



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

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2009

OR

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

Commission file number 001-33887

**Orion Energy Systems, Inc.**

(Exact name of Registrant as specified in its charter)

Wisconsin

(State or other jurisdiction of incorporation or organization)

39-1847269

(I.R.S. Employer Identification number)

2210 Woodland Drive, Manitowoc, Wisconsin

(Address of principal executive offices)

54220

(Zip code)

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

There were 21,808,480 shares of the Registrant's common stock outstanding on November 4, 2009.

**Orion Energy Systems, Inc.**  
**Quarterly Report On Form 10-Q**  
**For The Quarter Ended September 30, 2009**  
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**PART I — FINANCIAL INFORMATION****Item 1: Financial Statements**

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

	<u>March 31,</u> <u>2009</u>	<u>September 30,</u> <u>2009</u>
<b>Assets</b>		
Cash and cash equivalents	\$ 36,163	\$ 33,413
Short-term investments	6,490	1,000
Accounts receivable, net of allowances of \$222 and \$316	11,572	12,742
Inventories, net	20,232	19,672
Deferred tax assets	548	765
Prepaid expenses and other current assets	3,369	1,520
Total current assets	78,374	69,112
Property and equipment, net	22,999	25,739
Patents and licenses, net	1,404	1,482
Deferred tax assets	593	1,886
Other long-term assets	352	88
Total assets	<u>\$ 103,722</u>	<u>\$ 98,307</u>
<b>Liabilities and Shareholders' Equity</b>		
Accounts payable	\$ 7,817	\$ 5,479
Accrued expenses	2,315	2,885
Current maturities of long-term debt	815	693
Total current liabilities	10,947	9,057
Long-term debt, less current maturities	3,647	3,337
Other long-term liabilities	433	507
Total liabilities	<u>15,027</u>	<u>12,901</u>
Commitments and contingencies (See Note F)		
Shareholders' equity:		
Preferred stock, \$0.01 par value: Shares authorized: 30,000,000 shares at March 31, 2009 and September 30, 2009; no shares issued and outstanding at March 31, 2009 and September 30, 2009	—	—
Common stock, no par value: Shares authorized: 200,000,000 at March 31, 2009 and September 30, 2009; shares issued: 28,875,879 and 29,173,406 at March 31, 2009 and September 30, 2009; shares outstanding: 21,528,783 and 21,721,667 at March 31, 2009 and September 30, 2009	—	—
Additional paid-in capital	118,907	120,098
Treasury stock: 7,347,096 and 7,451,739 common shares at March 31, 2009 and September 30, 2009	(31,536)	(31,936)
Accumulated other comprehensive (loss) income	(32)	61
Retained earnings (deficit)	1,356	(2,817)
Total shareholders' equity	<u>88,695</u>	<u>85,406</u>
Total liabilities and shareholders' equity	<u>\$ 103,722</u>	<u>\$ 98,307</u>

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

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2008	2009	2008	2009
Product revenue	\$ 17,280	\$ 13,763	\$ 30,169	\$ 24,440
Service revenue	1,480	856	4,697	2,807
Total revenue	18,760	14,619	34,866	27,247
Cost of product revenue	11,467	9,222	20,080	17,094
Cost of service revenue	958	632	3,254	1,887
Total cost of revenue	12,425	9,854	23,334	18,981
Gross profit	6,335	4,765	11,532	8,266
Operating expenses:				
General and administrative	2,893	3,143	5,508	6,307
Sales and marketing	2,771	2,962	5,423	6,113
Research and development	373	491	791	910
Total operating expenses	6,037	6,596	11,722	13,330
Income (loss) from operations	298	(1,831)	(190)	(5,064)
Other income (expense):				
Interest expense	(41)	(74)	(108)	(130)
Dividend and interest income	550	76	1,167	198
Total other income	509	2	1,059	68
Income (loss) before income tax	807	(1,829)	869	(4,996)
Income tax expense (benefit)	354	(430)	382	(824)
Net income (loss)	<u>\$ 453</u>	<u>\$ (1,399)</u>	<u>\$ 487</u>	<u>\$ (4,172)</u>
Basic net income (loss) per share	\$ 0.02	\$ (0.06)	\$ 0.02	\$ (0.19)
Weighted-average common shares outstanding	26,959,790	21,707,477	26,998,857	21,648,246
Diluted net income (loss) per share	\$ 0.02	\$ (0.06)	\$ 0.02	\$ (0.19)
Weighted-average common shares and share equivalents outstanding	29,018,991	21,707,477	29,613,684	21,648,246

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

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

	<u>Six Months Ended September 30,</u> <u>2008</u>	<u>2009</u>
<b>Operating activities</b>		
Net income (loss)	\$ 487	\$ (4,172)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	856	1,325
Stock-based compensation expense	846	663
Deferred income tax (benefit) expense	193	(1,510)
Change in allowance for notes and accounts receivable	20	353
Other	62	(3)
Changes in operating assets and liabilities:		
Accounts receivable	1,275	(1,264)
Inventories	(2,096)	560
Prepaid expenses and other current assets	(1,504)	1,845
Accounts payable	(43)	(2,338)
Accrued expenses	(467)	651
<b>Net cash used in operating activities</b>	<u>(371)</u>	<u>(3,890)</u>
<b>Investing activities</b>		
Purchase of property and equipment	(6,865)	(2,501)
Purchase of property and equipment held under operating leases	—	(1,501)
Purchase of short-term investments	(17,415)	—
Sale of short-term investments	—	5,583
Additions to patents and licenses	(1,074)	(131)
Proceeds from sales of long term assets	860	6
Gain on sale of long term investment	(361)	—
<b>Net cash provided by (used in) investing activities</b>	<u>(24,855)</u>	<u>1,456</u>
<b>Financing activities</b>		
Payment of long-term debt	(405)	(433)
Repurchase of common stock into treasury	(8,138)	(400)
Excess tax benefits from stock-based compensation	505	—
Deferred financing costs and offering costs	7	—
Proceeds from issuance of common stock	1,352	517
<b>Net cash used in financing activities</b>	<u>(6,679)</u>	<u>(316)</u>
Net decrease in cash and cash equivalents	(31,905)	(2,750)
Cash and cash equivalents at beginning of period	78,312	36,163
Cash and cash equivalents at end of period	<u>\$ 46,407</u>	<u>\$ 33,413</u>
<b>Supplemental cash flow information:</b>		
Cash paid for interest	\$ 186	\$ 149
Cash paid for income taxes	83	30
<b>Supplemental disclosure of non-cash investing and financing activities</b>		
Long term note receivable received on sale of investment	\$ 298	\$ —

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

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

**NOTE A — DESCRIPTION OF BUSINESS**

***Organization***

The Company includes Orion Energy Systems, Inc., a Wisconsin corporation, and all consolidated subsidiaries. The Company is a developer, manufacturer and seller of lighting and energy management systems. The corporate offices and manufacturing operations are located in Manitowoc, Wisconsin and an operations facility is located in Plymouth, Wisconsin.

