fuels. These constraints are causing governments, utilities and businesses to focus on demand reduction and alternative energy supply initiatives, including energy efficiency, demand-side management solutions and renewable energy sources.

## Today's Electricity Market

*Growing Demand for Electricity.* Demand for electricity in the United States has grown steadily in recent years and is expected to grow significantly for the foreseeable future. According to the Energy Information Administration, or EIA, \$372.1 billion was spent on electricity in 2011 in the United States, up from \$353.3 billion in 2010 and \$247.3 billion in 2001, increases of 5% and 50%, respectively. Additionally, the EIA identified that consumption was 3,692 billion kW hours in 2011 and predicts it will increase by 21% to 4,483 billion kW hours in 2035. According to the North American Electric Reliability Corporation, or NERC, peak demand and anticipated supply resources are expected to grow at approximately the same rate over the next 10 year; however, as NERC notes, if peak demand grows faster than currently forecasted, additional generating resources will be required to maintain system adequacy. According to the International Energy Agency, or IEA, North America is expected to add 842,000 MW of additional capacity at a cost of \$3.0 trillion between 2010 and 2035 to reliably meet expected annual growth in demand. Worldwide, the IEA, expects 5,673,000 MW of additional capacity to be required over the same period at a total cost of \$17.8 trillion. We believe that meeting this increasing domestic electricity demand will require either an increase in energy supply through capacity expansion, broader adoption of demand management programs and renewables, or a combination of these solutions.

*Challenges to Capacity Expansion.* Based on the forecasted growth in electricity demand, the EIA, in its Annual Energy Outlook for 2012, estimates that the United States will require 222.5 gigawatts, or GW, of new generating capacity by 2035 (the equivalent of 445 power plants rated at an average of 500 MW each). According to data provided by the IEA, we estimate that new generating capacity and associated T&D investment will cost at least \$2.8 million per MW.

In addition to the high financial costs associated with adding power generation capacity, there are environmental concerns about the effects of emissions from additional power plants, especially coal-based power plants. According to the IEA in its Annual Energy Outlook for 2010, "federal and state energy policies recently enacted will stimulate the increased use of renewable technologies and efficiency improvements, slowing the growth of energy-related carbon dioxide emissions through 2035". Additionally, the EIA believes that by 2035, total carbon dioxide emissions will be approximately 5,806 million metric tons, which is approximately 13% higher than 2010 levels. Of the projected 223 GW of new generating capacity required by 2035, coal-fired plants, which generate significant emissions of carbon dioxide and other pollutants, are projected to account for only 7% of added capacity between 2011 and 2035; however, coal fired generation will still power 26% of the country's electricity generation in 2035, according to the EIA. We believe that concerns over emissions may make it increasingly difficult for utilities to add coal-based generating capacity. Clean coal energy initiatives are characterized by an uncertain legislative and regulatory framework and would involve substantial infrastructure cost to readily commercialize.

Although the EIA expects clean-burning natural gas-based plants to account for 38% of total required domestic capacity additions between 2011 and 2035, natural gas prices are directly tied to technological developments and opportunities to capture new sources of natural gas, which according to the EIA in its Annual Energy Outlook for 2010 is leading to “a great deal of uncertainty about the long term trend in natural gas prices”. According to the IEA, global natural gas consumption should catch global coal consumption by 2035, with over 80% of the growth in gas consumption coming from developing countries. Additionally, much of the growth is expected to be fueled by non-traditional gas sources, like shale, which accounts for approximately half of estimated global reserves and which is expected to rise to 20% of total global gas output by 2035. Environmentally responsible renewable energy alternatives, such as solar and wind, generally require subsidies and rebates to be cost competitive and do not provide continuous electricity generation. Despite these challenges, the EIA projects that 29% of new capacity additions between 2010 and 2035 will be renewable technologies, due in large part to regulatory initiatives mandating the use of renewable energy sources. We believe these challenges to expanding generating capacity will increase the need for energy efficiency initiatives to meet demand growth.

*Underinvestment in Electricity Transmission and Distribution.* According to the Department of Energy, or DOE, the majority of United States transmission lines, transformers and circuit breakers — the backbone of the United States T&D system — is more than 25 years old. The underinvestment in T&D infrastructure has led to well-documented power reliability issues, such as the August 2003 blackout that affected a number of states in the northeastern United States. According to a recent report by the Edison Electric Institute, electric utilities spent over \$70 billion upgrading their transmission infrastructure between 2001 and 2010 and plan to spend an additional \$60 billion for additional infrastructure between 2011 and 2022. Moreover, the IEA projects that the United States will have to invest over \$320 billion in new transmission and over \$690 Billion in new distribution infrastructure between 2010 and 2035 to support the generation required to meet demand growth and offset planned plant retirements.

*High Electricity Costs.* Due to the recent recessionary impact within the U.S. during 2009 and 2010, electricity pricing has declined slightly from prior years due to declining demand charges and lower capacity costs for open market purchases of electricity in deregulated states. Prior to 2009, the price of one kWh of electricity (in nominal dollars, including the effects of inflation) had reached historic highs, according to the EIA’s Annual Review of Energy 2007. Based on the most recent EIA electricity rate and consumption data available (March 2012), we estimate that commercial and industrial electricity expenditures rose 87.6% and 42.9%, respectively, from 1998 to 2011, and fell by 1.5% and 0.5%, respectively, in comparing monthly expenditures in February 2011 and February 2012. We believe increases in electricity costs will become more pronounced during an economic upturn or through the aging grid supply system and that electricity cost increases will return to the rates experienced prior to 2009 and will continue to increase. As a result, we believe that electricity costs will continue to be an increasingly significant operating expense for businesses, particularly those with large commercial and industrial facilities.

## **Our Market Opportunity**

We believe that energy efficiency measures represent permanent, cost-effective and environmentally responsible alternatives to expanding electricity capacity in order to meet demand growth. The American Council for an Energy Efficient Economy, or ACEEE, in a 2011 fact sheet, estimated that the United States can reduce up to 25%-30% of its estimated electricity usage over the next 25 to 30 years by deploying all currently available cost-effective energy efficiency products and technologies across commercial, industrial and residential market sectors. Moreover, the ACEEE report asserts that these gains can be achieved at significantly lower costs for energy efficiency (\$0.03 per kWh) than for traditional or renewable generation (\$0.06 to \$0.20 per kWh). As a result, we believe governmental entities, utilities and businesses are increasingly focused on demand reduction through energy efficiency and demand management programs. For example:

- Forty-nine states, through legislation, regulation or voluntary action, have seen their utilities design and fund programs that promote or deliver energy efficiency. In fact, as of May 1, 2012, only Alaska does not have some form of utility or state energy efficiency programs for any of their commercial or industrial customers.
- According to the ACEEE, as of October 2011, 27 states have implemented, or were in the process of implementing, Energy Efficiency Resource Standards, or EERS, or have an energy efficiency component to their Renewable Portfolio Standard, or RPS, which generally requires utilities to allocate funds to energy efficiency programs to meet near-term energy savings targets set by state governments or regulatory authorities.

- In recent years, there has also been an increased focus on “decoupling,” a regulatory initiative designed to break the linkage between utility kWh sales and revenues, in order to remove the disincentives for utilities to promote load reducing initiatives. Decoupling aims to encourage utilities to actively promote energy efficiency by allowing utilities to generate revenues and returns on investment by employing energy management solutions. According to the Pew Center on Global Climate Change, as of October 31, 2011, 20 states had adopted or were considering adopting some form of decoupling for electric utilities.

One method utilities use to reduce demand is the implementation of demand response programs. Demand response is a method of reducing electricity usage during periods of peak demand in order to promote grid stability, either by temporarily curtailing end use or by shifting generation to backup sources, typically at customer facilities. While demand response is an effective tool for addressing peak demand, these programs are called upon to reduce consumption typically for only up to 200 hours per year, based on demand conditions, and require end users to compromise their consumption patterns, for example, by reducing lighting or air conditioning.

We believe that given the costs of adding new capacity and the limited demand time period that is addressed by current demand response initiatives, there is a significant opportunity for more comprehensive energy efficiency solutions to permanently reduce electricity demand during both peak and off-peak periods. We believe such solutions are a compelling way for businesses, utilities and regulators to meet rising demand in a cost-effective and environmentally responsible manner. We also believe that, in order to gain acceptance among end users, energy efficiency solutions must offer substantial energy savings and return on investment, without requiring compromises in energy usage patterns.

### ***The Role of Lighting***

Commercial and industrial facilities in the United States employ a variety of lighting technologies, including HID, traditional fluorescents, LED and incandescent lighting fixtures. Our HIF and LED lighting systems typically replace HID fixtures, which operate inefficiently because, according to EPRI, HID fixtures only convert approximately 36% of the energy they consume into visible light. We believe that the U.S. market opportunity for HID retrofits is \$9.6 billion. We base this estimate on the most recent EIA Commercial and Manufacturing Energy Consumption Survey published in September 2008, which states that a total of 81.9 billion commercial and industrial square feet are estimated to exist in the U.S. Estimates from the DOE concur with this statistic, as they indicate that there is 85.0 billion square feet of rooftop surface area for commercial and industrial buildings. We estimate that 20.6 billion of these square feet are eligible for HID retrofits, based upon our analysis of the EIA’s market sector data giving consideration to a building’s principal activity or purpose and the related square feet. Based on our experience that each HID fixture covers 450 square feet, approximately 45.7 million HID fixtures would be required to cover the estimated 20.6 billion square feet eligible for HID retrofits, at an estimated average cost per fixture of approximately \$210.

### **Our Solution**

*50/50 Value Proposition.* We estimate our HIF lighting systems generally reduce lighting-related electricity costs by approximately 50% compared to HID fixtures, while increasing the quantity of light by approximately 50% and improving lighting quality. Additionally, our motion controls and advances in full-range dimming technology and strategies, we estimate that savings can reach up to 80%. From December 1, 2001 through March 31, 2012, we believe that the use of our HIF fixtures has saved our customers \$1.6 billion in electricity costs and reduced their energy consumption by 20.6 billion kWh.

*Multi-Facility Roll-Out Capability.* We offer our customers a single source, turn-key solution for project implementation in which we manage and maintain responsibility for entire multi-facility roll-outs of our energy management solutions across North American real estate portfolios. This capability allows us to offer our customers an orderly, timely and scheduled process for recognizing energy reductions and cost savings.

*Rapid Payback Period.* In most retrofit projects where we replace HID fixtures, our customers typically realize a two- to three-year payback period on our HIF lighting systems. These returns are achieved without considering utility incentives or government subsidies (although subsidies and incentives are increasingly being made available to our customers and us in connection with the installation of our systems and further shorten payback periods).

*Comprehensive Energy Management System.* Our comprehensive energy management system enables us to reduce our customers’ base and peak load electricity consumption. By replacing existing HID fixtures with our HIF lighting systems, our customers permanently reduce base load electricity consumption while significantly increasing their quantity and quality of light. We can also add intelligence to the customer’s lighting system through the implementation of our InteLite wireless dynamic control devices. These devices allow our customers the ability to control and adjust their lighting and energy use levels based upon occupancy and type of occupancy (transient or sustained) for additional cost savings. Finally, we offer a further reduction in electricity consumption through the installation and integration of our Apollo Solar Light Pipe, which is a lens-based device that collects and redistributes renewable sunlight without consuming electricity. By integrating our Apollo Solar Light Pipe and HIF lighting system with the intelligence of our InteLite product line, the output and electricity consumption of our HIF lighting systems can be automatically adjusted based on the level of natural light being provided by our Apollo Light Pipe and, in certain circumstances, our customers can illuminate their facilities and remain “off the grid” during peak hours of the day.



*Easy Installation, Implementation and Maintenance.* Our HIF fixtures are designed with a lightweight construction and modular plug-and-play architecture that allows for fast and easy installation, facilitates maintenance and allows for easy integration of other components of our energy management system. We believe our system's design reduces installation time and expense compared to other lighting solutions, which further improves our customers' return on investment. We also believe that our use of standard components reduces our customers' ongoing maintenance costs.

*Expanded Product/Service Offerings.* We have expanded our product and service offerings by providing our customers with alternative renewable energy systems through our Orion Engineered Systems division. We have also introduced exterior lighting products for parking lot, parking garage and convenience store canopies illumination, an LED product offering for freezer and cold storage applications, and a hybrid fixture combining the performance benefits of both LED and fluorescent bulb technologies.

*Base and Peak Load Relief for Utilities.* The implementation of our energy management systems can substantially reduce our customers' electricity demand during peak and off-peak periods. Since we believe that commercial and industrial lighting represents approximately 14% of total energy usage in the United States, our systems can substantially reduce the need for additional base and peak load generation and distribution capacity, while reducing the impact of peak demand periods on the electrical grid. We estimate that the HIF fixtures we have installed from December 1, 2001 through March 31, 2012 have had the effect of reducing base and peak load demand by approximately 724 MW.

*Environmental Benefits.* By allowing for the permanent reduction of electricity consumption, our energy management systems reduce indirect carbon dioxide emissions that are a negative by-product of energy generation. We estimate that one of our HIF lighting systems, when replacing a standard HID fixture, displaces 0.241 kW of electricity, which, based on information provided by the EPA, reduces a customer's indirect carbon dioxide emissions by approximately 1.2 tons per year. Based on these figures, we estimate that the use of our HIF fixtures has reduced indirect carbon dioxide emissions by approximately 13.7 million tons through March 31, 2012.

## **Our Competitive Strengths**

*Compelling Value Proposition.* By permanently reducing lighting-related electricity usage, our systems enable our commercial and industrial customers to achieve significant cost savings, without compromising the quantity or quality of light in their facilities. As a result, our energy management systems offer our customers a rapid return on their investment, without relying on government subsidies or utility incentives. We believe our ability to deliver improved lighting quality while reducing electricity costs differentiates our value proposition from other demand management solutions which require end users to alter the time, manner or duration of their electricity use to achieve cost savings. We also offer our customers a single source solution whereby we manage and are responsible for the entire project, including installation and manufacturing across the entire North American real estate portfolio. Our ability to offer such a turn-key, national solution allows us to deliver energy reductions and cost savings to our customers in timely, orderly and planned multi-facility roll-outs.

*Large and Growing Customer Base.* We have developed a large and growing national customer base, and have installed our products in more than 7,900 commercial and industrial facilities across North America. As of March 31, 2012, we have completed or are in the process of completing retrofits in over 1,600 facilities for our Fortune 500 customers. We believe that the willingness of our blue-chip customers to install our products across multiple facilities represents a significant endorsement of our value proposition, which in turn helps us sell our energy management systems to new customers.

*Systematized Sales Process.* We have invested substantial resources in the development of our innovative sales process. We sell to our end user customers using a systematic multi-step sales process that focuses on our value proposition and provides our sales force with specific, identified tasks that govern their interactions with our customers from the point of lead generation through delivery of our products and services. Management of this process seeks to continually improve salesforce effectiveness while simultaneously improving salesforce efficiency. We also train select partners and resellers to follow our systematic sales process, thereby extending our sales reach while making their businesses more effective.

*Innovative Technology.* We have developed a portfolio of 39 United States patents primarily covering various elements of our HIF fixtures. We believe these innovations allow our HIF fixtures to produce more light output per unit of input energy compared to competitive HIF product offerings. We also have 23 patents pending that primarily cover various elements of our InteLite wireless controls and our Apollo Solar Light Pipe and certain business methods. To complement our innovative energy management products, we have introduced integrated energy management services to provide our customers with a turnkey solution either at a single facility or across North American facility footprints. We believe that our demonstrated ability to innovate provides us with significant competitive advantages. We believe that our HIF and LED solutions offer significantly more light output as measured in foot-candles of light delivered per watt of electricity consumed when compared to HID or traditional fluorescent fixtures.

*Expanded Product/Service Offerings.* We have expanded our product and service offerings by providing our customers with alternative renewable energy systems through our Orion Engineered Systems division. In fiscal 2010, we began researching three test solar photovoltaic electricity generating projects, completing our test analysis on two of the three in the third quarter of fiscal 2010, and executed our first cash sale and our first purchase power agreement, or PPA, as a result of the successful testing of these systems. A PPA is a supply side agreement for the generation of electricity and subsequent sale to the end user. We completed the installation and customer acceptance of the third test system during our fiscal 2011 first quarter. During fiscal 2011, we executed seven additional contracts for renewable technology product sales. During fiscal 2012, we executed an additional 21 contracts for solar PV projects. We also have increased sales of our exterior lighting products and solutions for parking lots, gas station canopies and roadway illumination. Additionally, we have expanded our role in the LED market, especially for but not limited to freezer and cold storage applications.

*Expanded Partner Network.* In addition to selling directly to commercial and industrial customers, we sell our energy management products and services indirectly to end users through wholesale sales to electrical contractors and value-added resellers. In fiscal 2010, we increased our focus on selling through our contractor and value-added reseller channels with the development of a recruitment team that focuses on recruiting and developing partners in key markets with a high saturation of commercial and industrial buildings. In fiscal 2011, we began developing an integrated partner network and have developed standard operating procedures related to their sales and operations. Our integrated partners are required to have in-market technology demonstration centers to showcase our products and are trained to conduct their own energy workshops for their in-market customers. We now have relationships with more than 100 partners, some of whom are exclusive agents for our product lines. We intend to continue to selectively build out our partner network in the future with a focus on geographic regions where we do not currently have a strong partner or retail sales presence.

*Strong, Experienced Leadership Team.* We have a strong and experienced senior management team led by our chief executive officer, Neal R. Verfuert, who was the principal founder of our company in 1996 and invented many of the products that form our energy management system. Our senior executive management team of five individuals has a combined 44 years of experience with our company and a combined 69 years of experience in the lighting and energy management industries.

*Innovative Financing Solutions.* We have developed a patent-pending financing program called the Orion Throughput Agreement, or OTA. Our OTA is structured similarly to a supply contract under which we commit to deliver a set amount of energy savings to the customer at a fixed monthly rate. Our OTA program allows customers to deploy our energy management systems without having to make upfront investments or capital outlays. After the pre-determined amount of energy savings are delivered, our customers assume full ownership of the energy management system and benefit from the entire amount of energy savings over the remaining useful life of the technology. We believe the OTA allows us to capture customer sales opportunities that otherwise may not have occurred due to capital constraints.

*Efficient, Scalable Manufacturing Process.* We have made significant investments in our manufacturing facility since fiscal 2005, including investments in production efficiencies, automated processes and modern production equipment. These investments have substantially increased our production capacity, which we believe will enable us to support substantially increased demand. In addition, these investments, combined with our modular product design and use of standard components, enable us to reduce our cost of revenue, while better controlling production quality, and allow us to be responsive to customer needs on a timely basis. We generally are able to deliver standard products within several weeks of receipt of order which leads to greater energy savings to customers through shorter implementation time frames. We believe the sales to implementation cycles for our competitors are substantially longer.

## **Our Growth Strategies**

*Leverage Existing Customer Base.* Over the last several years, we have focused on expanding our relationships with our existing customers by transitioning from single-site facility implementations to comprehensive enterprise-wide roll-outs of our HIF lighting systems. We also intend to leverage our large installed base of HIF lighting systems to implement all aspects of our energy management system, particularly wireless controls and cloud-based power data analysis and storage capabilities, as well as our additional alternative/renewable energy solutions for our existing customers.

*Target Additional Customers.* We are expanding our base of commercial and industrial customers by executing our systematic sales process with our direct sales force and through our existing resellers and partners. In addition, we are continuing to build on a sales and marketing program designed to develop new relationships with partners, resellers and their respective customers. During fiscal 2012, we added a telemarketing group to generate sales leads and schedule appointments for our internal salespeople and our partners and resellers.

*Develop New Sources of Revenue Through Expanded Product/Service Offerings.* We have expanded our role in the LED marketplace, and plan to increase sales of LED fixtures for freezer and cold-storage applications, as well as high-bay interior applications. We have improved our InteLite wireless dynamic controls, Apollo Solar Light Pipe and outdoor lighting products to complement our core HIF lighting systems. We are continuing to develop new energy management products and services that can be utilized in connection with our current products, including intelligent HVAC integration controls, renewable energy solutions, comprehensive lighting management software and controls and additional consulting services.

*Expanded Partner Network.* In addition to selling directly to commercial and industrial customers, we sell our energy management products and services indirectly to end users through wholesale sales to electrical contractors and value-added resellers. We intend to continue to build out our partner network in the future, including the addition of new integration partners and value-added resellers. Our integration partners represent our products exclusively, maintain product demonstration areas within their facilities, are offered our lowest pricing level and follow our standard operating procedures related to their sales, project management and operational activities. Our partner expansion team focuses on aggressively recruiting and developing new partners in markets where we currently do not have representation and markets with high concentrations of commercial and industrial buildings.

*Provide Load Relief to Utilities and Grid Operators.* Because commercial and industrial lighting represents a significant percentage of overall electricity usage, we believe that as we increase our market penetration, our systems will, in the aggregate, have a significant impact on permanently reducing base and peak load electricity demand. We estimate our HIF lighting systems can generally eliminate demand at a cost of approximately \$1.0 million per MW when used in replacement of typical HID fixtures, as compared to the IEA's estimate of approximately \$3.5 million per MW of capacity for new generation and T&D assets. We have been marketing our energy management systems directly to utilities and grid operators as a lower-cost, permanent and distributed alternative to capacity expansion. We believe that utilities and grid operators may increasingly view our systems as a way to help them meet their requirements to provide reliable electric power to their customers in a cost-effective and environmentally responsible manner. In addition, we believe that potential regulatory decoupling initiatives could increase the amount of incentives that utilities and grid operators will be willing to pay us or our customers for the installation of our systems.

*Continue to Improve Operational Efficiencies.* We are focused on continually improving the efficiency of our operations to increase the profitability of our business. In our manufacturing operations, we pursue opportunities to reduce our materials, component and manufacturing costs through product engineering, manufacturing process improvements, research and development on alternative materials and components, volume purchasing and investments in manufacturing equipment and automation. We also seek to reduce our installation costs by training our authorized installers to perform retrofits more efficiently and cost effectively. We have also undertaken initiatives to achieve operating expense efficiencies by more effectively executing our systematic multi-step sales process and focusing on geographically-concentrated sales efforts. We believe that realizing these efficiencies will enhance our profitability potential and allow us to continue to deliver our compelling value proposition.

## **Products and Services**

We provide a variety of products and services that together comprise our energy management system. The core of our energy management system is our HIF lighting platform, which we primarily sell under the Compact Modular brand name. We offer our customers the option to build on our core HIF lighting platform by adding our InteLite wireless dynamic control devices and Apollo Solar Light Pipes. Together with these products, we offer our customers a variety of integrated energy management services, such as system design, project management and installation. We refer to the combination of these products and services as our energy management system. Additionally, we provide renewable energy solutions, including solar and wind energy solutions to our customers.

## Products

The following is a description of our primary products:

*The Compact Modular.* Our primary product is our line of high-performance HIF lighting systems, the Compact Modular, which includes a variety of fixture configurations to meet customer specifications. The Compact Modular generally operates at 224 watts per six-lamp fixture, compared to approximately 465 watts for the HID fixtures that it typically replaces. This wattage difference is the primary reason our HIF lighting systems are able to reduce electricity consumption by approximately 50% compared to HID fixtures. Our Compact Modular has a thermally efficient design that allows it to operate at significantly lower temperatures than HID fixtures and most other legacy lighting fixtures typically found in commercial and industrial facilities. Because of the lower operating temperatures of our fixtures, our ballasts and lamps operate more efficiently, allowing more electricity to be converted to light rather than to heat or vibration, while allowing these components to last longer before needing replacement. In addition, the heat reduction provided by installing our HIF lighting systems reduces the electricity consumption required to cool our customers' facilities, which further reduces their electricity costs. The EPRI estimates that commercial buildings use 5% to 10% of their electricity consumption for cooling required to offset the heat generated by lighting fixtures.

In addition, our patented optically-efficient reflector increases light quantity by efficiently harvesting and focusing emitted light. We and some of our customers have conducted tests that generally show that our Compact Modular product line can increase light quantity in footcandles by approximately 50% when replacing HID fixtures. Further, we believe, based on customer data, that our Compact Modular products provide a greater quantity of light per watt than competing HIF fixtures.

The Compact Modular product line also includes our modular power pack, which enables us to customize our customers' lighting systems to help achieve their specified lighting and energy savings goals. Our modular power pack integrates easily into a wide variety of electrical configurations at our customers' facilities, allowing for faster and less expensive installation compared to lighting systems that require customized electrical connections. In addition, our HIF lighting systems are lightweight and, we believe, easy to handle, which further reduces installation and maintenance costs and helps to build brand loyalty with electrical contractors and installers.

*LED technology.* When it comes to LED technology, we believe we have taken a responsible approach, focusing our research and development efforts on our core competencies: optical and thermal management and control. We recently introduced our first LED product into the cold-storage industry. Due to improvements in LED technology, drastic reduction of chip prices, availability of name-brand drivers and seamless integration with our InteLite controls, we believe that LED will become a larger part of our overall interior lighting strategy moving forward.

*InteLite Dynamic Control Device.* Our InteLite wireless dynamic control products allow customers to remotely communicate with and give commands to individual light fixtures and other peripheral devices through web-based software, and allow the customer to configure and easily change the control parameters of each fixture based on a number of inputs and conditions, including time-of-day, motion and ambient light levels. Our InteLite products can be added to our HIF lighting systems during or after installation on a "plug and play" basis by coupling the wireless transceivers directly with the modular power pack. Because of their modular design, our InteLite wireless products can be added to our energy management system easily and at lower cost when compared to lighting systems that require similar controls to be included at original installation or retrofitted. Recent improvements to our InteLite products allow us to provide reporting and metering capabilities at the individual control unit level. These capabilities allow for our customers to measure and evaluate energy consumption at the process level. Data can be collected and exported, allowing our customers to perform energy analysis across their facilities to identify operational practices and behaviors that better manage energy costs.

*Apollo Solar Light Pipe.* Our Apollo Solar Light Pipe is a lens-based device that collects and focuses renewable daylight, bringing natural light indoors without consuming electricity. Our Apollo Solar Light Pipe is designed and manufactured to maximize light collection during times of low sun angles, such as those that occur during early morning and late afternoon. The Apollo Solar Light Pipe produces maximum lighting "power" in peak summer months and during peak daylight hours, when electricity is most expensive. By integrating our Apollo Solar Light Pipe with our HIF lighting systems and InteLite wireless controls, the output and associated electricity consumption of our HIF lighting systems can be automatically adjusted based on the level of natural light being provided by our Apollo Solar Light Pipe to offer further energy savings for our customers. In certain circumstances, our customers can illuminate their facilities "off the grid" during peak hours of the day through the use of our integrated energy management system.

*Renewable Energy Products.* Our engineered systems division offers solar photovoltaic, or PV, systems to allow our customers to convert sunlight into electricity. We are a distributor, not a manufacturer, of solar PV systems; however, we do manufacture certain wiring assemblies used to connect the individual solar modules to the electrical panel. Our fully integrated solar power services include (i) project development; (ii) engineering, procurement, and construction (EPC) services; (iii) operating and maintenance (O&M) services; and (iv) project finance expertise. We provide EPC services for projects developed directly to our end customers, to projects developed by independent solar power project developers. EPC services include engineering design and related services, advanced development of grid integration solutions, and construction contracting and management. The procurement component of our EPC services includes recommendation and deployment of solar modules and components that we procure from third parties. We provide O&M services which can include all or a combination of the following scopes of work: warranty, preventative and scheduled maintenance, spare parts inventory, monitoring and reporting of plant performance and diagnosing performance to assist customers in maximizing energy production. We have developed a network of finance partners with experience in structuring non-recourse project debt finance, operating and capital leases, power purchase agreements (PPA) and project equity from tax oriented and strategic industry equity investors. We can provide support in arranging and/or facilitating financing for projects on behalf of our customers.

*Cloud-based data computing, storage.* We recently received Microsoft's coveted High Potential Managed Partner status, which only 1 percent of Microsoft's partners attain. We offer Microsoft's Windows Azure cloud computing and SQL Azure data storage, which allows for real-time energy use analysis and maximum energy savings.

*Other Products.* We also offer our customers a variety of other HIF fixtures to address their lighting and energy management needs, including fixtures designed for agribusinesses, parking lots, roadways, outdoor applications and private label resale.

Our warranty policy generally provides for a limited one-year warranty on our products. Ballasts, lamps and other electrical components are excluded from our standard warranty since they are covered by separate warranties offered by the original equipment manufacturers. We coordinate and process customer warranty inquiries and claims, including inquiries and claims relating to ballast and lamp components, through our customer service department.

## **Services**

We provide a range of fee-based lighting-related energy management services to our customers, including:

- comprehensive site assessment, which includes a review of the current lighting requirements and energy usage at the customer's facility;
- site field verification (SFV) or technology demonstration measurement verification (TDMV), during which we perform a test implementation of our energy management system at a customer's facility upon request;
- utility incentive and government subsidy management, where we assist our customers in identifying, applying for and obtaining available utility incentives or government subsidies;
- engineering design, which involves designing a customized system to suit our customer's facility lighting and energy management needs, and providing the customer with a written analysis of the potential energy savings and lighting and environmental benefits associated with the designed system;
- project management, which involves our working with the electrical contractor in overseeing and managing all phases of implementation from delivery through installation for a single facility or through multi-facility roll-outs tied to a defined project schedule;
- installation services, for our products, which we provide through our national network of qualified third-party installers; and
- recycling in connection with our retrofit installations, where we remove, dispose of and recycle our customer's legacy lighting fixtures.

We are also expanding our offering of other energy management services that we believe will represent additional sources of revenue for us in the future. Those services primarily include review and management of electricity bills, as well as management and control of power quality and remote monitoring and control of our installed systems. We also sell and distribute replacement lamps and fixture components into the after-market.

## Our Customers

We primarily target commercial and industrial customers who have warehousing and manufacturing facilities. As of March 31, 2012, we have installed our products in 7,986 commercial and industrial facilities across North America. Our diversified customer base includes:

American Standard International Inc.	Ecolab, Inc.	Newell Rubbermaid Inc.	SYSCO Corp.
Anheuser-Busch Companies, Inc.	Gap, Inc.	OfficeMax, Inc.	Textron, Inc.
Avery Dennison Corp.	General Electric Co.	PepsiCo Inc.	Toyota Motor Corp.
Big Lots Inc.	Kraft Foods Inc.	Sealed Air Corp.	United Stationers Inc.
The Coca-Cola Co.	Miller Coors LLC	Sherwin-Williams Co.	U.S. Foodservice

No single customer accounted for 10% or more of our total revenue in any of our last three fiscal years.

## Sales and Marketing

We sell our products directly to commercial and industrial customers using a systematic multi-step process that focuses on our value proposition and provides our sales force with specific protocol for working with our customers from the point of lead generation through delivery of our products and services. In fiscal 2010, we increased our sales and marketing headcount to further develop opportunities for our controls and exterior lighting products within the utility and governmental markets, expanded sales and sales support personnel dedicated to our in-market sales programs and added technical expertise for our wireless controls product lines. In fiscal 2011, we upgraded our Customer Relationship Management system, or CRM, to improve the information and tracking of our customer project pipeline and expanded the CRM system to include our elite partners, providing visibility into their project pipelines as well. In fiscal 2012, we created a telemarketing function for the purpose of lead generation and customer appointment scheduling, established a sales and technology office in Houston, Texas, and increased our sales and marketing headcount through the addition of direct in-market salespeople.

We also sell our products and services indirectly to our customers through their electrical contractors or distributors, or to electrical contractors and distributors who buy our products and resell them to end users as part of an installed project. We believe these relationships allow us to increase penetration into the lighting retrofit market because electrical contractors often have significant influence over their customers' lighting product selections. Even in cases where we sell through these indirect channels, we strive to have our own relationship with the end user customer.

We also sell our products on a wholesale basis to electrical contractors and value-added resellers. We often train our value-added resellers to implement our systematic sales process to more effectively resell our products to their customers. We attempt to leverage the customer relationships of these electrical contractors and value-added resellers to further extend the geographic scope of our selling efforts. In fiscal 2010, we increased our focus on selling through our contractor and value-added reseller channels through participation in national trade organizations, by providing training on our sales methodologies, including the development and distribution of standard sales partner operating procedures and by providing training to our partners to enable them to conduct their own energy workshops with their customer and prospect bases. We intend to focus on expanding our partner network, selectively adding new partners in geographic regions where we do not currently have a significant market presence.

We have historically focused our marketing efforts on traditional direct advertising, as well as developing brand awareness through customer education and active participation in trade shows and energy management seminars. In fiscal 2013, we expect to continue to selectively invest in advertising and marketing campaigns to increase the visibility of our brand name and raise awareness of our value proposition. In the past, these efforts have included participating in national, regional and local trade organizations, exhibiting at trade shows, executing targeted direct mail campaigns, advertising in select publications, public relations campaigns and other lead generation and brand building initiatives. We are also actively training contractors and partners on how to effectively represent our product offering and have designed an intensive classroom training program, which we refer to as Orion University, to complement the energy management workshops we conduct in the field.

## Competition

The market for energy management products and services is fragmented. We face strong competition primarily from manufacturers and distributors of energy management products and services as well as electrical contractors. We compete primarily on the basis of technology, price, quality, customer relationships, energy efficiency, customer service and marketing support.

There are a number of lighting fixture manufacturers that sell HIF products that compete with our Compact Modular product line. Some of these manufacturers also sell HID products that compete with our HIF lighting systems, including Cooper Industries, Ltd., Hubbell Incorporated and Acuity Brands, Inc. These companies generally have large and diverse product lines. Many of these competitors are better capitalized than we are, have strong existing customer relationships, greater name recognition, and more extensive engineering and marketing capabilities. We also compete for sales of our HIF lighting systems with manufacturers and suppliers of older fluorescent technology in the retrofit market. Some of the manufacturers of HIF and HID products that compete with our HIF lighting systems sell their systems at a lower initial capital cost than the cost at which we sell our systems, although we believe based on our industry experience that these systems generally do not deliver the light quality and the cost savings that our HIF lighting systems deliver over the long-term.

Many of our competitors market their manufactured lighting and other products primarily to distributors who resell their products for use in new commercial, residential, and industrial construction. These distributors, such as Graybar Electric Company, Gexpro (GE Supply) and W.W. Grainger, Inc., generally have large customer bases and wide distribution networks and supply to electrical contractors.

The renewable energy sector is highly competitive and continually evolving as sector participants strive to distinguish themselves within their markets. Competition in the renewable energy sector has resulted in significant materials price reductions and lower margins for solar panel providers, resulting in several panel providers being forced out of business during calendar year 2011. In the engineering and procurement sector, we compete with other energy service companies who provide similar engineering and contracting services, with roofing and electrical contractors who are seeking to expand their revenue generating product offerings and with solar panel manufacturers who are seeking to expand their renewable services product offering.

We also face competition from companies who provide energy management services. Some of these competitors, such as Johnson Controls, Inc. and Honeywell International, provide basic systems and controls designed to further energy efficiency. Other competitors provide demand response systems that compete with our energy management systems, such as Comverge, Inc. and EnerNOC, Inc.

### **Intellectual Property**

As of March 31, 2012, we had been issued 39 United States patents, and had applied for 23 additional United States patents. The patented and patent pending technologies include the following:

- Portions of our core HIF lighting technology (including our optically efficient reflector and some of our thermally efficient fixture I-frame constructions) are patented with additional patents pending.
- Our ballast assembly method is patent pending.
- Our Apollo Solar Light Pipe technology and its manufacturing methods are patented with additional patents pending.
- Our wireless lighting control system is patent pending.
- The technology and methodology of our OTA financing program is patent pending.
- Our exterior lighting fixture technology is patented with additional patents pending.
- Our hybrid HIF and LED lighting fixture technology is patent pending.

We believe that our patent portfolio as a whole is material to our business. We also believe that our patents covering certain component parts of our Compact Modular, including our thermally efficient I-frame and our optically efficient reflector, are material to our business, and that the loss of these patents could significantly and adversely affect our business, operating results and prospects.

## **Manufacturing and Distribution**

We own an approximately 266,000 square foot manufacturing and distribution facility located in Manitowoc, Wisconsin. Since fiscal 2005, we have made significant investments in new equipment and in the development of our workforce to expand our internal production capabilities and increase production capacity. As a result of these investments, we are generally able to manufacture and assemble our products internally. We supplement our in-house production with outsourcing contracts as required to meet short-term production needs. We believe we have sufficient production capacity to support a substantial expansion of our business.

We generally maintain a significant supply of raw material and purchased and manufactured component inventory. We manufacture products to order and are typically able to ship most orders within 14 days of our receipt of a purchase order. We contract with transportation companies to ship our products and manage all aspects of distribution logistics. We generally ship our products directly to the end user.

## **Research and Development**

Our research and development efforts are centered on developing new products and technologies, enhancing existing products, and improving operational and manufacturing efficiencies. The products, technologies and services we are developing are focused on increasing end user energy efficiency. We are also developing lighting products based on LED technology, intelligent HVAC integration controls, direct solar solutions and comprehensive lighting management software. Our research and development expenditures were \$1.9 million, \$2.3 million and \$2.5 million for fiscal years 2010, 2011 and 2012, respectively.

## **Regulation**

Our operations are subject to federal, state, and local laws and regulations governing, among other things, emissions to air, discharge to water, the remediation of contaminated properties and the generation, handling, storage transportation, treatment, and disposal of, and exposure to, waste and other materials, as well as laws and regulations relating to occupational health and safety. We believe that our business, operations, and facilities are being operated in compliance in all material respects with applicable environmental and health and safety laws and regulations.