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

***Principles of consolidation***

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

***Basis of presentation***

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the rules and regulations of the Securities Exchange Commission. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation have been included. Interim results are not necessarily indicative of results that may be expected for the year ending March 31, 2010 or other interim periods.

The condensed consolidated balance sheet at March 31, 2009 has been derived from the audited consolidated financial statements at that date but does not include all of the information required by GAAP for complete financial statements.

As of November 9, 2009, there were no subsequent events that materially affected these unaudited consolidated interim financial statements.

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2009.

***Use of estimates***

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

[Table of Contents](#)**Cash and cash equivalents**

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

**Short-term investments available for sale**

The amortized cost and fair value of marketable securities, with gross unrealized gains and losses, as of March 31, 2009 and September 30, 2009 were as follows (in thousands):

	March 31, 2009					
	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Cash and Cash Equivalents</u>	<u>Short Term Investments</u>
Money market funds	\$ 14,114	\$ —	\$ —	\$ 14,114	\$ 14,114	\$ —
Bank certificate of deposit	9,007	—	—	9,007	6,207	2,800
Commercial paper	3,690	—	—	3,690	—	3,690
Corporate obligations	2,257	—	(7)	2,250	2,250	—
Government agency obligations	12,412	—	(25)	12,387	12,387	—
Total	<u>\$ 41,480</u>	<u>\$ —</u>	<u>\$ (32)</u>	<u>\$ 41,448</u>	<u>\$ 34,958</u>	<u>\$ 6,490</u>

	September 30, 2009					
	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Cash and Cash Equivalents</u>	<u>Short Term Investments</u>
Money market funds	\$ 22,107	\$ —	\$ —	\$ 22,107	\$ 22,107	\$ —
Bank certificate of deposit	7,282	—	—	7,282	6,282	1,000
Commercial paper	3,639	61	—	3,700	3,700	—
Total	<u>\$ 33,028</u>	<u>\$ 61</u>	<u>\$ —</u>	<u>\$ 33,089</u>	<u>\$ 32,089</u>	<u>\$ 1,000</u>

The Company's 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 September 30, 2009, the Company's financial assets described in the table above were measured at fair value employing level 1 inputs.

**Fair value of financial instruments**

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



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### **Accounts receivable**

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

Included in accounts receivable are amounts due from a third party finance company to which the Company has sold, without recourse, the future cash flows from lease arrangements entered into with customers. Such receivables are recorded at the present value of the future cash flows discounted at 10.25%. As of September 30, 2009, the following amounts were due from the third party finance company in future periods (in thousands):

Fiscal 2010	\$	36
Fiscal 2011		25
Total gross receivable		61
Less: amount representing interest		(4)
Net contracts receivable	\$	57

### **Inventories**

Inventories consist of raw materials and components, such as ballasts, metal sheet and coil stock and molded parts; work in process inventories, such as frames and reflectors; and finished goods, including completed fixtures or systems and accessories, such as lamps, meters and power supplies. All inventories are stated at the lower of cost or market value with cost determined using the first-in, first-out (FIFO) method. The Company reduces the carrying value of its inventories for differences between the cost and estimated net realizable value, taking into consideration usage in the preceding 12 months, expected demand, and other information indicating obsolescence. The Company records as a charge to cost of product revenue the amount required to reduce the carrying value of inventory to net realizable value. As of March 31, 2009 and September 30, 2009, the Company had inventory obsolescence reserves of \$668,000 and \$680,000, respectively.

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

Inventories were comprised of the following (in thousands):

	March 31, 2009	September 30, 2009
Raw materials and components	\$ 9,629	\$ 9,383
Work in process	1,753	574
Finished goods	8,850	9,715
	<u>\$ 20,232</u>	<u>\$ 19,672</u>

### **Property and Equipment**

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

	March 31, 2009	September 30, 2009
Land and land improvements	\$ 822	\$ 1,435
Buildings	5,435	14,127
Furniture, fixtures and office equipment	3,432	6,955
Plant equipment	6,882	7,190
Construction in progress	11,366	2,263
	27,937	31,970
Less: accumulated depreciation and amortization	(4,938)	(6,231)
Net property and equipment	<u>\$ 22,999</u>	<u>\$ 25,739</u>

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

	March 31, 2009	September 30, 2009
Equipment	\$ 1,104	\$ 1,104
Less: accumulated amortization	(477)	(535)
Net equipment	<u>\$ 627</u>	<u>\$ 569</u>

The Company capitalized \$57,000 and \$0 of interest for construction in progress for the three months ended September 30, 2008 and 2009; and \$96,000 and \$21,000 for the six months ended September 30, 2008 and 2009. As of September 30, 2009, the Company had equipment held under operating leases of \$1.9 million, net of depreciation of \$0.2 million.

### ***Patents and Licenses***

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

### ***Investment***

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

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

Other long-term assets include \$33,000 and \$30,000 of deferred financing costs as of March 31, 2009 and September 30, 2009 and \$298,000 and \$39,000 of a note receivable as of March 31, 2009 and September 30, 2009, respectively. Upon the sale of the long-term investment noted above, the Company received a promissory note. The note provides for interest only payments at 7% for the first year and 15% for the second year and thereafter. The full principal amount of the note is due in June 2011. The note is secured by a personal guarantee from the CEO of the specialty aluminum products company. Based upon an assessment of the long-term note receivable, the Company has determined that a portion of the note receivable may not be collectible and accordingly, has established a reserve allowance of \$259,000 of the original face value of the promissory note. For the three and six months ended September 30, 2009, the Company recorded an expense of \$259,000.

### ***Accrued Expenses***

Accrued expenses include warranty accruals, accrued wages and benefits, accrued vacation, sales tax payable and other various unpaid expenses. Accrued health insurance costs were \$378,000 and \$469,000 as of March 31, 2009 and September 30, 2009. Accrued wages were \$542,000 and \$550,000 as of March 31, 2009 and September 30, 2009.

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.

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2008	2009	2008	2009
Beginning of period	\$ 63	\$ 65	\$ 69	\$ 55
Provision to cost of revenue	17	10	20	20
Charges	(34)	(33)	(43)	(33)
End of period	<u>\$ 46</u>	<u>\$ 42</u>	<u>\$ 46</u>	<u>\$ 42</u>

### **Revenue Recognition**

Revenue is recognized when the following four criteria are met:

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

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

For sales contracts consisting of multiple elements of revenue, such as a combination of product sales and services, the Company determines revenue by allocating the total contract revenue to each element based on the relative fair values.

Services other than installation and recycling that are completed prior to delivery of the product are recognized upon shipment and are included in product revenue as evidence of fair value does not exist. These services include comprehensive site assessment, site field verification, utility incentive and government subsidy management, engineering design, and project management.

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

In October 2008, the Company introduced a financing program called the Orion Virtual Power Plant ("OVPP") for a customer's lease of the Company's energy management systems. The OVPP is structured as an operating lease in which the Company receives monthly rental payments over the life of the lease, typically a 12-month renewable agreement with a maximum term of between three and five years. Upon successful installation of the system and customer acknowledgement that the product is operating as specified, revenue is recognized on a monthly basis over the life of the contract.

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

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

	March 31, 2009	September 30, 2009
Deferred revenue — current liability	\$ 103	\$ 98
Deferred revenue — long term liability	36	109
Total deferred revenue	<u>\$ 139</u>	<u>\$ 207</u>

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### **Income Taxes**

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

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

	Six Months Ended,	
	September 30, 2008	September 30, 2009
Unrecognized tax benefits as of beginning of period	\$392	\$397
Decreases relating to settlements with tax authorities	(5)	—
Additions based on tax positions related to the current period positions	6	1
Unrecognized tax benefits as of end of period	<u>\$393</u>	<u>\$398</u>

The income tax provision for the six months ended September 30, 2009 was determined by applying an estimated annual effective tax rate of (16.5)% to income (loss) before taxes. The estimated effective income tax rate was determined by applying statutory tax rates to pretax income adjusted for certain permanent book to tax differences and tax credits.

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

	Six Months Ended	
	September 30, 2008	September 30, 2009
Statutory federal tax rate	34.00%	(34.00)%
State taxes, net	5.47%	0.84%
Incentive stock options	4.16%	12.03%
Federal tax credit and other, net	0.35%	4.65%
Effective income tax rate	<u>43.98%</u>	<u>(16.48)%</u>

The Company is eligible for tax benefits associated with the excess of the tax deduction available for exercises of non-qualified stock options over the amount recorded at grant. The amount of the benefit is based on the ultimate deduction reflected in the applicable income tax return. As of September 30, 2009, the Company had approximately \$5.3 million of net operating losses that resulted from the current and prior years exercise of non-qualified stock options that had not been recognized as a reduction to current income taxes payable.

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

### **Stock Option Plans**

The fair value of each option grant for the three and six months ended September 30, 2008 and 2009 was determined using the assumptions in the following table:

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	<u>Three months Ended September 30,</u>		<u>Six months Ended September 30,</u>	
	<u>2008</u>	<u>2009</u>	<u>2008</u>	<u>2009</u>
Weighted average expected term	6.0 years	7.3 years	5.7 years	6.5 years
Risk-free interest rate	3.35%	2.77%	3.24%	2.57%
Expected volatility	60%	60%	60%	60%
Expected forfeiture rate	2%	3%	2%	3%
Expected dividend yield	0%	0%	0%	0%

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

Basic net income (loss) per common share is computed by dividing net income (loss) attributable to common shareholders by the weighted-average number of common shares outstanding for the period and does not consider common stock equivalents. For the three and six months ended September 30, 2009, the calculation of dilutive weighted average shares outstanding does not include the following potentially dilutive shares as their effect would be antidilutive.

The net income (loss) per share of common stock for the three and six months ended September 30, 2008 and 2009 was as follows (in thousands except share amounts):

	<u>Three Months Ended September 30,</u>		<u>Six Months Ended September 30,</u>	
	<u>2008</u>	<u>2009</u>	<u>2008</u>	<u>2009</u>
<b>Numerator:</b>				
Net income (loss)	<u>\$ 453</u>	<u>\$ (1,399)</u>	<u>\$ 487</u>	<u>\$ (4,172)</u>
<b>Denominator:</b>				
Weighted-average common shares outstanding	26,959,790	21,707,477	26,998,857	21,648,246
Weighted-average effect of restricted stock, and assumed conversion of stock options and warrants	<u>2,059,201</u>	<u>644,920</u>	<u>2,614,827</u>	<u>788,723</u>
Weighted-average common shares and common share equivalents outstanding	<u>29,018,991</u>	<u>22,352,397</u>	<u>29,613,684</u>	<u>22,436,969</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 14.9% and 22.5% of total cost of revenue for the three months ended September 30, 2008 and 2009 and 22.1% and 16.3% of total cost of revenue for the six months ended September 30, 2008 and 2009.

For the three and six months ended September 30, 2008 and September 30, 2009, no customers accounted for more than 10% of revenue.

As of March 31, 2009 and September 30, 2009, no customer accounted for more than 10% of the accounts receivable balance.

### **Segment Information**

The Company has determined that it operates in only one segment in accordance with the Segment Reporting Topic of the FASB Accounting Standards Codification as it does not disaggregate profit and loss information on a segment basis for internal management reporting purposes to its chief operating decision maker.

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

### **Recent Accounting Pronouncements**

In May 2009, the FASB issued ASC 855-10 (formerly "SFAS No. 165"), *Subsequent Events*. ASC 855-10 sets forth: (1) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may

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occur for potential recognition or disclosure in financial statements, (2) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements and (3) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. The pronouncement is effective with interim and annual financial periods ending after June 15, 2009. The Company adopted ASC 855-10 at the beginning of its 2009 second quarter. The adoption did not have a significant impact on the subsequent events that the Company reports, either through recognition or disclosure, in its consolidated financial statements.

In June 2009, the FASB issued ASC 105-10 (formerly "SFAS 168"), *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*. ASC 105-10 will become the source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernment entities. It also modifies the GAAP hierarchy to include only two levels of GAAP; authoritative and non-authoritative. ASC 105-10 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company adopted ASC 105-10 for the 2009 second quarter reporting. The adoption did not have a significant impact on the reporting of the Company's financial position, results of operations or cash flows.