State, county or municipal statutes often require that a licensed electrician be present and supervise each retrofit project. Further, all installations of electrical fixtures are subject to compliance with electrical codes in virtually all jurisdictions in the United States. In cases where we engage independent contractors to perform our retrofit projects, we believe that compliance with these laws and regulations is the responsibility of the applicable contractor.

## **Our Corporate and Other Available Information**

We were incorporated as a Wisconsin corporation in April 1996 and our corporate headquarters are located at 2210 Woodland Drive, Manitowoc, Wisconsin 54220. Our Internet website address is [www.oesx.com](http://www.oesx.com). Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, or the Exchange Act, are available through the investor relations page of our internet website free of charge as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission, or the SEC.

## **Employees**

As of March 31, 2012, we had 256 full-time and 21 part-time employees. Our employees are not represented by any labor union, and we have never experienced a work stoppage or strike. We consider our relations with our employees to be good.

## **ITEM 1A. RISK FACTORS**

*You should carefully consider the risk factors set forth below and in other reports that we file from time to time with the Securities and Exchange Commission and the other information in this Annual Report on Form 10-K. The matters discussed in the risk factors, and additional risks and uncertainties not currently known to us or that we currently deem immaterial, could have a material adverse effect on our business, financial condition, results of operation and future growth prospects and could cause the trading price of our common stock to decline.*



***Adverse conditions in the global economy and disruption of financial markets have negatively impacted, and could continue to negatively impact, our customers, suppliers and business.***

Financial markets in the United States, Europe and Asia have experienced extreme disruption over the past several years, including, among other things, extreme volatility in security prices, severely diminished liquidity and credit availability, rating downgrades, declines in asset valuations, inflation, reduced consumer spending and fluctuations in foreign currency exchange rates. While currently these conditions have not impaired our ability to finance our operations, such conditions coupled with recessionary type economic conditions, have adversely affected our customers' capital budgets, purchasing decisions and facilities managers and, therefore, have adversely affected our results of operations. In addition, some of our installer base of contractors have stopped doing business due to the challenging economic conditions, which has increased the cost and delayed the timing of installation of our products and thereby negatively impact our business and results of operations. Our business and results of operations will continue to be adversely affected to the extent these adverse financial market and general economic conditions continue to adversely affect our customers' purchasing decisions and the availability of installers.

***Adverse market conditions have led to increasing duration of customer sales cycles, limitations on customer capital budgets, closure of facilities and the loss of key contacts due to workforce reductions at existing and prospective customers.***

The volatility and uncertainty in the financial and credit markets along with current political uncertainty has led many customers to adopt strategies for conserving cash, including limits on capital spending. Our HIF lighting systems are often purchased as capital assets and therefore are subject to capital availability. Uncertainty around such availability has led customers to delay purchase decisions, which has elongated the duration of our sales cycles. Along with limiting capital spending, some customers have reduced expenses by closing facilities and reducing workforces. As a result, facilities that were or may be considering installing our HIF lighting systems have closed or may close. Due to downsizings, key contacts and decision-makers at some of our customers have lost or may lose their jobs, which requires us to re-initiate the sales cycle with other personnel, further elongating the sales cycle. We have experienced, and may in the future experience, variability in our operating results, on both an annual and a quarterly basis, as a result of these factors.

***Our financial performance is dependent on our ability to execute on our growth strategy.***

Our fiscal 2013 operating plan and financial expectations are predicated upon our growth strategy, and our ability to achieve our desired growth depends on our execution in areas including proposal development, marketing, sales training, project management and our new telemarketing initiative, and our ability to expand our partner network rapidly, as well as other factors. If we are unable to successfully execute in any of these areas or on our growth strategy as a whole, our business and financial performance will likely be adversely affected.

***Our inability to retain key employees or protect our partner network could adversely affect our operations and our ability to execute on our operating plan and growth strategy.***

We rely upon the knowledge, experience and skills of key employees throughout our organization, and particularly in our sales group, that require technical knowledge or contacts in and knowledge of the industry. We also depend on our value-added reseller channels, including our partner network. If we are unable to retain key employees or protect the integrity of our partner network because of competition or, in the case of employees, inadequate compensation or other factors, our operations and our ability to execute our operating plan could be adversely affected.

***Our renewable energy technologies involve many risks and uncertainties and many new technologies do not become commercially profitable products, applications or services despite extensive development and commercialization efforts.***

In fiscal 2012, we continued the expansion that began in fiscal 2010 of our product and service offerings by providing our customers with alternative renewable energy systems, such as photovoltaic solar systems and wind energy systems through our Orion Engineered Systems division. This division continues to conduct research on various additional renewable energy technologies that we may be able to add to our menu of products, applications and services offered, making recommendations to our senior management regarding the technologies' viability and developing commercialization tactics.

The process of developing and commercializing new products, applications and services, particularly relating to alternative renewable energy systems, is typically both time-consuming and costly and usually involves a high degree of business risk. We may be unable to successfully develop or commercialize new technologies in the form of new products, applications or services. This process may involve substantial expenditures in research and development, sourcing and marketing. Commercialization of new technological products, applications and services often requires a very long lead time. Because it is generally not possible to predict the amount of time required or the costs involved in achieving new product, application or service introduction objectives, actual development and commercialization costs may exceed budgeted amounts and estimated development and commercialization schedules may be extended. Developing new technological products, applications and services, and creating effective commercialization strategies for new renewable energy technologies, are subject to inherent risks that may include:

- Unanticipated and/or substantial delays;
- Unanticipated and/or substantially increased costs;
- Unrecoverable and/or substantially increased expenses;
- Technical, reliability, durability or quality problems, including potential warranty and/or product liability claims;
- Insufficiency of dedicated or budgeted funds;
- Inability to meet targeted cost or performance objectives;
- Inability of our suppliers of new products to remain solvent;
- Inability to satisfy industry standards or consumer expectations and needs;
- Regulatory obstacles;
- Competition;
- Inability to prove the original concept;
- Lack of demand; and
- Diversion of our management's and employees' focus and/or attention.

The occurrence of any one or more of these risks could cause us to incur substantial costs and expenses or even to abandon or substantially delay or change our strategy of exploring the addition of new alternative renewable energy technologies into our product, application and service offerings.

***Orion Engineered Systems may not be able to identify suitable new technologies, may invest too much in new technologies, or could fail to develop new products, applications or services successfully.***

Identifying suitable new alternative renewable energy technologies for addition into our product, application and service offerings may be difficult, and the failure to do so could harm our growth strategy. If we make an investment in one or more new alternative renewable energy technologies, we could have difficulty developing and commercializing it or integrating it into our product, application or service offerings. These difficulties could disrupt our ongoing business, distract our management and employees and increase our expenses and/or capital expenditures. As a result, our failure to fully develop and commercialize potential new alternative renewable energy technologies or to integrate them effectively into our product, application and service offerings properly could have a material adverse effect on our business, financial condition and operating results.

***Orion Engineered System's pursuit of solar photovoltaic and/or wind electricity generating technologies is subject to risks specific to the solar photovoltaic and/or wind industry.***

If we continue to expand our offerings of solar photovoltaic electricity generating technologies and/or wind electricity generating technologies into our product, application or service offerings, such business pursuits will involve risks specifically associated with such industries, including:

- The market for solar photovoltaic and wind electricity generating technologies has been adversely affected by the recessionary economic conditions, and we cannot guarantee that demand will return or increase in the future.
- The solar industry has experienced several high profile bankruptcies over the last eighteen months. Despite our efforts to research the financial health of our solar suppliers, future solvency concerns regarding our suppliers can negatively impact our ability to secure new customers and sell additional PV systems to existing customers.

- A variety of solar power, wind power and other renewable energy technologies may be currently under development by other companies that could result in higher or more effective product performance than the performance expected to be produced by any technology that we decide to offer.
- Our ability to generate revenue and profitability from adding solar photovoltaic and/or wind electricity generating technologies into our product, application or service offerings is dependent on consumer acceptance and the economic feasibility of solar and/or wind generated energy.
- A drop in the retail price of conventional energy or other alternate renewable energy sources may negatively impact our ability to generate revenue and profitability from solar photovoltaic and/or wind generated energy technologies.
- The reduction, elimination or expiration of government mandates and subsidies or economic or tax rebates, credits and/or incentives for alternative renewable energy systems would likely substantially reduce the demand for, and economic feasibility of, any solar photovoltaic and/or wind electricity generating products, applications or services and could materially reduce any prospects for our successfully introducing any new products, applications or services using such technologies.

The occurrence of any one or more of these risks could cause us to incur substantial costs and expenses or even to abandon or delay our strategy with respect to these industries.

***We may not be able to obtain equity capital or debt financing necessary to effectively introduce and commercialize any new alternative renewable energy technologies identified by Orion Engineered Systems into our product, application and service offerings.***

Our existing capital resources may not be sufficient to effectively introduce and commercialize any new alternative renewable energy technologies identified by Orion Engineered Systems into our product, application and service offerings. We may not be able to obtain sufficient equity capital and/or debt financing required to do so or we may not be able to obtain such equity capital or debt financing on acceptable terms or conditions. Factors affecting the availability to us of equity capital or debt financing on acceptable terms and conditions include:

- The price, volatility and trading volume and history of our common stock.
- Our current and future financial results and position.
- The market's view of our industry and products.
- The perception in the equity and debt markets of our ability to execute our business plan or achieve our operating results expectations.

Our inability to obtain the capital necessary to introduce new products to the market could have an adverse effect on our growth strategy and business operations.

***We operate in a highly competitive industry and if we are unable to compete successfully our revenue and profitability will be adversely affected.***

We face strong competition primarily from manufacturers and distributors of energy management products and services, as well as from electrical contractors. We compete primarily on the basis of customer relationships, price, quality, energy efficiency, customer service and marketing support. Our products are in direct competition with high intensity discharge, or HID, technology, as well as other HIF and LED products and older fluorescent technology in the lighting systems retrofit market.

Many of our competitors are better capitalized than we are, have strong existing customer relationships, greater name recognition, and more extensive engineering, manufacturing, sales and marketing capabilities. Competitors could focus their substantial resources on developing a competing business model or energy management products or services that may be potentially more attractive to customers than our products or services. In addition, we may face competition from other products or technologies that reduce demand for electricity. Our competitors may also offer energy management products and services at reduced prices in order to improve their competitive positions. Any of these competitive factors could make it more difficult for us to attract and retain customers, require us to lower our prices in order to remain competitive, and reduce our revenue and profitability, any of which could have a material adverse effect on our results of operations and financial condition.

***Our products use components and raw materials that may be subject to price fluctuations, shortages or interruptions of supply.***

We may be vulnerable to price increases for components or raw materials that we require for our products, including aluminum, copper, certain rare earth minerals, ballasts, power supplies and lamps. In particular, our cost of aluminum can be subject to commodity price fluctuation. Further, suppliers' inventories of certain components that our products require may be limited and are subject to acquisition by others. We have had to purchase quantities of certain components that are critical to our product manufacturing and were in excess of our estimated near-term requirements as a result of supplier delivery constraints and concerns over component availability, and we may need to do so in the future. As a result, we have had, and may need to continue, to devote additional working capital to support a large amount of component and raw material inventory that may not be used over a reasonable period to produce saleable products, and we may be required to increase our excess and obsolete inventory reserves to provide for these excess quantities, particularly if demand for our products does not meet our expectations. Also, any shortages or interruptions in supply of our components or raw materials could disrupt our operations. If any of these events occurs, our results of operations and financial condition could be materially adversely affected.

***Our success is largely dependent upon the skills, experience and efforts of our senior management, and the loss of their services could have a material adverse effect on our ability to expand our business or to maintain profitable operations.***

Our continued success depends upon the continued availability, contributions, skills, experience and effort of our senior management. We are particularly dependent on the services of Neal R. Verfuert, our chief executive officer and principal founder, Michael J. Potts, our president and chief operating officer, and John Scribante, our president of Orion Engineered Systems division. Messrs. Verfuert, Potts and Scribante have major responsibilities with respect to sales, engineering, product development, operations and executive administration. We do not have a formal succession plan in place for Messrs. Verfuert, Potts and Scribante. Our current employment agreements with Messrs. Verfuert, Potts and Scribante do not guarantee their respective services for a specified period of time. All of the current employment agreements with our senior management team may be terminated by the employee at any time and without notice. While all such agreements include noncompetition and confidentiality covenants, there can be no assurance that such provisions will be enforceable or adequately protect us. The loss of the services of either of these persons might impede our operations or the achievement of our strategic and financial objectives, and we may not be able to attract and retain individuals with the same or similar level of experience or expertise. Additionally, while we have key man insurance on the lives of Messrs. Verfuert and Potts and other members of our senior management team, such insurance may not adequately compensate us for the loss of these individuals. The loss or interruption of the service of members of our senior management, particularly Messrs. Verfuert, Potts or Scribante, or our inability to attract or retain other qualified personnel could have a material adverse effect on our ability to expand our business, implement our strategy or achieve profitable operations.

***We have made a significant investment in inventory related to our wireless controls product offering, which is costly and, if not properly managed, may result in an inability to provide our products on a timely basis or in unforeseen valuation adjustments.***

Our wireless control inventories comprised approximately 50% of our total March 31, 2012 inventory balance of \$30.5 million. The components for our wireless inventories are manufactured and assembled overseas and require longer delivery lead times. Suppliers require deposit payments at time of purchase order and suppliers also require volume commitments to secure production capacity. We maintain this significant investment in our wireless controls inventory in order to provide prompt and complete service to our customers. There can be no guarantees that our customers will purchase our wireless technologies or that unforeseen evolutions in technologies may render our inventories unsalable. Additionally, price changes or other circumstances could result in unforeseen valuation adjustments to such inventories, which could have a negative effect on our results of operations and financial condition.

***We depend upon a limited number of customers in any given period to generate a substantial portion of our revenue and the loss of significant customers could have an adverse effect on our operations.***

We do not have long-term contracts with our customers, and our dependence on individual key customers can vary from period to period as a result of the significant size of some of our retrofit and multi-facility roll-out projects. Our top 10 customers accounted for approximately 31% and 44%, respectively, of our total revenue for fiscal 2011 and 2012. In fiscal 2011 and fiscal 2012, our top customer accounted for less than 8% and 9% of our total revenues, respectively. We expect large retrofit and roll-out projects and large single location solar projects to continue to be a significant component of our total revenue. As a result, we may experience more customer concentration in any given future period. The loss of, or substantial reduction in sales to, any of our significant customers could have a material adverse effect on our results of operations in any given future period.

***We depend on a limited number of key suppliers and the loss of a key supplier could have an adverse effect on our operations.***

We depend on certain key suppliers for the raw materials and key components that we require for our current products, including sheet, coiled and specialty reflective aluminum, power supplies, ballasts and lamps. In particular, we buy most of our specialty reflective aluminum from a single supplier and we also purchase most of our ballast and lamp components from a single supplier. Additionally, while we purchase solar panels from several vendors, we have experienced business disruption in the past as solar suppliers have gone out of business. Purchases of components from our current primary ballast and lamp supplier constituted 22% and 14% of our total cost of revenue in fiscal 2011 and fiscal 2012, respectively. If these components become unavailable, or our relationships with suppliers become strained, particularly as relates to our primary suppliers, our results of operations and financial condition could be materially adversely affected.

***Increasing use of our OTA financing program could require us to seek additional debt financing and/or equity capital and expose us to financing risk and additional customer credit risk and impact our financial results.***

Our financing program, the Orion Throughput Agreements, or OTA, is an installment based payment plan for our customers in contrast to our traditional cash terms. This financing program may subject us to additional credit risk as we do not have a long history or experience related to longer term credit decision making. Poor credit decisions or customer defaults could result in increases to our allowances for doubtful accounts and/or write-offs of accounts receivable and could have material adverse effects on our results of operations and financial condition.

Over the past 12 months, we have financed our OTA contracts through a blend of bank debt and through the non-recourse sale of the equipment to third party equipment finance providers. If we choose to increase the amount of OTA contracts funded by debt, we may not be able to obtain such debt financing on acceptable terms or conditions. Any national economic downturn or disruption of financial markets could reduce our access to capital necessary for these programs. The agreements and their increased use also may subject us to additional credit risk as we do not have a long history or experience related to longer term credit decision making.

***Product liability claims could adversely affect our business, results of operations and financial condition.***

We face exposure to product liability claims in the event that our energy management products fail to perform as expected or cause bodily injury or property damage. Since the majority of our products use electricity, it is possible that our products could result in injury, whether by product malfunctions, defects, improper installation or other causes. Particularly because our products often incorporate new technologies or designs, we cannot predict whether or not product liability claims will be brought against us in the future or result in negative publicity about our business or adversely affect our customer relations. Moreover, we may not have adequate resources in the event of a successful claim against us. A successful product liability claim against us that is not covered by insurance or is in excess of our available insurance limits could require us to make significant payments of damages and could materially adversely affect our results of operations and financial condition.

***The success of our business depends on the market acceptance of our energy management products and services.***

Our future success depends on continued commercial acceptance of our energy management products and services. If we are unable to convince current and potential customers of the advantages of our HIF and LED lighting systems and energy management products and services, then our ability to sell our HIF and LED lighting systems and energy management products and services will be limited. In addition, because the market for energy management products and services is rapidly evolving, we may not be able to accurately assess the size of the market, and we may have limited insight into trends that may emerge and affect our business. If the market for our HIF and LED lighting systems and energy management products and services does not continue to develop, or if the market does not accept our products, then our ability to grow our business could be limited and we may not be able to increase our revenue or achieve profitability.

***We depend on our ability to develop new products and services.***

The market for our products and services is characterized by rapid market and technological changes, uncertain product life cycles, changes in customer demands and evolving government, industry and utility standards and regulations. As a result, our future success will depend, in part, on our ability to continue to design and manufacture new products and services. We may not be able to successfully develop and market new products or services that keep pace with technological or industry changes, satisfy changes in customer demands or comply with present or emerging government and industry regulations and technology standards.

***We may pursue acquisitions and investments in new product lines, businesses or technologies that involve numerous risks, which could disrupt our business or adversely affect our financial condition and results of operations.***

In the future, we may pursue acquisitions of, or investments in, new product lines, businesses or technologies to expand our current capabilities. We have limited experience in making such acquisitions or investments. Acquisitions present a number of potential risks and challenges that could disrupt our business operations, increase our operating costs or capital expenditure requirements and reduce the value of the acquired product line, business or technology. For example, if we identify an acquisition candidate, we may not be able to successfully negotiate or finance the acquisition on favorable terms. The process of negotiating acquisitions and integrating acquired products, services, technologies, personnel, or businesses might result in significant transaction costs, operating difficulties or unexpected expenditures, and might require significant management attention that would otherwise be available for ongoing development of our business. If we are successful in completing an acquisition, we may not be able to integrate the acquired product line, business or technology into our existing business and products, and we may not achieve the anticipated benefits of any acquisition. Furthermore, potential acquisitions and investments may divert our management's attention, require considerable cash outlays and require substantial additional expenses that could harm our existing operations and adversely affect our results of operations and financial condition. To complete future acquisitions, we may issue equity securities, incur debt, assume contingent liabilities or incur amortization expenses and write-downs of acquired assets, which could dilute the interests of our shareholders or adversely affect our profitability.

***Our inability to protect our intellectual property, or our involvement in damaging and disruptive intellectual property litigation, could adversely affect our business, results of operations and financial condition or result in the loss of use of the product or service.***

We attempt to protect our intellectual property rights through a combination of patent, trademark, copyright and trade secret laws, as well as employee and third-party nondisclosure and assignment agreements. Our failure to obtain or maintain adequate protection of our intellectual property rights for any reason could have a material adverse effect on our business, results of operations and financial condition.

We own United States patents and patent applications for some of our products, systems, business methods and technologies. We offer no assurance about the degree of protection which existing or future patents may afford us. Likewise, we offer no assurance that our patent applications will result in issued patents, that our patents will be upheld if challenged, that competitors will not develop similar or superior business methods or products outside the protection of our patents, that competitors will not infringe upon our patents, or that we will have adequate resources to enforce our patents. Effective protection of our United States patents may be unavailable or limited in jurisdictions outside the United States, as the intellectual property laws of foreign countries sometimes offer less protection or have onerous filing requirements. In addition, because some patent applications are maintained in secrecy for a period of time, we could adopt a technology without knowledge of a pending patent application, and such technology could infringe a third party's patent.

We also rely on unpatented proprietary technology. It is possible that others will independently develop the same or similar technology or otherwise learn of our unpatented technology. To protect our trade secrets and other proprietary information, we generally require employees, consultants, advisors and collaborators to enter into confidentiality agreements. We cannot assure you that these agreements will provide meaningful protection for our trade secrets, know-how or other proprietary information in the event of any unauthorized use, misappropriation or disclosure of such trade secrets, know-how or other proprietary information. If we are unable to maintain the proprietary nature of our technologies, our business could be materially adversely affected.

We rely on our trademarks, trade names, and brand names to distinguish our company and our products and services from our competitors. Some of our trademarks may conflict with trademarks of other companies. Failure to obtain trademark registrations could limit our ability to protect our trademarks and impede our sales and marketing efforts. Further, we cannot assure you that competitors will not infringe our trademarks, or that we will have adequate resources to enforce our trademarks.

In addition, third parties may bring infringement and other claims that could be time-consuming and expensive to defend. Also, parties making infringement and other claims may be able to obtain injunctive or other equitable relief that could effectively block our ability to provide our products, services or business methods and could cause us to pay substantial damages. In the event of a successful claim of infringement, we may need to obtain one or more licenses from third parties, which may not be available at a reasonable cost, or at all. It is possible that our intellectual property rights may not be valid or that we may infringe upon existing or future proprietary rights of others. Any successful infringement claims could subject us to significant liabilities, require us to seek licenses on unfavorable terms, prevent us from manufacturing or selling products, services and business methods and require us to redesign or, in the case of trademark claims, re-brand our company or products, any of which could have a material adverse effect on our business, results of operations or financial condition.

***If our information technology systems fail, or if we experience an interruption in their operation, then our business, results of operations and financial condition could be materially adversely affected.***

The efficient operation of our business is dependent on our information technology systems. We rely on those systems generally to manage the day-to-day operation of our business, manage relationships with our customers, maintain our research and development data and maintain our financial and accounting records. We recently replaced our then-existing enterprise resource planning, or ERP, system. Our ERP implementation project has consumed, and may continue to consume, significant business resources, including personnel and financial resources, and is not yet fully complete. The failure of our information technology systems, our inability to successfully maintain, enhance and/or replace our information technology systems, or any compromise of the integrity or security of the data we generate from our information technology systems, could adversely affect our results of operations, disrupt our business and product development and make us unable, or severely limit our ability, to respond to customer demands. In addition, our information technology systems are vulnerable to damage or interruption from:

- earthquake, fire, flood and other natural disasters;
- employee or other theft;
- attacks by computer viruses or hackers;
- power outages; and
- computer systems, internet, telecommunications or data network failure.

Any interruption of our information technology systems could result in decreased revenue, increased expenses, increased capital expenditures, customer dissatisfaction and potential lawsuits, any of which could have a material adverse effect on our results of operations or financial condition.

***Our retrofitting process frequently involves responsibility for the removal and disposal of components containing hazardous materials.***

When we retrofit a customer's facility, we typically assume responsibility for removing and disposing of its existing lighting fixtures. Certain components of these fixtures typically contain trace amounts of mercury and other hazardous materials. Older components may also contain trace amounts of polychlorinated biphenyls, or PCBs. We currently rely on contractors to remove the components containing such hazardous materials at the customer job site. The contractors then arrange for the disposal of such components at a licensed disposal facility. Failure by such contractors to remove or dispose of the components containing these hazardous materials in a safe, effective and lawful manner could give rise to liability for us, or could expose our workers or other persons to these hazardous materials, which could result in claims against us.

***The cost of compliance with environmental laws and regulations and any related environmental liabilities could adversely affect our results of operations or financial condition.***

Our operations are subject to federal, state and local laws and regulations governing, among other things, emissions to air, discharge to water, the remediation of contaminated properties and the generation, handling, storage, transportation, treatment and disposal of, and exposure to, waste and other materials, as well as laws and regulations relating to occupational health and safety. These laws and regulations frequently change, and the violation of these laws or regulations can lead to substantial fines, penalties and other liabilities. The operation of our manufacturing facility entails risks in these areas and there can be no assurance that we will not incur material costs or liabilities in the future which could adversely affect our results of operations or financial condition.

***We expect our quarterly revenue and operating results to fluctuate. If we fail to meet the expectations of market analysts or investors, the market price of our common stock could decline substantially, and we could become subject to securities litigation.***

Our quarterly revenue and operating results have fluctuated in the past and will likely vary from quarter to quarter in the future. For example, our first fiscal quarter typically reflects operating results that do not compare favorably with our other fiscal quarters. You should not rely upon the results of one quarter as an indication of our future performance. Our revenue and operating results may fall below the expectations of market analysts or investors in some future quarter or quarters. Our failure to meet these expectations could cause the market price of our common stock to decline substantially. If the price of our common stock is volatile or falls significantly below our current price, we may be the target of securities litigation. If we become involved in this type of litigation, regardless of the outcome, we could incur substantial legal costs, management's attention could be diverted from the operation of our business, and our reputation could be damaged, which could adversely affect our business, results of operations or financial condition.

***Our net operating loss carryforwards may be subject to limitation based upon ownership changes.***

As of March 31, 2012, we had aggregate federal net operating loss carryforwards of approximately \$7.0 million and state net operating loss carryforwards of approximately \$4.5 million. 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. We believe that past issuances and transfers of our stock caused an ownership change in fiscal 2007 that may affect the timing of the use of our net operating loss carryforwards, but we do not believe the ownership change affects the use of the full amount of our net operating loss carryforwards. As a result, our ability to use our net operating loss carryforwards attributable to the period prior to such ownership change to offset taxable income will be subject to limitations in a particular year, which could potentially result in increased future tax liability for us. In fiscal 2008, utilization of our net operating loss carryforwards was limited to \$3.0 million. For fiscal 2010, 2011 and 2012, utilization of our net operating loss carryforwards was not limited.

***Our net operating loss carryforwards may be subject to a valuation adjustment if we do not maintain our profitability.***

As of March 31, 2012, we had aggregate federal net operating loss carryforwards of approximately \$7.0 million and state net operating loss carryforwards of approximately \$4.5 million. Our ability to utilize our net operating loss carryforwards and related deferred tax assets is based upon our ability to generate future taxable income. Our ability to generate future taxable income can be impacted by many circumstances. If we fail to maintain our recent profitability, our net operating loss carryforwards and related deferred tax assets may be subject to a valuation adjustment.

***We are subject to financial and operating covenants in our credit agreement and any failure to comply with such covenants could result in our being unable to borrow under the agreement and other negative consequences.***

Our credit agreement with JP Morgan Chase Bank, N.A., contains certain financial covenants including minimum net income requirements and requirements that we maintain net worth ratios at prescribed levels. The credit agreement also contains certain restrictions on our ability 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 our stock, redeem or repurchase shares of our stock, or pledge assets. The credit agreement also contains other customary covenants.

There can be no assurance that we will be able to comply with the financial and other covenants in the credit agreement. Our failure to comply with these covenants could cause us to be unable to borrow under the agreement and may constitute an event of default which, if not cured or waived, could result in the acceleration of the maturity of any indebtedness then outstanding under the agreement, which would require us to pay all amounts outstanding. Due to our cash and cash equivalent position and the fact that we have no borrowings currently outstanding, we do not currently anticipate that our failure to comply with the covenants under the credit agreement would have a significant impact on our ability to meet our financial obligations in the near term. Our failure to comply with such covenants, however, would be a disclosable event and may be perceived negatively. Such perception could adversely affect the market price for our common stock and our ability to obtain financing in the future.

***The failure to establish and maintain internal controls over financial reporting could harm our business and financial results.***

Our management is responsible for establishing and maintaining effective internal control over financial reporting. Internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of financial reporting for external purposes in accordance with accounting principles generally accepted in the United States. Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that we would prevent or detect a misstatement of our financial statements or fraud. As of March 31, 2012, our Chief Executive Officer and Chief Financial Officer concluded that our internal controls were not effective due to the certain material weaknesses. The failure to maintain an effective system of internal control over financial reporting could limit our ability to report our financial results accurately and in a timely manner or to detect and prevent fraud and could also cause a loss of investor confidence and decline in the market price of our common stock.



***The restatements of our historical financial statements has consumed a significant amount of our time and resources and may have a material adverse effect on our reputation, business and stock price.***

Previously, we have restated our consolidated financial statements for fiscal 2010 and fiscal 2011, our first three quarters of fiscal 2010 and 2011 and our first two quarters of fiscal 2012. The restatement process was highly time and resource-intensive and involved substantial attention from management and significant legal and accounting costs. Furthermore, we cannot guarantee that we will have no inquiries from the SEC regarding our restated financial statements or matters relating thereto. Any future inquiries from the SEC as a result of the restatement of our historical financial statements will, regardless of the outcome, likely consume a significant amount of our resources. Further, many companies that have been required to restate their historical financial statements have experienced a decline in stock price and shareholder lawsuits related thereto.

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

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

***The market price of our common stock could be adversely affected by future sales of our common stock in the public market by our executive officers and directors.***

Our executive officers and directors may from time to time sell shares of our common stock in the public market or otherwise. We cannot predict the size or the effect, if any, that future sales of shares of our common stock by our executive officers and directors, or the perception of such sales, would have on the market price of our common stock.

***Anti-takeover provisions included in the Wisconsin Business Corporation Law, provisions in our amended and restated articles of incorporation or bylaws and the common share purchase rights that accompany shares of our common stock could delay or prevent a change of control of our company, which could adversely impact the value of our common stock and may prevent or frustrate attempts by our shareholders to replace or remove our current board of directors or management.***

A change of control of our company may be discouraged, delayed or prevented by certain provisions of the Wisconsin Business Corporation Law. These provisions generally restrict a broad range of business combinations between a Wisconsin corporation and a shareholder owning 15% or more of our outstanding voting stock. These and other provisions in our amended and restated articles of incorporation, including our staggered board of directors and our ability to issue "blank check" preferred stock, as well as the provisions of our amended and restated bylaws and Wisconsin law, could make it more difficult for shareholders or potential acquirers to obtain control of our board of directors or initiate actions that are opposed by the then-current board of directors, including to delay or impede a merger, tender offer or proxy contest involving our company.

Each currently outstanding share of our common stock includes, and each newly issued share of our common stock will include, a common share purchase right. The rights are attached to and trade with the shares of common stock and generally are not exercisable. The rights will become exercisable if a person or group acquires, or announces an intention to acquire, 20% or more of our outstanding common stock. The rights have some anti-takeover effects and generally will cause substantial dilution to a person or group that attempts to acquire control of us without conditioning the offer on either redemption of the rights or amendment of the rights to prevent this dilution. The rights could have the effect of delaying, deferring or preventing a change of control.

In addition, our employment arrangements with senior management provide for severance payments and accelerated vesting of benefits, including accelerated vesting of stock options, upon a change of control. These provisions could limit the price that investors might be willing to pay in the future for shares of our common stock, thereby adversely affecting the market price of our common stock. These provisions may also discourage or prevent a change of control or result in a lower price per share paid to our shareholders.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

We own our approximately 266,000 square foot manufacturing and distribution facility in Manitowoc, Wisconsin. We own our approximately 70,000 square foot technology center and corporate headquarters adjacent to our Manitowoc manufacturing and distribution facility. We own our approximately 23,000 square foot sales and operations support facility in Plymouth, Wisconsin. Our Plymouth facility is used by our Orion Engineered Systems segment. We also lease a 5,600 square foot sales and technology office in Houston, Texas.

**ITEM 3. LEGAL PROCEEDINGS**

We are subject to various claims and legal proceedings arising in the ordinary course of our business. As of the date hereof, we believe that the ultimate resolution of such claims in the ordinary course of business will not materially affect our financial condition.

**ITEM 4. MINE SAFETY DISCLOSURES**

None.

**ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES****Price Range of our Common Stock**

Our common stock is listed on the NYSE MKT under the symbol "OESX". The following table sets forth the range of high and low sales prices per share as reported on the NYSE MKT for the periods indicated.

	<u>High</u>	<u>Low</u>
<b>Fiscal 2011</b>		
First Quarter	\$5.43	\$2.84
Second Quarter	\$3.43	\$2.10
Third Quarter	\$4.14	\$3.11
Fourth Quarter	\$4.94	\$3.21
<b>Fiscal 2012</b>		
First Quarter	\$4.29	\$2.99
Second Quarter	\$4.10	\$2.31
Third Quarter	\$3.20	\$2.34
Fourth Quarter	\$3.46	\$2.20

## Shareholders

The closing sales price of our common stock on the NYSE MKT as of June 6, 2012 was \$2.26. As of June 6, 2012, there were approximately 255 record holders of the 22,562,258 outstanding shares of our common stock. The number of record holders does not include shareholders for whom shares are held in a “nominee” or “street” name.

## Dividend Policy

We have never paid or declared any cash dividends on our common stock. We currently intend to retain all available funds and any future earnings to fund the development and expansion of our business, and we do not anticipate paying any cash dividends in the foreseeable future. In addition, the terms of our existing credit agreement restrict the payment of cash dividends on our common stock. Any future determination to pay dividends will be at the discretion of our board of directors and will depend on our financial condition, results of operations, capital requirements, contractual restrictions (including those under our loan agreements) and other factors that our board of directors deems relevant.

## Securities Authorized for Issuance under Equity Compensation Plans

The following table represents shares outstanding under the 2003 Stock Option Plan and the 2004 Equity Incentive Plan as of March 31, 2012.

Plan Category	Equity Compensation Plan Information		Number of Securities Remaining Available for Future Issuances Under the Equity Compensation Plans (1)
	Number of Securities to be Issued Upon Exercise of Outstanding Options	Weighted Average Exercise Price of Outstanding Options	
Equity Compensation plans approved by security holders	3,697,633	\$ 3.76	1,406,090
Equity Compensation plans not approved by security holders	—	—	—
<b>Total</b>	<b>3,697,633</b>	<b>\$ 3.76</b>	<b>1,406,090</b>

(1) Excludes shares reflected in the column titled “Number of Securities to be Issued Upon Exercise of Outstanding Options”.

## Issuer Purchase of Equity Securities

The table below summarizes our repurchases of our common stock during the three-month period ended March 31, 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>Maximum Dollar Amount that May Yet Be Purchased Under the Plans or Programs (2)</u>
January 1 – January 31, 2012	5,000	\$ 2.68	5,000	\$ 2,207,000
February 1 – February 29, 2012	40,000	\$ 2.56	40,000	\$ 2,105,000
March 1 – March 31, 2012	135,000	\$ 2.55	135,000	\$ 1,760,000

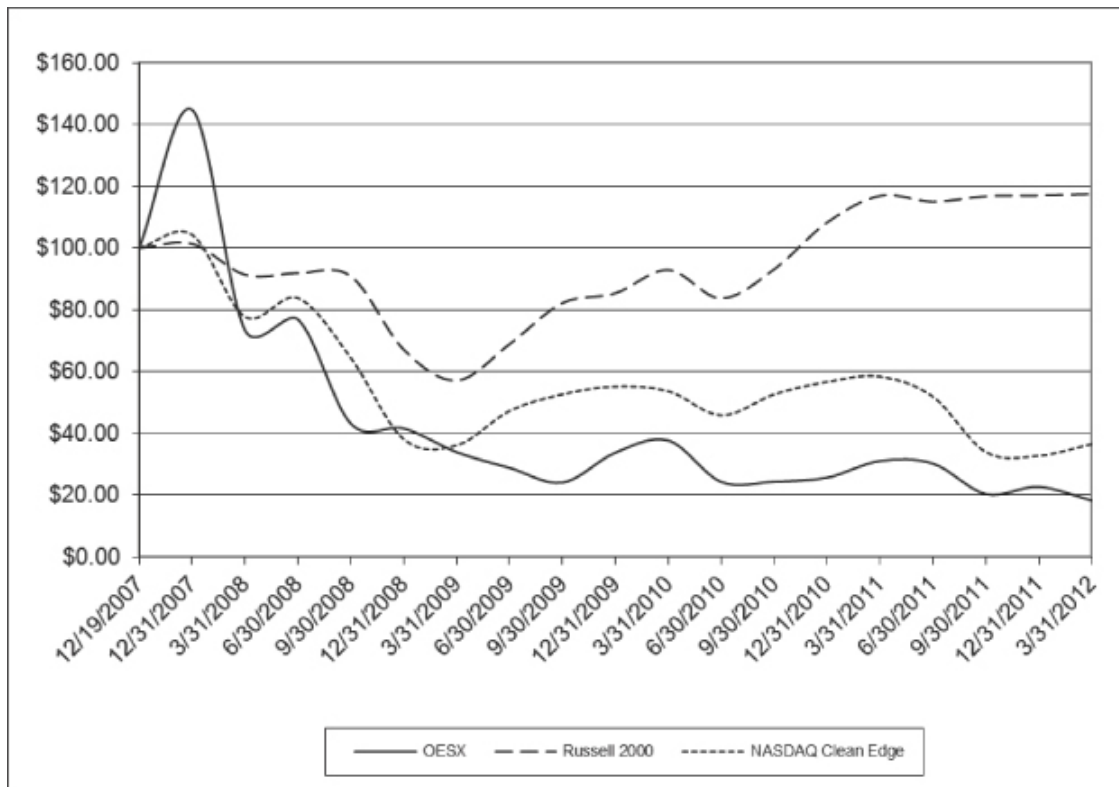
- (1) In October 2011, the Company's Board of Directors approved a share repurchase program authorizing the Company to repurchase in aggregate up to a maximum of \$1.0 million of the Company's outstanding common stock. In November 2011, the Company's Board of Directors approved an increase to the share repurchase program authorizing the Company to repurchase in aggregate up to a maximum of \$2.5 million of the Company's outstanding common stock, which was increased to a total of \$7.5 million in April 2012. Through March 31, 2012, the Company had repurchased approximately \$740,000 of its shares under this repurchase plan.
- (2) Excludes the increase of the amount of the stock repurchase program to \$7.5 million in April 2012.