In October 2009, the FASB issued Accounting Standards Update 2009-13, *Multiple-Deliverable Revenue Arrangements — a consensus of the FASB Emerging Issues Task Force* (Topic 605), which amends the revenue guidance under ASC 605. This update requires entities to allocate revenue in an arrangement using estimated selling prices of the delivered goods and services based on a selling price hierarchy. This guidance eliminates the residual method of revenue allocation and requires revenue to be allocated using the relative selling price method. This update is effective for fiscal years ending after June 15, 2010, and may be applied prospectively for revenue arrangements entered into or materially modified after the date of adoption or retrospectively for all revenue arrangements for all periods presented. The Company is currently evaluating the impact this update will have on our consolidated financial statements.

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

The Company incurred fees of \$12,000 for the six months ended September 30, 2008 for intellectual property fees paid to an executive pursuant to an employment agreement. In April 2008, the intellectual property rights were purchased from the executive for a cash payment of \$950,000. Please refer to "Patents and Licenses" under footnote B for additional disclosure.

During the six months ended September 30, 2008 and 2009, the Company recorded revenue of \$8,000 and \$25,000 for products and services sold to an entity for which a director of the Company was formerly the executive chairman. During the same six month periods, the Company purchased goods and services from the same entity in the amounts of \$114,000 and \$30,000. The terms and conditions of such relationship are believed to be not materially more favorable to the Company or the entity than could be obtained from an independent third party.

During the six months ended September 30, 2008 and 2009, the Company recorded revenue of \$1,000 and \$116,000 for products and services sold to an entity for which a member of the board of directors previously served as an executive vice president. The terms and conditions of such relationship are believed to be not materially more favorable to the Company or the entity than could be obtained from an independent third party.

During the six months ended September 30, 2008 and 2009, the Company recorded revenue of \$52,000 and \$41,000 for products and services sold to an entity for which a member of the board of directors serves as the chief executive officer. During the six months ended September 30, 2008 and 2009, the Company purchased goods and services from the same entity in the amounts of \$42,000 and \$14,000.

During the six months ended September 30, 2008 and 2009, the Company recorded revenue of \$382,000 and \$526,000 for products and services sold to various entities affiliated or associated with an entity for which an executive officer of the Company serves 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 executive officer serves.

### **NOTE D — LONG-TERM DEBT**

Long-term debt as of March 31, 2009 and September 30, 2009 consisted of the following (in thousands):

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	March 31, 2009	September 30, 2009
Term note	\$ 1,235	\$ 1,128
First mortgage note payable	990	956
Debenture payable	885	867
Lease obligations	227	87
Other long-term debt	1,125	992
Total long-term debt	4,462	4,030
Less current maturities	(815)	(693)
Long-term debt, less current maturities	<u>\$ 3,647</u>	<u>\$ 3,337</u>

**Revolving Credit Agreement**

On March 18, 2008, the Company entered into a credit agreement (“Credit Agreement”) to replace a previous agreement between the Company and Wells Fargo Bank, N.A. The Credit Agreement provides for a revolving credit facility (“Line of Credit”) that matures on August 31, 2010. The initial maximum aggregate amount of availability under the Line of Credit is \$25.0 million. The Company has a one-time option to increase the maximum aggregate amount of availability under the Line of Credit to up to \$50.0 million, although any advance from the Line of Credit over \$25.0 million is discretionary to Wells Fargo even if no event of default has occurred. Borrowings are limited to a percentage of eligible trade accounts receivables and inventories, less any borrowing base reserve that may be established from time to time. In December 2008, the Company briefly drew \$4.0 million on the line of credit due to the timing of treasury repurchases and funds available in the Company’s operating account. In May 2009, the Company completed an amendment to the Credit Agreement, effective as of March 31, 2009, which formalized Wells Fargo’s prior consent to the Company’s treasury repurchase program, increased the capital expenditures covenant for fiscal 2009 and revised certain financial covenants by adding a minimum requirement for unencumbered liquid assets, increasing the quarterly rolling net income requirement and modifying the merger and acquisition covenant exemption. As of March 31, 2009 and September 30, 2009, there was no outstanding balance due on the Line of Credit.

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

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

The Credit Agreement contains certain financial covenants including minimum net income requirements, fixed charge coverage ratio and requirements that the Company maintain a net worth ratio at prescribed levels. The Credit Agreement also contains certain restrictions on the ability of the Company to make capital or lease expenditures over prescribed limits, incur additional indebtedness, consolidate or merge, guarantee obligations of third parties, make loans or advances, declare or pay any dividend or distribution on its stock, redeem or repurchase shares of its stock, or pledge assets.

As of September 30, 2009, the Company was not in technical compliance with the rolling quarterly net income and the fixed charge coverage ratio covenants in the Credit Agreement, although because it had no borrowings outstanding under its Line of Credit, no immediately foreseeable need to utilize its Line of Credit and the benefit of \$34.4 million of available cash and short-term liquid investment securities, it does not believe such technical noncompliance is material or otherwise adversely affects its liquidity or capital resources. The Company is currently in discussions with Wells Fargo, as well as with other banks, on a further amended or new credit facility.

**NOTE E — INCOME TAXES**

As of September 30, 2009, the Company had federal net operating loss carryforwards of approximately \$9.2 million, of which \$5.3 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 \$6.8 million, of which \$3.8 million are associated with the exercise of non-qualified stock options. The Company also has federal tax credit carryforwards of approximately \$630,000, of which \$171,000 has not yet been recognized in the financial statements, and state tax credit carryforwards of \$518,000, net of a valuation allowance of \$45,000, as of September 30, 2009. The Company has not recorded a valuation allowance for federal loss carryforwards or tax credits. Both the net operating losses and tax credit carryforwards expire between 2020 and 2029.

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In 2007, the Company's past issuances and transfers of stock caused an ownership change. 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 will 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 the ownership change affects the use of the full amount of the net operating loss carryforwards.

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

#### ***Operating Leases and Purchase Commitments***

The Company leases vehicles and equipment under operating leases. Rent expense under operating leases was \$318,000 and \$336,000 for the three months ended September 30, 2008 and 2009; and \$581,000 and \$623,000 for the six months ended September 30, 2008 and 2009. In addition, the Company enters into non-cancellable purchase commitments for certain inventory items in order to secure better pricing and ensure materials on hand, as well as for capital expenditures. As of September 30, 2009, the Company had entered into \$11.4 million of purchase commitments related to fiscal 2010, including \$0.9 million related to the remaining capital committed for information technology improvements and other manufacturing equipment, \$0.9 million for commitments under operating leases and \$9.6 million for inventory purchases.