## Unregistered Sales of Securities

None

## Stock Price Performance Graph

The following graph shows the total shareholder return of an investment of \$100 in cash on December 19, 2007, the date we priced our stock pursuant to our IPO, through March 31, 2012, for (1) our common stock, (2) the Russell 2000 Index and (3) The NASDAQ Clean Edge Green Energy Index. Data for the Russell 2000 Index and the NASDAQ Clean Edge Green Energy Index assume reinvestment of dividends. The stock price performance graph should not be deemed filed or incorporated by reference into any other filing made by us under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that we specifically incorporate the stock performance graph by reference in another filing.



	December 19, 2007	March 31, 2008	March 31, 2009	March 31, 2010	March 31, 2011	March 31, 2012
Orion Energy Systems, Inc.	\$ 100	\$ 73	\$ 34	\$ 38	\$ 31	\$ 18
Russell 2000 Index	\$ 100	\$ 91	\$ 57	\$ 93	\$ 117	\$ 118
NASDAQ Clean Edge Green Energy Index	\$ 100	\$ 78	\$ 36	\$ 54	\$ 58	\$ 37

**ITEM 6. SELECTED FINANCIAL DATA**

You should read the following selected consolidated financial data in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and the related notes included elsewhere in this Form 10-K. The consolidated statements of operations data for the fiscal years ended March 31, 2010, 2011 and 2012 and the consolidated balance sheet data as of March 31, 2011 and 2012 are derived from our audited consolidated financial statements included elsewhere in this Form 10-K, which have been prepared in accordance with generally accepted accounting principles in the United States. The consolidated statements of operations data for the years ended March 31, 2008 and 2009, and the consolidated balance sheet data as of March 31, 2008, 2009 and 2010 have been derived from our audited consolidated financial statements which are not included in this Form 10-K. The selected historical consolidated financial data are not necessarily indicative of future results.

	Fiscal Year Ended March 31,				
	2008	2009	2010	2011	2012
(in thousands, except per share amounts)					
<b>Consolidated statements of operations data:</b>					
Product revenue	\$65,359	\$63,008	\$60,882	\$75,870	\$ 90,782
Service revenue	<u>15,328</u>	<u>9,626</u>	<u>7,191</u>	<u>6,167</u>	<u>9,780</u>
Total revenue	80,687	72,634	68,073	82,037	100,562
Cost of product revenue(1)	42,127	42,235	40,063	49,809	62,842
Cost of service revenue	<u>10,335</u>	<u>6,801</u>	<u>5,266</u>	<u>4,589</u>	<u>7,682</u>
Total cost of revenue	<u>52,462</u>	<u>49,036</u>	<u>45,329</u>	<u>54,398</u>	<u>70,524</u>
Gross profit	28,225	23,598	22,744	27,639	30,038
General and administrative expenses(1)	10,200	10,451	12,836	11,686	11,399
Sales and marketing expenses(1)	8,832	11,261	12,596	13,674	15,599
Research and development expenses(1)	<u>1,832</u>	<u>1,942</u>	<u>1,891</u>	<u>2,333</u>	<u>2,518</u>
Income (loss) from operations	7,361	(56)	(4,579)	(54)	522
Interest expense	1,390	167	256	406	551
Gain (loss) on sale of receivables	—	—	(561)	(1,012)	32
Extinguishment of debt	—	—	250	—	—
Dividend and interest income	<u>1,189</u>	<u>1,661</u>	<u>670</u>	<u>571</u>	<u>850</u>
Income (loss) before income tax	7,160	1,438	(4,476)	(901)	853
Income tax expense (benefit)	<u>2,750</u>	<u>927</u>	<u>(1,003)</u>	<u>(1,242)</u>	<u>370</u>
Net income (loss)	4,410	511	(3,473)	341	483
Accretion of redeemable preferred stock and preferred stock dividends(2)	(225)	—	—	—	—
Participation rights of preferred stock in undistributed earnings(3)	<u>(775)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Net income (loss) attributable to common shareholders	<u>\$ 3,410</u>	<u>\$ 511</u>	<u>\$ (3,473)</u>	<u>\$ 341</u>	<u>\$ 483</u>
Net income (loss) per share attributable to common shareholders:					
Basic	\$ 0.22	\$ 0.02	\$ (0.16)	\$ 0.02	\$ 0.02
Diluted	\$ 0.19	\$ 0.02	\$ (0.16)	\$ 0.01	\$ 0.02
Weighted-average shares outstanding:					
Basic	15,548	25,352	21,844	22,678	22,953
Diluted	23,454	27,445	21,844	23,198	23,387

- (1) Includes stock-based compensation expense recognized under Financial Accounting Standards Board Accounting Standards Codification Topic 718, or ASC Topic 718, as follows:

	Fiscal Year Ended March 31,		
	2010	2011	2012
	(in thousands)		
Cost of product revenue	\$ 222	\$ 187	\$ 189
General and administrative expenses	539	560	548
Sales and marketing expenses	691	523	501
Research and development expenses	39	31	29
Total stock-based compensation expense	<u>\$1,491</u>	<u>\$1,301</u>	<u>\$1,267</u>

- (2) For fiscal 2008, represents the impact attributable to the accretion of accumulated dividends on our Series C preferred stock, plus accumulated dividends on our Series A preferred stock prior to its conversion into common stock on March 31, 2007.
- (3) For fiscal 2008, represents the impact attributable to the accretion of accumulated dividends on our Series C preferred stock, plus accumulated dividends on our Series A preferred stock prior to its conversion into common stock on March 31, 2007.

	As of March 31,				
	2008	2009	2010	2011	2012
	(in thousands)				
<b>Consolidated balance sheet data:</b>					
Cash and cash equivalents	\$ 78,312	\$ 36,163	\$ 23,364	\$ 11,560	\$ 23,011
Short-term investments	2,404	6,490	1,000	1,011	1,016
Total assets	130,702	103,722	104,578	121,087	125,650
Long-term debt, less current maturities	4,473	3,647	3,156	4,225	6,704
Shareholder notes receivable	—	—	—	(193)	(221)
Shareholders' equity	\$113,190	\$ 88,695	\$ 88,387	\$ 90,455	\$ 92,769

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with our consolidated financial statements and related notes, included elsewhere in this Annual Report on Form 10-K. See also "Forward-Looking Statements" and Item 1A. "Risk Factors".

### 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 currently generate a majority of our revenue from sales of high intensity fluorescent, or HIF, lighting systems and related services to commercial and industrial customers. We typically sell our HIF lighting systems in replacement of our customers' existing high intensity discharge, or HID, fixtures. We call this replacement process a "retrofit." We frequently engage our customer's existing electrical contractor to provide installation and project management services. We also sell our HIF lighting systems on a wholesale basis, principally to electrical contractors and value-added resellers to sell to their own customer bases.

We have sold and installed more than 2.3 million of our HIF lighting systems in more than 7,900 facilities from December 1, 2001 through March 31, 2012. 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 fiscal years which ended on March 31, 2010, 2011 and 2012, "fiscal 2010," "fiscal 2011" and "fiscal 2012," respectively. Our fiscal first quarter ends on June 30, our fiscal second quarter ends on September 30, our fiscal third quarter ends on December 31 and our fiscal fourth quarter ends on March 31.

Because of the recessed state of the global economy since 2009, especially as it impacts capital equipment manufacturers, our results for fiscal 2012 continued to be impacted 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.

In response to the constraints on our customers' capital spending budgets, we have more aggressively promoted 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 with immediate availability for the purpose of funding OTA projects upon the project completion and customer acceptance, for which we chose to hold the contracts internally. We now have secured multiple funding sources for our OTA projects. We expect that the number of customers who choose to purchase our systems by using our OTA financing program will continue to 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 near-term and long-term financial performance. Our near-term optimism is based upon our record level of revenue in fiscal 2012 along with our return to profitability, our strong backlog of orders entering fiscal 2013, our fiscal 2012 investments into revenue generation, specifically the creation of our call center, the establishment of a sales office and staff in Texas and the headcount additions to our retail sales force, the completion of financing arrangements providing multiple capital sources to grow our OTA program and the increasing volume of unit sales of our new products, specifically our exterior HIF fixtures. 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, the opportunity for recurring revenue from the replacement parts aftermarket and the opportunity to increase gross margins through the leverage of our under-utilized manufacturing capacity.

In August 2009, we created our engineered systems division, which has been offering our customers additional alternative renewable energy systems. In fiscal 2010, we sold and installed three solar photovoltaic, or PV, electricity generating projects, completing our test analysis on two of the three in the fiscal 2010 third quarter, and executed our first cash sale and our first Power Purchase Agreement, or PPA, as a result of the successful testing of these systems. We completed the installation and customer acceptance of the third system, a cash sale, during our fiscal 2011 first quarter. During our fiscal 2011 second quarter, we received an \$8.3 million cash order for a solar PV generating system for which we recognized revenue in fiscal 2012. During fiscal 2012, we recorded \$51.6 million in new contracted revenues across 19 contracts.

During our fiscal 2011 third quarter, we introduced the presentation of operating segments. We now report our energy management and engineered systems groups as separate segments. Our energy management division develops, manufactures, integrates and sells commercial high intensity fluorescent, or HIF, lighting systems and energy management systems. Our engineered systems division sells and integrates alternative renewable energy systems.

## 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 our partner network and through wholesale sales to electrical contractors and value-added resellers. We currently generate the substantial majority of our revenue from sales of HIF lighting systems and related services to commercial and industrial customers. While our services include comprehensive site assessment, site field verification, utility incentive and government subsidy management, engineering design, project management, installation and recycling in connection with our retrofit installations, we separately recognize service revenue only for our installation and recycling services. Our service revenues are recognized when services are complete and customer acceptance has been received. In fiscal 2010 and fiscal 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 43%, 54% and 64% of our total revenue volume in fiscal 2010, fiscal 2011 and fiscal 2012, respectively, not taking into consideration our renewable technologies revenue generated through our engineered systems division. 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.

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 customers 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 an unrelated third party finance company in exchange for cash and future payments.

In fiscal 2010, we recognized \$5.5 million of revenue from 85 completed OTA contracts. In fiscal 2011, we recognized \$10.7 million of revenue from 127 completed OTA contracts. In fiscal 2012, we recognized \$10.2 million of revenue from 139 completed OTA contracts. In the future, we expect an increase in the volume of OTAs as our customers take advantage of our 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 2010, we did not recognize any revenue from completed PPAs. In fiscal 2011, we recognized \$0.4 million of revenue from completed PPAs. In fiscal 2012, we recognized \$0.6 million of revenue from completed PPAs. As of March 31, 2012, we had signed one customer to two separate PPAs representing future potential discounted revenue streams of \$3.1 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 March 31, 2012 (in thousands):

Fiscal 2013	\$ 646
Fiscal 2014	536
Fiscal 2015	426
Fiscal 2016	425
Fiscal 2017	425
Beyond	623
<b>Total expected future discounted revenue from PPAs</b>	<b><u>\$3,081</u></b>

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 retrofit and multi-facility roll-out projects. Our top 10 customers accounted for approximately 29%, 31% and 44% of our total revenue for fiscal 2010, fiscal 2011 and fiscal 2012, respectively. No customer accounted for more than 10% of our total revenue in any of fiscal 2010, 2011 or 2012. To the extent that large retrofit and roll-out projects and/or large solar projects or solar roll-outs 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 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.

*Contracted Revenue.* Although “Contracted Revenue” is not a term recognized under GAAP, since the volume of our OTA and solar business is expected to continue to increase and because our OTA revenues are not recognized until project completion occurs and our solar contracts are recognized over a longer time period, we believe Contracted Revenue provides our management and investors with an informative measure of our relative order activity for any particular period. We define Contracted Revenue as the total contractual value of all firm purchase orders received for our products and services and the discounted future cash flows expected, including all renewal periods, for all OTAs upon the execution of the contract and the discounted value of future potential revenue from energy generation over the life of all PPAs along with the discounted value of revenue for renewable energy credits, or RECs, for as long as the REC programs are currently defined to be in existence with the governing body. For cash Contracted Revenue for sales of our HIF lighting and energy management systems, we generally expect that we will begin to recognize GAAP revenue within 30 days from receipt of purchase order. For cash Contracted Revenue for sales of our solar PV systems, we generally expect that we will begin to recognize GAAP revenue within three to 15 months, from receipt of purchase order. For OTA Contracted Revenue, we generally expect that we will begin to recognize GAAP revenue under the terms of the agreements within 90-120 days from the firm contract date. For PPA Contracted Revenue, we generally expect that we will begin to recognize GAAP revenue under the terms of the PPAs within 180 days from the firm contract date. We believe that total Contracted Revenues are a key financial metric for evaluating and measuring our performance because the measure is an indicator of our success in our customers’ adoption and acceptance of our energy products and services as it measures firm contracted revenue value, regardless of the contract’s cash or deferred financial structure and the related different GAAP revenue recognition treatment. In fiscal 2010, total Contracted Revenue was \$73.9 million, which included \$10.0 million of expected potential gross cash flow streams associated with OTAs and \$1.7 million of potential discounted revenue streams from PPAs. In fiscal 2011, total Contracted Revenue was \$103.9 million, an increase of 41% compared to fiscal 2010, which included \$14.6 million of expected potential gross cash flow streams associated with OTAs and \$1.9 million of potential discounted revenue streams from PPAs. In fiscal 2012, total Contracted Revenue was \$122.6 million, an increase of 18% compared to fiscal 2011, which included \$8.9 million of discounted cash flow streams associated with OTAs and \$0 of potential discounted revenue streams from PPAs. A reconciliation of our Contracted Revenues to our GAAP revenues is as follows:

	<b>Fiscal Year ended March 31, 2011</b>	<b>Fiscal Year ended March 31, 2012</b>
Total Contracted Revenues	\$ 103.9	\$ 122.6
Change in backlog (1)	(15.7)	(24.5)
Solar PV change orders (2)	—	4.3
Contracted Revenue from PPAs (3)	(1.9)	—
PPA GAAP revenue recognized	0.4	0.6
Other miscellaneous (4)	(4.7)	(2.4)
Revenue – GAAP basis	<u>\$ 82.0</u>	<u>\$ 100.6</u>

- (1) Change in backlog reflects the increase in cash orders at the end of the respective period where product delivery or service performance has not yet occurred. GAAP revenue will be recognized when the performance conditions have been satisfied.
- (2) Solar PV change orders reflects the decrease in contracted revenue related to customer change orders received for solar PV systems where the customer subsequently elected to purchase solar panels directly.
- (3) Contracted Revenue from PPAs is subtracted to reconcile the GAAP revenue as recognition of GAAP revenue will occur in future periods.
- (4) Other miscellaneous includes a reduction from OTA contracted revenues measured at gross future cash flows and GAAP revenue measured at the net present value of future cash flows for completed OTA projects.

*Backlog.* We define backlog as the total contractual value of all firm orders and OTA contracts received for our lighting 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 March 31, 2011, we had a backlog of firm purchase orders of approximately \$21.2 million, which included \$17.0 million of solar PV orders. As of March 31, 2012, we had a backlog of firm purchase orders of approximately \$41.4 million, which included \$36.1 million of solar PV orders. We expect \$17.1 million of our \$36.1 million solar backlog as of March 31, 2012 to be converted into revenue during fiscal 2013. We generally expect this level of firm purchase order backlog related to HIF lighting systems to be converted into revenue within the following quarter. We generally expect our firm purchase order backlog related to solar PV systems to be recognized within the following three to 15 months, although during fiscal 2012, we received an \$18.3 million single order for which the solar PV system construction will not begin until our fiscal 2014. 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.

*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, and most of our ballast and lamp components from a single supplier, although we believe we could obtain sufficient quantities of these raw materials and components on a price and quality competitive basis from other suppliers if necessary. Purchases from our current primary supplier of ballast and lamp components constituted 26%, 22% and 14% of our total cost of revenue in fiscal 2010, fiscal 2011 and fiscal 2012, respectively. 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 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 generally have substantially lower relative gross margins than 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 fiscal 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) bad debt and 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; and (vi) other related overhead.

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

In fiscal 2010, our operating expenses increased as a result of the completion of our new technology center and the related building occupancy costs. During fiscal 2011, we invested in marketing efforts to our direct end customers and to our channel partners through increasing advertising, marketing collateral materials and participating in national industry and customer trade shows. 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 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. 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 awards granted over their related vesting period. We recognized \$1.5 million, \$1.3 million and \$1.3 million of stock-based compensation expense in fiscal 2010, fiscal 2011 and fiscal 2012, respectively. As a result of prior option grants, including option grants in fiscal 2012, we expect to recognize an additional \$3.5 million of stock-based compensation over a weighted average period of approximately seven years. 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 two to ten years.

*Loss or Gain on Sale of Receivable.* Our loss or gain on sale of receivables consists of losses or gains associated with sales of receivables from OTA contracts to a third party and the discounted value of the long-term payments associated with such sale.

*Dividend and Interest Income.* We report interest income earned from our financed OTA contracts and on our cash and cash equivalents and short term investments. For fiscal 2010, fiscal 2011 and fiscal 2012, our interest income increased as a result of the increasing OTA finance contracts completed and the related interest charged to customers.

*Income Taxes.* As of March 31, 2012, we had net operating loss carryforwards of approximately \$7.0 million for federal tax purposes and \$4.5 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 \$1.0 million and state tax credits of \$0.4 million as of March 31, 2012. A valuation allowance has been set up to fully reserve for the state tax credits due to our state apportioned income and the potential expiration of the state tax credits due to the carry forward period. These federal and state net operating losses and credit carryforwards are available, subject to the discussion in the following paragraph, to offset future taxable income and, if not utilized, will begin to expire in varying amounts between 2014 – 2030. Our valuation allowance for deferred tax assets is based upon estimates of future taxable income. It is reasonably possible that this estimate may change in the near term and this change could be material to the financial statements.

Generally, a change of more than 50% in the ownership of a company's stock, by value, over a three year period constitutes an ownership change for federal income tax purposes. An ownership change may limit a company's ability to use its net operating loss carryforwards attributable to the period prior to such change. In fiscal 2007 and prior to our IPO, past issuances and transfers of stock caused an ownership change for certain tax purposes. When certain ownership changes occur, tax laws require that a calculation be made to establish a limitation on the use of net operating loss carryforwards created in periods prior to such ownership change. 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:

	Fiscal Year Ended March 31,								
	2010			2011			2012		
	Amount	% of Revenue	Amount	% of Revenue	% Change	Amount	% of Revenue	% Change	
	(Dollars in thousands)								
Product revenue	\$60,882	89.4%	\$75,870	92.5%	24.6%	\$ 90,782	90.3%	19.7%	
Service revenue	7,191	10.6%	6,167	7.5%	(14.2)%	9,780	9.7%	58.6%	
Total revenue	68,073	100.0%	82,037	100.0%	20.5%	100,562	100.0%	22.6%	
Cost of product revenue	40,063	58.9%	49,809	60.7%	24.3%	62,842	62.5%	26.2%	
Cost of service revenue	5,266	7.7%	4,589	5.6%	(12.9)%	7,682	7.6%	67.4%	
Total cost of revenue	45,329	66.6%	54,398	66.3%	20.0%	70,524	70.1%	29.6%	
Gross profit	22,744	33.4%	27,639	33.7%	21.5%	30,038	29.9%	8.7%	
General and administrative expenses	12,836	18.8%	11,686	14.2%	(9.0)%	11,399	11.3%	(2.5)%	
Sales and marketing expenses	12,596	18.5%	13,674	16.7%	8.6%	15,599	15.5%	14.1%	
Research and development expenses	1,891	2.8%	2,333	2.9%	23.4%	2,518	2.5%	7.9%	
Income (loss) from operations	(4,579)	(6.7)%	(54)	(0.1)%	98.8%	522	0.5%	1066.7%	
Interest expense	(256)	(0.4)%	(406)	(0.5)%	(58.6)%	(551)	(0.5)%	(35.7)%	
Gain (loss) on sale of receivable	(561)	(0.8)%	(1,012)	(1.2)%	(80.4)%	32	0.0%	103.2%	
Extinguishment of debt	250	0.4%	—	0.0%	(100.0)%	—	0.0%	0.0%	
Dividend and interest income	670	1.0%	571	0.7%	(14.8)%	850	0.9%	48.9%	
Income (loss) before income tax	(4,476)	(6.6)%	(901)	(1.1)%	79.9%	853	0.9%	194.7%	
Income tax expense (benefit)	(1,003)	(1.5)%	(1,242)	(1.5)%	23.8%	370	0.4%	(129.8)%	
Net income (loss)	<u>\$ (3,473)</u>	<u>(5.1)%</u>	<u>\$ 341</u>	<u>0.4%</u>	<u>109.8%</u>	<u>\$ 483</u>	<u>0.5%</u>	<u>41.6%</u>	

## Consolidated Results

### *Fiscal 2012 Compared to Fiscal 2011*

**Revenue.** Product revenue increased from \$75.9 million for fiscal 2011 to \$90.8 million for fiscal 2012, an increase of \$14.9 million, or 19.7%. The increase in product revenue was due to an increase of \$19.8 million from our sales of solar photovoltaic, or PV, systems. Service revenue increased from \$6.2 million for fiscal 2011 to \$9.8 million for fiscal 2012, an increase of \$3.6 million, or 58.6%. The increase in service revenue was due to the related installation services resulting from the increased sales of PV systems during fiscal 2012. Our service revenue from sales of our HIF energy efficiency systems decreased as a result of the increased percentage of total revenue to our wholesale channels where services are not provided. We believe that our HIF energy efficiency business continues to be challenged by a difficult capital spending environment. Accordingly, we believe that the opportunity for our OTA financed sales will continue to increase during fiscal 2013.

**Cost of Revenue and Gross Margin.** Cost of product revenue increased from \$49.8 million for fiscal 2011 to \$62.8 million for fiscal 2012, an increase of \$13.0 million, or 26.2%. Cost of service revenue increased from \$4.6 million for fiscal 2011 to \$7.7 million for fiscal 2012, an increase of \$3.1 million, or 67.4%. Total gross margins declined to 29.9% for fiscal 2012 from 33.7% for fiscal 2011. The decrease in total gross margin in fiscal 2012 was due to the higher mix of renewables revenue which have lower gross margins than sales of our HIF energy management systems. Gross margins from the sale of our solar PV systems were 18.2% for fiscal 2012. Gross margins from the sale of our HIF energy management systems were 34.5% for fiscal 2012. The negative impact from the product mix shift was partially offset by cost containment efforts through improved production efficiencies resulting from the reengineering of our assembly process and reductions in discretionary spending.

### *Operating Expenses*

**General and Administrative.** Our general and administrative expenses decreased from \$11.7 million for fiscal 2011 to \$11.4 million for fiscal 2012, a decrease of \$0.3 million, or 2.5%. The decrease was a result of \$0.4 million in reduced legal expenses and a \$0.3 million reduction in compensation costs and other discretionary spending, offset by an increase in depreciation of \$0.4 million resulting from the new ERP system put into service at the beginning of fiscal year 2012.

**Sales and Marketing.** Our sales and marketing expenses increased from \$13.7 million for fiscal 2011 to \$15.6 million for fiscal 2012, an increase of \$1.9 million, or 14.1%. The increase was a result of our investment into the formation and staffing of our telemarketing function, the establishment and staffing of a Houston technology center, headcount additions for retail sales and in sales and project management to support the increase in our solar PV revenue during fiscal 2012.

**Research and Development.** Our research and development expenses increased from \$2.3 million for fiscal 2011 to \$2.5 million for fiscal 2012, an increase of \$0.2 million, or 7.9%. The increase in expenses for fiscal 2012 was due to increased spending on the development of new product offerings, including our LED product and energy management controls initiatives.

**Interest Expense.** Our interest expense increased from \$0.4 million for fiscal 2011 to \$0.6 million for fiscal 2012, an increase of \$0.2 million, or 35.7%. The increase in interest expense for fiscal 2012 was due to the full year impact of additional debt funding completed during fiscal 2011 and additional debt funding completed during fiscal 2012 for the purpose of financing our OTA projects.

**Gain (loss) on sale of receivables.** Our loss from the sale of receivables from our OTA contracts decreased from \$1.0 million for fiscal 2011 to a gain from the sale of receivables of \$32,000 for fiscal 2012. Due to the establishment of multiple financing arrangements for OTAs during fiscal 2011 and 2012, in future periods, we do not expect to sell OTA contracts at significant losses similar to fiscal 2011.

**Dividend and Interest Income.** Our interest income increased from \$0.6 million for fiscal 2011 to \$0.9 million for fiscal 2012, an increase of \$0.3 million, or 48.9%. Interest income earned from customer financed programs was \$0.8 million in fiscal 2012 compared to \$0.5 million in fiscal 2011. Interest income related to investments in fiscal 2012 was \$0.1 million and increased slightly from the prior year as a result of higher cash balances.

**Income Taxes.** Our income taxes increased from a benefit of \$1.2 million for fiscal year 2011 to income tax expense of \$0.4 million for fiscal 2012. Our effective income tax rate for the fiscal year 2011 was a benefit rate of 137.8%, compared to an income tax rate of 43.3% for the fiscal year 2012. During the fourth quarter of fiscal 2011, we converted almost all of our existing incentive stock options, or ISOs, to non-qualified stock options, or NQSOs. This conversion was applied retrospectively allowing us to benefit from \$0.6 million of income tax expense related to non-deductible ISO stock compensation expense that was previously deferred for income tax purposes. The conversion reduced our effective tax rate for the full fiscal year to a benefit rate of 137.8% from a pre-conversion income tax expense rate of 69.8%. The conversion of ISOs to NQSOs greatly reduced the effective tax rate volatility that we have historically experienced at nominal pre-tax earnings levels. The change in tax rate versus the prior fiscal year is due to the difference between taxable losses during fiscal 2011 and the related impact of the non-deductible stock compensation expense and taxable income during fiscal 2012, along with the impact of federal credits available to us.

**Contracted Revenue.** Total contracted revenue increased from \$103.9 million for fiscal 2011 (which included \$1.9 million of future potential revenue streams associated with PPAs) to \$122.6 million for fiscal 2012 (which included \$0 of future potential revenue streams associated with PPAs), an increase of \$18.7 million, or 18%. We attribute this improvement in contracted revenue to an increase in orders for renewable technologies through our engineered systems division.

#### **Fiscal 2011 Compared to Fiscal 2010**

**Revenue.** Product revenue increased from \$60.9 million for fiscal 2010 to \$75.9 million for fiscal 2011, an increase of \$15.0 million, or 24.6%. The increase in product revenue was due to \$4.2 million of revenue from sales of renewable energy photovoltaic systems, or PV, and increased revenue from the sale of energy goods and management systems through cash sales and OTA contracts. Service revenue decreased from \$7.2 million for fiscal 2010 to \$6.2 million for fiscal 2011, a decrease of \$1.0 million, or 14.2%. The decrease in service revenue was a result of the increased percentage of total revenue to our wholesale channels where services are not provided. We believe that the increase in our OTA revenues, \$10.7 million for fiscal 2011 compared to \$5.5 million for fiscal 2010, has helped to address our customers' capital spending constraints by providing an alternative to the up-front capital requirements of a cash purchase.

**Cost of Revenue and Gross Margin.** Cost of product revenue increased from \$40.1 million for fiscal 2010 to \$49.8 million for fiscal 2011, an increase of \$9.7 million, or 24.3%. Cost of service revenue decreased from \$5.3 million for fiscal 2010 to \$4.6 million for fiscal 2011, a decrease of \$0.7 million, or 12.9%. Total gross margins increased to 33.7% for fiscal 2011 from 33.4% for fiscal 2010. Gross margins from the sale of our solar PV systems were 28.9% for fiscal 2011. Gross margins from the sale of our HIF energy management systems were 34.0% for fiscal 2011. The increase in total gross margin in fiscal 2011 was due to cost containment efforts through the reduction of direct and indirect headcounts, improved production efficiencies resulting from the reengineering of our assembly process, negotiated price decreases on raw materials and reductions in discretionary spending.

#### **Operating Expenses**

**General and Administrative.** Our general and administrative expenses decreased from \$12.8 million for fiscal 2010 to \$11.7 million for fiscal 2011, a decrease of \$1.1 million, or 9.0%. The decrease was a result of \$0.5 million in reduced compensation costs resulting from headcount reductions and reduced severance payments, a \$0.2 million decrease in legal expenses, a \$0.2 million decrease in consulting and auditing services and \$0.2 million in discretionary spending reductions.

**Sales and Marketing.** Our sales and marketing expenses increased from \$12.6 million for fiscal 2010 to \$13.7 million for fiscal 2011, an increase of \$1.1 million, or 8.6%. The increase was a result \$0.5 million in increased travel costs for customer site visits, a \$0.2 million increase in compensation costs related to headcount additions during the year, a \$0.2 million in business development expenses related to our efforts to expand our partner channels, a \$0.1 million increase for advertising and marketing expenses and \$0.1 million for additional technology costs.

**Research and Development.** Our research and development expenses increased from \$1.9 million for fiscal 2010 to \$2.3 million for fiscal 2011, an increase of \$0.4 million, or 23.4%. The increase in expense for fiscal 2011 was due to increased spending on the development of new product offerings, including our new exterior lighting and our LED product initiatives. We also incurred expenses improving our existing energy management control solutions, including our recent improvements to our dynamic control devices.

**Interest Expense.** Our interest expense increased from \$0.3 million for fiscal 2010 to \$0.4 million for fiscal 2011, an increase of \$0.1 million, or 58.6%. The increase in interest expense for fiscal 2011 was due to additional debt funding completed during fiscal 2011 for the purpose of financing our OTA projects. For fiscal 2010 and fiscal 2011, we capitalized \$21,000 and \$0 of interest for construction in progress, respectively.

**Loss on sale of receivables.** Our loss from the sale of receivables from our OTA contracts increased from \$0.6 million for fiscal 2010 to \$1.0 million for fiscal 2011, an increase of \$0.4 million, or 80.4%.



**Dividend and Interest Income.** Our interest income decreased from \$0.7 million for fiscal 2010 to \$0.6 million for fiscal 2011, a decrease of \$0.1 million, or 14.8%. Interest income earned from customer financed programs was \$0.5 million in fiscal 2011 compared to \$0.4 million in fiscal 2010. Interest income related to investments in fiscal 2011 decreased by \$0.2 million as a result of less cash invested and a decrease in interest rates on our short-term investments.

**Income Taxes.** Our income tax benefit increased from a benefit of \$1.0 million for fiscal year 2010 to a benefit of \$1.2 million for fiscal 2011. Our effective income tax rate for the fiscal year 2010 was a benefit rate of 22.4%, compared to a benefit rate of 137.8% for the fiscal year 2011. During the fourth quarter of fiscal 2011, we converted almost all of our existing incentive stock options, or ISOs, to non-qualified stock options, or NQSOs. This conversion was applied retrospectively allowing us to benefit from \$0.6 million of income tax expense related to non-deductible ISO stock compensation expense that was previously deferred for income tax purposes. The conversion increased our effective tax rate for the full fiscal year to a benefit rate of 137.8% from a pre-conversion income tax benefit rate of 69.8%. The conversion of ISOs to NQSOs will greatly reduce the effective tax rate volatility that we have historically experienced at nominal pre-tax earnings levels. The change in tax rate versus the prior fiscal year is due to the difference between taxable losses during fiscal 2010 and the related impact of the non-deductible stock compensation expense and taxable income during fiscal 2011, along with the impact of federal credits available to us.

**Contracted Revenue.** Total contracted revenue increased from \$73.9 million for fiscal 2010 (which included \$10.0 million of future gross cash flow streams associated with OTAs and \$1.7 million of future potential revenue streams associated with PPAs) to \$103.9 million for fiscal 2011 (which included \$14.6 million of future gross cash flow streams associated with OTAs and \$1.9 million of future potential revenue streams associated with PPAs), an increase of \$30.0 million, or 40.6%. We attribute this improvement in contracted revenue to an increase in orders for renewable technologies through our engineered systems division and an increase in new customer OTA contracts, along with increased order activity for our integrated lighting systems from a slightly improved economic environment during the second half of fiscal 2011.

## Energy Management Segment

The following table summarizes the energy management segment operating results:

(dollars in thousands)	For the Year Ended March 31,	
	2011	2012
Revenues	\$ 77,861	\$ 72,097
Operating income	\$ 6,460	\$ 4,974
Operating Margin	8.3%	6.9%

Energy management segment revenue decreased from \$77.9 million for fiscal 2011 to \$72.1 million for fiscal 2012, a decrease of \$5.8 million, or 7.4%. The decrease was due to decreased sales of our HIF lighting systems due to capital spending constraints resulting from a challenging economic environment.

Energy Management segment operating income decreased from \$6.5 million for fiscal 2011 to \$5.0 million for fiscal 2012, a decrease of \$1.5 million, or 23.0%. The decrease in operating income for fiscal 2012 was a result of the decreased revenue and the increase in selling and marketing expense resulting from the headcount additions for our telemarketing and retail sales initiatives and the increase in our research and development spending.

## Engineered Systems Segment

The following table summarizes the engineered systems segment operating results:

(dollars in thousands)	For the Year Ended March 31,	
	2011	2012
Revenues	\$ 4,176	\$ 28,465
Operating (loss) income	\$ (1,507)	\$ 569
Operating Margin	(36.1)%	2.0%

Engineered systems segment revenue increased from \$4.2 million for fiscal 2011 to \$28.5 million for fiscal 2012, an increase of \$24.3 million, or 581.6%. The increase was due to an increase in the number of and the relative size of the renewable PV systems sold during fiscal 2012 versus the prior year.

Engineered systems segment operating (loss) income increased from a \$1.5 million loss for fiscal 2011 to \$0.6 million of operating income for fiscal 2012, an increase of \$2.1 million, or 137.8%. The increase in operating income for fiscal 2012 was a result of the increased revenue volume and resulting contribution margin from sales of solar renewable energy systems.

### Quarterly Results of Operations

The following tables present our unaudited quarterly results of operations for the last eight fiscal quarters in the period ended March 31, 2012 (i) on an absolute dollar basis (in thousands) and (ii) as a percentage of total revenue for the applicable fiscal quarter. You should read the following tables in conjunction with our consolidated financial statements and related notes contained elsewhere in this Form 10-K. In our opinion, the unaudited financial information presented below has been prepared on the same basis as our audited consolidated financial statements, and includes all adjustments, consisting only of normal recurring adjustments, that we consider necessary for a fair presentation of our operating results for the fiscal quarters presented. Operating results for any fiscal quarter are not necessarily indicative of the results for any future fiscal quarters or for a full fiscal year.