#### ***Litigation***

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

On August 1, 2008, the court-appointed lead plaintiff filed a consolidated amended complaint in the United States District Court for the Southern District of New York. On September 15, 2008, the Company and the other director and officer defendants filed a motion to dismiss the consolidated complaint, and the underwriters filed a separate motion to dismiss the consolidated complaint on January 16, 2009. After oral argument on August 19, 2009, the Court granted in part and denied in part the motions to dismiss. The plaintiff filed a second consolidated amended complaint on September 4, 2009, and the defendants filed an answer to the complaint on October 9, 2009.

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

### **NOTE G — SHAREHOLDERS' EQUITY**

#### ***Share Repurchase Program***

In July 2008, the Company's board of directors approved a share repurchase program authorizing the Company to repurchase in the aggregate up to a maximum of \$20 million of the Company's outstanding common stock. In December 2008, the Company's board of directors supplemented the share repurchase program authorizing the Company to repurchase up to an additional \$10 million of the Company's outstanding common stock. As of September 30, 2009, the Company had repurchased 7,075,733 shares of common stock at a cost of \$29.7 million under the program.



**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.

**NOTE H — STOCK OPTIONS AND WARRANTS**

The Company grants stock options and restricted stock awards under its 2003 Stock Option and 2004 Stock and Incentive Awards Plans (the "Plans"). Under the terms of the Plans, the Company has reserved 10,500,000 shares for issuance to key employees, consultants and directors. The options generally vest and become exercisable ratably between one month and five years although longer vesting periods have been used in certain circumstances. In August and September of 2009, the Company granted stock option awards which vest based upon market or service conditions. The Company determined the vesting period for these option awards based upon an analysis of employment conditions and simulations of market conditions. 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.

In fiscal 2009, the Company granted 16,627 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 \$3.00 to \$11.61 per share. For the three months and six months ended September 30, 2009, the Company granted 1,323 and 2,843 shares from the 2004 Stock Incentive Awards Plan to a non-employee director who elected to receive stock awards in lieu of cash compensation. The shares were valued ranging from \$3.29 to \$3.78 per share, the market prices as of the grant dates.

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2008	2009	2008	2009
Cost of product revenue	\$ 65	\$ 53	\$ 130	\$ 112
General and administrative	171	145	425	267
Sales and marketing	145	136	271	265
Research and development	7	9	20	19
Total	<u>\$ 388</u>	<u>\$ 343</u>	<u>\$ 846</u>	<u>\$ 663</u>

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As of September 30, 2009, compensation cost related to non-vested stock-based compensation amounted to \$4.6 million over a remaining weighted average expected term of 6.9 years.

The following table summarizes information with respect to the Plans:

	Options Outstanding				Aggregate Intrinsic value
	Shares Available for Grant	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	
Balance at March 31, 2009	1,070,954	3,680,945	\$3.40	6.82	
Granted stock options	(549,227)	549,227	3.38		
Granted shares in lieu of cash compensation	(2,843)	—	—		
Forfeited	212,360	(212,360)	5.22		
Exercised	—	(265,498)	1.70		
Balance at September 30, 2009	731,244	3,752,314	\$3.41	6.89	\$2,871,547
Exercisable at September 30, 2009		1,702,251	\$2.65	5.21	\$1,999,824

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 \$3.13 as of September 30, 2009.

A summary of the status of the Company's outstanding non-vested stock options as of September 30, 2009 was as follows:

Non-vested at March 31, 2009	1,821,827
Granted	549,227
Vested	(108,631)
Forfeited	(212,360)
Non-vested at September 30, 2009	<u>2,050,063</u>

The Company has previously issued warrants in connection with various private placement stock offerings and services rendered. The warrants granted the holder the option to purchase common stock at specified prices for a specified period of time. No warrants were issued in fiscal 2009 or for the six months ended September 30, 2009.

Outstanding warrants are comprised of the following:

	Number of Shares	Weighted Average Exercise Price
Balance at March 31, 2009	488,504	\$ 2.31
Issued	—	—
Exercised	(29,186)	\$ 2.30
Cancelled	—	—
Balance at September 30, 2009	<u>459,318</u>	<u>\$ 2.31</u>

A summary of outstanding warrants at September 30, 2009 follows:

Exercise Price	Number of Warrants	Expiration
\$2.25	38,980	Fiscal 2014
\$2.30	383,078	Fiscal 2010
\$2.50	37,260	Fiscal 2011
Total	<u>459,318</u>	

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

*The following discussion and analysis of our financial condition and results of operations should be read together with our unaudited condensed consolidated financial statements and related notes included elsewhere in the Form 10-Q. It should also be read in conjunction with our audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended March 31, 2009.*

### Cautionary Note Regarding Forward-Looking Statements

Any statements in this Quarterly Report on Form 10-Q about our expectations, beliefs, plans, objectives, prospects, financial condition, assumptions or future events or performance are not historical facts and are "forward-looking statements" as that term is defined under the federal securities laws. These statements are often, but not always, made through the use of words or phrases such as "believe", "anticipate", "should", "intend", "plan", "will", "expects", "estimates", "projects", "positioned", "strategy", "outlook" and similar words. You should read the statements that contain these types of words carefully. Such forward-looking statements are subject to a number of risks, uncertainties and other factors that could cause actual results to differ materially from what is expressed or implied in such forward-looking statements. There may be events in the future that we are not able to predict accurately or over which we have no control. Potential risks and uncertainties include, but are not limited to, those discussed in "Part I, Item 1A. Risk Factors" in our 2009 Annual Report filed on Form 10-K for the year ended March 31, 2009 and elsewhere in this Quarterly Report. We urge you not to place undue reliance on these forward-looking statements, which speak only as the date of this report. We do not undertake any obligation to release publicly any revisions to such forward-looking statements to reflect events or uncertainties after the date hereof or to reflect the occurrence of unanticipated events.

### Overview

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

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

We have sold and installed more than 1,571,000 of our HIF lighting systems in over 5,000 facilities from December 1, 2001 through September 30, 2009. We have sold our products to 120 Fortune 500 companies, many of which have installed our HIF lighting systems in multiple facilities. Our top direct customers by revenue in fiscal 2009 included Coca-Cola Enterprises Inc., Anheuser-Busch Companies, Inc., Kraft Foods Inc., Ben E. Keith Co., SYSCO Corp., Americold Logistics, LLC and U.S. Foodservice. Our top direct customers by revenue for the six months ended September 30, 2009 included Coca-Cola Enterprises Inc., U.S. Foodservice, SYSCO Corp., Americold Logistics, LLC and Pepsico, Inc. and its affiliates.