	June 30, 2010	Sept. 30, 2010	Dec. 31, 2010	For the Three Months Ended		Sept. 30, 2011	Dec. 31, 2011	Mar. 31, 2012
				Mar. 31, 2011	June 30, 2011			
	(in thousands, unaudited)							
Product revenue	\$15,758	\$15,086	\$21,633	\$23,393	\$17,361	\$30,111	\$24,274	\$19,036
Service revenue	1,219	767	2,011	2,170	860	3,364	3,132	2,424
Total revenue	16,977	15,853	23,644	25,563	18,221	33,475	27,406	21,460
Cost of product revenue	10,307	9,745	14,134	15,623	11,592	21,447	17,445	12,358
Cost of service revenue	917	498	1,676	1,498	622	2,647	2,447	1,966
Total cost of revenue	11,224	10,243	15,810	17,121	12,214	24,094	19,892	14,324
Gross profit	5,753	5,610	7,834	8,442	6,007	9,381	7,514	7,136
General and administrative expenses	2,945	2,988	2,709	3,044	3,075	2,748	2,848	2,728
Sales and marketing expenses	3,590	3,299	3,235	3,550	3,775	3,728	4,054	4,042
Research and development expenses	610	573	614	536	622	597	552	747
Income (loss) from operations	(1,392)	(1,250)	1,276	1,312	(1,465)	2,308	60	(381)
Interest expense	70	55	98	183	87	150	160	154
(Loss) gain on sale of asset	—	—	—	(1,012)	—	26	4	2
Interest income	93	153	189	136	154	214	226	256
Income (loss) before income tax	(1,369)	(1,152)	1,367	253	(1,398)	2,398	130	(277)
Income tax expense (benefit)	(833)	(1,692)	1,549	(266)	(606)	1,040	56	(120)
Net income (loss)	\$ (536)	\$ 540	\$ (182)	\$ 519	\$ (792)	\$ 1,358	\$ 74	\$ (157)

	June 30, 2010	Sept. 30, 2010	Dec. 31, 2010	Mar. 31, 2011	June 30, 2011	Sept. 30, 2011	Dec. 31, 2011	Mar. 31, 2012
Product revenue	92.8%	95.2%	91.5%	91.5%	95.3%	90.0%	88.6%	88.7%
Service revenue	7.2%	4.8%	8.5%	8.5%	4.7%	10.0%	11.4%	11.3%
Total revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100%
Cost of product revenue	60.7%	61.5%	59.8%	61.1%	63.6%	64.1%	63.7%	57.6%
Cost of service revenue	5.4%	3.1%	7.1%	5.9%	3.4%	7.9%	8.9%	9.1%
Total cost of revenue	66.1%	64.6%	66.9%	67.0%	67.0%	72.0%	72.6%	66.7%
Gross margin	33.9%	35.4%	33.1%	33.0%	33.0%	28.0%	27.4%	33.3%
General and administrative expenses	17.3%	18.9%	11.5%	11.9%	16.9%	8.2%	10.4%	12.7%
Sales and marketing expenses	21.2%	20.8%	13.6%	13.9%	20.7%	11.1%	14.8%	18.8%
Research and development expenses	3.6%	3.6%	2.6%	2.1%	3.4%	1.8%	2.0%	3.6%
Income (loss) from operations	(8.2)%	(7.9)%	5.4%	5.1%	(8.0)%	6.9%	0.2%	(1.8)%
Interest expense	0.4%	0.3%	0.4%	0.7%	0.5%	0.4%	0.5%	0.7%
(Loss) gain on sale of asset	0.0%	0.0%	0.0%	(3.9)%	0.0%	0.1%	0.0%	0.0%
Interest income	0.5%	(0.9)%	0.8%	0.5%	0.8%	0.6%	0.8%	1.2%
Income (loss) before income tax	(8.1)%	(7.3)%	5.8%	1.0%	(7.7)%	7.2%	0.5%	(1.3)%
Income tax expense (benefit)	(4.9)%	(10.7)%	6.6%	(1.0)%	(3.4)%	3.1%	0.2%	(0.6)%
Net income (loss)	(3.2)%	3.4%	(0.8)%	2.0%	(4.3)%	4.1%	0.3%	(0.7)%

Our total revenue can fluctuate from quarter to quarter depending on the purchasing decisions of our customers and our overall level of sales activity. Historically, our energy management customers have tended to increase their purchases near the beginning or end of their capital budget cycles, which tend to correspond to the beginning or end of the calendar year. As a result, we have in the past experienced lower relative total revenue in our fiscal first and second quarters and higher relative total revenue in our fiscal third quarter. These seasonal fluctuations have been largely offset by our customers' decisions to initiate multiple facility roll-outs. Our more recent engineered systems solar revenues have resulted in higher total revenue during our fiscal second and third quarters due to construction seasons and system installation progress occurring during those periods. We expect that there may be future variations in our quarterly total revenue depending on our level of national account roll-out projects, wholesale sales and the size and geographic locations of our PV solar systems projects. Our results for any particular fiscal quarter may not be indicative of results for other fiscal quarters or an entire fiscal year.

## **Liquidity and Capital Resources**

### **Overview**

We had approximately \$23.0 million in cash and cash equivalents and \$1.0 million in short-term investments as of March 31, 2012 compared to \$11.6 million in cash and cash equivalents and \$1.0 million in short-term investments as of March 31, 2011. Our cash equivalents are invested in money market accounts and bank certificates of deposits 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 June 2012 and a yield of 0.5%.

During fiscal 2010 and fiscal 2011, we funded \$2.7 million and \$2.3 million, respectively, for our investment in company owned equipment under our PPA projects. We do not expect to use our own cash in the future to fund PPA project opportunities and are investigating financing options with third parties to fund future solar projects. We expect that our volume of OTA financed projects will continue to increase in the future and that the cash required to fund these projects will continue to increase as well. 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 with immediate availability for the purpose of funding OTA projects upon the project completion and customer acceptance, for which we choose to hold the contracts internally. We now have secured multiple funding sources for our OTA projects. In fiscal 2011, we completed two separate debt financing transactions with a regional bank to provide funding for a pool of individual OTA contracts that we hold the contracts for. We believe that having multiple funding sources for our internally held OTA contracts, as well as having multiple external sources to purchase the OTA contracts out-right, has greatly reduced the cash strain created by funding these contracts ourselves and is no longer an impediment to our ability to increase the number of OTA contracts we complete in the future.

The return to a recessionary state of the global economy could potentially have negative effects on our near-term liquidity and capital resources, including slower collections of receivables, delays of existing order deliveries and postponements of incoming orders. However, 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 with J.P. Morgan Chase Bank, N.A. will be sufficient to meet our anticipated cash needs for the next 12 months. As a result of the \$24.0 million in cash and cash equivalents as of March 31, 2012, we do not anticipate drawing on our revolving line of credit nor do we expect to use significant amounts of our cash balances for operating activities during fiscal 2013. Our future working capital requirements thereafter will depend on many factors, including our rate of revenue, our rate of OTA growth and our ability to maintain external funding for our OTA contracts, our rate of investment into our financed sales programs, our introduction of new products and services and enhancements to our existing energy management system, the timing and extent of expansions of our sales force and other administrative and production personnel, the timing and extent of advertising and promotional campaigns, and our research and development activities.

## Cash Flows

The following table summarizes our cash flows for our fiscal 2010, fiscal 2011 and fiscal 2012:

	Fiscal Year Ended March 31,		
	2010	2011	2012
	(in thousands)		
Operating activities	\$(10,718)	\$ (8,645)	\$ 11,495
Investing activities	(3,070)	(5,121)	(4,532)
Financing activities	989	1,962	4,488
Decrease in cash and cash equivalents	<u>\$(12,799)</u>	<u>\$(11,804)</u>	<u>\$ 11,451</u>

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

Cash provided by operating activities for fiscal 2012 was \$11.5 million and consisted of net cash of \$5.9 million provided from changes in working capital and net income adjusted non-cash expenses of \$5.6 million. Cash provided by working capital improvements was primarily due to the completion of contracts and a reduction in deferred project costs, improved collections of our accounts receivable and an increase in accounts payable related to payment terms on inventory purchases during the fiscal 2012 fourth quarter. These benefits were partially offset by a decrease in deferred revenue related to project completions and an increase in inventory for purchases described in the section below.

Cash used in operating activities for fiscal 2011 was \$8.6 million and consisted of net cash of \$13.8 million used for working capital purposes offset by net income adjusted for non-cash expense items of \$5.2 million. Cash used for working capital consisted of an increase of \$12.9 million in accounts receivable due to the increase in revenue and advanced customer billings, an \$8.0 million increase in deferred contract costs for material and service expenses incurred for in-process projects and a \$3.1 million increase in inventory for purchases of ballast components and wireless controls inventories. Cash provided by working capital included a \$9.7 million increase in deferred revenue for advanced customer billings and a \$4.7 million increase in accounts payable related to payment terms on inventory purchases during the fiscal 2011 fourth quarter.

Cash used in operating activities for fiscal 2010 was \$10.7 million and consisted of net cash of \$11.2 million used for working capital purposes and a net loss of \$3.5 million, offset by non-cash expense items of \$4.0 million. Cash used for working capital purposes consisted of an increase of \$4.6 million in trade receivables and a \$6.4 million increase in inventories resulting from purchases of ballast and wireless component inventories. We increased our level of inventory for these components due to longer lead times and supply availability concerns for inventory components shipping out of Asia. These amounts were offset by an increase of \$1.8 million in accrued expenses resulting from increases in accrued severance costs, increases in accrued legal expenses and increased deposit payments for OTA contracts.

*Cash Flows Related to Investing Activities.* Cash used in investing activities was \$3.1 million, \$5.1 million and \$4.5 million for fiscal 2010, 2011 and 2012, respectively. In fiscal 2012, we invested \$4.3 million for capital improvements related to our information systems, facilities, renewables and manufacturing improvements and \$0.2 million for patent investments. In fiscal 2011, we invested a net \$2.3 million in equipment related to our PPA finance programs, \$2.6 million for capital improvements related to our information technology systems, renewable technologies, manufacturing and tooling improvements and facility investments and \$0.2 million for patent investments. In fiscal 2010, we invested \$5.6 million in capital expenditures related to the completion of our new corporate technology center, operating and customer relationship software systems, a photovoltaic solar generated power system and for purchases of manufacturing equipment and tooling. Additionally, we invested \$2.7 million in equipment related to our PPA finance programs and \$0.3 million for the development of our intellectual property. We generated cash flow from investing activities of \$5.5 million from the sale of short-term investments.

*Cash Flows Related to Financing Activities.* Cash provided by financing activities was \$4.5 million for fiscal 2012. This included \$6.0 million in new debt borrowings to fund OTA projects, \$0.2 million received from stock option and warrant exercises, \$1.0 million for excess tax benefits from stock based compensation and \$0.1 million from the collection of shareholder notes. Cash flows used in financing activities included \$1.9 million for repayment of long-term debt, \$0.7 million used for common share repurchases and \$0.1 million for costs related to our new OTA credit agreement.

Cash provided by financing activities was \$2.0 million for fiscal 2011. This included \$3.7 million in new debt borrowings to fund OTA and capital projects and \$0.5 million received from stock option and warrant exercises. Cash flows used in financing activities included \$2.0 million for repayment of long-term debt, \$0.1 million for excess tax benefits from stock based compensation and \$0.1 million for costs related to the credit agreement.

Cash provided by financing activities was \$1.0 million for fiscal 2010. This included proceeds of \$2.0 million received from stock option and warrant exercises, \$0.2 million for proceeds from long-term debt and \$0.1 million for excess tax benefits from stock based compensation. Cash used in financing activities included \$0.8 million for debt principal payments and \$0.5 million used for common share repurchases.

### **Working Capital**

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 net working capital as of March 31, 2011 was \$40.0 million, consisting of \$64.2 million in current assets and \$24.2 million in current liabilities. Our current accounts receivables decreased from our prior fiscal year end by \$4.2 million as a result of increased collections and our increased revenues from our solar PV systems. Our net collection terms for solar PV sales are typically net 25 days or less versus our 30-60 day collection terms for sales of our HIF lighting and energy management systems. Our inventories increased from our fiscal 2011 year end by \$2.3 million due to an increase in the level of our fluorescent lamp inventories. During fiscal 2012, we increased our inventories of fluorescent lamps by \$2.2 million due to concerns over shortages of rare earth minerals used in the production of fluorescent lamps.

During fiscal 2011, we increased our inventory levels of key electronic components, specifically electronic ballasts, to avoid potential shortages and customer service issues as a result of lengthening supply lead times and product availability issues. We continue to monitor supply side concerns within the electronic components market and the fluorescent lamp market and believe that our current inventory levels are sufficient to protect us against the risk of being unable to deliver product as specified by our customers' requirements. We are continually monitoring supply side concerns through conversations with our key vendors and currently believe that supply availability concerns appear to have moderated, but have not diminished to the point where we anticipate reducing safety stock to the levels that existed prior to these supply issues.

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.

### **Indebtedness**

On June 30, 2010, we entered into a credit agreement, which we refer to herein as the Credit Agreement, with JP Morgan Chase Bank, N.A., whom we refer to herein as JP Morgan. The Credit Agreement replaced our former credit agreement.

The Credit Agreement provides for a revolving credit facility, which we refer to herein as the Credit Facility, that matures on June 30, 2012. We are currently working on an amendment to the Credit Facility to extend the maturity date to 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. 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 March 31, 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 and we were in compliance with all of our covenants under the Credit Agreement as of March 31, 2012.

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 photovoltaic 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.

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 or our affiliates maintain funds on deposit with JP Morgan or its affiliates above a specified amount. We met the deposit requirement to waive the unused fee as of March 31, 2012.

In addition to our Credit Facility, we also have other existing long-term indebtedness and obligations under various debt instruments, including pursuant to a bank term note, a bank first mortgage, a debenture to a community development organization, a federal block grant loan, two city industrial revolving loans, three notes for funding OTA contracts and a credit facility for the sole purpose of funding OTA contracts. As of March 31, 2012, the total amount of principal outstanding on these various obligations was \$9.5 million. These obligations have varying maturity dates between 2014 and 2024 and bear interest at annual rates of between 2.0% and 7.0%. The weighted average annual interest rate of such obligations as of March 31, 2012 was 5.8%. Based on interest rates in effect as of March 31, 2012, we expect that our total debt service payments on such obligations for fiscal 2013, including scheduled principal, lease and interest payments, but excluding any repayment of borrowings on the Credit Facility, will approximate \$3.3 million. All of these obligations are subject to security interests on our assets. Several of these obligations have covenants, such as customary financial and restrictive covenants, including maintenance of a minimum debt service coverage ratio; a minimum current ratio; quarterly rolling net income requirement; limitations on executive compensation and advances; limits on capital expenditures per year; limits on distributions; and restrictions on our ability to make loans, advances, extensions of credit, investments, capital contributions, incur additional indebtedness, create liens, guaranty obligations, merge or consolidate or undergo a change in control. As of March 31, 2012, we were in compliance with all such covenants, as amended.

### Capital Spending

Over the past three fiscal years, we have made capital expenditures primarily for general corporate purposes for our corporate headquarters and technology center, production equipment and tooling and for information technology systems. Our capital expenditures totaled \$8.3 million, \$5.0 million and \$4.3 million in fiscal 2010, 2011 and 2012, respectively. We plan to incur approximately \$3.5 million to \$3.7 million in capital expenditures in fiscal 2013, excluding capital to support OTA contracts. Our capital spending plans predominantly consist of further cost improvements in our manufacturing facility, improvements to our building and headquarters, 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, or by using our available capacity under our Credit Facility.

### Contractual Obligations

Information regarding our known contractual obligations of the types described below as of March 31, 2012 is set forth in the following table:

	Payments Due By Period				
	Total	Less than 1 Year	1-3 Years (in thousands)	3-5 Years	More than 5 Years
Bank debt obligations	\$ 9,495	\$ 2,792	\$ 4,998	\$ 1,185	\$ 520
Cash interest payments on debt	1,298	476	496	106	220
Operating lease obligations	7,781	1,524	1,835	1,670	2,752
Purchase order and capital expenditure commitments(1)	18,390	13,907	4,483	—	—
<b>Total</b>	<b>\$36,964</b>	<b>\$18,699</b>	<b>\$11,812</b>	<b>\$ 2,961</b>	<b>\$ 3,492</b>

(1) Reflects non-cancellable purchase commitments in the amount of \$18.4 million for certain inventory items entered into in order to secure better pricing and ensure materials on hand.

The table of contractual obligations and commitments does not include our unrecognized tax benefits which were \$0.4 million at March 31, 2012. We have a high degree of uncertainty regarding the timing of any adjustments to these unrecognized benefits. Furthermore, we believe that any negative impact from future tax audits would result in a minimal cash liability due to our net operating loss carryforwards.

## 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 below.

*Revenue Recognition.* We recognize revenue when the following criteria have been met: there is persuasive evidence of an arrangement; 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. The majority of our revenue is recognized when products are shipped to a customer or when services are completed and acceptance provisions, if any, have been met. In certain of our contracts, we provide multiple deliverables. We record the revenue associated with each element of these arrangements by allocating the total contract revenue to each element based on their relative selling prices. In such circumstances, we use a hierarchy to determine the selling price to be used for allocating revenue to deliverables: (1) vendor-specific objective evidence, or "VSOE, of fair value, if available, (2) third-party evidence, or "TPE" of selling price if VSOE is not available, and (3) best estimate of the selling price if neither VSOE nor TPE is available. We established VSOE of selling price for our HIF lighting and energy management system products using the price charged for a deliverable when sold separately. We determine the selling price for installation and recycling services and for solar renewable product and services using management's best estimate of selling price. We consider external and internal factors including, but not limited to, pricing practices, margin objectives, competition, geographies in which we offer our products and services, internal costs, and the scope and size of projects. Our PPA contracts are supply side agreements for the generation of electricity for which we recognize revenue on a monthly basis over the life of the PPA contract, typically in excess of 10 years. For sales of our solar PV systems, we recognize revenue using the percentage-of-completion method by measuring project progress by the percentage of costs incurred to date of the total estimated costs for each contract as materials are installed. Revenue from sales of our solar PV systems is generally recognized over a period of three to 15 months. Additionally, we offer our OTA sales-type financing program under which we finance the customer's purchase of our energy management systems. Our OTA contracts are sales-type capital leases under GAAP and we record revenue at the net 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. 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 an unrelated third party finance company in exchange for cash and future payments.

Deferred revenue or deferred costs are recorded for project sales consisting of multiple elements or performance milestones, where the criteria for revenue recognition has not been met. The majority of our deferred revenue relates to advance customer billings for solar PV projects or to prepaid services to be provided at determined future dates. As of March 31, 2011 and 2012, our deferred revenue was \$10.2 million and \$5.7 million, respectively. Deferred costs on product are recorded as a current or long-term asset dependent upon when the project completion is expected to occur. As of March 31, 2011 and 2012, our deferred costs were \$9.6 million and \$2.2 million, respectively.

**Inventories.** Inventories are stated at the lower of cost or market value and include raw materials, work in process and finished goods. Items are removed from inventory using the first-in, first-out method. Work in process inventories are comprised of raw materials that have been converted into components for final assembly. Inventory amounts include the cost to manufacture the item, such as the cost of raw materials and related freight, labor and other applied overhead costs. We review our inventory for obsolescence and marketability. If the estimated market value, which is based upon assumptions about future demand and market conditions, falls below cost, then the inventory value is reduced to its market value. Our inventory obsolescence reserves at March 31, 2011 and 2012 were \$1.3 million and \$1.5 million, respectively.

**Allowance for Doubtful Accounts.** We perform ongoing evaluations of our customers and continuously monitor collections and payments and estimate an allowance for doubtful accounts based upon the aging of the underlying receivables, our historical experience with write-offs and specific customer collection issues that we have identified. While such credit losses have historically been within our expectations, and we believe appropriate reserves have been established, we may not adequately predict future credit losses. If the financial condition of our customers were to deteriorate and result in an impairment of their ability to make payments, additional allowances might be required which would result in additional general and administrative expense in the period such determination is made. Our allowance for doubtful accounts was \$0.8 million and \$0.9 million at March 31, 2011 and March 31, 2012, respectively.

**Investments.** Our accounting and disclosures for short-term investments are in accordance with the requirements of the Fair Value Measurements and Disclosure, Financial Instrument, and Investments: Debt and Security Topics of the FASB Accounting Standards Codification. The Fair Value Measurements and Disclosure Topic defines fair value, establishes a framework for measuring fair value under GAAP and requires certain disclosures about fair value measurements. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value 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 — Quoted prices in active markets for identical assets or liabilities.
- Level 2 — Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

As of March 31, 2011 and 2012, our financial assets were measured at fair value employing level 1 inputs.

**Stock-Based Compensation.** We have historically issued stock options to our employees, executive officers and directors. We adopted the provisions of ASC 718, *Compensation – Stock Compensation*, which requires us to expense the estimated fair value of employee stock options and similar awards based on the fair value of the award on the date of grant. Compensation costs for options granted are recognized in earnings, net of estimated forfeitures, on a straight-line basis over the requisite service period.

The fair value of each option for financial reporting purposes was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions used for grants:

	Fiscal Year Ended March 31,		
	2010	2011	2012
Weighted average expected term	6.6 years	5.7 years	5.7 years
Risk-free interest rate	2.68%	2.14%	1.46%
Expected volatility	60.0%	60.0% – 74.8%	70.0%
Expected forfeiture rate	3.0%	11.4%	15.1%



The Black-Scholes option-pricing model requires the use of certain assumptions, including fair value, expected term, risk-free interest rate, expected volatility, expected dividends, and expected forfeiture rate to calculate the fair value of stock-based payment awards.

We estimated the expected term of our stock options based on the vesting term of our options and expected exercise behavior.

Our risk-free interest rate was based on the implied yield available on United States treasury zero-coupon issues as of the option grant date with a remaining term approximately equal to the expected life of the option.

For fiscal 2010, we determined volatility based on an analysis of a peer group of public companies due to a limited history of trading of our common stock. For fiscal 2011 and fiscal 2012, we determined volatility based upon the volatility of our common share price as we determined that we now had sufficient information regarding the trading volatility of our common stock.

As required by our 2004 Stock and Incentive Awards Plan, since the closing of our IPO in December 2007, we have solely used the closing sale price of our common shares on the NYSE MKT or the NASDAQ Global Market on the date of grant to establish the exercise price of our stock options.

We recognized stock-based compensation expense under ASC 718 of \$1.5 million for fiscal 2010, \$1.3 million for fiscal 2011 and \$1.3 million for fiscal 2012. As of March 31, 2012, \$3.5 million of total stock option compensation cost was expected to be recognized by us over a weighted average period of 6.6 years. We expect to recognize \$1.2 million of stock-based compensation expense in fiscal 2013 based on our stock options outstanding as of March 31, 2012. This expense will increase further to the extent we have granted, or will grant, additional stock options in the future.

*Common Stock Warrants.* As of March 31, 2012, warrants were outstanding to purchase a total of 38,980 shares of our common stock at weighted average exercise prices of \$2.25 per share. These warrants were valued using a Black-Scholes option pricing model with the following assumptions: (i) contractual terms of five years; (ii) weighted average risk-free interest rates of 4.35% to 4.62%; (iii) expected volatility ranging between 50% and 60%; and (iv) dividend yields of 0%.

*Accounting for Income Taxes.* As part of the process of preparing our consolidated financial statements, we are required to determine our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax expenses, together with assessing temporary differences resulting from recognition of items for income tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe that recovery is not likely, establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must reflect this increase as an expense within the tax provision in our statements of operations.

Our judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities, and any valuation allowance recorded against our net deferred tax assets. We continue to monitor the realizability of our deferred tax assets and adjust the valuation allowance accordingly. For fiscal 2012, we determined that a valuation allowance against our net state deferred tax assets was necessary in the amount of \$428,000 due to our state apportioned income and the potential expiration of state tax credits due to the carryforward periods. In making this determination, we considered all available positive and negative evidence, including projected future taxable income, tax planning strategies, recent financial performance and ownership changes.

We believe that past issuances and transfers of our stock caused an ownership change in fiscal 2007 that affected the timing of the use of our net operating loss carryforwards, but we do not believe the ownership change affects the use of the full amount of the net operating loss carryforwards. As a result, our ability to use our net operating loss carryforwards attributable to the period prior to such ownership change to offset taxable income will be subject to limitations in a particular year, which could potentially result in increased future tax liability for us.

As of March 31, 2012, we had net operating loss carryforwards of approximately \$7.0 million for federal tax purposes and \$4.5 million for state tax purposes. Included in these loss carryforwards were \$3.2 million for federal and \$2.1 million for state tax expenses that were associated with the exercise of non-qualified 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 first recognize tax benefits from current period stock option expenses against current period income. The remaining current period income is offset by net operating losses under the tax law ordering approach. Under this approach, we will utilize the net operating losses from stock option expenses last.

We also had federal tax credit carryforwards of \$1.0 million and state tax credit carryforwards of \$0, which is net of a \$428,000 valuation allowance. Both the net operating losses and tax credit carryforwards will begin to expire in varying amounts between 2014 and 2030. We recognize penalties and interest related to uncertain tax liabilities in income tax expense. Penalties and interest were immaterial as of the date of adoption and are included in unrecognized tax benefits. Due to the existence of net operating loss and credit carryforwards, all years since 2002 are open to examination by tax authorities.

By their nature, tax laws are often subject to interpretation. Further complicating matters is that in those cases where a tax position is open to interpretation, differences of opinion can result in differing conclusions as to the amount of tax benefits to be recognized under Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 740, *Income Taxes*. ASC 740 utilizes a two-step approach for evaluating tax positions. Recognition (Step 1) occurs when an enterprise concludes that a tax position, based solely on its technical merits, is more likely than not to be sustained upon examination. Measurement (Step 2) is only addressed if Step 1 has been satisfied. Under Step 2, the tax benefit is measured as the largest amount of benefit, determined on a cumulative probability basis that is more likely than not to be realized upon ultimate settlement. Consequently, the level of evidence and documentation necessary to support a position prior to being given recognition and measurement within the financial statements is a matter of judgment that depends on all available evidence. As of March 31, 2012, the balance of gross unrecognized tax benefits was approximately \$0.4 million, all of which would reduce our effective tax rate if recognized. We believe that our estimates and judgments discussed herein are reasonable, however, actual results could differ, which could result in gains or losses that could be material.

#### **Recent Accounting Pronouncements**

See Note B—Summary of Significant Accounting Policies to our accompanying audited consolidated financial statements for a full description of recent accounting pronouncements including the respective expected dates of adoption and expected effects on results of operations and financial condition.

#### **Item 7A Quantitative and Qualitative Disclosure About Market Risk**

Market risk is the risk of loss related to changes in market prices, including interest rates, foreign exchange rates and commodity pricing that may adversely impact our consolidated financial position, results of operations or cash flows.

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

*Foreign Exchange Risk.* We face minimal exposure to adverse movements in foreign currency exchange rates. Our foreign currency losses for all reporting periods have been nominal.

*Interest Rate Risk.* Our investments consist primarily of investments in money market funds and certificate of deposits. While the instruments we hold are subject to changes in the financial standing of the issuer of such securities, we do not believe that we are subject to any material risks arising from changes in interest rates, foreign currency exchange rates, commodity prices, equity prices or other market changes that affect market risk sensitive instruments. It is our policy not to enter into interest rate derivative financial instruments. As a result, we do not currently have any significant interest rate exposure.

As of March 31, 2012, \$3.7 million of our \$9.5 million of outstanding debt was at floating interest rates. An increase of 1.0% in the prime rate would result in an increase in our interest expense of approximately \$37,000 per year.

*Commodity Price Risk.* We are exposed to certain commodity price risks associated with our purchases of raw materials, most significantly our aluminum purchases. We attempt to mitigate commodity price fluctuation for our aluminum through 12- to 24-month forward fixed-price purchase orders and minimum quantity purchase commitments with suppliers. We have currently locked pricing for our aluminum requirements through the second quarter of fiscal 2013 and for our specialty reflective aluminum requirements through the end of calendar year 2012. Additionally, we recycle legacy HID fixtures and recover the salvaged scrap value which we believe provides a raw materials cost hedge as commodity prices change.

*Credit Risk.* Credit risk refers to the potential for economic loss arising from the failure of our customers to meet their contractual agreements. Our financing program, the Orion Throughput Agreements, or OTA, is an installment based payment plan for our customers. This financing program subjects us to credit risk as poor credit decisions or customer defaults could result in increases to our allowances for doubtful accounts and/or write-offs of accounts receivable and could have material adverse effects on our results of operations and financial condition. These agreements and their increased use will require us to make significant investments of capital, whether we finance them internally or raise additional debt financing and/or equity capital to support the expansion. Our ability to accurately measure and manage credit risk will be integral to the profitability of our business and our capital adequacy.

ITEM 8. INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Shareholders  
Orion Energy Systems, Inc.  
Manitowoc, Wisconsin

We have audited the accompanying consolidated balance sheets of Orion Energy Systems, Inc. as of March 31, 2012 and 2011 and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the two years then ended. In connection with our audits of the financial statements, we have also audited the financial statement schedule II, Valuation and Qualifying Accounts, for each of the two years in the period ended March 31, 2012. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements and schedule. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Orion Energy Systems, Inc. at March 31, 2012 and 2011, and the results of its operations and its cash flows for each of the two years in the period ended March 31, 2012, in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, the financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein, for each of the two years in the period ended March 31, 2012.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Orion Energy Systems, Inc. internal control over financial reporting as of March 31, 2012, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated June 14, 2012 expressed an adverse opinion thereon.

/s/ BDO USA, LLP  
Milwaukee, Wisconsin  
June 14, 2012

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders  
Orion Energy Systems, Inc.  
Manitowoc, Wisconsin

We have audited Orion Energy Systems, Inc. internal control over financial reporting as of March 31, 2012, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Orion Energy Systems, Inc.’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying “Item 9A, Management’s Report on Internal Control Over Financial Reporting”. Our responsibility is to express an opinion on the company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed 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. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company’s annual or interim financial statements will not be prevented or detected on a timely basis. Material weaknesses regarding management’s failure to design and maintain controls over revenue recognition and ineffective controls over the financial close and reporting process have been identified and described in management’s assessment. These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2012 financial statements, and this report does not affect our report dated June 14, 2012 on those financial statements.

In our opinion, Orion Energy Systems, Inc. did not maintain, in all material respects, effective internal control over financial reporting as of March 31, 2012, based on the COSO criteria.

We do not express an opinion or any other form of assurance on management’s statements referring to any corrective actions taken by the company after the date of management’s assessment.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Orion Energy Systems, Inc. as of March 31, 2012 and 2011, and the related consolidated statements of operations, shareholders’ equity, and cash flows for each of the two years in the period ended March 31, 2012 and our report dated June 14, 2012 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP  
Milwaukee, Wisconsin  
June 14, 2012

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Shareholders  
Orion Energy Systems, Inc.

We have audited the accompanying consolidated statement of operations, shareholders' equity and cash flows of Orion Energy Systems, Inc. (a Wisconsin Corporation) and subsidiaries (the "Company") for the year ended March 31, 2010. Our audit of the basic financial statements includes the financial statement schedule as of March 31, 2010, listed in the index appearing under item 15(b). These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the operations and cash flows of Orion Energy System, Inc. and subsidiaries for the year ended March 31, 2010, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule as of March 31, 2010, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ Grant Thornton LLP  
Milwaukee, Wisconsin  
July 22, 2011 (except for Note I, as to which the date is June 14, 2012)

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

	March 31,	
	2011	2012
<b>Assets</b>		
Cash and cash equivalents	\$ 11,560	\$ 23,011
Short-term investments	1,011	1,016
Accounts receivable, net of allowances of \$757 and \$947	23,401	19,167
Inventories, net	15,877	18,132
Deferred contract costs	9,589	2,193
Deferred tax assets	1,049	1,549
Prepaid expenses and other current assets	1,727	2,174
Total current assets	64,214	67,242
Property and equipment, net	30,017	30,225
Long-term inventory	13,212	12,328
Patents and licenses, net	1,620	1,689
Deferred tax assets	2,354	2,609
Long-term accounts receivable	7,251	7,555
Other long-term assets	2,419	4,002
Total assets	<u>\$121,087</u>	<u>\$125,650</u>
<b>Liabilities and Shareholders' Equity</b>		
Accounts payable	\$ 12,483	\$ 14,300
Accrued expenses	2,184	3,018
Deferred revenue	8,427	2,614
Current maturities of long-term debt	1,137	2,791
Total current liabilities	24,231	22,723
Long-term debt, less current maturities	4,225	6,704
Deferred revenue	1,777	3,048
Other long-term liabilities	399	406
Total liabilities	<u>30,632</u>	<u>32,881</u>
Commitments and contingencies (See Note F)		
Shareholders' equity:		
Preferred stock, \$0.01 par value: Shares authorized: 30,000,000 shares at March 31, 2011 and 2012; no shares issued and outstanding at March 31, 2011 and 2012	—	—
Common stock, no par value: Shares authorized: 200,000,000 at March 31, 2011 and 2012; shares issued: 30,312,758 and 30,445,479 at March 31, 2011 and 2012; shares outstanding: 22,893,803 and 22,785,258 at March 31, 2011 and 2012	—	—
Additional paid-in capital	124,132	126,753
Treasury stock: 7,431,897 common shares at March 31, 2011 and 7,660,221 at March 31, 2012	(31,708)	(32,470)
Shareholder notes receivable	(193)	(221)
Retained deficit	(1, 776)	(1,293)
Total shareholders' equity	90,455	92,769
Total liabilities and shareholders' equity	<u>\$121,087</u>	<u>\$125,650</u>



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

	Fiscal Year Ended March 31,		
	2010	2011	2012
Product revenue	\$ 60,882	\$ 75,870	\$ 90,782
Service revenue	7,191	6,167	9,780
Total revenue	68,073	82,037	100,562
Cost of product revenue	40,063	49,809	62,842
Cost of service revenue	5,266	4,589	7,682
Total cost of revenue	45,329	54,398	70,524
Gross profit	22,744	27,639	30,038
Operating expenses:			
General and administrative	12,836	11,686	11,399
Sales and marketing	12,596	13,674	15,599
Research and development	1,891	2,333	2,518
Total operating expenses	27,323	27,693	29,516
Income (loss) from operations	(4,579)	(54)	522
Other income (expense):			
Interest expense	(256)	(406)	(551)
(Loss) gain on sale of OTA contract receivables	(561)	(1,012)	32
Extinguishment of debt	250	—	—
Dividend and interest income	670	571	850
Total other income (expense)	103	(847)	331
Income (loss) before income tax	(4,476)	(901)	853
Income tax expense (benefit)	(1,003)	(1,242)	370
Net income (loss)	\$ (3,473)	\$ 341	\$ 483
Basic net income (loss) per share attributable to common shareholders	\$ (0.16)	\$ 0.02	\$ 0.02
Weighted-average common shares outstanding	21,844,150	22,678,411	22,953,037
Diluted net income (loss) per share	\$ (0.16)	\$ 0.01	\$ 0.02
Weighted-average common shares and share equivalents outstanding	21,844,150	23,198,063	23,386,525

**ORION ENERGY SYSTEMS, INC. AND SUBSIDIARIES**  
**STATEMENT OF SHAREHOLDERS' EQUITY**  
(in thousands, except share amounts)

	Shareholders' Equity						
	Common Stock		Treasury Stock	Shareholder Notes Receivable	Accumulated Other Comprehensive Loss	Retained Earnings (Deficit)	Total Shareholders' Equity
	Shares	Additional Paid-in Capital					
Balance, March 31, 2009	21,528,783	\$ 118,907	\$(31,536)	\$ —	\$ (32)	\$ 1,356	\$ 88,695
Issuance of stock and warrants for services	11,211	48	—	—	—	—	48
Exercise of stock options and warrants for cash	1,024,113	1,989	—	—	—	—	1,989
Tax benefit from exercise of stock options	—	80	—	—	—	—	80
Stock-based compensation	—	1,491	—	—	—	—	1,491
Treasury stock purchase	(121,727)	—	(475)	—	—	—	(475)
Net loss	—	—	—	—	—	(3,473)	(3,473)
Unrealized gain on short-term investments	—	—	—	—	32	—	32
Comprehensive Loss	—	—	—	—	—	—	(3,441)
Balance, March 31, 2010	22,442,380	\$ 122,515	\$(32,011)	\$ —	\$ —	\$(2,117)	\$ 88,387
Issuance of stock and warrants for services	15,475	51	—	—	—	—	51
Exercise of stock options and warrants for cash	386,080	529	—	—	—	—	529
Shares issued under Employee Stock Purchase Plan	65,776	(132)	353	(196)	—	—	25
Tax benefit from exercise of stock options	—	(132)	—	—	—	—	(132)
Collection of shareholder notes receivable	—	—	—	3	—	—	3
Stock-based compensation	—	1,301	—	—	—	—	1,301
Treasury stock purchase	(15,908)	—	(50)	—	—	—	(50)
Net income	—	—	—	—	—	341	341
Comprehensive income	—	—	—	—	—	—	341
Balance, March 31, 2011	22,893,803	\$ 124,132	\$(31,708)	\$ (193)	\$ —	\$(1,776)	\$ 90,455
Issuance of stock and warrants for services	29,308	85	—	—	—	—	85
Exercise of stock options and warrants for cash	103,413	147	—	—	—	—	147
Shares issued under Employee Stock Purchase Plan	37,034	133	(22)	(84)	—	—	27
Tax benefit from exercise of stock options	—	989	—	—	—	—	989
Collection of shareholder notes receivable	—	—	—	56	—	—	56
Stock-based compensation	—	1,267	—	—	—	—	1,267
Treasury stock purchase	(278,300)	—	(740)	—	—	—	(740)
Net income	—	—	—	—	—	483	483
Comprehensive income	—	—	—	—	—	—	483
Balance, March 31, 2012	<u>22,785,258</u>	<u>\$ 126,753</u>	<u>\$(32,470)</u>	<u>\$ (221)</u>	<u>\$ —</u>	<u>\$(1,293)</u>	<u>\$ 92,769</u>

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

	Fiscal Year Ended March 31,		
	2010	2011	2012
<b>Operating activities</b>			
Net income (loss)	\$ (3,473)	\$ 341	\$ 483
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	2,673	3,270	4,236
Stock-based compensation expense	1,491	1,301	1,267
Deferred income tax (benefit)	(1,112)	(1,184)	(755)
Loss on sale of assets	546	1,025	133
Change in bad debt expense	458	375	190
Extinguishment of debt	(139)	—	—
Other	48	51	85
Accounts receivable	(4,579)	(12,944)	3,740
Inventories	(6,409)	(3,098)	(1,371)
Prepaid expenses and other assets	(1,979)	(2,542)	(2,025)
Deferred contract costs	—	(8,036)	7,396
Deferred revenue	—	9,680	(4,542)
Accounts payable	(56)	4,722	1,817
Accrued expenses	1,813	(1,606)	841
<b>Net cash provided by (used in) operating activities</b>	<b>(10,718)</b>	<b>(8,645)</b>	<b>11,495</b>
<b>Investing activities</b>			
Purchase of property and equipment	(5,649)	(2,611)	(4,324)
Purchase of property and equipment leased to customers under PPAs	(2,651)	(2,343)	(3)
Purchase of short-term investments	—	(11)	(5)
Sale of short-term investments	5,522	—	—
Additions to patents and licenses	(299)	(157)	(224)
Proceeds from disposal of equipment	7	1	24
<b>Net cash used in investing activities</b>	<b>(3,070)</b>	<b>(5,121)</b>	<b>(4,532)</b>
<b>Financing activities</b>			
Proceeds from issuance of long-term debt	200	3,721	5,989
Proceeds from shareholder notes	—	3	56
Deferred financing and offering costs	—	(57)	(124)
Repurchase of common stock into treasury	(475)	—	(740)
Payment of long-term debt	(805)	(2,077)	(1,856)
Excess benefit for deferred taxes on stock-based compensation	80	(132)	989
Proceeds from issuance of common stock	1,989	504	174
<b>Net cash provided by financing activities</b>	<b>989</b>	<b>1,962</b>	<b>4,488</b>
Net increase (decrease) in cash and cash equivalents	(12,799)	(11,804)	11,451
Cash and cash equivalents at beginning of period	36,163	23,364	11,560
Cash and cash equivalents at end of period	<u>\$ 23,364</u>	<u>\$ 11,560</u>	<u>\$ 23,011</u>
<b>Supplemental cash flow information:</b>			
Cash paid for interest	\$ 277	\$ 368	\$ 488
Cash paid for income taxes	\$ 32	\$ 34	\$ 104
<b>Supplemental disclosure of non-cash investing and financing activities:</b>			
Shares issued from treasury for stock note receivable	\$ —	\$ 196	\$ 84
Shares surrendered into treasury for stock option exercise	\$ —	\$ 50	\$ —

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

**NOTE A — DESCRIPTION OF BUSINESS**

***Organization***

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

In August 2009, the Company created Orion Engineered Systems, a new operating division offering additional alternative renewable energy systems. The Company first introduced the presentation of operating segments for the quarter ended December 31, 2010. See Note I “Segment Reporting” of these financial statements for further discussion of our reportable segments.

The corporate offices and manufacturing operations are located in Manitowoc, Wisconsin and an operations facility occupied by Orion Engineered Systems is located in Plymouth, Wisconsin. The company leases office space for sales offices located in New Jersey and Texas.

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

***Principles of Consolidation***

The 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.

***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. It is reasonably possible that this estimate may change in the near term and this change could be material to the financial statements.

***Cash and cash equivalents***

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

### Short-term investments available for sale

The amortized cost and fair value of short-term investments, with gross unrealized gains and losses, as of March 31, 2011 and 2012 were as follows (in thousands):

	March 31, 2011					
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Short-Term Investments
Money market funds	\$ 485	\$ —	\$ —	\$ 485	\$ 485	\$ —
Bank certificates of deposit	1,011	—	—	1,011	—	1,011
Total	<u>\$ 1,496</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1,496</u>	<u>\$ 485</u>	<u>\$ 1,011</u>

	March 31, 2012					
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Short-Term Investments
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>

As of March 31, 2011 and 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).

The Company's certificate of deposit is pledged as security for an equipment lease.

### Fair value of financial instruments

The Company's financial instruments consist of cash, 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. 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.

### 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 sold sales-type leases and lease balances included in accounts receivable are as follows:

Age Analysis as of March 31, 2011 (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	\$ 1,190	\$ 17	\$ 5	\$ 22	\$ 1,212
Lease balances included in consolidated accounts receivable—long-term	3,696	—	—	—	3,696
Total gross sales-type leases	4,886	17	5	22	4,908
Allowance	—	—	(2)	(2)	(2)
Total net sales type leases	<u>\$ 4,886</u>	<u>\$ 17</u>	<u>\$ 3</u>	<u>\$ 20</u>	<u>\$ 4,906</u>

Age Analysis as of March 31, 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	\$ 2,833	\$ 40	\$ 20	\$ 60	\$ 2,893
Lease balances included in consolidated accounts receivable - long-term	5,521	—	—	—	5,521
Total gross sales-type leases	8,354	40	20	60	8,414
Allowance	—	(4)	(20)	(24)	(24)
Total net sales type leases	<u>\$ 8,354</u>	<u>\$ 36</u>	<u>\$ —</u>	<u>\$ 36</u>	<u>\$ 8,390</u>

Allowance for credit losses on finance 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 our customers and an analysis of historical bad debts and other adjustments. If there is a deterioration of a major customer's credit worthiness or 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's provision write-off's and credit losses against the OTA sales-lease receivable balances in fiscal 2011 and fiscal 2012, respectively, was as follows:

March 31,		Balance at beginning of period	Provisions charged to expense (in Thousands)	Write offs and other	Balance at end of period
2011	Allowance for Doubtful Accounts on finance receivables	\$ 0	\$ 2	\$ 0	\$ 2
2012	Allowance for Doubtful Accounts on finance receivables	\$ 2	\$ 81	\$ 59	\$ 24

## **Inventories**

Inventories consist of raw materials and components, such as ballasts, metal sheet and coil stock and molded parts; work in process inventories, such as frames and reflectors; and finished goods, including completed fixtures or systems, 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, 2011 and 2012, the Company had inventory obsolescence reserves of \$1.3 million and \$1.5 million.

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

Inventories were comprised of the following (in thousands):

	<u>March 31,</u> <u>2011</u>	<u>March 31,</u> <u>2012</u>
Raw materials and components	\$ 12,005	\$ 10,466
Work in process	459	969
Finished goods	3,413	6,697
	<u>\$ 15,877</u>	<u>\$ 18,132</u>

## **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 \$9.6 million and \$2.2 million as of March 31, 2011 and March 31, 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, prepaid taxes and miscellaneous receivables.

## **Property and Equipment**

Property and equipment are stated at cost. Expenditures for additions and improvements are capitalized, while replacements, maintenance and repairs which do not improve or extend the lives of the respective assets are expensed as incurred. Properties sold, or otherwise disposed of, are removed from the property accounts, with gains or losses on disposal credited or charged to income from operations.

The Company periodically reviews the carrying values of property and equipment for impairment in accordance with ASC 360, *Property, Plant and Equipment*, if events or changes in circumstances indicate that the assets may be impaired. The estimated future undiscounted cash flows expected to result from the use of the assets and their eventual disposition are compared to the assets' carrying amount to determine if a write down to market value is required. No write downs were recorded in fiscal 2010, 2011 or 2012.

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

	March 31,	
	2011	2012
Land and land improvements	\$ 1,474	\$ 1,545
Buildings	15,104	14,717
Furniture, fixtures and office equipment	8,323	11,000
Leasehold improvements	9	54
Equipment leased to customers under Power Purchase Agreements	4,994	4,997
Plant equipment	8,067	9,990
Construction in progress	2,272	1,080
	40,243	43,383
Less: accumulated depreciation and amortization	(10,226)	(13,158)
Net property and equipment	<u>\$ 30,017</u>	<u>\$ 30,225</u>

The Company has no equipment under capital leases.

Depreciation is provided over the estimated useful lives of the respective assets using the straight-line method. The Company recorded depreciation expense of \$2.6 million, \$2.7 million and \$4.0 million for the years ended March 31, 2010, 2011 and 2012, respectively. Depreciable lives by asset category are as follows:

Land improvements	10 – 15 years
Buildings	10 – 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

No interest was capitalized for construction in progress during fiscal 2011 or fiscal 2012.

#### **Patents and Licenses**

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

The Company capitalized \$299,000, \$157,000 and \$224,000 of costs associated with obtaining patents and licenses in fiscal 2010, 2011 and 2012, respectively. Amortization expense recorded to cost of revenue for fiscal 2010, 2011 and 2012 was \$113,000, \$127,000 and \$136,000, respectively. The costs and accumulated amortization for patents and licenses were \$2,062,000 and \$442,000 as of March 31, 2011; and \$2,262,000 and \$573,000 as of March 31, 2012. The average remaining useful life of the patents and licenses as of March 31, 2012 was approximately 12.0 years.

As of March 31, 2012, future amortization expense of the patents and licenses is estimated to be as follows (in thousands):

Fiscal 2013	\$ 139
Fiscal 2014	139
Fiscal 2015	138
Fiscal 2016	138
Fiscal 2017	138
Thereafter	997
	<u>\$1,689</u>

The Company's management periodically reviews the carrying value of patents and licenses for impairment. No write-offs were recorded in fiscal 2010 or fiscal 2011 and \$19,000 was recorded in fiscal 2012.



### **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 March 31, 2012, the following amounts were due from the third party finance company in future periods (in thousands):

Fiscal 2013	\$ 955
Fiscal 2014	1,015
Fiscal 2015	958
Fiscal 2016	310
Fiscal 2017	9
Total gross long-term receivable	3,247
Less: amount representing interest	(521)
Net long-term receivable	<u>\$2,726</u>

### **Long-Term Inventories**

The Company records long-term inventory for the non-current portion of its wireless controls inventory. The 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 and deferred financing costs. Other long-term assets include \$55,000 and \$87,000 of deferred financing costs as of March 31, 2011 and March 31, 2012, respectively. Deferred financing costs related to debt issuances are amortized to interest expense over the life of the related debt issue (2 to 10 years). For the years ended March 31, 2010, 2011 and 2012, the amortization was \$6,000, \$29,000 and \$52,000, respectively.

### **Accrued Expenses**

Accrued expenses include warranty accruals, accrued wages, accrued vacations, accrued insurance, accrued interest, sales tax payable and other miscellaneous accruals. No accrued expenses exceeded 5% of current liabilities as of March 31, 2011 and March 31, 2012.

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

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

	<u>March 31,</u>	
	<u>2011</u>	<u>2012</u>
Beginning of year	\$ 60	\$ 59
Provision to cost of revenue	114	102
Charges	(115)	(77)
End of year	<u>\$ 59</u>	<u>\$ 84</u>

## ***Incentive Compensation***

The Company's compensation committee approved an Executive Fiscal Year 2009 Annual Cash Incentive Program under its 2004 Stock and Incentive Awards Plan which became effective as of July 30, 2008. The plan provided for performance and discretionary bonus payments ranging from 28-125% of the base salaries of the Company's named executive officers. The range of financial performance-based bonus guidelines under the approved plan began if the Company achieved a minimum of 1.125 times the prior fiscal year's revenue and/or up to 2.00 times the prior fiscal year's operating income, and correspondingly increased on a pro rata basis up to a maximum of 1.67 times those initial measures. The Company's compensation committee chose to freeze target bonus programs for fiscal 2010 at their respective fiscal 2009 levels due to the economic environment the Company was operating in. Based upon the results for the year ended March 31, 2010, the Company did not accrue any expense related to this plan.

The Company's compensation committee approved an Executive Fiscal Year 2011 Annual Cash Incentive Program under its 2004 Stock and Incentive Awards Plan which became effective as of July 21, 2010. The plan provided for performance and discretionary bonus payments ranging from 7-19% of the fiscal 2011 base salaries of the Company's named executive officers. The range of fiscal 2011 financial performance-based bonus guidelines under the approved plan began if the Company achieved a minimum of 1.2 times the fiscal 2010 revenue and a minimum of \$4.0 million operating income. Based upon the results for the year ended March 31, 2011, the Company did not accrue any expense related to this plan.

The Company's compensation committee approved an Executive Fiscal Year 2012 Annual Cash Incentive Program under its 2004 Stock and Incentive Awards Plan which became effective as of May 21, 2011. The plan provided for performance based stock option awards ranging in fair value from 13-15% of the fiscal 2012 base salaries of the Company's named executive officers. The range of fiscal 2012 financial performance-based bonus guidelines under the approved plan began if the Company achieved all of the following: a minimum of \$115.0 million in revenue, a minimum of \$4.9 million in net income and a minimum of \$4.9 million in free cash flow. Free cash flow was defined as cash flow from operations less cash flow used for the purchase of property, plant and equipment. Additionally, if the Company's performance was greater than 120% of the targets, a cash performance bonus payment was earned that would range from 12-14% of the fiscal 2012 base salaries. Based upon the results for the year ended March 31, 2012, the Company did not accrue any expense related to this plan.

## ***Revenue Recognition***

The Company offers a financing program called the Orion Throughput Agreement, or OTA, for a customer's lease of the Company's energy management systems. The OTA is structured as a sales-type lease 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, 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 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 current 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.

As discussed in "Recent Accounting Pronouncements", the Company elected to adopt the revised guidance of ASC 605-25 related to multiple-element arrangements during the quarter ended December 31, 2010. This guidance was retrospectively applied to the beginning of the Company's fiscal year. The adoption had no impact on revenue, income before taxes, net income or earnings per share.

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 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 contract is executed.

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

	<u>March 31,</u> <u>2011</u>	<u>March 31,</u> <u>2012</u>
Deferred revenue – current liability	\$ 8,427	\$ 2,614
Deferred revenue – long term liability	1,777	3,048
<b>Total deferred revenue</b>	<b><u>\$ 10,204</u></b>	<b><u>\$ 5,662</u></b>

### ***Shipping and Handling Costs***

The Company records costs incurred in connection with shipping and handling of products as cost of product revenue. Amounts billed to customers in connection with these costs are included in product revenue.

### ***Advertising***

Advertising costs of \$482,000, \$384,000 and \$117,000 for fiscal 2010, 2011 and 2012, respectively, were charged to operations as incurred.

### ***Research and Development***

The Company expenses research and development costs as incurred.

### ***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.

ASC 740 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 were immaterial as of the date of adoption 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. Realized tax benefits and (expense) from the exercise of stock options were \$80,000, \$(132,000) and \$989,000 for the fiscal years 2010, 2011 and 2012, respectively.

### ***Stock Option Plans***

The Company's share-based payments to employees are measured at fair value and are recognized in earnings, net of estimated forfeitures, on a straight-line basis over the requisite service period.

Cash flows from the exercise of stock options resulting from tax benefits in excess of recognized cumulative compensation costs (excess tax benefits) are classified as financing cash flows. For the years ended March 31, 2010, 2011 and 2012, \$80,000, \$(132,000) and \$989,000, respectively, of such excess tax benefits were classified as financing cash flows.

The Company uses the Black-Scholes option-pricing model. Prior to fiscal 2011, the Company had determined volatility based on an analysis of a peer group of public companies due to a limited share price history. In fiscal 2011 and fiscal 2012, the Company calculated volatility based upon the historical market price of its common stock. The risk-free interest rate is the rate available as of the option date on zero-coupon U.S. Government issues with a remaining term equal to the expected term of the option. The expected term is based upon the vesting term of the Company's options and expected exercise behavior. The Company has not paid dividends in the past and does not plan to pay any dividends in the foreseeable future. The Company estimates its forfeiture rate of unvested stock awards based on historical experience.

The fair value of each option grant in fiscal 2010, 2011 and 2012 was determined using the assumptions in the following table:

	Fiscal Year Ended March 31,		
	2010	2011	2012
Weighted average expected term	6.6 years	5.7 years	5.7 years
Risk-free interest rate	2.68%	2.14%	1.46%
Expected volatility	60.0%	60.0 - 74.8%	70.0%
Expected forfeiture rate	3.0%	11.4%	15.1%

### Net Income per Common Share

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

Diluted net income per common share reflects the dilution that would occur if warrants and employee stock options were exercised. In the computation of diluted net income per common share, the Company uses the "treasury stock" method for outstanding options and warrants. In addition, in computing the dilutive effect of the convertible notes, the numerator is adjusted to add back the after-tax amount of interest recognized in the period. Diluted net loss per common share is the same as basic net loss per common share for the year ended March 31, 2010, because the effects of potentially dilutive securities are anti-dilutive. The effect of net income per common share is calculated based upon the following shares (in thousands except share amounts):

	Fiscal Year Ended March 31,		
	2010	2011	2012
<b>Numerator:</b>			
Net income (loss) (in thousands)	\$ (3,473)	\$ 341	\$ 483
<b>Denominator:</b>			
Weighted-average common shares outstanding	21,844,150	22,678,411	22,953,037
Weighted-average effect of assumed conversion of stock options and warrants	—	519,652	433,488
Weighted-average common shares and common share equivalents outstanding	<u>21,844,150</u>	<u>23,198,063</u>	<u>23,386,525</u>
<b>Net income (loss) per common share:</b>			
Basic	\$ (0.16)	\$ 0.02	\$ 0.02
Diluted	\$ (0.16)	\$ 0.01	\$ 0.02

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

	March 31,		
	2010	2011	2012
Common stock options	3,546,249	3,658,768	3,697,633
Common stock warrants	76,240	38,980	38,980
Total	<u>3,622,489</u>	<u>3,697,748</u>	<u>3,736,613</u>

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

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

The Company currently depends on one supplier for a number of components necessary for its products, including ballasts and lamps. If the supply of these components were to be disrupted or terminated, or if this supplier were unable to supply the quantities of components required, the Company may have short-term difficulty in locating alternative suppliers at required volumes. Purchases from this supplier accounted for 26%, 22% and 14% of cost of revenue in fiscal 2010, 2011 and 2012, respectively.

In fiscal 2010, 2011 and 2012, there were no customers who individually accounted for greater than 10% of revenue.

As of March 31, 2011, one customer accounted for 17% of accounts receivable. As of March 31, 2012, one customer accounted for 11% and one customer accounted for 10% of accounts receivable.

### **Recent Accounting Pronouncements**

Effective April 1, 2010, the Company adopted ASU 2009-13, *Multiple-Deliverable Revenue Arrangements*, which amends ASC Subtopic 650-25 Revenue Recognition—Multiple-Element Arrangements to eliminate the requirement that all undelivered elements have vendor-specific objective evidence (“VSOE”) or third-party evidence (“TPE”) before an entity can recognize the portion of an overall arrangement fee that is attributable to items that already have been delivered. In the absence of VSOE or TPE of the standalone selling price for one or more delivered or undelivered elements in a multiple-element arrangement, entities will be required to estimate the selling prices of those elements. The overall arrangement fee will be allocated to each element (both delivered and undelivered items) based on their relative selling prices, regardless of whether those selling prices are evidenced by VSOE or TPE or are based on the entity’s estimated selling price. Additionally, the new guidance will require entities to disclose more information about their multiple-element revenue arrangements. The adoption of this ASU did not result in a material change in either the units of accounting or a change in the pattern or timing of revenue recognition. Additionally, the adoption of this ASU did not have a material impact on the Company’s consolidated financial statements.

In July 2010, the FASB issued Accounting Standards Update 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* (ASU 2010-20). ASU 2010-20 requires further disaggregated disclosures that improve financial statement users’ understanding of (1) the nature of an entity’s credit risk associated with its financing receivables and (2) the entity’s assessment of that risk in estimating its allowance for credit losses as well as changes in the allowance and the reasons for those changes. The new and amended disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The adoption of ASU 2010-20 did not have a significant impact on the Company’s consolidated financial statements.

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 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 fiscal 2010, 2011 and 2012, the Company purchased goods and services from an entity in the amounts of \$46,000, \$48,000 and \$46,000, 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.

During fiscal 2010 and 2011, the Company recorded revenue of \$29,000 and \$2,623,000 for products and services sold to an entity for which a former director of the Company was formerly the executive chairman. Included in the fiscal 2011 revenue was \$2,586,000 in revenue from OTA contracts completed during the fiscal 2011 fourth quarter. As of March 31, 2011, current and long-term accounts receivable related to OTA contracts were \$0.2 million and \$1.1 million, respectively. During fiscal 2010 and 2011, the Company purchased goods and services from the same entity in the amounts of \$30,000 and \$0. 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. The related party relationship did not exist as of March 31, 2012.

During fiscal 2010 and 2011, the Company recorded revenue of \$766,000 and \$241,000 for products and services sold to various entities affiliated or associated with an entity for which a director of the Company previously served as a member of the board of directors. The Company is not able to identify the respective amount of revenues attributable to specifically identifiable entities within such group of affiliated or associated entities or the extent to which any such individual entities are related to the entity on whose board of directors the Company's director served. 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. The related party relationship did not exist as of March 31, 2012.

#### NOTE D — LONG-TERM DEBT

Long-term debt as of March 31, 2011 and 2012 consisted of the following (in thousands):

	March 31,	
	2011	2012
Term note	\$ 782	\$ 532
Customer equipment finance notes payable	1,793	6,568
First mortgage note payable	853	776
Debenture payable	807	765
Other long-term debt	1,127	854
Total long-term debt	5,362	9,495
Less current maturities	(1,137)	(2,791)
Long-term debt, less current maturities	<u>\$ 4,225</u>	<u>\$ 6,704</u>

#### *Revolving Credit Agreement*

On June 30, 2010, the Company entered into a new credit agreement (Credit Agreement) with JP Morgan Chase Bank, N.A. (JP Morgan), which was amended by a First Amendment on September 30, 2011. The Credit Agreement replaced the Company's former credit agreement with a different bank.

The Credit Agreement provides for a revolving credit facility (Credit Facility) that matures on June 30, 2012. The Company is currently working on an amendment to the Credit Facility to extend the maturity date to 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 amount of each issued letter of credit counting against the overall limit on borrowings under the Credit Facility. As of March 31, 2012, the Company had outstanding letters of credit totaling \$1.7 million, primarily for securing collateral requirements under equipment operating leases. The Company incurred \$61,000 of deferred financing costs related to the Credit Agreement which will be amortized over the two-year term of the Credit Agreement. There were no borrowings by the Company under the Credit Agreement as of March 31, 2012. The Company was in compliance with all of its covenants under the Credit Agreement as of March 31, 2012.

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 photovoltaic 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 satisfied as of March 31, 2012.

#### ***Customer Equipment Finance Notes Payable***

In September 2010, the Company entered into a note agreement with a financial institution that provided the Company with \$2.4 million to fund completed customer contracts under the Company's OTA finance program. In February 2011, the Company sold a portion of the OTA contracts collateralizing the note to a third party equipment finance company. Accordingly, the Company repaid \$1.3 million of the outstanding note balance and recorded a prepayment penalty of \$33,000. This note is included in the table above as customer equipment finance note payable. The note is collateralized by the OTA-related equipment and the expected future monthly payments under the supporting 17 individual OTA customer contracts. The note bears interest at 7% and matures in September 2015. The note agreement includes certain prepayment penalties and a covenant that the Company maintain at least \$5 million in cash liquidity. The Company was in compliance with all covenants in the note agreement as of March 31, 2012.

In March 2011, the Company entered into a note agreement with a financial institution that provided the Company with \$0.9 million to fund completed customer contracts under the Company's OTA finance program. This note is included in the table above as customer equipment finance note payable. The note is collateralized by the OTA-related equipment and the expected future monthly payments under the supporting three individual OTA customer contracts. The note bears interest at 7% and requires monthly payments of \$20,900 through April 2015. The note agreement includes certain prepayment penalties and a covenant that the Company maintain at least \$5 million in cash liquidity. The Company was in compliance with all covenants in the note agreement as of March 31, 2012.

In June 2011, the Company entered into a note agreement with a financial institution that provided the Company with \$2.8 million to fund completed customer contracts under the Company's OTA finance program. The note is collateralized by the OTA-related equipment and the expected future monthly payments under the supporting 46 individual OTA contracts. The note bears interest at 7.85% and matures in March 2016 and is included in the customer equipment finance notes payable line in the table above. The note agreement includes a debt service covenant with respect to the supporting OTA contracts that the aggregate amount of all remaining scheduled payments due with respect to the individual OTA contracts be not less than 1.25 to 1.0 of the remaining principal and interest payments due under the loan. As of March 31, 2012 the Company was in compliance with the debt service covenant.

In September 2011, the Company entered into a credit agreement with JP Morgan Chase Bank, N.A. (JP Morgan) that provided the Company with \$5.0 million immediately available to fund completed customer contracts under the Company's OTA finance program and an additional \$5.0 million upon the Company's achievement of meeting a trailing 12-month earnings before interest, taxes, depreciation and amortization (EBITDA) target of \$8.0 million. As of March 31, 2012, the Company had not yet achieved the trailing 12-month EBITDA target. The Company has one year from the date of the commitment to borrow under the credit agreement. During fiscal 2012, the Company borrowed \$3.2 million against the OTA credit note and repaid \$0.3 million. The borrowing is collateralized by the OTA-related equipment and the expected future monthly payments under the supporting 39 individual OTA customer contracts. The current borrowing under the credit agreement bears interest at LIBOR plus 4% and matures in December 2016. The Company incurred \$0.1 million of deferred financing costs related to the Credit Agreement which will be amortized over the repayment term of the Credit Agreement. The credit agreement includes certain financial covenants, including funded debt to EBITDA and debt service coverage ratios. The Company was in compliance with all covenants in the credit agreement as of March 31, 2012.



**Term Note**

The Company's term note requires principal and interest payments of \$25,000 per month payable through February 2014 at an interest rate of 6.9%. Amounts outstanding under the note are secured by a first security interest and first mortgage in certain long-term assets and a secondary interest in inventory and accounts receivable and a secondary general business security agreement on all assets. In addition, the agreement precludes the payment of dividends on our common stock. Amounts outstanding under the note are 75% guaranteed by the United States Department of Agriculture Rural Development Association.

**First Mortgage Note Payable**

The Company's first mortgage note payable has an interest rate of prime plus 2.25% (effective rate of 5.50% at March 31, 2012), and requires monthly payments of principal and interest of \$10,000 through September 2014. The mortgage is secured by a first mortgage on the Company's manufacturing facility. The mortgage includes certain prepayment penalties and various restrictive covenants, with which the Company was in compliance as of March 31, 2012.

**Debenture Payable**

The Company's debenture payable was issued by Certified Development Company at an effective interest rate of 6.18%. The balance is payable in monthly principal and interest payments of \$8,000 through December 2024 and is guaranteed by United States Small Business Administration 504 program. The amount due was collateralized by a second mortgage on the manufacturing facility.

**Other Long-Term Debt**

In November 2007, the Company completed a Wisconsin Community Development Block Grant with the local city government to provide financing in the amount of \$750,000 for the purpose of acquiring additional production equipment. The loan has an interest rate of 4.9% and is collateralized by the related equipment. The loan requires monthly payments of \$11,000 through December 2014.

In September 2010, the Company entered into a note agreement with the Wisconsin Department of Commerce that provided the Company with \$0.3 million to fund the Company's rooftop solar project at its Manitowoc manufacturing facility. This note is included in the table above as other long-term debt. The note is collateralized by the related solar equipment. The note allows for two years without interest accruing or principal payments due. Beginning in July 2012, the note bears interest at 2% and requires monthly payments of \$4,600. The note matures in June 2017. The note agreement requires the Company to maintain a certain number of jobs at its Manitowoc facilities during the note's duration. The Company was in compliance with all covenants in the note agreement as of March 31, 2012.

In January 2011, the Company amended its November 2007 Wisconsin Community Development Block Grant with the local city government to provide the Company with \$0.2 million to fund equipment at its Manitowoc facility. The loan is included in the table above as other long-term debt. The amendment to the loan agreement is collateralized by the related equipment. The loan bears interest at 2.1125% and requires monthly payment of \$3,600 through December 2014. The amendment to the loan agreement requires the Company to create and maintain a certain number of jobs at its Manitowoc facilities during the note's duration. The Company was in compliance with all covenants in the loan agreement as of March 31, 2012.

Other long-term debt consists of a promissory note from state government to provide working capital and equipment for the development of daylighting technologies. The note is secured by the related equipment. The loan bears interest at 2.0% and requires monthly payments of \$3,400 through November 2015.

In fiscal 2010, \$250,000 of debt was forgiven related to the creation of certain types and numbers of jobs within the lending locality.

## Aggregate Maturities

As of March 31, 2012, aggregate maturities of long-term debt were as follows (in thousands):

Fiscal 2013	\$ 2,792
Fiscal 2014	2,599
Fiscal 2015	2,399
Fiscal 2016	926
Fiscal 2017	259
Thereafter	520
	<u>\$ 9,495</u>

## NOTE E — INCOME TAXES

The total provision (benefit) for income taxes consists of the following for the fiscal years ending (in thousands):

	Fiscal Year Ended March 31,		
	2010	2011	2012
Current	\$ 109	\$ (48)	\$ 520
Deferred	(1,112)	(1,194)	(150)
	<u>\$(1,003)</u>	<u>\$(1,242)</u>	<u>\$ 370</u>
	2010	2011	2012
Federal	\$(1,348)	\$(1,294)	\$ 292
State	345	52	78
	<u>\$(1,003)</u>	<u>\$(1,242)</u>	<u>\$ 370</u>

A reconciliation of the statutory federal income tax rate and effective income tax rate is as follows:

	Fiscal Year Ended March 31,		
	2010	2011	2012
Statutory federal tax rate	(34.0)%	(34.0)%	34.0%
State taxes, net	2.6%	1.2%	9.2%
Stock-based compensation expense	5.0%	(68.0)%	0.0%
Federal tax credit	(3.5)%	(26.5)%	(11.6)%
State tax credit	(0.4)%	(3.2)%	(5.9)%
Change in valuation reserve	5.1%	12.4%	5.9%
Permanent items	0.1%	(19.7)%	10.0%
Change in tax contingency reserve	0.0%	0.1%	0.8%
Other, net	2.7%	(0.1)%	0.9%
Effective income tax rate	<u>(22.4)%</u>	<u>(137.8)%</u>	<u>43.3%</u>

The net deferred tax assets and liabilities reported in the accompanying consolidated financial statements include the following components (in thousands):

	March 31,	
	2011	2012
Inventory, accruals and reserves	\$ 1,230	\$ 1,176
Other	82	105
Deferred revenue	(263)	268
Total net current deferred tax assets and liabilities	1,049	1,549
Federal and state operating loss carryforwards	1,416	1,404
Tax credit carryforwards	1,211	1,412
Non-qualified stock options	1,540	1,870
Deferred revenue	318	448
Fixed assets	(1,753)	(2,097)
Valuation allowance	(378)	(428)
Total net long-term deferred tax assets and liabilities	<u>\$ 2,354</u>	<u>\$ 2,609</u>
Total net deferred tax assets	<u>\$ 3,403</u>	<u>\$ 4,158</u>

The Company is eligible for tax benefits associated with the excess tax deduction available for exercises of non-qualified stock options over the fair value determined at the grant date. The amount of the benefit is based upon the ultimate deduction reflected in the applicable income tax return. Benefits of \$0.1 million, \$(0.1) million and \$1.0 million were recorded in fiscal 2010, fiscal 2011 and fiscal 2012, respectively, as a reduction in taxes payable and a credit to additional paid in capital based on the amount that was utilized in the current year.

During the fourth quarter of fiscal 2011, the Company converted almost all of its existing incentive stock options, or ISOs, to non-qualified stock options, or NQSOs. This conversion was applied retrospectively, allowing the Company to benefit \$0.6 million of income tax expense related to non-deductible ISO stock compensation expense that was previously deferred for income tax purposes. The conversion reduced the effective tax rate for fiscal 2011 to a benefit rate of 137.8% from a pre-conversion income tax benefit rate of 69.8%.

As of March 31, 2012, the Company has federal net operating loss carryforwards of approximately \$7.0 million, of which \$3.2 million are associated with the exercise of non-qualified stock options that have not yet been recognized by the Company in its financial statements. The Company also has state net operating loss carryforwards of approximately \$4.5 million, of which \$2.1 million are associated with the exercise of non-qualified stock options. The benefit from the net operating losses created from these exercises will be recorded as a reduction in taxes payable and a credit to additional paid-in capital in the period in which the benefits are realized.

As of March 31, 2012, The Company also has federal tax credit carryforwards of approximately \$1.0 million and state tax credits of \$0.4 million. A valuation allowance has been set up for the state tax credits due to the state apportioned income and the potential expiration of the state tax credits due to the carry forward period. These federal and state net operating losses and credit carryforwards are available, subject to the discussion in the following paragraph, to offset future taxable income and, if not utilized, will begin to expire in varying amounts between 2014 – 2030.

Generally, a change of more than 50% in the ownership of the Company's stock, by value, over a three year period constitutes an ownership change for federal income tax purposes. As a result, the Company's ability to use its net operating loss carryforwards, attributable to the period prior to such ownership change, to offset taxable income can be subject to limitations in a particular year, which could potentially result in increased future tax liability for the Company. The Company does not believe an ownership change affects the use of the full amount of the net operating loss carryforwards. There was no limitation that occurred for fiscal 2011 or fiscal 2012.

The Company records its tax provision based on the respective tax rules and regulations for the jurisdictions in which it operates. Where the Company believes that a tax position is supportable for income tax purposes, the item is included in their income tax returns. Where treatment of a position is uncertain, a liability is recorded based upon the expected most likely outcome taking into consideration the technical merits of the position based on specific tax regulations and facts of each matter. These liabilities may be affected by changing interpretations of laws, rulings by tax authorities, or the expiration of the statute of limitations.

As of December 31, 2011, an examination of the Company's U.S. federal income tax returns for tax years 2009 to 2011 was complete. The resolution of this examination did not have a material effect on its business, financial condition, results of operations or liquidity.

State income tax returns are generally subject to examination for a period of 3 to 5 years after filing of the respective return. The state effect of any federal changes remains subject to examination by various states for a period of up to two years after formal notification to the states. The Company currently has no state income tax return positions in the process of examination, administrative appeals or litigation.

#### **Uncertain tax positions**

As of March 31, 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 any of these amounts to change in the next twelve months 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.

	<u>Fiscal Year Ended March 31,</u>		
	<u>2010</u>	<u>2011</u>	<u>2012</u>
Unrecognized tax benefits as of beginning of fiscal year	\$ 397	\$ 398	\$ 399
Decreases relating to settlements with tax authorities	—	—	—
Additions based on tax positions related to the current period positions	1	1	7
Unrecognized tax benefits as of end of fiscal year	<u>\$ 398</u>	<u>\$ 399</u>	<u>\$ 406</u>

#### **NOTE F —COMMITMENTS AND CONTINGENCIES**

##### **Operating Leases**

The Company leases vehicles and equipment under operating leases expiring at various dates through 2021. Rent expense under operating leases was \$1,385,000, \$1,810,000 and \$2,111,000 for fiscal 2010, 2011 and 2012, respectively. Total annual commitments under non-cancelable operating leases with terms in excess of one year at March 31, 2012 are as follows (in thousands):

Fiscal 2013	\$ 1,524
Fiscal 2014	924
Fiscal 2015	911
Fiscal 2016	888
Fiscal 2017	782
Thereafter	2,752
	<u>\$ 7,781</u>

##### **Purchase Commitments**

The Company enters into non-cancellable purchase commitments for certain inventory items in order to secure better pricing and ensure materials on hand and capital expenditures. As of March 31, 2012, the Company had entered into \$13.9 million of purchase commitments related to fiscal 2013 for inventory purchases.

### **Retirement Savings Plan**

The Company sponsors a tax deferred retirement savings plan that permits eligible employees to contribute varying percentages of their compensation up to the limit allowed by the Internal Revenue Service. This plan also provides for discretionary Company contributions. In fiscal 2010, 2011 and 2012, the Company made matching contributions of approximately \$12,000, \$7,000 and \$15,000, respectively.

### **Litigation**

From time to time, the Company is subject to various claims and legal proceedings arising out of the ordinary course of business. The Company is not currently subject to any material litigation.

In February and March 2008, three class action lawsuits were filed in the United States District Court for the Southern District of New York against the Company, several of its officers, all members of its then existing board of directors, and certain underwriters relating to the Company's December 2007 initial public offering (IPO). In the fourth quarter of fiscal 2010, the Company reached a preliminary agreement to settle the class action lawsuits and on January 3, 2011, the court in the Southern District of New York issued an order granting preliminary approval of the settlement. After a fairness hearing on April 14, 2011, the court approved the settlement in a final judgment and order. No shareholder appeared at the hearing to object. Accordingly, the case has concluded. Of the final settlement amount of \$3.25 million, the Company contributed \$0.49 million and the its insurer contributed \$2.76 million. The Company recorded the settlement charge in the fourth quarter of fiscal 2010.

### **NOTE G —SHAREHOLDERS' EQUITY**

#### ***Conversion of Preferred Stock Upon Completion of Initial Public Offering***

Upon completion of the Company's IPO, all preferred shares were converted into common stock. Prior to the IPO, the Company had issued various classes of preferred stock. Series B and Series C preferred stock carried terms allowing for liquidation preference, voting rights, and conversion into common stock at a one-to-one ratio upon certain qualifying exit events.

#### ***Share Repurchase Program and Treasury Stock***

In July 2008, the Company's board of directors approved a share repurchase program authorizing the Company to repurchase in the aggregate up to a maximum of \$20 million of the Company's outstanding common stock. In December 2008, the Company's board of directors supplemented the share repurchase program authorizing the Company to repurchase up to an additional \$10 million of the Company's outstanding common stock. Through January 31, 2010, the date the program was effectively terminated, the Company had repurchased 7,092,817 shares of common stock at a cost of \$29.8 million under the 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. As of March 31, 2012, the Company had repurchased 278,300 shares of common stock at a cost of \$740,000 under the program.

In fiscal 2009, the Company affected a net stock option exercise with an executive vice president. The executive surrendered 317,629 shares in lieu of a cash payment to cover the exercise price and taxes related to the stock option exercise. The shares surrendered were valued at \$4.25, the closing market price of the Company's stock on the date of exercise.