Our fiscal year ends on March 31. We call our prior fiscal year which ended on March 31, 2009, "fiscal 2009". We call our current fiscal year, which will end on March 31, 2010, "fiscal 2010." 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 current recessed state of the global economy, especially as it relates to capital equipment manufacturers, our first half of fiscal 2010 continued to be impacted by lengthened customer sales cycles and sluggish customer capital spending. To address these conditions, we implemented \$3.2 million of annualized cost reductions, which are beginning to be realized over fiscal 2010. These cost containment initiatives included reductions related to headcount, work hours and discretionary spending. We believe these cost reduction efforts will better position us for profitability in the second half of fiscal 2010, dependent upon the economic environment, customer capital spending and other factors.

### Recent Developments

In August 2009, we created Orion Technology Ventures ("OTV"), a new operating division to explore whether we should offer our customers additional alternative renewable energy systems, such as those using wind and solar technologies. This division will conduct research on various renewable energy technologies that we may be able to add to our menu of products, applications and services offered, make

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recommendations to our senior management regarding the technologies' viability, develop commercialization tactics, and if determined commercially viable, ultimately add the technology into our menu of products, applications and services offered through our distribution channels. We are currently researching three test solar photovoltaic electricity generating projects. These projects are expected to help us answer technological, installation and commercial feasibility questions before determining how this technology may fit into our overall business plan.

### **Revenue and Expense Components**

*Revenue.* We sell our energy management products and services directly to commercial and industrial customers, and indirectly to end users through wholesale sales to electrical contractors and value-added resellers. We currently generate the substantial majority of our revenue from sales of HIF lighting systems and related services to commercial and industrial customers. While our services include comprehensive site assessment, site field verification, utility incentive and government subsidy management, engineering design, project management, installation and recycling in connection with our retrofit installations, we separately recognize service revenue only for our installation and recycling services. Except for our installation and recycling services, all other services are completed prior to product shipment and revenue from such services is included in product revenue because evidence of fair value for these services does not exist. In the first half of fiscal 2010, we maintained our efforts in selling through our contractor and value-added reseller channels with marketing through mass mailings, participating in national trade organizations and providing training to channel partners on our sales methodologies. These wholesale channels accounted for approximately 38% of our total revenue volume in the first half of fiscal 2010 which was comparable to the 40% of total revenues contributed in fiscal 2009.

In October 2008, we introduced to the market a financing program called the Orion Virtual Power Plant ("OVPP") for our customer's purchase of our energy management systems without an up-front capital outlay. The OVPP is structured as an operating lease in which we receive monthly rental payments over the life of the contract, typically 12 months, with an annual renewable agreement with a maximum term between three and five years. This program creates a revenue stream, but may lessen near-term revenues as the payments are recognized as revenue on a monthly basis over the life of the contract versus upfront upon product shipment or project completion. However, we do retain the option to sell the payment stream to a third party finance company, as we have done under the terms of our former financing program, in which case the revenue would be recognized at the net present value of the total future payments from the finance company upon completion of the project. The OVPP program was established to assist customers who are interested in purchasing our energy management systems but who have capital expenditure budget limitations. For the six months ended September 30, 2009, we recognized \$0.2 million of revenue from completed OVPP contracts. As of September 30, 2009, we had signed 67 customers to OVPP contracts representing future gross revenue streams of \$6.2 million. In the future, we expect an increase in the volume of OVPP contracts as our customers take advantage of our value proposition without incurring an up-front capital cost.

We recognize revenue on product only sales at the time of shipment. For projects consisting of multiple elements of revenue, such as a combination of product sales and services, we separate the project into separate units of accounting based on their relative fair values for revenue recognition purposes. Additionally, the deferral of revenue on a delivered element may be required if such revenue is contingent upon the delivery of the remaining undelivered elements. We recognize revenue at the time of product shipment on product sales and on services completed prior to product shipment. We recognize revenue associated with services provided after product shipment, based on their fair value, when the services are completed and customer acceptance has been received. When other significant obligations or acceptance terms remain after products are delivered, revenue is recognized only after such obligations are fulfilled or acceptance by the customer has occurred.

Our dependence on individual key customers can vary from period to period as a result of the significant size of some of our retrofit and multi-facility roll-out projects. Our top 10 customers accounted for approximately 32% and 38% of our total revenue for the first half of fiscal 2010 and fiscal 2009, respectively. No single customer accounted for more than 10% of our total revenue for either our first half of fiscal 2010 or fiscal 2009. To the extent that large retrofit and roll-out projects become a greater component of our total revenue, we may experience more customer concentration in given periods. The loss of, or substantial reduction in sales volume to, any of our significant customers could have a material adverse effect on our total revenue in any given period and may result in significant annual and quarterly revenue variations.

Our level of total revenue for any given period is dependent upon a number of factors, including (i) the demand for our products and systems, including our OVPP program and any new products, applications and services that we may introduce through our new OTV 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 and our OVPP program, including whether we decide to either retain or resell the expected future cash flows under our OVPP program and the relative timing of the resultant revenue recognition; (v) market conditions; (vi) our execution of our sales process; (vii) our ability to compete in a highly competitive market and our ability to

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respond successfully to market competition; (viii) the selling price of our products and services; (ix) changes in capital investment levels by our customers and prospects; and (x) customer sales cycles. As a result, our total revenue may be subject to quarterly variations and our total revenue for any particular fiscal quarter may not be indicative of future results.

*Bookings.* We define bookings as the total contractual value of all firm purchase orders received for our products and services and the gross revenue stream for all OVPP contracts upon the execution of the contract. For the three months ended September 30, 2008 and 2009, our bookings were \$20.2 million and \$20.3 million, which for the September 30, 2009 quarter included \$2.4 million of future gross revenue streams associated with OVPP contracts. For the six months ended September 30, 2008 and 2009, our bookings were \$33.6 million and \$35.8 million, which for the September 30, 2009 first half included \$4.7 million of future gross revenue streams associated with OVPP contracts.

*Backlog.* We define backlog as the total contractual value of all firm orders received for our lighting products and services. Such orders must be evidenced by a signed proposal acceptance or purchase order from the customer. Our backlog does not include OVPP contracts or national account contracts that have been negotiated, but for which we have not yet received a purchase order for the specific location. As of September 30, 2009, we had a backlog of firm purchase orders of approximately \$4.0 million. We generally expect this level of firm purchase order backlog to be converted into revenue within the following quarter. Principally as a result of the continued lengthening of our customer's purchasing decisions because of current economic conditions and related factors, the continued shortening of our installation cycles and the number of projects sold through national and OVPP contracts, a comparison of backlog from period to period is not necessarily meaningful and may not be indicative of actual revenue recognized in future periods.