#### ***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").

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 million shares to be issued from treasury or authorized shares to satisfy employee share purchases under the ESPP. All full-time employees of the Company are eligible to be granted a non-transferable purchase right each calendar quarter to purchase directly from the Company up to \$20,000 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 during fiscal 2011 and fiscal 2012:

	<b>As of March 31, 2011</b>				
	<b>Shares Issued Under ESPP Plan</b>	<b>Closing Market Price</b>	<b>Shares Issued Under Loan Program</b>	<b>Dollar Value of Loans Issued</b>	<b>Repayment of Loans</b>
Quarter Ended September 30, 2010	40,560	\$ 3.17	38,202	\$ 121,100	\$ —
Quarter Ended December 31, 2010	12,274	3.34	10,898	36,400	844
Quarter Ended March 31, 2011	12,942	4.04	9,555	38,600	1,841
Total	<u>65,776</u>	<u>\$ 3.37</u>	<u>58,655</u>	<u>\$ 196,100</u>	<u>\$ 2,685</u>
	<b>As of March 31, 2012</b>				
	<b>Shares Issued Under ESPP Plan</b>	<b>Closing Market Price</b>	<b>Shares Issued Under Loan Program</b>	<b>Dollar Value of Loans Issued</b>	<b>Repayment of Loans</b>
Quarter Ended June 30, 2011	9,788	\$ 3.93	8,601	\$ 33,800	\$ 1,650
Quarter Ended September 30, 2011	16,753	2.65	11,265	29,850	11,101
Quarter Ended December 31, 2011	3,756	2.95	2,543	7,500	34,650
Quarter Ended March 31, 2012	6,737	2.38	5,084	12,100	8,790
Total	<u>37,034</u>	<u>\$ 2.97</u>	<u>27,493</u>	<u>\$ 83,250</u>	<u>\$ 56,191</u>

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

## NOTE H — STOCK OPTIONS 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 12,000,000 shares for issuance to key employees, consultants and directors. The Company’s board of directors approved an increase to the number of shares available under the 2004 Stock and Incentive Awards Plan of 1,500,000 shares, and such share increase was approved by the Company’s shareholders at the 2010 annual shareholders meeting and such shares are included above. The options generally vest and become exercisable ratably between one month and five years although longer vesting periods have been used in certain circumstances. Exercisability of the options granted to employees are contingent on the employees’ continued employment and non-vested options are subject to forfeiture if employment terminates for any reason. Options under the Plans have a maximum life of 10 years. In the past, the Company has granted both incentive stock options and non-qualified stock options, although in July 2008, the Company adopted a policy of thereafter only granting non-qualified stock options. Restricted stock awards have no vesting period and have been issued to certain non-employee directors 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.

The Company granted accelerated vesting stock options in May 2011 under its 2004 Stock and Incentive Awards Plan to provide an opportunity for its employees to earn long-term equity incentive awards based on the Company’s financial performance for fiscal 2012. An aggregate of 459,041 stock options were granted on the third business day following the Company’s public release of its fiscal 2011 results at an exercise price per share of \$4.19, which was the closing sale price of the Company’s Common Stock on that date. The stock options only vested, however, if the optionee remained employed and the Company was successful in achieving at least 100% of the target levels for each of the Company’s three financial metric targets for fiscal 2012, and if the Company’s stock price equaled or exceeded \$5.00 per share for at least 20 trading days during any 90-day period during the options’ ten-year term. As of March 31, 2012, the Company did not achieve 100% of all three of the financial metric targets and the options were subsequently cancelled.

In fiscal 2010, the Company granted 11,211 shares from 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 the market price as of the grant date, ranging from \$3.29 to \$5.44 per share. In fiscal 2011, the Company granted 15,475 shares from 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 the market price as of the grant date, ranging from \$2.86 to \$3.93 per share. In fiscal 2012, the Company granted 29,308 shares from 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 the market price as of the grant date, ranging from \$2.43 to \$4.19 per share.

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

	Fiscal Year Ended		
	2010	2011	2012
Cost of product revenue	\$ 222	\$ 187	\$ 189
General and administrative	539	560	548
Sales and marketing	691	523	501
Research and development	39	31	29
	<u>\$1,491</u>	<u>\$1,301</u>	<u>\$1,267</u>

The number of shares available for grant under the plans were as follows:

Available at March 31, 2009	1,070,954
Granted stock options	(888,018)
Granted shares	(11,211)
Forfeited	397,965
Available at March 31, 2010	569,690
Amendment to Plan	1,500,000
Granted stock options	(744,077)
Granted shares	(15,475)
Forfeited	267,538
Available at March 31, 2011	1,577,676
Granted stock options	(1,481,356)
Granted shares	(29,308)
Forfeited	1,339,078
Available at March 31, 2012	<u>1,406,090</u>

The following table summarizes information with respect to outstanding stock options:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Fair Value of Options Granted	Aggregate Intrinsic Value
Outstanding at March 31, 2009	3,680,945	\$ 3.40	\$ 4.25	
Granted	888,018	\$ 3.92		
Exercised	(624,749)	\$ 1.71		
Forfeited	(397,965)	\$ 4.89		
Outstanding at March 31, 2010	3,546,249	\$ 3.66	\$ 2.23	
Granted	744,077	\$ 3.57		
Exercised	(364,020)	\$ 1.30		
Forfeited	(267,538)	\$ 4.33		
Outstanding at March 31, 2011	3,658,768	\$ 3.83	\$ 2.04	
Granted	1,481,356	\$ 3.56		
Exercised	(103,413)	\$ 1.45		
Forfeited	(1,339,078)	\$ 4.18		
Outstanding at March 31, 2012	3,697,633	\$ 3.76	\$ 1.95	\$ 176,041
Exercisable at March 31, 2012	1,887,384			\$ 154,351



The following table summarizes the range of exercise prices on outstanding stock options at March 31, 2012:

	March 31, 2012				
	Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Vested	Weighted Average Exercise Price
\$0.75	10,000	3.00	0.75	10,000	0.75
1.50	20,500	1.83	1.50	20,500	1.50
2.20 – 2.25	813,646	4.42	2.21	693,146	2.21
2.41 – 2.75	570,167	8.56	2.57	105,167	2.51
2.86 – 4.32	1,270,817	8.16	3.52	324,853	3.38
4.48 – 4.76	419,932	4.11	4.54	371,132	4.51
5.34 – 6.05	389,220	6.92	5.42	204,035	5.42
9.00 – 10.04	51,000	5.87	9.00	47,200	9.00
10.14 – 11.61	152,351	6.04	10.93	111,351	10.87
	<u>3,697,633</u>	<u>6.64</u>	<u>\$ 3.76</u>	<u>1,887,384</u>	<u>\$ 3.89</u>

The aggregate intrinsic value represents the total pre-tax intrinsic value, which is calculated as the difference between the exercise price of the underlying stock options and the fair value of the Company's closing common stock price of \$2.38 as of March 30, 2012.

Unrecognized compensation cost related to non-vested common stock-based compensation as of March 31, 2012 is as follows (in thousands):

Fiscal 2013	\$1,157
Fiscal 2014	942
Fiscal 2015	646
Fiscal 2016	443
Fiscal 2017	258
Thereafter	72
	<u>\$3,518</u>
Remaining weighted average expected term	6.6 years

The Company has issued warrants to placement agents in connection with various stock offerings and services rendered. The warrants grant the holder the option to purchase common stock at specified prices for a specified period of time. There were no warrants issued in fiscal 2010, 2011 or 2012.

Outstanding warrants are comprised of the following:

	Number of Shares	Weighted Average Exercise Price
Outstanding at March 31, 2009	488,504	\$ 2.31
Issued	—	—
Exercised	(399,364)	\$ 2.30
Cancelled	(12,900)	\$ 2.30
Outstanding at March 31, 2010	76,240	\$ 2.37
Issued	—	—
Exercised	(22,060)	\$ 2.50
Cancelled	(15,200)	\$ 2.50
Outstanding at March 31, 2011	38,980	\$ 2.25
Issued	—	—
Exercised	—	—
Cancelled	—	—
Outstanding at March 31, 2012	<u>38,980</u>	<u>\$ 2.25</u>

A summary of outstanding warrants as of March 31, 2012 follows:

<u>Exercise Price</u>	<u>Number of Warrants</u>	<u>Expiration</u>
\$ 2.25	38,980	Fiscal 2015

#### NOTE I — SEGMENT DATA

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

##### **Energy Management**

The Energy Management division develops, manufactures, integrates and sells commercial high intensity fluorescent, or HIF, lighting systems and energy management systems.

##### **Engineered Systems**

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

##### **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)	<u>Revenues</u>			<u>Operating (Loss) Profit</u>		
	<u>For the year ended March 31,</u>			<u>For the year ended March 31,</u>		
	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
<b>Segments:</b>						
Energy Management	\$67,663	\$77,861	\$ 72,097	\$ 2,421	\$ 6,460	\$ 4,974
Engineered Systems	410	4,176	28,465	(1,688)	(1,507)	569
Corporate and Other	—	—	—	(5,312)	(5,007)	(5,021)
	<u>\$68,073</u>	<u>\$82,037</u>	<u>\$100,562</u>	<u>\$ (4,579)</u>	<u>\$ (54)</u>	<u>\$ 522</u>

(dollars in thousands)	<u>Depreciation</u>			<u>Capital Expenditures</u>		
	<u>For the year ended March 31,</u>			<u>For the year ended March 31,</u>		
	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
<b>Segments:</b>						
Energy Management	\$ 1,214	\$ 997	\$ 1,448	\$ 1,325	\$ 699	\$ 1,179
Engineered Systems	31	175	287	2,682	2,373	34
Corporate and Other	1,308	1,539	2,246	4,293	1,882	3,114
	<u>\$ 2,553</u>	<u>\$ 2,711</u>	<u>\$ 3,981</u>	<u>\$ 8,300</u>	<u>\$ 4,954</u>	<u>\$ 4,327</u>

(dollars in thousands)	<b>Total Assets</b>		<b>Deferred Revenue</b>	
	<b>For the year ended March 31,</b>		<b>For the year ended March 31,</b>	
	2011	2012	2011	2012
<b>Segments:</b>				
Energy Management	\$ 66,795	\$ 61,873	\$ 533	\$ 734
Engineered Systems	20,422	13,424	9,671	4,928
Corporate and Other	33,870	50,353	—	—
	<u>\$ 121,087</u>	<u>\$ 125,650</u>	<u>\$ 10,204</u>	<u>\$ 5,662</u>

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

#### NOTE J — SUBSEQUENT EVENTS

In April 2012, the Company's Board of Directors approved an increase to the share repurchase program previously approved in November 2011, authorizing the Company to repurchase in aggregate up to a maximum of \$7.5 million of the Company's outstanding common stock.

#### NOTE K — QUARTERLY FINANCIAL DATA (UNAUDITED)

Summary quarterly results for the years ended March 31, 2011 and March 31, 2012 are as follows:

	<b>June 30, 2011</b>	<b>Three Months Ended</b>			<b>Total</b>
		<b>Sept. 30, 2011</b>	<b>Dec. 31, 2011</b>	<b>Mar. 31, 2012</b>	
	(in thousands, except per share amounts)				
Total revenue	\$18,221	\$33,475	\$27,406	\$21,460	\$100,562
Gross profit	6,007	9,381	7,514	7,136	30,038
Net income (loss)	(792)	1,358	74	(157)	483
Basic net income per share	(0.03)	0.06	0.00	(0.01)	0.02
Shares used in basic per share calculation	22,921	22,990	22,996	22,904	22,953
Diluted net income per share	(0.03)	0.06	0.00	(0.01)	0.02
Shares used in diluted per share calculation	22,921	23,370	23,255	22,904	23,387

	June 30, 2010	Three Months Ended			Total
		Sept. 30, 2010	Dec. 31, 2010	Mar. 31, 2011	
	(in thousands, except per share amounts)				
Total revenue	\$16,977	\$15,853	\$23,644	\$25,563	\$82,037
Gross profit	5,753	5,610	7,834	8,442	27,639
Net income (loss)	(536)	540	(182)	519	341
Basic net income per share	(0.02)	0.02	(0.01)	0.02	0.02
Shares used in basic per share calculation	22,523	22,639	22,726	22,827	22,678
Diluted net income per share	(0.02)	0.02	(0.01)	0.01	0.01
Shares used in diluted per share calculation	22,523	22,902	22,726	23,332	23,198

The four quarters for net earnings per share may not add to the total year because of differences in the weighted average number of shares outstanding during the quarters and the year.

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

### ITEM 9A. CONTROLS AND PROCEDURES

#### Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive and principal financial officers, as appropriate, to allow timely decisions regarding required disclosure.

Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures and our internal control over financial reporting as of March 31, 2012, pursuant to Exchange Act Rule 13a-15 and 15d-15. In light of the restatement of our consolidated financial statements for the fiscal year ended March 31, 2011 and for the quarters ended June 30, 2011 and September 30, 2011, our Chief Executive Officer and our Chief Financial Officer have identified material weaknesses in internal controls over financial reporting described below and have, therefore, concluded that our disclosure controls and procedures were not effective as of March 31, 2012.

#### Material Weaknesses in Internal Control over Financial Reporting

In connection with the assessment of our internal control over financial reporting as of March 31, 2012, management has identified the following deficiencies that constituted individually, or in the aggregate, material weaknesses in our internal control over financial reporting as of March 31, 2012:

- We did not maintain an effective control environment, as evidenced by the combination of (i) having an insufficient number of personnel appropriately qualified to perform an appropriately detailed review of the accounting for nonroutine revenue transactions, and (ii) having inadequate disclosure controls to ensure timely internal notification of business transactions impacting revenue recognition and decisions requiring accounting entries.
- We did not maintain an effective control environment over our financial close and reporting processes as evidenced by having an insufficient number of personnel appropriately qualified to support timely and thorough reconciliation of significant accounts.

The material weaknesses described above resulted in a restatement of our annual and interim consolidated financial statements. Because of these material weaknesses, management concluded that we did not maintain effective internal control over financial reporting as of March 31, 2012.

## Plans for Remediation of Material Weaknesses

Our Board, the Audit & Finance Committee and management have added resources and are developing and implementing new processes, procedures and internal controls to remediate the material weaknesses that existed in our internal control over financial reporting as it related to revenue recognition, and our disclosure controls and procedures, as of March 31, 2012.

We have developed a remediation plan (the “Remediation Plan”) to address the material weaknesses for the affected areas presented above. The Remediation Plan ensures that each area affected by a material control weakness is put through a comprehensive remediation process. The Remediation Plan entails a thorough analysis which includes the following phases:

- Define and assess each control deficiency: ensure a thorough understanding of the “as is” state, process owners, and procedural or technological gaps causing the deficiency;
- Design and evaluate a remediation action for each control deficiency for each affected area; validate or improve the related policy and procedures; evaluate skills of the process owners with regard to the policy and adjust as required;
- Implement specific remediation actions: train process owners, allow time for process adoption and adequate transaction volume for next steps;
- Test and measure the design and effectiveness of the remediation actions; test and provide feedback on the design and operating effectiveness of the controls, and;
- Review and acceptance of completion of the remediation effort by management and the Audit & Finance Committee.

The following are steps we have taken in this process:

- In the second quarter of fiscal 2012, we hired a Corporate controller and in the third quarter of fiscal 2012, we hired a corporate tax manager;
- In April 2012, we developed and implemented a new sub-certification process with our management group in order to identify new revenue sources and identify legal contractual terms and conditions revisions;
- In the first quarter of fiscal 2012, we implemented a new enterprise resource planning, or ERP, system to improve our process transactions and the underlying data that supports our financial closing and reporting process.
- We have identified external resources for the purpose of engaging them to perform detailed accounting analysis on complex nonroutine revenue transactions.

The Remediation Plan is being administered by our Chief Financial Officer and involves key leaders from across the organization.

We will continue to monitor the effectiveness of our internal control over financial reporting in the areas affected by the material weaknesses described above and employ any additional tools and resources deemed necessary to ensure that our financial statements are fairly stated in all material respects.

## Management’s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act as a process designed by, or under the supervision of, our principal executive and principal financial officers and effected by our board of directors, management and other personnel, 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, and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;

- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorization of our management and directors: and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting as of March 31, 2012. In making this assessment, management used the criteria set forth by the Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria).

Based on this assessment using the COSO criteria, management believes that, as of March 31, 2012, our internal control over financial reporting was not effective as explained in the preceding sections.

BDO USA, LLP, independent registered public accounting firm has audited our consolidated financial statements for the fiscal years ended March 31, 2011 and 2012, and our internal control over financial reporting as of March 31, 2012. Their report appears in Item 8 under the heading “Reports of Independent Registered Public Accounting Firm” of this Annual Report on Form 10-K.

### **Changes in Internal Controls Over Financial Reporting**

Except as described above in Plans for Remediation of Material Weakness, there were no other changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended March 31, 2012, that have materially affected or are reasonably likely to materially affect, our internal control over financial reporting.

### **ITEM 9B. OTHER INFORMATION**

None.

## **PART III**

### **ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

#### **Directors**

Information with respect to our current directors is set forth below.

#### ***Class II Directors — Terms Expiring 2012***

*Mark C. Williamson*, 58, has served as a director since April 2009 and has been our lead independent director since October 2009. Mr. Williamson has been a partner of Putnam Roby Williamson Communications of Madison, Wis., a strategic communications firm specializing in energy utility matters, since 2008. He has more than 20 years of executive-level utility experience. Prior to joining Putnam Roby Williamson Communications, Mr. Williamson was vice president of major projects for American Transmission Company from 2002 to 2008, served as executive vice president and chief strategic officer with Madison Gas and Electric Company from 1986 to 2002 and, prior to 1986, was a trial attorney with the Madison firm Geisler and Kay S.C. We believe that Mr. Williamson’s background in the energy utility industry and in management positions qualify him for service as a director of our company.

*Michael W. Altschaeftl*, 53, has served as a director since October 2009. Mr. Altschaeftl is an owner and chief executive officer of Albany-Chicago Company LLC, a custom die cast and machined components company. Mr. Altschaeftl is a certified public accountant. Prior to joining Albany-Chicago Company LLC in 2008, Mr. Altschaeftl served as a partner with Grant Thornton LLP, an independent registered public accounting firm, for six years. We believe that Mr. Altschaeftl’s experience in leadership positions at manufacturing companies and his background as an accountant qualify him for service as a director of our company.

*Tryg C. Jacobson*, 56, was appointed to our board of directors on May 31, 2011. Since 2010, Mr. Jacobson has been the founder and president of Jake's Café LLC, a collaborative community for creative professionals. Prior to founding Jake's Café LLC, Mr. Jacobson was the owner and chairman of Jacobson Rost, a Wisconsin-based marketing communications firm specializing in corporate branding, from 1981 to 2010. Before joining Jacobson Rost, Mr. Jacobson ran Ice Nine Corporation, a Minneapolis textile printing firm he founded in 1978. In addition to his business responsibilities, Mr. Jacobson served until 2010 on the Kohler Foundation's Board of Directors. He has also been a brand specialist/speaker for The Executive Committee since 1995, focusing on teaching his brand methodology to businesses in the United States and Canada. Mr. Jacobson has also served as a director of US Sailing Center Sheboygan since 2009. We believe that Mr. Jacobson's experiences in leadership positions at companies in the corporate communications and branding industry qualify him for service as a director of our company.

### ***Class III Directors — Terms Expiring 2013***

*Neal R. Verfuert*, 53, has been a director since 1998 and our chief executive officer since 2005. From 1998 until July 2009, Mr. Verfuert also served as our president, and from 2009 until August 25, 2010, he served as chairman of our board. He co-founded our company in 1996 and served until 1998 as our vice president. From 1993 to 1996, he was employed as director of sales/marketing and product development of Lights of America, Inc., a manufacturer and distributor of compact fluorescent lighting technology. Prior to that time, Mr. Verfuert served as president of Energy 2000/Virtus Corp., a solar heating and energy efficient lighting business. Mr. Verfuert has invented many of our products, principally our Compact Modular energy efficient lighting system, and other related energy control technologies used by our company. We believe that Mr. Verfuert's role as founder of our company and inventor of many of our products and his experience in leadership positions in the energy management industry qualify him for service as a director of our company.

*James R. Kackley*, 70, has been a director since 2005 and the non-executive chairman of our board since August 25, 2010, and served as our president and chief operating officer from July 2009 until May 2010. Mr. Kackley practiced as a public accountant for Arthur Andersen, LLP from 1963 to 1999. From 1974 to 1999, he was an audit partner for the firm. In addition, in 1998 and 1999, he served as chief financial officer for Andersen Worldwide. From June 1999 to May 2002, Mr. Kackley served as an adjunct professor at the Kellstadt School of Management at DePaul University. Mr. Kackley serves as a director, a member of the executive committee and the audit committee chairman of Herman Miller, Inc. From 2004 until 2010, Mr. Kackley served as a director and member of the management resources and compensation committee and audit committee of PepsiAmericas, Inc. prior to its sale, and from February 2007 to October 2007 he also served as a director and a member of the nominating and governance committee and the audit committee of Ryerson, Inc. prior to its sale. In December 2010, Mr. Kackley was elected to the board of directors of Perficient, Inc., a publicly-traded information technology consulting firm, where he serves as non-executive chairman of the board and as a member of the audit committee and nominating and governance committee. We believe that Mr. Kackley's background as an accountant and chief financial officer, his public company board of directors service, his role as our president and chief operating officer and his experience in leadership positions in business qualify him for service as a director of our company.

*Thomas N. Schueller*, 69, was appointed to our board of directors in April 2010 and elected by shareholders at our 2010 annual meeting. From 2007 until his retirement in 2009, Mr. Schueller was chief credit officer and managing director of Lake Shore Wisconsin Corporation, a commercial banking enterprise headquartered in Sheboygan, Wisconsin. Prior to his position at Lake Shore Wisconsin Corporation, Mr. Schueller served as president and senior loan review officer of Community Bank and Trust of Sheboygan, a commercial bank headquartered in Sheboygan, Wisconsin, from 1990 to 2007. From 1970 to 1989, Mr. Schueller served in a variety of positions, including senior vice president and regional senior lender, for Citizens Bank and Trust in Sheboygan. We believe that Mr. Schueller's career in the commercial finance industry and his experience in helping to finance many growth companies qualify him for service as a director of our company.

### ***Class I Directors — Terms Expiring 2014***

*Michael J. Potts*, 48, became our president and chief operating officer in July 2010. Prior to becoming our president and chief operating officer, Mr. Potts served as our executive vice president since 2003 and has served as a director since 2001. Mr. Potts joined our company as our vice president—technical services in 2001. Prior to joining our company, Mr. Potts founded Energy Executives Inc., a consulting firm that assisted large energy-consuming clients on energy issues. From 1988 through 2001, Mr. Potts was employed by Kohler Co., one of the world's largest manufacturers of plumbing products. From 1990 through 1999 he held the position of supervising engineer—energy in Kohler's energy and utilities department. In 2000, Mr. Potts assumed the position of supervisor—energy management group of Kohler's entire corporate energy portfolio, as well as the position of general manager of its natural gas subsidiary. Mr. Potts is licensed as a professional engineer in Wisconsin. We believe that Mr. Potts' experiences as our executive vice president and in leadership roles in the energy industry and his public affairs experience and engineering background qualify him for service as a director of our company.

*Elizabeth Gamsky Rich*, 53, was appointed to our board of directors in June 2010. Since January 2009 and from 2000 to 2007, Ms. Rich has been the owner of, and an attorney with, Elizabeth Gamsky Rich & Associates S.C., a law firm offering legal services in the areas of energy law, environmental law, land use, real estate law and business law. From September 2007 to January 2009, Ms. Rich was a principal shareholder of Petrie & Stocking S.C., supervising a general legal practice and practicing in the areas of energy, environmental and real estate law and related litigation. Ms. Rich has served as a member of the board of directors for Outpost Natural Foods, Gateway 2 Center Inc., the Wisconsin State Bar Board of Governors and the Plymouth Arts Foundation, and she currently serves on the board of directors for the Farm-to-Consumer Legal Defense Foundation. We believe that Ms. Rich’s background in advising companies in the energy and environmental sectors and her experience as a director for various entities qualify her for service as a director of our company.

## Executive Officers

Information with respect to our current executive officers is set forth below.

Name	Age	Position
Neal R. Verfuerrth	53	Chief Executive Officer
Scott R. Jensen	45	Chief Financial Officer, Chief Accounting Officer and Treasurer
Michael J. Potts	48	President and Chief Operating Officer
John H. Scribante	47	President, Orion Engineered Systems
Paul J. Kardish	49	Vice President, General Counsel and Secretary

The following biographies describe the business experience of our executive officers. (For biographies of Messrs. Verfuerrth and Potts, see “Directors” above.)

*Scott R. Jensen* has been our Chief Financial Officer since June 3, 2011, our Chief Accounting Officer since October 31, 2011 and our Treasurer since July 2008. He also served as our Chief Accounting Officer from April 2011 until June 3, 2011, as our Chief Financial Officer from July 2008 until April 2011, as our Controller and Vice President of Corporate Finance from 2007 until 2008 and as our Director of Finance from 2004 to 2007. From 2002 to 2004, Mr. Jensen was the manager of financial planning and analysis at the Mirro Co. (a division of Newell Rubbermaid). Mr. Jensen is a certified public accountant.

*John H. Scribante* became President of Orion Engineered Systems Division in August 2009, after serving as our Senior Vice President of Business Development since 2007. Mr. Scribante served as our Vice President of Sales from 2004 until 2007. Prior to joining our company, Mr. Scribante co-founded and served as chief executive officer of Xe Energy, LLC, a distribution company that specialized in marketing energy reduction technologies, from 2003 to 2004. From 1996 to 2003, he co-founded and served as president of Innovize, LLC, a company that provided outsourcing services to mid-market manufacturing companies.

*Paul J. Kardish* became our Vice President—General Counsel on October 17, 2011. Mr. Kardish was subsequently appointed by the Board of Directors as Corporate Secretary on November 15, 2011. Prior to joining our company, Mr. Kardish served as senior corporate attorney and director—labor relations and corporate security at Kohler Co., a manufacturer of kitchen products, bath products, engines, power systems, furniture and decorative tile with more than 30,000 employees worldwide, since 2010. In his position at Kohler Co., Mr. Kardish had global responsibilities that included leading labor, employment and corporate security functions. From 2006 to 2010, Mr. Kardish was assistant general counsel at 1M Flash Technologies, LLC, a joint venture of Intel Corporation and Micron Technology, Inc. that manufactures memory technology for use in consumer electronics, removable storage and handheld communication devices, and served as the joint venture’s primary legal advisor, reporting directly to its chief executive officers. Mr. Kardish was assistant general counsel at Honeywell International Inc., a technology and manufacturing company, from 2003-2005, and served as benefits and employment counsel at Freeport McMoran Copper & Gold Inc., an international mining company, from 2001-2003. Prior to his employment at Freeport McMoran Copper & Gold Inc., Mr. Kardish was associated with a Dallas, Texas-based law firm from 1999-2000.

## Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires our executive officers, directors, and persons who beneficially own more than ten percent of our common stock, no par value per share (which we refer to as our “Common Stock”), to file initial statements of beneficial ownership (Form 3), and statements of changes in beneficial ownership (Forms 4 or 5) of our Common Stock with the Securities and Exchange Commission (which we refer to as the “SEC”). The SEC requires executive officers, directors and greater than ten percent shareholders to furnish us with copies of all these forms filed with the SEC.



To our knowledge, based solely upon our review of the copies of these forms received by us, or written representations from certain reporting persons that no additional forms were required for those persons, we believe that all of our executive officers and directors complied with their reporting obligations during fiscal 2012, except that each of Messrs. Altschaeffl and Jacobson inadvertently did not file a Form 4 within two business days following the receipt of shares of our Common Stock on February 28, 2012 as part of their fiscal 2012 retainer.

### **Code of Conduct**

We have adopted a Code of Conduct that applies to all of our directors, employees and officers, including our principal executive officer, our principal financial officer, our controller and persons performing similar functions. Our Code of Conduct is available on our web site at [www.oesx.com](http://www.oesx.com). Future material amendments or waivers relating to the Code of Conduct will be disclosed on our web site referenced in this paragraph within four business days following the date of such amendment or waiver.

### **Shareholder Nominations**

No material changes have been made to the procedures by which security holders may recommend nominees to our board of directors.

### **Audit and Finance Committee**

Our board of directors has established an audit and finance committee and has adopted a charter for the committee describing its responsibilities. The charter is available on our website at [www.oesx.com](http://www.oesx.com).

Our audit and finance committee was established in accordance with Section 3(a)(58)(A) of the Exchange Act and is currently comprised of Messrs. Altschaeffl, Schueller and Williamson, with Mr. Altschaeffl acting as the chair. Each member of the audit and finance committee is an audit committee financial expert, as defined under rules of the SEC implementing Section 407 of the Sarbanes-Oxley Act of 2002 (which we refer to as the "Sarbanes-Oxley Act"). The principal responsibilities and functions of our audit and finance committee are to (i) oversee the reliability of our financial reporting, the effectiveness of our internal control over financial reporting, and the independence of our internal and external auditors and audit functions and (ii) oversee the capital structure of our company and assist our board of directors in assuring that appropriate capital is available for operations and strategic initiatives. In carrying out its accounting and financial reporting oversight responsibilities and functions, our audit and finance committee, among other things, oversees and interacts with our independent auditors regarding the auditors' engagement and/or dismissal, duties, compensation, qualifications and performance; reviews and discusses with our independent auditors the scope of audits and our accounting principles, policies and practices; reviews and discusses our audited annual financial statements with our independent auditors and management; and reviews and approves or ratifies (if appropriate) related party transactions. Our audit and finance committee also is directly responsible for the appointment, compensation, retention and oversight of our independent auditors. Our audit and finance committee met twelve times in fiscal 2012. Our audit and finance committee meets the requirements for independence under the current rules of the NYSE MKT and the SEC, as Messrs. Altschaeffl, Schueller and Williamson are all independent directors for such purposes.

## **ITEM 11. EXECUTIVE COMPENSATION**

### **Compensation Discussion and Analysis**

This compensation discussion and analysis describes the material elements of compensation awarded to, earned by, or paid to each of our named executive officers, whom we refer to as our "NEOs," during fiscal 2012 and describes our policies and decisions made with respect to the information contained in the following tables, related footnotes and narrative for fiscal 2012. The NEOs are identified below in the table titled "Summary Compensation Table for Fiscal 2012." In this compensation discussion and analysis, we also describe various actions regarding NEO compensation taken before or after fiscal 2012 when we believe it enhances the understanding of our executive compensation program.

## Overview of Our Executive Compensation Philosophy and Design

We believe that a skilled, experienced and dedicated senior management team is essential to the future performance of our company and to building shareholder value. We have sought to establish competitive compensation programs that enable us to attract and retain executive officers with these qualities. The other objectives of our compensation programs for our executive officers are the following:

- to motivate our executive officers to achieve strong financial performance, particularly increased revenue, profitability, free cash flow and shareholder value;
- to attract and retain executive officers who we believe have the experience, temperament, talents and convictions to contribute significantly to our future success; and
- to align the interests of our executive officers with the interests of our shareholders.

In light of these objectives, we have sought to reward our NEOs for achieving financial performance goals, creating value for our shareholders, and for loyalty and dedication to our company. We also seek to reward initiative, innovation and creation of new products, technologies, business methods and applications, since we believe our future success depends, in part, on our ability to continue to expand our revenue, product and market opportunities.

At the beginning of fiscal 2012, our compensation committee, with the concurrence and support of our chief executive officer, took the following actions with respect to the compensation of our NEOs and other executive officers:

- Paid no bonuses for fiscal 2011, despite increasing revenue by over 35% from fiscal 2010;
- Continued to freeze base salaries for fiscal 2012 at their respective fiscal 2011 levels (in most cases at fiscal 2009 levels), except for new hires and certain limited exceptions; and
- Substituted, in lieu of our prior annual cash bonus program and annual grants under our long-term equity incentive program, a new, comprehensive equity- and performance-based incentive compensation program, described below, which was designed to focus our management team and key employees on delivering substantial financial performance improvements in fiscal 2012 over fiscal 2011.

Our compensation committee has reserved the right and discretion to make exceptions to the executive compensation program, including as any such exception may apply to the determination of any and/or all of the relative base salaries, cash bonuses, long-term incentive compensation and/or total direct compensation of our executives, for outstanding contributions to the overall success of our company and the creation of shareholder value, as well as in cases where it may be necessary or advisable to attract and/or retain executives who our compensation committee believes are or will be key contributors to creating and sustaining shareholder value, as determined by our compensation committee based on the recommendations of our chief executive officer (in all cases other than our chief executive officer's own compensation).

### *Setting Executive Compensation*

Our board of directors, our compensation committee and our chief executive officer each play a role in setting the compensation of our NEOs. Our board of directors appoints the members of our compensation committee and delegates to the compensation committee the direct responsibility for overseeing the design and administration of our executive compensation program. Our compensation committee consists of Messrs. Williamson (Chair) and Jacobson and Ms. Rich. Each member of our compensation committee is an "outside director" for purposes of Section 162(m) of the Internal Revenue Code of 1986, as amended, which we refer to as the "Code," and a "non-employee director" for purposes of Rule 16b-3 under the Securities and Exchange Act of 1934, which we refer to as the "Exchange Act."

Our compensation committee has primary responsibility for, among other things, determining our compensation philosophy, evaluating the performance of our executive officers, setting the compensation and other benefits of our executive officers, overseeing the company's response to the outcome of the advisory votes of shareholders on executive compensation and administering our

incentive compensation plans. Our chief executive officer makes recommendations to our compensation committee regarding the compensation of other executive officers and attends meetings of our compensation committee at which our compensation committee considers the compensation of other executives. Our compensation committee considers these recommendations, but has the final discretionary responsibility for determining the compensation of all of our executive officers.

The compensation committee considered the results from the shareholder advisory vote on executive compensation at our 2011 annual meeting of shareholders as support for the company's compensation policies and practices. At our 2011 annual meeting of shareholders, more than 92% of the votes cast on the shareholder advisory vote on executive compensation were in favor of our executive compensation. Our board of directors and our compensation committee value the opinions of our shareholders and are committed to ongoing engagement with our shareholders on executive compensation practices. Our board of directors has determined that our shareholders should vote on a say-on-pay proposal each year in accordance with the preference expressed by shareholders on the "say-when-on-pay" proposal at our 2011 annual meeting of shareholders.

Because of the general recessionary economic and industry conditions and their adverse impact on our fiscal 2011 financial performance and fiscal 2012 prospects, the compensation committee, with the concurrence and support of our chief executive officer, determined in the beginning of fiscal 2012 that it would (i) no bonuses for fiscal 2011, despite increasing revenue by over 35% from fiscal 2010; (ii) continue to freeze base salaries for fiscal 2012 at their respective fiscal 2010 levels (in most cases at fiscal 2009 levels), except for new hires and certain limited exceptions; and (iii) implement a new, comprehensive equity- and performance-based incentive compensation program, described below, which was designed to focus our management team and key employees on delivering substantial financial performance improvements in fiscal 2012 over fiscal 2011.

Our compensation committee did not engage a compensation consultant in setting executive compensation levels or making decisions regarding executive compensation plans for fiscal 2012. The committee determined that it was not necessary to incur the expense of obtaining additional advice and guidance from an executive compensation consultant for fiscal year 2012 for the following reasons:

- Towers Watson had undertaken extensive work on behalf of the committee in the preceding fiscal year relating to our executive compensation levels relative to our peer group and market trends.
- The compensation committee believed, based on informal discussions with Towers Watson, that the relative market trends for executive compensation for our peer group, and for the market generally, had not significantly changed during fiscal 2011, and that our relative executive compensation levels remain well within the median range of our peer group.
- The committee did not expect to change significantly the total base compensation levels for our executive officers for fiscal 2012. In particular, the committee expected to maintain executive base salary levels flat with prior years for the third year in a row and bonus opportunities were largely the same as provided in fiscal 2011 (unless we achieved exceptional performance).

The committee engaged Towers Watson to provide it with Towers Watson's market assessment, with a focus on competitiveness, of the total compensation of the company's executive officers to assist the committee in determining fiscal 2013 compensation. Towers Watson provided the committee with certain benchmarking data for base salaries, annual incentive compensation, long-term incentive compensation and total direct compensation. In compiling the benchmarking data, Towers Watson relied on the Towers Watson 2011/2012 Top Management Compensation Survey, the Towers Watson 2011 Compensation Data Bank Executive Compensation Survey (for companies with less than \$1 billion in revenues) and the Towers Watson 2011/2012 Long-Term Incentive Survey (for companies with less than \$500 million in revenues). To approximate our labor market, Towers Watson used market results corresponding to the participating companies in the surveys who are in the electrical equipment and supplies industry or, to the extent such results were not available for a position, results corresponding to participating companies in the durable goods manufacturing industry. Towers Watson used regression analysis to adjust the survey data to compensate for differences among the revenue sizes of the companies in the survey and our revenue size. The compensation committee did not receive or review the identities of the individual participating companies in the surveys on which Towers Watson relied, which information is proprietary and confidential to Towers Watson.

## Elements of Executive Compensation

Our current executive compensation program for our NEOs consists of the following elements:

- Base salary;
- Incentive compensation; and
- Retirement and other benefits.

### Base Salary

We pay our NEOs a base salary to compensate them for services rendered and to provide them with a steady source of income for living expenses throughout the year. In fiscal 2012, as a result of the challenging economic and industry market conditions and their adverse impact on our fiscal 2011 financial results and fiscal 2012 prospects, our compensation committee continued the freeze on the base salaries of all of our NEOs (other than Mr. Jensen). Mr. Jensen's base salary was increased from \$200,00 to \$225,000 for fiscal 2012 in connection with his appointment as our chief financial officer in June 2011 due to the increased duties and responsibilities as chief financial officer.