*Cost of Revenue.* Our total cost of revenue consists of costs for: (i) raw materials, including sheet, coiled and specialty reflective aluminum; (ii) electrical components, including ballasts, power supplies and lamps; (iii) wages and related personnel expenses, including stock-based compensation charges, for our fabricating, coating, assembly, logistics and project installation service organizations; (iv) manufacturing facilities, including depreciation on our manufacturing facilities and equipment, taxes, insurance and utilities; (v) warranty expenses; (vi) installation and integration; and (vii) shipping and handling. Our cost of aluminum can be subject to commodity price fluctuations, which we attempt to mitigate with forward fixed-price, minimum quantity purchase commitments with our suppliers. We also purchase many of our electrical components through forward purchase contracts. We buy most of our specialty reflective aluminum from a single supplier, and most of our ballast and lamp components from a single supplier, although we believe we could obtain sufficient quantities of these raw materials and components on a price and quality competitive basis from other suppliers if necessary. Purchases from our current primary supplier of ballast and lamp components constituted 16% of our total cost of revenue for the first six months of fiscal 2010 and were 22% of total cost of revenue for the first six months of fiscal 2009. Our production labor force is non-union and, as a result, our production labor costs have been relatively stable. We have been expanding our network of qualified third-party installers to realize efficiencies in the installation process. Toward the end of fiscal 2008, we began to vertically integrate some of our processes performed at outside suppliers to help us better manage delivery lead time, control process quality and inventory supply. We installed a coating line and acquired production fabrication equipment. In fiscal 2009, we installed a power cord assembly line. Each of these production lines provide us with additional capacity and we expect that these additions will help to reduce overall unit costs upon the equipment becoming more fully utilized. In the first half of fiscal 2010, 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 mix of large retrofit and multi-facility roll-out projects with national accounts; (ii) the level of our wholesale sales (which generally have historically resulted in higher relative gross margins, but lower relative net margins, than our sales to direct customers); (iii) our realization rate on our billable services; (iv) our project pricing; (v) our level of warranty claims; (vi) our level of utilization of our manufacturing facilities and production equipment and related absorption of our manufacturing overhead costs; (vii) our level of efficiencies in our manufacturing operations; and (viii) our level of efficiencies from our subcontracted installation service providers.

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

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

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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 2009, we incurred increased general and administrative expenses in connection with our becoming a public company, including increased accounting, audit, investor relations, legal and support services and Sarbanes-Oxley compliance fees and expenses. Our operating expenses continued to increase in the first half of fiscal 2010 as a result of the completion of our new technology center and the related building occupancy costs. We expense all pre-sale costs incurred in connection with our sales process prior to obtaining a purchase order. These pre-sale costs may reduce our net income in a given period prior to recognizing any corresponding revenue. We also intend to continue to invest in our research and development of new and enhanced energy management products and services.

We recognize compensation expense for the fair value of our stock option awards granted over their related vesting period. We recognized \$0.7 million in the first six months of fiscal 2010 and \$1.6 million of stock-based compensation expense in fiscal 2009. As a result of prior option grants, we expect to recognize an additional \$4.6 million of stock-based compensation over a weighted average period of approximately seven years, including \$0.7 million in the last six months of fiscal 2010. 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 described under “— Liquidity and Capital Resources — Indebtedness” below, including the amortization of previously incurred financing costs. We amortize deferred financing costs to interest expense over the life of the related debt instrument, ranging from six to fifteen years.

*Dividend and Interest Income.* Our dividend income consists of dividends paid on preferred shares that we acquired in July 2006. The terms of these preferred shares provided for annual dividend payments to us of \$0.1 million. The preferred shares were sold back to the issuer in June 2008 and all dividends accrued were paid upon sale. We also report interest income earned on our cash and cash equivalents and short term investments. For the first half of fiscal 2010, our interest income declined as a result of the decrease in our cash and cash equivalents and declining market rates.

*Income Taxes.* As of September 30, 2009, we had net operating loss carryforwards of approximately \$9.2 million for federal tax purposes and \$6.8 million for state tax purposes. Included in these loss carryforwards were \$5.3 million for federal and \$3.8 million for state tax purposes of compensation expenses that were associated with the exercise of nonqualified stock options. The benefit from our net operating losses created from these compensation expenses has not yet been recognized in our financial statements and will be accounted for in our shareholders’ equity as a credit to additional paid-in capital as the deduction reduces our income taxes payable. We also had federal and state credit carryforwards that each total approximately \$0.5 million as of March 31, 2009. We believe it is more likely than not that we will realize the benefits of most of these assets and have recorded for an allowance of \$45,000 due to our state apportioned income and the potential expiration of the state tax credits due to the carryforwards period. These federal and state net operating losses and credit carryforwards are available, subject to the discussion in the following paragraph, to offset future taxable income and, if not utilized, will begin to expire in varying amounts between 2020 and 2029.

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. For

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fiscal year 2008, utilization of our federal loss carryforwards was limited to \$3.0 million. There was no limitation that occurred for fiscal 2009. For fiscal 2010, we do not anticipate a limitation on the use of our net operating loss carryforwards.