The fiscal 2012 annual base salaries for our current NEOs were as follows:

Name and Current Position	Base Salary (\$)
Neal R. Verfuert Chief Executive Officer	\$ 460,000
Michael J. Potts President and Chief Operating Officer	275,000
John H. Scribante President of Orion Engineered Systems	275,000
Scott R. Jensen Chief Financial Officer, Chief Accounting Officer and Treasurer	225,000

### Incentive Compensation – Fiscal 2012

Early in fiscal 2012, our management proposed, and our compensation committee approved, a new, comprehensive incentive and pay-for-performance compensation program with three basic elements:

- A grant of stock options, which we refer to as “accelerated vesting” stock options, the vesting of which was tied directly to our achievement of significant improvements in three financial metrics in fiscal 2012: total revenues, net income, and free cash flow (calculated as described below).
- An annual incentive award payable after the end of fiscal 2012 in a grant of stock options, which we refer to as “immediately vested” stock options, the relative size of which was also tied directly to our achievement of significant improvements in total revenues, net income, and free cash flow in fiscal 2012.
- A potential cash incentive award for extraordinary performance during fiscal 2012 (performance at a 120% or greater level as measured by each of the three specified financial metric targets in fiscal 2012).

Each of these elements is discussed and analyzed further below. The target levels for the three financial metrics for fiscal 2012 were tied directly to our fiscal 2012 budget as approved by our board of directors:

- (i) Fiscal 2012 revenues of \$115.0 million, determined pursuant to generally accepted accounting principles (“GAAP”);

- (ii) Fiscal 2012 net income of \$4.9 million, determined pursuant to GAAP, but excluding the impact of material gains or losses that were non-cash in nature (as determined by our compensation committee); and
- (iii) Fiscal 2012 free cash flow of \$4.9 million, calculated as operating cash flow as determined pursuant to GAAP, less traditional capital expenditures and OTA capital expenditures (in each case, as determined by our compensation committee).

The new program encompassed all of our key employees, including our NEOs, but the following discussion will focus on our current NEOs as required by the rules of the Securities and Exchange Commission.

*Accelerated Vesting Stock Options*

We granted the accelerated vesting stock options in May 2011 under our 2004 Stock and Incentive Awards to provide an opportunity for our current NEOs to earn long-term equity incentive awards based on our financial performance for fiscal 2012. The stock options were granted on the third business day following our public release of our fiscal 2011 results at an exercise price per share of \$4.19, which was the closing sale price of our Common Stock on that date. The stock options were only to vest, however, if the optionee remained employed and we were successful in achieving at least 100% of the target levels for each of our three financial metric targets for fiscal 2012, and if our stock price equaled or exceeded \$5.00 per share for at least 20 trading days during any 90-day period during the option's ten-year term. Our compensation committee believed that these awards served to enhance the alignment of the interests of our NEOs and the interests of our shareholders and provided our NEOs with incentives to remain in our employment.

The number of accelerated vesting option shares granted to each of our NEOs was determined by dividing the expected grant date fair value of the options by the product of the NEO's target bonus under last fiscal year's bonus program (expressed as a percentage of base salary) and the NEO's current base salary.

Our compensation committee determined to substitute the accelerated stock option grants in fiscal 2012 for our normal practice of granting cash bonus opportunities as a way to minimize potential dilution to our earnings per share while enhancing pay-for-performance by incentivizing management to deliver significant performance in all three targeted financial metrics for fiscal 2012 and, as a result, expected increased shareholder value.

The number of accelerated vesting stock options granted to our current NEOs was as follows:

**Fiscal 2012 Accelerated Vesting Option Grants**

	Number of Shares Subject to Option
Neal Verfueth	36,166
Mike Potts	21,621
John Scribante	21,621
Scott Jensen	15,724

The accelerated vesting stock options granted to each of our NEOs were cancelled because we did not achieve at least 100% of the target levels for each of our three financial metric targets for fiscal 2012.

*Immediately Vested Stock Options and Extraordinary Performance Cash Bonus Opportunities*

Our compensation committee also determined to grant to participants in our fiscal 2012 incentive program, including our NEOs, an incentive award, the amount of which was contingent upon our fiscal 2012 financial performance as measured against our target fiscal 2012 GAAP revenue, target fiscal 2012 GAAP net income and target fiscal 2012 free cash flows, and which was payable in the form of stock options and, if we achieved extraordinary performance, additional cash bonuses.

If our performance with respect to any of the three financial metrics was under 100% of target, no immediately vested stock options or cash bonuses would be granted under our fiscal 2012 incentive program. If our performance with respect to all three of the financial metrics was 100% or greater, then a pool of options to purchase 684,600 shares of our Common Stock would have been created. If our performance with respect to all three of the financial metrics was 120% or greater, then, in addition to the option pool, a cash bonus pool of \$806,667 would have been created.

Our compensation committee determined that these pools would have been allocated according to the recommendations of our chief executive officer with respect to all NEOs and other senior executives (other than our chief executive officer), subject to review and concurrence by the compensation committee. The committee would have determined the allocation of a portion of the option and cash bonus pools to our chief executive officer. With respect to all other employees, our chief executive officer would have coordinated with the applicable senior officers and other managers to determine an appropriate allocation of options and/or cash bonuses to individual subordinate employees based on such employees' relative performance and contributions to the relative success of our company.

Any options granted from the option pool would have been immediately fully vested, would have been granted with an effective grant date on the third business day following our release of our fiscal 2012 results and would have had an exercise price equal to the closing sale price of our Common Stock on the grant date. Our compensation committee determined the size of the option and bonus pools based on our management's and compensation committee's views, in their subjective judgment, of an acceptable impact on our earnings per share if we had achieved 100% and 120%, respectively, or more of each of our three specified financial metric targets in fiscal 2012.

No immediately vested stock options or cash bonuses were granted under our fiscal 2012 incentive program because we did not achieve at least 100% of the target levels for each of our three financial metric targets for fiscal 2012.

#### *Retirement and Other Benefits*

*Welfare and Retirement Benefits.* As part of a competitive compensation package, we sponsor a welfare benefit plan that offers health, life and disability insurance coverage to participating employees. We also sponsor an employee stock purchase plan under which our employees may purchase shares of our Common Stock. In addition, to help our employees prepare for retirement, we sponsor the Orion Energy Systems, Inc. 401(k) Plan and match employee contributions at a rate of 3% of the first \$5,000 of an employee's contributions (*i.e.*, capped at \$150). Our NEOs participate in the broad-based welfare plans, our employee stock purchase plan and the 401(k) Plan on the same basis as our other employees, except that they are not eligible for the loan program under the employee stock purchase plan. We also provide enhanced life and disability insurance benefits for our NEOs. Under our enhanced life insurance benefit, we pay the full cost of premiums for life insurance policies for our NEOs. The amounts of the premiums are reflected in the Summary Compensation Table below. Our enhanced disability insurance benefit includes a higher maximum benefit level than under our broad-based plan, cost of living adjustments and a portability feature.

*Perquisites and Other Personal Benefits.* We provide perquisites and other personal benefits that we believe are reasonable and consistent with our overall compensation program to better enable our executives to perform their duties and to enable us to attract and retain employees for key positions. We provided Messrs. Verfueth and Potts with a car allowance of \$1,000 per month. Mr. Scribante participates in a program for our sales group under which we provide mileage reimbursement for business travel. We lease a corporate aircraft that we use primarily to transport customers to and from our facilities in Manitowoc and for business travel by our executive officers and certain other employees. Use of the corporate aircraft avoids some of the time inefficiencies associated with commercial travel, particularly given that our headquarters is not located in proximity to any major airports, and allows business to be conducted efficiently and securely during flights. During fiscal 2012, on a limited basis, we also permitted certain of our NEOs to use the aircraft for personal travel. We provided this limited benefit to enhance their ability to conduct business during personal travel, to increase their safety and security and to lessen the amount of time they must allocate to travel and away from company business.

#### *Severance and Change of Control Arrangements*

We provide certain protections to our NEOs in the event of certain terminations of their employment, including enhanced protections for certain terminations that may occur after a change of control of our company. However, our NEOs will only receive the enhanced severance benefits following a change in control if their employment terminates without cause or for good reason. We describe this type of severance arrangement as being subject to a "double trigger." All payments, including any double trigger severance payments, to be made to our NEOs in connection with a change of control under their employment agreements and any other of our agreements or plans will be subject to a potential "cut-back" in the event any such severance payments or other benefits become subject to non-deductibility or excise taxes as "excess parachute payments" under Code Section 280G or 4999. The cut-back provisions have been structured such that all amounts payable under their employment agreements and other of our agreements or plans that constitute change of control payments will be cut back to one dollar less than three times the executive's "base amount," as defined by Code Section 280G, unless the executive would retain a greater amount by receiving the full amount of the payment and paying the related excise taxes (a so-called "valley provision").

Our 2003 Stock Option Plan and our 2004 Stock and Incentive Awards Plan also provide potential protections to our NEOs in the event of certain changes of control. Under these plans, our NEOs' stock options that are unvested at the time of a change of control may become vested on an accelerated basis in the event of certain changes of control.

We selected these triggering events to afford our NEOs some protection in the event of a termination of their employment, particularly after a change of control of our company. We believe these types of protections better enable our NEOs to focus their efforts on behalf of our company without undue concern over the impact on their employment or financial security of a change of control of our company. We also provide severance benefits in order to obtain from our NEOs certain concessions that protect our interests, including their agreement to confidentiality, intellectual property rights waiver, non-solicitation and non-competition provisions. See below under the heading "Payments upon Termination or Change of Control" for a description of the specific circumstances that would trigger payment or the provision of other benefits under these arrangements, as well as a description, explanation and quantification of the payments and benefits under each circumstance.

#### **Other Policies**

*Policies On Timing of Option Grants.* Our compensation committee and board of directors have adopted a policy on the timing of option grants, under which our compensation committee generally will make annual option grants beginning effective as of the date three business days after our next quarterly (or year-end) earnings release following the decision to make the grant, regardless of the timing of the decision. Our compensation committee has elected to grant and price option awards shortly following our earnings releases so that options are priced at a point in time when the most important information about our company then known to management and our board is likely to have been disseminated in the market.

Our board of directors has also delegated limited authority to our chief executive officer, acting as a subcommittee of our compensation committee, to grant equity-based awards under our 2004 Stock and Incentive Awards Plan. Our chief executive officer may grant awards covering up to 250,000 shares of our Common Stock per fiscal year to certain non-executive officers in connection with offers of employment, promotions and certain other circumstances. Shares subject to awards granted under this delegated authority which were subsequently cancelled or forfeited may be added back to the share authority amount. Under this delegation of authority, any options or stock appreciation rights granted by our chief executive officer must have an effective grant date on the first business day of the month following the event giving rise to the award.

Our 2004 Stock and Incentive Awards Plan does not permit awards of stock options or stock appreciation rights with an effective grant date prior to the date our compensation committee or our chief executive officer takes action to approve the award.

*Executive Officer Stock Ownership Guidelines.* One of the key objectives of our executive compensation program is alignment of the interests of our executive officers with the interests of our shareholders. We believe that ensuring that executive officers are shareholders and have a significant financial interest in our company is an effective means to accomplish this objective. In early fiscal 2011, our compensation committee recommended and our board of directors approved amended guidelines that fixed the number of shares required to be held.

The number of shares now required to be held by our executive officers is as follows:

<b>Position</b>	<b>Number Of Shares</b>
Chief Executive Officer	112,154
Chief Operating Officer	38,077
Executive Vice President	38,077
Chief Financial Officer	38,077
Senior Vice President	11,539
Vice President	11,539

Executive officers are permitted to satisfy these ownership guidelines with shares of our Common Stock that they acquire through the exercise of stock options or other similar equity-based awards, through retention upon vesting of restricted shares or other similar equity-based awards and through direct share purchases. Our executive officers who were executive officers at the time of the adoption of the amended guidelines have until the fifth anniversary of the adoption to satisfy the ownership requirement. Newly appointed executive officers will have until the fifth anniversary of their appointment as executive officers to satisfy the ownership requirement. All of our executive officers have either satisfied the ownership requirement or have additional time to do so.

*Tax Considerations.* In setting compensation for our NEOs, our compensation committee considers the deductibility of compensation under the Code. Section 162(m) of the Code prohibits us from taking a tax deduction for compensation in excess of \$1.0 million that is paid to our chief executive officer and our NEOs, excluding our chief financial officer, and that is not considered “performance-based” compensation under Section 162(m). However, certain transition rules of Section 162(m) have permitted us to treat as performance-based compensation that is not subject to the \$1.0 million cap on the following: (i) the compensation resulting from the exercise of stock options that we granted prior to our initial public offering; (ii) the compensation payable under bonus arrangements that were in place prior to our initial public offering; and (iii) compensation resulting from the exercise of stock options, or the vesting of restricted stock, that granted during the period that began after the closing of our initial public offering and ending with our 2011 annual meeting of shareholders. Our 2004 Stock and Incentive Awards Plan provides for the grant of performance-based compensation under Section 162(m), and we obtained shareholder approval of the Plan at the 2011 annual meeting to enable us to qualify awards granted under the Plan to be considered performance-based compensation for purposes of Section 162(m). Our compensation committee may, however, approve compensation that will not meet the requirements of Section 162(m) in order to ensure competitive levels of total compensation for our executive officers.

In past years, we granted incentive stock options to our NEOs under our equity-based plans. We have also granted non-qualified stock options under our equity-based plans. Because our company does not receive an income tax deduction with respect to incentive stock options unless there is a disqualifying disposition of the stock acquired under the option, our compensation committee decided in fiscal 2009 to discontinue the grant of incentive stock options to our NEOs and other employees. We also converted almost all of our outstanding incentive stock options to nonqualified stock options in fiscal 2011.

We maintain certain deferred compensation arrangements for our employees and non-employee directors that are potentially subject to Code Section 409A. If such an arrangement is neither exempt from the application of Code Section 409A nor complies with the provisions of Code Section 409A, then the employee or non-employee director participant in such arrangement is considered to have taxable income when the deferred compensation vests, even if not paid at such time, and such income is subject to an additional 20% income tax. In such event, we are obligated to report such taxable income to the IRS and, for employees, withhold both regular income taxes and the 20% additional income tax. If we fail to do so, we could be liable for the withholding taxes and interest and penalties thereon. Stock options with an exercise price lower than the fair market value of our Common Stock on the date of grant are not exempt from coverage under Code Section 409A. We believe that all of our stock option grants are exempt from coverage under Code Section 409A. Our deferred compensation arrangements are intended to either qualify for an exemption from, or to comply with, Code Section 409A.

#### **Compensation Committee Interlocks and Insider Participation**

During the last fiscal year, no member of the compensation committee had a relationship with us that required disclosure under Item 404 of Regulation S-K. During the past fiscal year, none of our executive officers served as a member of the board of directors or compensation committee, or other committee serving an equivalent function, of any entity that has one or more executive officers who served as members of our board of directors or our compensation committee. None of the members of our compensation committee is an officer or employee of our Company, nor have they ever been an officer or employee of our Company.



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## Compensation Committee Report

Our compensation committee has reviewed and discussed the “Compensation Discussion and Analysis” contained in this Form 10-K with management. Based on our compensation committee’s review and discussions with management, our compensation committee recommended to our board of directors that the Compensation Discussion and Analysis be included in this Form 10-K.

Mark A. Williamson, Chair  
Tryg C. Jacobson  
Elizabeth Gamsky Rich

### Summary Compensation Table for Fiscal 2012

The following table sets forth for our NEOs the following information for each of the past three fiscal years or for such shorter period as the NEO has been a NEO: (i) the dollar amount of base salary earned; (ii) the dollar value of bonuses and non-equity incentive plan compensation earned; (iii) the grant date fair value, determined under Accounting Standards Codification Topic 718 ("ASC Topic 718"), for all equity-based awards held by our NEOs; (iv) all other compensation; and (v) the dollar value of total compensation.

Name and Current Principal Position	Fiscal Year	Salary (\$)	Bonus (\$)	Option Awards (\$)(1)	Non-Equity Incentive Plan Compensation (\$)	All Other Compensation (\$)	Total (\$)
Neal R. Verfueth	2012	\$460,000	\$—	\$ 66,907	\$ —	\$ 48,947(2)	\$575,854
Chief Executive Officer	2011	460,000	—	67,467	—	68,655	596,122
	2010	460,000	—	75,991	—	59,943	595,934
Scott R. Jensen	2012	216,843	—	29,089	—	7,932	253,865
Chief Financial Officer,	2011	200,000	—	20,372	—	144	220,516
Chief Accounting Officer and Treasurer (3)	2010	173,750	—	336,464	—	144	510,358
Michael J. Potts	2012	275,000	—	39,999	—	16,194(5)	331,193
President and Chief Operating Officer(4)	2011	260,016	—	22,918	—	16,530	299,465
	2010	225,000	—	25,331	—	16,194	266,525
John H. Scribante	2012	275,000	—	39,999	—	22,600(6)	337,599
President of Orion Engineered Systems	2011	254,437	—	32,999	—	7,673	295,109
	2010	225,000	—	482,831	—	—	707,831
Daniel J. Waibel	2012	219,087	—	32,726	—	13,392(8)	265,205
Former President of Orion Asset Management Division(7)	2011	225,000	—	32,999	—	13,392	271,391
	2010	225,000	—	—	—	12,960	237,960
Michael W. Harris	2012	48,966	—	186,497	—	8,870	244,333
Former Chief Financial Officer(9)							

(1) Represents the grant date fair value calculated pursuant to ASC Topic 718 for the indicated fiscal year. Additional information about the assumptions that we used when valuing equity awards is set forth in our Annual Report on Form 10-K in the Notes to Consolidated Financial Statements for our fiscal year ended March 31, 2012.

- (2) Includes (i) an automobile allowance of \$12,000; (ii) \$27,462 in life insurance premiums; (iii) personal use of leased corporate aircraft with an aggregate incremental cost of \$3,647 and (iv) \$5,838 in disability insurance premiums. The aggregate incremental cost of the aircraft was calculated as follows: the actual per mileage cost for fiscal 2012 multiplied by the personal miles flown during fiscal 2012.
- (3) Mr. Jensen became our chief accounting officer and treasurer effective as of April 1, 2011 and our chief financial officer effective June 3, 2011.
- (4) Mr. Potts became our president and chief operating officer effective as of July 21, 2010.
- (5) Includes an automobile allowance of \$12,000 and \$4,194 in life insurance premiums.
- (6) Includes personal use of leased corporate aircraft of \$22,600.
- (7) Mr. Waibel ceased service with the company effective March 21, 2012.
- (8) Includes (i) an automobile allowance of \$12,000; (ii) \$1,242 in life insurance premiums; and (iii) 401(k) matching contribution of \$150.
- (9) Mr. Harris served at the company's chief financial officer from April 1, 2011 until June 3, 2011.

## Grants of Plan-Based Awards for Fiscal 2012

As described above in the Compensation Discussion and Analysis, under our 2004 Stock and Incentive Awards Plan and employment agreements with certain of our NEOs, we granted stock options and non-equity incentive awards (i.e., cash bonuses) to certain of our NEOs in fiscal 2012. The following table sets forth information regarding all such stock options and awards.

Name	Grant Date	Date of Committee Action	Estimated Future Payouts Under Non-Equity Incentive Plan Awards			Estimated Future Payouts Under Equity Incentive Plan Awards			All Other Option Awards: Number of Securities Underlying Options (#)	Exercise Price of Option Awards (\$/Sh) (1)	Grant Date Fair Value of Option Awards (\$)(2)
			Thres-hold (\$)	Target (\$)	Max (\$)	Thres-hold (#)	Target (#)	Max (#)			
Neal R. Verfuert	5/23/11	4/28/11	—	(3)	—	—	(3)	—	36,166(4)	4.19	66,907
Scott R. Jensen	5/23/11	4/28/11	—	(3)	—	—	(3)	—	15,724(4)	4.19	29,089
Michael J. Potts	5/23/11	4/28/11	—	(3)	—	—	(3)	—	21,621(4)	4.19	39,999
John H. Scribante	5/18/10	4/28/11	—	(3)	—	—	(3)	—	21,621(4)	4.19	39,999
Daniel J. Waibel	5/18/10	4/28/11	—	(3)	—	—	(3)	—	17,960(4)	4.19	32,726
Michael W. Harris	5/23/11	4/28/11	—	(3)	—	—	(3)	—	17,960(4)	4.19	32,726
	5/23/11	4/28/11							58,000	4.19	153,771

(1) The exercise price per share is equal to closing market price of a share of our Common Stock on the grant date.

(2) Represents the grant date fair value of the stock options computed in accordance with ASC Topic 718.

(3) Pursuant to our fiscal 2012 incentive compensation program, if our performance with respect to specific financial metrics was 100% or greater, then a pool of options to purchase 684,600 shares of our common stock would have been created. If our performance with respect to specific financial metrics was 120% or greater, then, in addition to the option pool, a cash bonus pool of \$806,667 would have been created. Our compensation committee determined that these pools would have been allocated according to the recommendations of our chief executive officer with respect to all named executive officers and other senior executives (other than our chief executive officer), subject to review and concurrence by the compensation committee. Due to our performance in fiscal 2012, the pool of immediately vested stock options and cash bonus pool were not created. As a result, the target awards payable to each of our named executive officers from the pool of immediately vested stock options and cash bonus pool are not able to be determined. See “Immediately Vested Stock Options and Extraordinary Performance Cash Bonus Opportunities” above for a complete discussion of the fiscal 2012 incentive compensation program.

(4) We granted the accelerated vesting stock options under our 2004 Stock and Incentive Awards to provide an opportunity for our NEOs to earn long-term equity incentive awards based on our financial performance for fiscal 2012. The stock options were only to vest, however, if the optionee remains employed and we were successful in achieving at least 100% of the target levels for each of our three financial metric targets for fiscal 2012, and if our stock price equals or exceeds \$5.00 per share for at least 20 trading days during any 90-day period during the option’s ten-year term. The accelerated vesting option shares granted to each of our NEOs were cancelled because the company was not successful in achieving at least 100% of the target levels for each of our three financial metric targets for fiscal 2012. See “Accelerated Vesting Stock Options” above for a complete discussion of the fiscal 2012 incentive compensation program.

## Outstanding Equity Awards at Fiscal 2012 Year End

The following table sets out information on outstanding stock option awards held by our NEOs at the end of our fiscal 2012 on March 31, 2012, including the number of shares underlying both exercisable and unexercisable portions of each stock option, as well as the exercise price and expiration date of each outstanding option.

Name	Option Awards			
	Number of Shares Underlying Unexercised Options (#) Exercisable	Number of Shares Underlying Unexercised Options (#) Unexercisable	Option Exercise Price (\$)	Option Expiration Date
Neal R. Verfuert	—	36,166(1)	4.19	05/23/2021
	6,841	27,366(2)	3.46	05/18/2020
	14,110	21,166(3)	3.78	05/19/2019
	65,347	43,564 (4)	5.35	08/08/2018
	204,546	—	2.20	12/20/2016
Scott R. Jensen	—	15,724(1)	4.19	05/23/2021
	2,066	8,263(5)	3.46	05/18/2020
	40,000	60,000(6)	5.44	02/05/2020
	4,704	7,055(7)	3.78	05/19/2019
	9,901	6,601 (8)	5.35	08/08/2018
	25,000	—	2.20	03/01/2017
Michael J. Potts	7,000	—	2.25	08/30/2014
	—	21,621(1)	4.19	05/23/2021
	2,324	9,296(9)	3.46	05/18/2020
	4,704	7,055(10)	3.78	05/19/2019
	12,871	8,581 (11)	5.35	08/08/2018
John H. Scribante	45,000	—	2.20	12/20/2016
	—	21,621(1)	4.19	05/23/2021
	3,346	13,385(12)	3.46	05/18/2020
	100,000	150,000(13)	3.01	09/01/2019
	4,704	7,055(14)	3.78	05/19/2019
	12,871	8,581 (15)	5.35	08/08/2018
	40,000	—	2.50	06/02/2016
25,000	—	2.25	07/31/2014	
Daniel J. Waibel	—	17,960(1)	4.19	05/23/2021
	3,346	13,385(16)	3.46	05/18/2020
	15,841	10,562 (17)	5.35	08/08/2018
	100,000	—	2.20	12/20/2016

- (1) The options vest only if the optionee remains employed and we were successful in achieving at least 100% of the target levels for each of our three financial metric targets for fiscal 2012, and if our stock price equals or exceeds \$5.00 per share for at least 20 trading days during any 90-day period during the option's ten-year term. The options were cancelled because the company was not successful in achieving at least 100% of the target levels for each of our three financial metric targets for fiscal 2012.

- (2) This option vests 20% per year on each anniversary of the date of grant with the remainder vesting in equal increments on May 18, 2012, 2013, 2014 and 2015, respectively, contingent on Mr. Verfueth's continued employment through the applicable vesting date.
- (3) This option vests 20% per year on each anniversary of the date of grant with the remainder vesting in equal increments on May 19, 2012, 2013 and 2014, contingent on Mr. Verfueth's continued employment through the applicable vesting date.
- (4) This option vests 20% per year on each anniversary of the date of grant with the remainder vesting in equal increments on August 8, 2012 and 2013, contingent on Mr. Verfueth's continued employment through the applicable vesting date.
- (5) This option vests 20% per year on each anniversary of the date of grant with the remainder vesting in equal increments on May 18, 2012, 2013, 2014 and 2015, respectively, contingent on Mr. Jensen's continued employment through the applicable vesting date.
- (6) This option vests 20% per year on each anniversary of the date of grant with the remainder vesting in equal increments on February 5, 2013, 2014 and 2015, contingent on Mr. Jensen's continued employment through the applicable vesting date.
- (7) This option vests 20% per year on each anniversary of the date of grant with the remainder vesting in equal increments on May 19, 2012, 2013 and 2014, contingent on Mr. Jensen's continued employment through the applicable vesting date.
- (8) This option vests 20% per year on each anniversary of the date of grant with the remainder vesting in equal increments on August 8, 2012 and 2013, contingent on Mr. Jensen's continued employment through the applicable vesting date.
- (9) This option vests 20% per year on each anniversary of the date of grant with the remainder vesting in equal increments on May 18, 2012, 2013, 2014 and 2015, respectively, contingent on Mr. Potts' continued employment through the applicable vesting date.
- (10) This option vests 20% per year on each anniversary of the date of grant with the remainder vesting in equal increments on May 19, 2012, 2013 and 2014, contingent on Mr. Potts' continued employment through the applicable vesting date.
- (11) This option vests 20% per year on each anniversary of the date of grant with the remainder vesting in equal increments on August 8, 2012 and 2013, contingent on Mr. Potts' continued employment through the applicable vesting date.
- (12) This option vests 20% per year on each anniversary of the date of grant with the remainder vesting in equal increments on May 18, 2012, 2013, 2014 and 2015, respectively, contingent on Mr. Scribante's continued employment through the applicable vesting date.
- (13) The option will vest in 50,000 share increments when our Common Stock's average closing price over five consecutive trading days equals or exceeds \$6.00, \$7.00 and \$8.00 per share, respectively, contingent on Mr. Scribante's continued employment through the applicable vesting date.
- (14) This option vests 20% per year on each anniversary of the date of grant with the remainder vesting in equal increments on May 19 2012, 2013 and 2014, contingent on Mr. Scribante's continued employment through the applicable vesting date.
- (15) This option vests 20% per year on each anniversary of the date of grant with the remainder vesting in equal increments on August 8, 2012 and 2013, contingent on Mr. Scribante's continued employment through the applicable vesting date.

- (16) This option was scheduled to vest 20% per year on each anniversary of the date of grant with the remainder scheduled to vest in equal increments on May 18, 2012, 2013, 2014 and 2015, respectively, contingent on Mr. Waibel's employment through the applicable vesting date. In connection with the cessation of Mr. Waibel's employment, this option will expire on June 19, 2012 (90 days after March 21, 2012) and all unvested options ceased vesting as of March 21, 2012.
- (17) This option was scheduled to vest 20% per year on each anniversary of the date of grant with the remainder scheduled to vest in equal increments on August 8 of each of 2012 and 2013, contingent on Mr. Waibel's employment through the applicable vesting date. In connection with the cessation of Mr. Waibel's employment, this option will expire on June 19, 2012 (90 days after March 21, 2012) and all unvested options ceased vesting as of March 21, 2012.

## Option Exercises for Fiscal 2012

None of our NEOs exercised stock options during fiscal 2012.

### Payments Upon Termination or Change of Control

#### Employment Agreements

Under the employment agreements we currently have with Messrs. Verfuert, Potts and Scribante, such NEOs are entitled to certain severance payments and other benefits upon a qualifying employment termination, including certain enhanced protections under such circumstances occurring after a change in control of our company. If such executive's employment is terminated without "cause" or for "good reason" prior to the end of the employment period, the executive will be entitled to a lump sum severance benefit equal to a multiple (indicated in the table below) of the sum of his base salary plus the average of the prior three years' bonuses; a pro rata bonus for the year of the termination; and COBRA premiums at the active employee rate for the duration of the executive's COBRA continuation coverage period. To receive these benefits, such executives must execute and deliver to us (and not revoke) a general release of claims.

"Cause" is defined in the employment agreements as a good faith finding by our board of directors that the executive has (i) failed, neglected, or refused to perform the lawful employment duties related to his position or that we assigned to him (other than due to disability); (ii) committed any willful, intentional, or grossly negligent act having the effect of materially injuring our interests, business, or reputation; (iii) violated or failed to comply in any material respect with our published rules, regulations, or policies; (iv) committed an act constituting a felony or misdemeanor involving moral turpitude, fraud, theft, or dishonesty; (v) misappropriated or embezzled any of our property (whether or not an act constituting a felony or misdemeanor); or (vi) breached any material provision of the employment agreement or any other applicable confidentiality, non-compete, non-solicit, general release, covenant not-to-sue, or other agreement with us.

"Good reason" is defined in the employment agreements as the occurrence of any of the following without the executive's consent: (i) a material diminution in the executive's base salary; (ii) a material diminution in the executive's authority, duties or responsibilities; (iii) a material diminution in the authority, duties or responsibilities of the supervisor to whom the executive is required to report; (iv) a material diminution in the budget over which the executive retains authority; (v) a material change in the geographic location at which the executive must perform services; or (vi) a material breach by us of any provision of the employment agreement.

The severance multiples, employment and renewal terms and restrictive covenants under the employment agreements, prior to any change of control occurring, are as follows:

Executive	Severance	Employment Term	Renewal Term	Noncompete and Confidentiality
Neal R. Verfuert	2 × Salary + Avg. Bonus	2 Years	2 Years	Yes
Michael J. Potts	1 × Salary + Avg. Bonus	1 Year	1 Year	Yes
John H. Scribante	1/2 × Salary + Avg. Bonus	1 Year	1 Year	Yes

We set the severance multiples, employment and renewal terms and restrictive covenants under the new employment agreements based on advice from Towers Watson received prior to our initial public offering that such multiples and terms were then consistent with general public company practice and our subjective belief at the time that these amounts and terms were necessary to provide our NEOs with compensation arrangements that will help us to retain and attract high-quality executives in a competitive job market. The severance multiples and employment and renewal terms vary among our individual NEOs based on the advice of Towers Watson received prior to our initial public offering that such multiples and terms were then consistent with general public company practice and our subjective judgment. We did not ascertain the basis or support for Towers Watson's advice that such multiples and other terms are consistent with general public company practice.



The employment agreements for Messrs. Verfueth, Potts and Scribante also provide enhanced benefits following a change of control of our company. Upon a change of control, such executive's employment term is automatically extended for a specified period, which varies among the individual executives as shown in the chart below. Following the change of control, the executive is guaranteed the same base salary and a bonus opportunity at least equal to 100% of the prior year's target award and with the same general probability of achieving performance goals as was in effect prior to the change of control. In addition, the executive is guaranteed participation in salaried and executive benefit plans that provide benefits, in the aggregate, at least as great as the benefits being provided prior to the change of control.

The severance provisions remain the same as in the pre-change of control context as described above, except that the multiplier used to determine the severance amount and the post change of control employment term increases, as is shown in the table below. The table also indicates the provisions in the employment agreements regarding triggering events and the treatment of payments under the agreements if the non-deductibility and excise tax provisions of Code Sections 280G and 4999 are triggered, as discussed below.

Executive	Severance	Post Change of Control Employment Term	Trigger	Excise Tax Gross-Up	Valley
Neal R. Verfueth	3 × Salary + Avg. Bonus	3 Years	Double	No	Yes
Michael J. Potts	2 × Salary + Avg. Bonus	2 Years	Double	No	Yes
John H. Scribante	1 × Salary + Avg. Bonus	1 Year	Double	No	Yes

Prior to our initial public offering, we set the post change of control severance multiples and employment terms under the NEOs' employment agreements based on our belief at the time that these amounts and terms would provide appropriate levels of protection for the NEOs to enable them to focus their efforts on behalf of our company without undue concern for their employment or financial security following a change in control. In making this determination, our compensation committee considered information provided by Towers Watson prior to our initial public offering indicating that the proposed change of control severance multiples and employment terms were then generally consistent with the practices of Towers Watson's surveyed companies.

A change of control under the employment agreements generally occurs when a third party acquires 20% or more of our outstanding stock, there is a hostile board election, a merger occurs in which our shareholders cease to own 50% of the equity of the successor, we are liquidated or dissolved, or substantially all of our assets are sold. We have agreed to treat these events as triggering events under the employment agreements because such events would represent significant changes in the ownership of our company and could signal potential uncertainty regarding the job or financial security of the NEOs. Specifically, we believe that an acquisition by a third party of 20% or more of our outstanding stock would constitute a significant change in ownership of our company because we have a relatively diverse, widely-dispersed shareholder base. We believe the types of protections provided under our employment agreements better enable our executives to focus their efforts on behalf of our company during such times of uncertainty.

The employment agreements contain a "valley" excise tax provision to address Code Sections 280G and 4999 non-deductibility and excise taxes on "excess parachute payments." Code Sections 280G and 4999 may affect the deductibility of, and impose additional excise taxes on, certain payments that are made upon or in connection with a change of control. The valley provision provides that all amounts payable under the employment agreement and any other of our agreements or plans that constitute change of control payments will be cut back to one dollar less than three times the executive's "base amount," as defined by Code Section 280G, unless the executive would retain a greater amount by receiving the full amount of the payment and personally paying the excise taxes. Under the employment agreements, we are not obligated to gross up executives for any excise taxes imposed on excess parachute payments under Code Section 280G or 4999.

## Equity Plans

Our equity plans provide for certain benefits in the event of certain changes of control. Under both our existing 2003 Stock Option Plan and our 2004 Stock and Incentive Awards Plan, if there is a change of control, our compensation committee may, among other things, accelerate the exercisability of all outstanding stock options and/or require that all outstanding options be cashed out. Our 2003 Stock Option Plan defines a change of control as the occurrence of any of the following:

- With certain exceptions, any “person” (as such term is used in sections 13(d) and 14(d) of the Exchange Act), becomes a “beneficial owner” (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities representing more than 50% of the voting power of our then outstanding securities.
- Our shareholders approve (or, if shareholder approval is not required, our board approves) an agreement providing for (i) our merger or consolidation with another entity where our shareholders immediately prior to the merger or consolidation will not beneficially own, immediately after the merger or consolidation, securities of the surviving entity representing more than 50% of the voting power of the then outstanding securities of the surviving entity, (ii) the sale or other disposition of all or substantially all of our assets, or (iii) our liquidation or dissolution.
- Any person has commenced a tender offer or exchange offer for 30% or more of the voting power of our then outstanding shares.
- Directors are elected such that a majority of the members of our board shall have been members of our board for less than two years, unless the election or nomination for election of each new director who was not a director at the beginning of such two-year period was approved by a vote of at least two-thirds of the directors then still in office who were directors at the beginning of such period.

A change of control under our 2004 Stock and Incentive Awards Plan generally occurs when a third party acquires 20% or more of our outstanding stock, there is a hostile board election, a merger occurs in which our shareholders cease to own 50% of the equity of the successor, or we are liquidated or dissolved or substantially all of our assets are sold.

## Payments Upon Termination

The following table summarizes the estimated value of payments and other benefits to which our NEOs would have been entitled under the employment agreements and equity plans described above upon certain terminations of employment, assuming, solely for purposes of such calculations, that (i) the triggering event or events occurred on March 31, 2012 and (ii) in the case of a change of control, the vesting of all stock options held by our NEOs was accelerated.

Name	Benefit	Without Cause or for Good Reason (\$)	Without Cause or for Good Reason in Connection With a Change of Control (\$)
Neal R. Verfuert	Severance	\$ 920,000	\$ 1,380,000
	Pro Rata Target Bonus	0	0
	Benefits	15,457	15,457
	Acceleration of Options	0	0
	Excise Tax Cut-Back	0	0
	<b>Total</b>	<b>\$ 935,457</b>	<b>\$ 1,395,457</b>
Michael J. Potts	Severance	\$ 275,000	\$ 550,000
	Pro Rata Target Bonus	0	0
	Benefits	23,616	23,616
	Acceleration of Options	0	0
	Excise Tax Cut-Back	0	0
	<b>Total</b>	<b>\$ 298,616</b>	<b>\$ 573,616</b>
John H. Scribante	Severance	\$ 137,500	\$ 275,000
	Pro Rata Target Bonus	0	0
	Benefits	0	0
	Acceleration of Options	0	0
	Excise Tax Cut-Back	0	0
	<b>Total</b>	<b>\$ 137,500</b>	<b>\$ 275,000</b>
<b>Total</b>	<b>\$ 1,371,573</b>	<b>\$ 2,244,073</b>	

**Payments Upon Change of Control (No Termination)**

If a change of control had occurred at the end of our fiscal 2012 on March 31, 2012, and our compensation committee had accelerated the vesting of all of the unvested stock options then held by our NEOs and cashed them out for a payment equal to the product of (i) the number of shares underlying such options and (ii) the excess, if any, of the closing price per share of our Common Stock on such date and the exercise price per share of such options, our NEOs would have received approximately the following benefits:

Name	Number of Unvested Option	Value Realized (\$)
	Shares Accelerated and Cashed Out (#)	
Neal R. Verfuert	0	\$0
Scott R. Jensen	0	0
Michael J. Potts	0	0
John H. Scribante	0	0

**RISK ASSESSMENT OF OUR COMPENSATION POLICIES AND PRACTICES**

Each year, our compensation committee conducts a review of our compensation policies and practices to assess whether any risks arising from such policies and practices are reasonably likely to materially adversely affect our company. We believe that we have designed a balanced approach to our compensation programs that rewards both our NEOs and our other key employees for achieving our annual and longer-term strategic objectives and financial and business performance goals that we believe will help us achieve sustained growth and success over the long term. We believe that our compensation committee has structured our total executive compensation to ensure that there is a focus on incentivizing and rewarding both near-term financial performance and sustained long-term shareholder appreciation. While it is possible that the pursuit of our strategic objectives and our annual financial performance targets that determine our incentive compensation may lead to employee behavior that may increase certain risks to our company, we believe that we have designed our compensation programs to help mitigate against such concerns and to help ensure that our compensation practices and decisions are consistent with our strategic business plan and our enterprise risk profile.

During our annual review, our compensation committee takes the following actions:

- Identifies our material compensation arrangements and categorizes them according to the levels of potential risk-taking behaviors that our compensation committee believes they may encourage.

- Meets with our chief executive officer and chief financial officer to develop a better understanding of our enterprise risk profile and the material risks, including reputational risk and those described under Part I, Item 1A, “Risk Factors,” in our Annual Report on Form 10-K, that we face and the relationship of our compensation policies and practices to those identified enterprise-related risks.
- Evaluates the levels of potential risk-taking that may be encouraged by each material compensation arrangement to determine whether it is appropriate in the context of our overall compensation arrangements, our objectives for our compensation arrangements, our strategic goals and objectives and our enterprise risk profile.
- Identifies and evaluates the likely effectiveness of the risk-mitigation attributes contained in our compensation policies and practices, as set forth below.

As part of its review of our fiscal 2012 compensation policies and practices, our compensation committee identified the following attributes that it believes help to mitigate against the potential for excessive or unnecessary risks to be realized by our company as a result of our compensation policies and practices:

- We believe that we have set base salaries at a sufficient level to discourage excessive or unnecessary risk taking. We believe that base salary, as a non-variable element of compensation, helps to moderate the incentives to incur risk in the pursuit of increased financial performance metrics that are directly tied to the payment of variable elements of compensation. To perform its moderating function, we believe that base salary should make up a substantial portion of target total compensation. Our NEOs’ fiscal 2012 base salaries were, on average, more than 75% of their fiscal 2012 total actual compensation. Although we do not expect base salaries to continue to comprise such a significant portion of total actual compensation, we intend for base salary to make up a substantial portion of target total compensation in future years. We also did not increase base salaries for executives in fiscal 2012.
- Our incentive compensation goals are directly tied to and support our strategic business plan and are based upon annual operating budget levels that are reviewed and approved by our board of directors and that we believe are attainable at their targeted levels without the need to (i) take excessive or unnecessary risks; (ii) take actions that would violate our Code of Conduct; or (iii) make material changes to our long-term business strategy or our methods of management or operation.
- Our fiscal 2012 incentive compensation program included an overall limit on the number of option shares that could have been granted and capped the amount of the cash bonus opportunity.
- We used three different corporate financial performance metrics, revenue, net income and free cash flow, under our fiscal 2012 incentive compensation program, as well as the price of our common stock, to determine the total amount of our incentive compensation awards to our named executive officers and certain other management-level employees. We believed that using different financial metrics helped to mitigate excessive or unnecessary risk taking and the motivation to focus on achieving any single financial performance measure that was directly tied to the amount of our incentive compensation awards.
- Almost all of our incentive compensation awards for fiscal 2012 (other than the cash bonus opportunity for extraordinary performance) were equity-based so that employees would have only realized value through the sustained long-term appreciation of our shareholder value. We also believed that the overall size of the potential incentive compensation program was moderate and was spread over a broad group of employees.
- We have implemented stock ownership guidelines for all of our executive officers, which we believe help to focus them on long-term stock price appreciation and sustainability.
- We have adopted a “clawback” policy as an additional risk mitigation provision. Our clawback policy calls on our board of directors to require reimbursement from any officer of an amount equal to the amount of any overpayment or overrealization of any incentive compensation paid to, or realized by, the officer if:

i. The payment or vesting of incentive compensation was predicated upon the achievement of certain company financial or operating results with respect to the applicable performance period that were subsequently the subject of a material financial statement restatement (other than a restatement due to subsequent changes in generally accepted accounting principles, policies or practices) that adversely affects our prior announced or stated financial results, financial condition or cash flows;

ii. In our board's view, the recipient engaged in misconduct that caused, partially caused or otherwise contributed to the need for the financial statement restatement; and

iii. Vesting would not have occurred, or no payment or a lower payment would have been made to the recipient, based upon our restated financial results, financial condition or cash flow.

As a result of the compensation committee's annual review, our compensation committee did not believe that our compensation policies and practices encourage excessive or unnecessary risk-taking in light of our strategic plan, business objectives and our enterprise risk profile. Accordingly, our compensation committee did not implement any material changes in response to this review.

### **Director Compensation**

We offer the following compensation program for our non-employee directors: (a) an annual retainer of \$40,000, payable in cash or shares of our Common Stock at the election of the recipient; (b) an annual stock option grant, vesting ratably over three years, with a grant date fair value of \$45,000; (c) an annual retainer of \$20,000 for the independent chairman of our board of directors, payable in cash or shares of Common Stock at the election of the recipient; (d) an annual retainer of \$15,000 for the independent lead director and the chairman of the audit and finance committee of our board of directors, payable in cash or shares of Common Stock at the election of the recipient; and (e) an annual retainer of \$10,000 for each of the chairmen of the compensation committee and the nominating and corporate governance committee of our board of directors, payable in cash or shares of Common Stock at the election of the recipient. In order to attract potential new independent directors in the future, our board of directors has retained the flexibility to make an initial stock option or other form of equity-based grant or a cash award to any such new non-employee directors upon joining our board.

Our compensation committee did not engage a compensation consultant to establish the compensation program for our non-employee directors. However, the committee reviewed the National Association of Corporate Directors (NACD) Director Compensation Report, which provided a comprehensive report on director pay practices across a wide range of industries and company sizes, to determine the appropriate compensation levels for our non-employee directors.

All non-management directors are required to own at least 25,000 shares. Directors are permitted to satisfy these ownership guidelines with shares of our Common Stock that they acquire through the exercise of stock options or other similar equity-based awards, through retention upon vesting of restricted shares or other similar equity-based awards and through direct share purchases. Our directors who were directors at the time of the adoption of the amended guidelines have until the fifth anniversary of the adoption to satisfy the ownership requirement. Newly elected directors will have until the fifth anniversary of their election to satisfy the ownership requirement. All of our directors have either satisfied the ownership requirement or have additional time to do so.

## Director Compensation for Fiscal 2012

The following table summarizes the compensation of our non-employee directors for fiscal 2012. As employee directors, neither Mr. Verfuert nor Mr. Potts received any compensation for their service as directors, and they are therefore omitted from the table. We reimbursed each of our directors, including our employee directors, for expenses incurred in connection with attendance at meetings of our board and its committees.

Name	Fees Earned or Paid in Cash (\$) (1)	Option Awards \$(2)(3)	All Other Compensation (\$)	Total (\$)
Michael W. Altschaeffl	55,000	48,900	—	103,900
Tryg C. Jacobson	33,332	35,941	—	69,273
James R. Kackley	60,000	48,900	—	108,900
Thomas A. Quadracci(4)	30,466	48,900	—	79,366
Elizabeth Gamsky Rich	40,000	48,900	—	88,900
Thomas N. Schueller	44,293	48,900	—	93,193
Mark C. Williamson	65,000	48,900	—	113,900

- (1) As permitted under our compensation program for non-employee directors, the following directors elected to received the following portions of their fiscal 2012 retainer in shares of our Common Stock: Mr. Altschaeffl — \$55,000, which equated to 18,349 shares; Mr. Jacobson — \$30,000, which equated to 10,959 shares.
- (2) Represents the grant date fair value of the awards pursuant to ASC Topic 718. Additional information about the assumptions that we used when valuing equity awards is set forth in our Annual Report on Form 10-K in the Notes to Consolidated Financial Statements for our fiscal year ended March 31, 2012.
- (3) The option awards outstanding as of March 31, 2012 for each non-employee director were as follows: Mr. Altschaeffl held options to purchase 47,248 shares of our Common Stock; Mr. Jacobson held options to purchase 22,045 shares of our Common Stock; Mr. Kackley held options to purchase 112,391 shares of our Common Stock; Ms. Gamsky Rich held options to purchase 41,957 shares of our Common Stock; Mr. Schueller held options to purchase 41,957 shares of our Common Stock; and Mr. Williamson held options to purchase 52,540 shares of our Common Stock. All options vest ratably over a three-year continued board service period.
- (4) Mr. Quadracci did not stand for reelection at the 2011 annual meeting and, therefore, is no longer a member of our board of directors.

### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS

#### Security Ownership Of Certain Beneficial Owners and Management

The following table sets forth certain information regarding the beneficial ownership of our Common Stock as of May 31, 2012, by:

- each person (or group of affiliated persons) known to us to be the beneficial owner of more than 5% of our Common Stock;
- each of our named executive officers;
- each of our directors; and
- all of our directors and current executive officers as a group.

Beneficial ownership is determined in accordance with the rules of the SEC and includes any shares over which a person exercises sole or shared voting or investment power. Under these rules, beneficial ownership also includes any shares as to which the individual or entity has the right to acquire beneficial ownership of within 60 days of May 31, 2012, through the exercise of any warrant, stock option or other right. Except as noted by footnote, and subject to community property laws where applicable, we believe that the shareholders named in the table below have sole voting and investment power with respect to all shares of Common Stock shown as beneficially owned by them. Information is based on 22,582,258 shares outstanding as of May 31, 2012.

Except as set forth below, the address of all shareholders listed under “Directors and executive officers” is c/o Orion Energy Systems, Inc. 2210 Woodland Drive, Manitowoc, WI 54220.

	Shares Beneficially Owned	
	Number	Percentage of Outstanding
<b>Directors and executive officers</b>		
Neal R. Verfuert(1)	2,037,602	9.0%
Michael J. Potts(2)	491,927	2.2%
John Scribante(3)	230,434	1.0%
Scott R. Jensen(4)	105,088	*
Paul J. Kardish (5)	3,000	*
James R. Kackley(6)	334,033	1.5%
Michael W. Altschaefl(7)	64,917	*
Tryg C. Jacobson (8)	17,859	*
Elizabeth G. Rich (9)	17,577	*
Thomas N. Schueller(10)	27,819	*
Mark C. Williamson(11)	41,206	*
<b>All current directors and executive officers as a group (11 individuals)(12)</b>	<b>3,371,462</b>	<b>14.9%</b>
<b>Principal shareholders</b>		
GE Capital Equity Investments, Inc.(13)	1,570,990	7.0%
Ariel Investments, LLC (14)	1,235,583	5.5%

\* Indicates less than 1%.

- (1) Consists of (i) 1,732,861 shares of Common Stock; and (ii) 304,741 shares of Common Stock issuable upon the exercise of vested and exercisable options. The number does not reflect (i) 114,365 shares of Common Stock subject to options held by Mr. Verfuert that will not become exercisable within 60 days of May 31, 2012. 294,196 of such shares have been pledged as security for a loan.
- (2) Consists of (i) 422,352 shares of Common Stock; and (ii) 69,575 shares of Common Stock issuable upon the exercise of vested and exercisable options. The number does not include 71,877 shares of Common Stock subject to options held by Mr. Potts that will not become exercisable within 60 days of May 31, 2012.
- (3) Consists of (i) 23,815 shares of Common Stock owned by Garden Villa on 3rd LLP; (ii) 15,000 shares of Common Stock held in the TMS Trust; and (iii) 191,619 shares of Common Stock issuable upon the exercise of vested and exercisable options. The number does not include 194,944 shares of Common Stock subject to options held by Mr. Scribante that will not become exercisable within 60 days of May 31, 2012.
- (4) Consists of (i) 12,000 shares of Common Stock; and (ii) 93,088 shares of Common Stock issuable upon the exercise of vested and exercisable options. The number does not include 93,226 shares of Common Stock subject to options held by Mr. Jensen that will not become exercisable within 60 days of May 31, 2012. 12,000 of such shares have been pledged as security for a loan.
- (5) The number does not include 100,000 shares of Common Stock subject to options held by Mr. Kardish that will not become exercisable within 60 days of May 31, 2012.
- (6) Consists of (i) 197,976 shares of Common Stock; (ii) 91,057 shares of Common Stock issuable upon the exercise of vested and exercisable options; and (iii) 45,000 shares of Common Stock beneficially owned by Mr. Kackley’s grandchildren. The number does not include 21,334 shares of Common Stock subject to options held by Mr. Kackley that will not become exercisable within 60 days of May 31, 2012.
- (7) Consists of (i) 40,767 shares of Common Stock; and (ii) 24,150 shares of Common Stock issuable upon the exercise of vested and exercisable options. The number does not include 23,098 shares of Common Stock subject to options held by Mr. Altschaefl that will not become exercisable within 60 days of May 31, 2012.
- (8) The number does not include 22,045 shares of Common Stock subject to options held by Mr. Jacobson that will not become exercisable within 60 days of May 31, 2012.

- (9) Consists of (i) 3,591 shares of Common Stock and (ii) 13,986 shares of Common Stock issuable upon the exercise of vested and exercisable options. The number does not include 27,971 shares of Common Stock subject to options held by Ms. Rich that will not become exercisable within 60 days of May 31, 2012.
- (10) Consists of (i) 7,196 shares of Common Stock held in an IRA; and (ii) 20,623 shares of Common Stock issuable upon the exercise of vested and exercisable options. The number does not include 21,334 shares of Common Stock subject to options held by Mr. Schueller that will not become exercisable within 60 days of May 31, 2012.
- (11) Consists of (i) 10,000 shares of Common Stock and (ii) 31,206 shares of Common Stock issuable upon the exercise of vested and exercisable options. The number does not include 21,334 shares of Common Stock subject to options held by Mr. Williamson that will not become exercisable within 60 days of May 31, 2012.
- (12) Includes 1,021,003 shares of Common Stock issuable upon the exercise of vested and exercisable options. The number does not include 711,528 shares of Common Stock subject to options that will not become exercisable within 60 days of May 31, 2012.
- (13) The address of GE Capital Equity Investments, Inc., which we refer to as “GECEI,” is 201 Merritt 7, Norwalk, Connecticut 06851. Other than share ownership percentage information, the information set forth is as of December 31, 2010, as reported by GECEI in its Schedule 13G filed with us and the SEC.
- (14) The address of Ariel Investments, LLC, which we refer to as “Ariel,” is 200 E. Randolph Drive, Suite 2900, Chicago, Illinois 60601. Other than share ownership percentage information, the information set forth is as of December 31, 2011, as reported by Ariel in its Schedule 13G filed with us and the SEC. Ariel has sole voting power as to 359,134 shares and sole dispositive power over 1,235,583 shares.

### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE**

#### **Policies and Procedures Governing Related Person Transactions**

Our policy is to enter into transactions with related persons on terms that, on the whole, are no less favorable to us than those available from unaffiliated third parties. Our board of directors has adopted written policies and procedures regarding related person transactions. For purposes of these policies and procedures:

- a “related person” means any of our directors, executive officers, nominees for director, holder of 5% or more of our Common Stock or any of their immediate family members; and
- a “related person transaction” generally is a transaction (including any indebtedness or a guarantee of indebtedness) in which we were or are to be a participant and the amount involved exceeds \$120,000, and in which a related person had or will have a direct or indirect material interest.

Each of our executive officers, directors or nominees for director is required to disclose to our audit and finance committee certain information relating to related person transactions for review, approval or ratification by our audit and finance committee. In making a determination about approval or ratification of a related person transaction, our audit and finance committee will consider the information provided regarding the related person transaction and whether consummation of the transaction is believed by the committee to be in our best interests. Our audit and finance committee may take into account the effect of a director’s related person transaction on the director’s status as an independent member of our board of directors and eligibility to serve on committees of our board under SEC rules and the listing standards of the NYSE MKT. Any related person transaction must be disclosed to our full board of directors.

#### **Related Person Transactions**

Set forth below are certain related person transactions that occurred in our fiscal year 2012. Based on our experience in the business sectors in which we participate and the terms of our transactions with unaffiliated third persons, we believe that all of the transactions set forth below (i) were on terms and conditions that were not materially less favorable to us than could have been obtained from unaffiliated third parties and (ii) complied with the terms of our policies and procedures regarding related person transactions. All of the transactions set forth below have been ratified by our audit and finance committee.



## Neal R. Verfueth

In fiscal 2012, Josh Kurtz and Zach Kurtz, two of our national account managers, and Mike Martin, our project manager, received \$183,273, \$183,273 and \$123,707, respectively, of compensation from us in their capacities as employees. Included in this compensation was \$23,273, \$23,273 and \$20,251, respectively, related to the grant date fair value calculated pursuant to ASC Topic 718 for stock options granted during the fiscal year. Messrs. Kurtz, Kurtz and Martin are family members of Neal R. Verfueth, our chief executive officer.

## Director Independence

Our board has determined that each of Ms. Rich and Messrs. Altschaeffl, Jacobson, Schueller and Williamson is independent under listing standards of the NYSE MKT (which we refer to as the "NYSE MKT"). Our board generally uses the director independence standards set forth by the NYSE MKT as its subjective independence criteria for directors, and then makes an affirmative determination as to each director's independence by taking into account other, objective criteria as applicable.

## ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

BDO USA, LLP (which we refer to as "BDO") serves as our independent registered public accounting firm. Grant Thornton LLP served as our independent registered public accounting firm prior to the appointment of BDO.

The following table presents fees billed for professional services rendered for the audit of our annual financial statements for fiscal 2012 and fiscal 2011 and fees billed for other services rendered during fiscal 2012 and fiscal 2011:

	<u>Fiscal 2012</u>	<u>Fiscal 2011</u>
Audit fees(1)	\$284,006	\$187,530
Audit-related fees(2)	14,763	14,150
Tax fees(3)	50,741	57,817
All other(4)	100,550	345,373
Total fees	<u>\$450,060</u>	<u>\$604,870</u>

- (1) Represents the aggregate fees billed for the integrated audit of our fiscal 2012 and 2011 financial statements, respectively, review of quarterly financial statements and attendance at audit committee meetings and shareholder meetings.
- (2) Represents the aggregate fees billed for audit of our benefit plans by prior audit firm.
- (3) Represents the aggregate fees billed for tax compliance by prior audit firm.
- (4) Represents the aggregate fees billed for audit and consent fees by prior audit firm.

The audit and finance committee has considered whether the provision of these services not related to the audit of the financial statements acknowledged above was compatible with maintaining the independence of our independent registered public accounting firm and is of the opinion that the provision of these services were compatible with maintaining our independent registered public accounting firm's independence.

The audit and finance committee, in accordance with its charter, must pre-approve all non-audit services provided by our independent registered public accountants. The audit and finance committee generally pre-approves specified services in the defined categories of audit services, audit related services and tax services up to specified amounts. Pre-approval may also be given as part of our audit and finance committee's approval of the scope of the engagement of the independent registered public accountants or on an individual, explicit case-by-case basis before the independent auditor is engaged to provide each service.

**PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

**(a) Financial Statements**

Our financial statements are set forth in Item 8 of this Form 10-K.

**(b) Financial Statement Schedule**

		SCHEDULE II VALUATION and QUALIFYING ACCOUNTS			
		Balance at beginning of period	Provisions charged to expense (in Thousands)	Write offs and other	Balance at end of period
March 31,					
2010	Allowance for Doubtful Accounts	\$ 222	\$ 388	\$ 228	\$ 382
2011	Allowance for Doubtful Accounts	382	507	132	757
2012	Allowance for Doubtful Accounts	757	566	376	947
2010	Inventory Obsolescence Reserve	\$ 668	\$ 105	\$ 17	\$ 756
2011	Inventory Obsolescence Reserve	756	584	2	1,338
2012	Inventory Obsolescence Reserve	1,338	167	5	1,500

## EXHIBIT INDEX

<u>Number</u>	<u>Exhibit Title</u>
3.1	Amended and Restated Articles of Incorporation of Orion Energy Systems, Inc., filed as Exhibit 3.3 to the Registrant's Form S-1 filed August 20, 2007 (File No. 333-145569), is hereby incorporated by reference.
3.2	Amended and Restated Bylaws of Orion Energy Systems, Inc., filed as Exhibit 3.5 to the Registrant's Form S-1 filed August 20, 2007 (File No. 333-145569), is hereby incorporated by reference.
4.1	Rights Agreement, dated as of January 7, 2009, between Orion Energy Systems, Inc. and Wells Fargo Bank, N.A., which includes as Exhibit A thereto the Form of Right Certificate and as Exhibit B thereto the Summary of Common Share Purchase Rights, filed as Exhibit 4.1 to the Registrant's Form 8-A filed January 8, 2009 (File No. 001-33887), is hereby incorporated by reference.
10.1	Credit Agreement, dated June 30, 2010, by and among Orion Energy Systems, Inc., Orion Asset Management LLC, Clean Energy Solutions, LLC and JP Morgan Chase Bank, N.A., filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed July 2, 2010 (File No. 001-33887), is hereby incorporated by reference.
10.1(a)	First Amendment to Credit Agreement dated September 30, 2011 by and among Orion Energy Systems, Inc., Orion Asset Management LLC, Clean Energy Solutions, LLC and JP Morgan Chase Bank, N.A., filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed October 5, 2011 (File No. 001-33887), is hereby incorporated by reference.
10.2	Credit Agreement, dated September 30, 2011, by and among Orion Energy Systems, Inc., Orion Asset Management LLC, Clean Energy Solutions, LLC and JP Morgan Chase Bank, N.A., filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed October 5, 2011 (File No. 001-33887), is hereby incorporated by reference.
10.3	Orion Energy Systems, Inc. 2003 Stock Option Plan, as amended, filed as Exhibit 10.6 to the Registrant's Form S-1 filed August 20, 2007 (File No. 333-145569), is hereby incorporated by reference.*
10.4	Form of Stock Option Agreement under the Orion Energy Systems, Inc. 2003 Stock Option Plan, filed as Exhibit 10.7 to the Registrant's Form S-1 filed August 20, 2007 (File No. 333-145569), is hereby incorporated by reference.*
10.5	Orion Energy Systems, Inc. 2004 Stock and Incentive Awards Plan, filed as Exhibit 10.9 to the Registrant's Form S-1 filed August 20, 2007 (File No. 333-145569), is hereby incorporated by reference.*
10.5(a)	Amendment to Orion Energy Systems, Inc. 2004 Stock and Incentive Awards Plan, filed September 9, 2011 as Appendix A to the Registrant's definitive proxy statement is hereby incorporated by reference.*
10.6	Form of Stock Option Agreement under the Orion Energy Systems, Inc. 2004 Equity Incentive Plan, filed as Exhibit 10.10 to the Registrant's Form S-1 filed August 20, 2007 (File No. 333-145569), is hereby incorporated by reference.*
10.7	Form of Stock Option Agreement under the Orion Energy Systems, Inc. 2004 Stock and Incentive Awards Plan.* +
10.8	Summary of Non-Employee Director Compensation, filed as Exhibit 10.8 to the Registrant's Form 10-K filed July 22, 2011 (File No. 001-33887) is hereby incorporated by reference.*
10.9	Executive Employment and Severance Agreement, dated February 21, 2008, by and between Orion Energy Systems, Inc. and Michael J. Potts, filed as Exhibit 10.2 to the Registrant's Form 8-K filed February 22, 2008 (File No. 001-33887), is hereby incorporated by reference.*

- 10.10 Executive Employment and Severance Agreement, dated March 18, 2008, by and between Orion Energy Systems, Inc. and John H. Scribante, filed as Exhibit 10.3 to the Registrant's Form 8-K filed March 21, 2008 (File No. 001-33887), is hereby incorporated by reference.\*
- 10.11 Executive Employment and Severance Agreement, dated April 14, 2008, by and between Orion Energy Systems, Inc. and Neal R. Verfueth, filed as Exhibit 10.1 to the Registrant's Form 8-K filed April 18, 2008 (File No. 001-33887), is hereby incorporated by reference.\*
- 10.12 Letter Agreement, dated as of August 27, 2009, between the Company and John H. Scribante, filed as Exhibit 10.1 to the Company's Form 8-K filed on September 2, 2009, is hereby incorporated by reference.\*
- 21.1 Subsidiaries of Orion Energy Systems, Inc. +
- 23.1 Consent of Independent Registered Public Accounting Firm. +
- 23.2 Consent of Independent Registered Public Accounting Firm. +
- 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 and 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. +
- 101 101.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

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\* Management contract or compensatory plan or arrangement required to be filed (and/or incorporated by reference) as an exhibit to this Annual Report on Form 10-K pursuant to Item 15(a)(3) of Form 10-K.

+ Filed herewith

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Annual Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized, on June 14, 2012.

ORION ENERGY SYSTEMS, INC.

By: /s/ NEAL R. VERFUERTH

Neal R. Verfuertth  
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report on Form 10-K has been signed by the following persons on behalf of the Registrant in the capacities indicated on June 14, 2012.

<u>Signature</u>	<u>Title</u>
<u>/s/ Neal R. Verfuertth</u> Neal R. Verfuertth	Chief Executive Officer and Director (Principal Executive Officer)
<u>/s/ Scott R. Jensen</u> Scott R. Jensen	Chief Financial Officer, Chief Accounting Officer and Treasurer (Principal Financial Officer)
<u>/s/ James R. Kackley</u> James R. Kackley	Chairman of the Board
<u>/s/ Michael W. Altschaefl</u> Michael W. Altschaefl	Director
<u>/s/ Michael J. Potts</u> Michael J. Potts	Director
<u>/s/ Elizabeth Gamsky Rich</u> Elizabeth Gamsky Rich	Director
<u>/s/ Thomas N. Schueller</u> Thomas N. Schueller	Director
<u>/s/ Mark C. Williamson</u> Mark C. Williamson	Director
<u>/s/ Tryg C. Jacobson</u> Tryg C. Jacobson	Director

**ORION ENERGY SYSTEMS, INC.  
2004 STOCK AND INCENTIVE AWARDS PLAN  
STOCK OPTION AWARD**

[Name]

[Address]

You have been granted an option (your "Option") to purchase shares of common stock ("Shares") of Orion Energy Systems, Inc. (the "Company") under the Orion Energy Systems, Inc. 2004 Stock and Incentive Awards Plan (the "Plan") with the following terms and conditions:

Grant Date: \_\_\_\_\_, 20

Type of Option: [Nonqualified or Incentive Stock Option]

Number of Option Shares: \_\_\_\_\_

Exercise Price per Share: U.S. \$ \_\_\_\_\_

Vesting: \_\_\_\_\_ percent (\_\_\_%) of your Option will vest and become exercisable on each of the first \_\_\_\_\_ anniversaries of the Grant Date, provided you remain in employment or service during such period. Upon your termination of employment or service with the Company and its Affiliates, any senior officer of the Company may in his or her discretion cause any then-unvested portion of your Option to become vested and exercisable in whole or in part if, based on the circumstances of the termination of employment or service, such officer deems such action to be in the best interests of the Company.

Any portion of your Option that is not vested upon such termination of employment or service and is not caused by a senior officer to become vested and exercisable pursuant to the foregoing will immediately terminate upon such termination of employment or service.

Termination Date: Your Option expires at, and cannot be exercised after, the close of business at the Company's headquarters on the earliest to occur of:

- The tenth (10<sup>th</sup>) anniversary of the Grant Date;
- One year after your termination of employment or service as a result of death or disability (within the meaning of Code Section 22(e)(3)); or
- 90 days after your termination of employment or service for any other reason, provided that (i) if you die during this 90-day period, the exercise period will be extended until one year after the date of your death, and (ii) any senior officer of the Company may, in his or her discretion, extend this 90-day period for up to one year after such termination of employment if, based on the circumstances of the termination of employment or service, such officer deems such an extension to be in the best interests of the Company.

If the date this Option terminates as specified above falls on a day on which the stock market is not open for trading or on a date that you are prohibited by Company policy (such as an insider trading policy) from exercising the Option, the termination date shall be automatically extended to the first available trading day following the original termination date, but not beyond the tenth (10<sup>th</sup>) anniversary of the Grant Date.

Notwithstanding the above, your entire Option is terminated immediately if the Company or an Affiliate terminates you for Cause (as defined below), or if your employment or service is otherwise terminated at a time when you could be terminated for Cause, or you voluntarily terminate without the Company's prior consent.

For purposes of this Agreement, "Cause" means any of the following: (i) failure to perform or observe any of the terms or provisions of any written employment agreement with the Company or an Affiliate, or if no written employment agreement exists, the gross dereliction of your employment duties; (ii) failure to comply fully with the lawful directives of the Board of Directors of the Company; (iii) dishonesty; (iv) misconduct; (v) conviction of a crime involving moral turpitude; (vi) substance abuse; (vii) misappropriation of funds; (viii) disloyalty or disparagement of the Company, and of its Affiliates, or any of their management or employees; or (ix) other proper cause determined in good faith by the Committee.

Manner of Exercise:

You may exercise your Option only to the extent vested and only if it has not terminated. To exercise your Option, you must complete the "Notice of Stock Option Exercise" form provided by the Company and return it to the address indicated on the form. The form will be effective when it is received by the Company, but exercise will not be completed until you pay the total exercise price and all applicable withholding taxes due as a result of the exercise to the Company.

If someone else wants to exercise your Option after your death, that person must contact the Company and prove to the Company's satisfaction that he or she is entitled to do so.

Your ability to exercise your Option may be restricted by the Company if required by applicable law.

Restrictions on Resale:

By accepting your Option, you agree not to sell any Shares acquired under your Option at a time when applicable laws, Company policies or an agreement between the Company and its underwriters prohibit a sale.

Restrictions on Transfer:

During your lifetime, this Option is only exercisable by you. You may not transfer, pledge or assign this Option, by operation of law or otherwise, except pursuant to your will or the laws of descent and distribution. If you attempt to transfer, assign, pledge, hypothecate or otherwise dispose of this Option, except as provided above, or in the event this Option is subject to levy or attachment, execution or similar process, the Company may terminate this Option by providing written notice to you.

Rescission of Exercise;

Disgorgement of Option Gains:

If you are terminated for Cause, or if you are not terminated for Cause but the Committee later determines that you could have been terminated for Cause if all facts had been known at that time, or if the Committee determines that, after your termination of employment, you have violated the provisions of any non-competition, non-solicitation, confidentiality or assignment of inventions agreement then in effect, then your Option will terminate immediately on the date of such termination or determination, as applicable, and the Committee may, in its sole and absolute discretion, (i) rescind any notice of exercise submitted by you for which payment or the issuance of Shares has not been completed, in which event any exercise price you have tendered will be promptly returned to you or retained by the Company as an offset as provided below, and/or (ii) notify you in writing within two (2) years after exercise of all or any portion of the Option that any exercise made within the one (1) year period prior to your termination or prior to your breach of any non-competition, non-solicitation, confidentiality or assignment of inventions agreement, is rescinded. Within ten (10) days after receiving such notice from the Company, you shall pay to the Company the amount of any cash payment received, or the value of any other gain realized, as a result of the rescinded exercise. Notwithstanding the foregoing, the Company shall have the right to retain (as an offset against any amounts due hereunder), the exercise price and withholding amount tendered by you with respect to any rescinded exercise, and the Company shall have the right to offset against any other amounts due from the Company to you the amount owed by you hereunder.

Notice of Sale:

If your Option is designated as an incentive stock option, you must promptly report to the Secretary of the Company any disposition of the Shares acquired under your Option that is made within two (2) years from the Grant Date or within twelve (12) months from the date you acquired the Shares (the "Notice Period"). In addition, the Company may, at any time during the Notice Period, place a legend or legends on any certificate(s) for the Shares issued under your Option requesting the Company's transfer agent to notify the Company of any transfer of the Shares.

Miscellaneous:

- As a condition of the granting of your Option, you agree, for yourself and your legal representatives or guardians, that this Stock Option Award shall be interpreted by the Committee and that any interpretation by the Committee of the terms of this Stock Option Award or the Plan and any determination made by the Committee pursuant to this Stock Option Award or the Plan shall be final, binding and conclusive. Notwithstanding the foregoing, this Stock Option Award may not be amended, and the Company may not take any other action the effect of which is, to reduce the Exercise Price per Share other than (i) pursuant to Section 6.4 of the Plan, and in accordance with Section 1.409A-1(b)(5)(v)(B) of the Treasury Regulations, or (ii) in connection with a transaction which is considered the grant of a new option for purposes of Section 409A of the Code, provided that the new Exercise Price per Share is not less than Fair Market Value of a Share on the new grant date.
- As a condition of the granting of your Option, except as required by law, you agree not to disclose information regarding the existence, terms, or conditions of this Option to any person or entity whatsoever, including without limitation any members of the media (including, but not limited to, print journalists, newspapers, radio, television, cable, satellite programs, or Internet media) or any Internet web page or "chat room," or any other entity or person, with the exception of your spouse, accountant, tax advisor, and/or attorneys. Any violation of this provision may result in immediate and complete forfeiture of all rights granted under this Option if so determined by the Committee.
- As a condition of the granting of your Option, you acknowledge and agree that this Stock Option Award and the Plan constitute the entire agreement of the parties with respect to the subject matter of this Stock Option Award. This Stock Option Award and the Plan supersede any and all other agreements or representations, both verbal and written, between the parties to this Stock Option Award with respect to your Option. You represent and warrant that you have no other outstanding options to purchase Common Stock or any other security of the Company other than your Option or any options previously granted and described in any agreement similar to this Stock Option Award, and you hereby release the Company from any claims and liabilities relating thereto.
- This Stock Option Award may be executed in counterparts.

Your Option is granted under and governed by the terms and conditions of the Plan. Additional provisions regarding your Option and definitions of capitalized terms used and not defined in your Option can be found in the Plan.

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BY SIGNING BELOW AND ACCEPTING THIS STOCK OPTION AWARD, YOU AGREE TO ALL OF THE TERMS AND CONDITIONS DESCRIBED HEREIN AND IN THE PLAN. YOU ALSO ACKNOWLEDGE RECEIPT OF THE PLAN.

\_\_\_\_\_  
Authorized Officer

\_\_\_\_\_  
**Optionee**



**Subsidiaries**

Entity	Jurisdiction of Organization
Great Lakes Energy Technologies, LLC	Wisconsin
Clean Energy Solutions, LLC	Wisconsin
Orion Asset Management, LLC	Wisconsin

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Orion Energy Systems, Inc.  
Manitowoc, Wisconsin

We hereby consent to the incorporation by reference in the Registration Statement Forms S-8 (No. 333-169611 and 333-148401) of Orion Energy Systems, Inc. of our reports dated June 14, 2012, relating to the consolidated financial statements, and the effectiveness of Orion Energy Systems, Inc.'s internal control over financial reporting, which appears in the Annual Report to Shareholders, which is incorporated by reference in this Annual Report on Form 10-K. We also consent to the incorporation by reference of our report dated June 14, 2012 relating to the financial statement schedule, which appears in this Form 10-K.

/s/ BDO USA, LLP  
Milwaukee, Wisconsin  
June 14, 2012

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We have issued our report dated July 22, 2011 (except for Note I, as to which the date is June 14, 2012), with respect to the consolidated financial statements and schedule included in the Annual Report of Orion Energy Systems, Inc. on Form 10-K for the year ended March 31, 2010. We hereby consent to the incorporation by reference of said report in the Registration Statements of Orion Energy Systems, Inc. on Forms S-8 (File No. 333-169611, effective September 28, 2010 and File No. 333-148401, effective December 28, 2007).

/s/ GRANT THORNTON LLP  
Milwaukee, Wisconsin  
June 14, 2012

**Certification of Chief Executive Officer  
Pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934**

I, Neal R. Verfuert, certify that:

1. I have reviewed this Annual Report on Form 10-K for Orion Energy Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) 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: June 14, 2012

/s/ Neal R. Verfuert  
\_\_\_\_\_  
Neal R. Verfuert  
Chief Executive Officer

**Certification of Chief Financial Officer**  
**Pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934**

I, Scott R. Jensen, certify that:

1. I have reviewed this Annual Report on Form 10-K for Orion Energy Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) 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: June 14, 2012

/s/ Scott R. Jensen

\_\_\_\_\_  
Scott R. Jensen

Chief Financial Officer, Chief Accounting Officer and Treasurer

**Written Statement of the Chief Executive Officer and Chief Financial Officer  
Pursuant to 18 U.S.C. Section 1350**

Solely for the purposes of complying with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, we, the undersigned Chief Executive Officer and Chief Financial Officer of Orion Energy Systems, Inc. (the "Company"), hereby certify, based on our knowledge, that the Annual Report on Form 10-K of the Company for the twelve-month period ended March 31, 2012, (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and that information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Neal R. Verfuert

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Neal R. Verfuert

Chief Executive Officer

/s/ Scott R. Jensen

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Scott R. Jensen

Chief Financial Officer,

Chief Accounting Officer and Treasurer

Date: June 14, 2012