## Results of Operations

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

	Three Months Ended September 30,					Six Months Ended September 30,				
	2008		2009		% Change	2008		2009		% Change
	Amount	% of Revenue	Amount	% of Revenue		Amount	% of Revenue	Amount	% of Revenue	
Product revenue	\$ 17,280	92.1%	\$ 13,763	94.1%	(20.4)%	\$ 30,169	86.5%	\$ 24,440	89.7%	(19.0)%
Service revenue	1,480	7.9%	856	5.9%	(42.2)%	4,697	13.5%	2,807	10.3%	(40.2)%
Total revenue	18,760	100.0%	14,619	100.0%	(22.1)%	34,866	100.0%	27,247	100.0%	(21.9)%
Cost of product revenue	11,467	61.1%	9,222	63.1%	(19.6)%	20,080	57.6%	17,094	62.8%	(14.9)%
Cost of service revenue	958	5.1%	632	4.3%	(34.0)%	3,254	9.3%	1,887	6.9%	(42.0)%
Total cost of revenue	12,425	66.2%	9,854	67.4%	(20.7)%	23,334	66.9%	18,981	69.7%	(18.7)%
Gross profit	6,335	33.8%	4,765	32.6%	(24.8)%	11,532	33.1%	8,266	30.3%	(28.3)%
General and administrative expenses	2,893	15.4%	3,143	21.5%	8.6%	5,508	15.8%	6,307	23.1%	14.5%
Sales and marketing expenses	2,771	14.8%	2,962	20.2%	6.9%	5,423	15.6%	6,113	22.4%	12.7%
Research and development expenses	373	2.0%	491	3.4%	31.9%	791	2.3%	910	3.3%	15.0%
Income (loss) from operations	298	1.6%	(1,831)	(12.5)%	(714.4)%	(190)	(0.5)%	(5,064)	(18.5)%	NM
Interest expense	41	0.2%	74	0.5%	80.5%	108	0.3%	130	0.5%	20.4%
Dividend and interest income	550	2.9%	76	0.5%	(86.2)%	1,167	3.3%	198	0.7%	(83.0)%
Income (loss) before income tax	807	4.3%	(1,829)	(12.5)%	(326.6)%	869	2.5%	(4,996)	(18.3)%	(674.9)%
Income tax expense (benefit)	354	1.9%	(430)	(2.9)%	221.5%	382	1.1%	(824)	(3.0)%	315.7%
Net income (loss)	\$ 453	2.4%	\$ (1,399)	(9.6)%	(408.8)%	\$ 487	1.4%	\$ (4,172)	(15.3)%	(956.7)%

NM = Not Meaningful

**Revenue.** Product revenue decreased from \$17.3 million for the fiscal 2009 second quarter ended September 30, 2008 to \$13.8 million for the fiscal 2010 second quarter ended September 30, 2009, a decrease of \$3.5 million, or 20%. Product revenue decreased from \$30.2 million for the first half ended September 30, 2008 to \$24.4 million for the first half ended September 30, 2009, a decrease of \$5.8 million, or 19%. The decrease in product revenue was a result of decreased sales of our HIF lighting systems and an increase in the number of projects sold under our OVPP financing terms, which reduces revenue in the near term but provides recurring revenues into future fiscal periods. Service revenue decreased from \$1.5 million for the fiscal 2009 second quarter to \$0.9 million for the fiscal 2010 second quarter, a decrease of \$0.6 million, or 42%. Service revenue decreased from \$4.7 million for the fiscal 2009 first half to \$2.8 million for the fiscal 2010 first half, a decrease of \$1.9 million, or 40%. The decrease in service revenue was a result of the decreased sales of our HIF lighting systems. Our first half fiscal 2010 revenue continued to be impacted by a lengthening sales cycle in the marketplace. We attribute this circumstance to general conservatism in the marketplace concerning capital spending and purchase decisions due to continuing adverse economic and credit market conditions. In our fiscal 2010 second quarter, we realized a slight improvement in our order volumes in relation to our fiscal 2010 first quarter, including the receipt of orders from customers who have not purchased product from us during the preceding 12-month period. We believe that this trend will likely continue during the fiscal 2010 third quarter, depending upon economic conditions, capital spending budgets and other factors.

**Cost of Revenue and Gross Margin.** Our cost of product revenue decreased from \$11.5 million for the fiscal 2009 second quarter to \$9.2 million for the fiscal 2010 second quarter, a decrease of \$2.3 million, or 20%. Our cost of product revenue decreased from \$20.1 million for the fiscal 2009 first half to \$17.1 million for the fiscal 2010 first half, a decrease of \$3.0 million, or 15%. Our cost of service revenues decreased from \$1.0 million for the fiscal 2009 second quarter to \$0.6 million for the fiscal 2010 second quarter, a decrease of \$0.4 million, or 40%. Total gross margin decreased from 33.8% for the fiscal 2009 second quarter to 32.6% for the fiscal 2010 second quarter and decreased from 33.1% for the fiscal 2009 first half to 30.3% for the fiscal 2010 first half. The decrease in gross margin was attributable to unabsorbed manufacturing capacity costs related to the decline in product revenues. During the fiscal 2010 second quarter, we saw improvements in our product gross margins, relative to the volume decline, resulting from our efforts to reengineer our assembly processes, including the implementation of cell manufacturing stations, a reduction in headcount and a reduction in work hours.

## Operating Expenses

**General and Administrative.** Our general and administrative expenses increased from \$2.9 million for the fiscal 2009 second quarter to \$3.1 million for the fiscal 2010 second quarter, an increase of \$0.2 million, or 9%. The increase was a result of: (i) \$0.2 million in costs related to the write down of a long term note receivable; (ii) \$0.1 million for bad debt charges on aged accounts receivables; and (iii) \$0.3 million for occupancy costs related to the completion of our new technology center. These cost increases were partially offset by \$0.4 million in decreased compensation costs resulting from headcount reductions and other discretionary spending reductions.

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General and administrative expenses increased from \$5.5 million for the fiscal 2009 first half to \$6.3 million for the fiscal 2010 first half, an increase of \$0.8 million, or 15%. The increase was a result of: (i) \$0.3 million in costs related to the write down of a long term note receivable and bad debt charges on aged accounts receivables; (ii) \$0.3 million in severance compensation costs; (iii) \$0.4 million as a result of a one-time gain on asset disposal in the first half of fiscal 2009 that did not recur and (iv) \$0.6 million increase for occupancy costs related to the completion of our new technology center, including approximately \$0.1 million for one-time start-up charges. These cost increases were partially offset by \$0.8 million in decreased compensation costs resulting from headcount reductions and other discretionary spending reductions.

*Sales and Marketing.* Our sales and marketing expenses increased from \$2.8 million for the fiscal 2009 second quarter to \$3.0 million for the fiscal 2010 second quarter, an increase of \$0.2 million, or 7%. The increase was a result of increased employee compensation and benefit costs resulting from our hiring additional sales and marketing personnel during our fiscal 2010 first quarter. We increased our sales and marketing headcount to further develop opportunities for our 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 control product lines. Total sales and marketing headcount as of September 30, 2009 was 78 compared to 62 at September 30, 2008.

Sales and marketing expenses increased from \$5.4 million for the fiscal 2009 first half to \$6.1 million for the fiscal 2010 first half, an increase of \$0.7 million, or 13%. The increase was a result of compensation and benefit costs for additional sales and marketing personnel.

*Research and Development.* Our research and development expenses increased from \$0.4 million for the fiscal 2009 second quarter to \$0.5 million for the fiscal 2010 second quarter by \$0.1 million, or 32%. Research and development expenses increased from \$0.8 million for the fiscal 2009 first half to \$0.9 million for the fiscal 2010 first half. Expenses incurred for the first half of fiscal 2010 related to compensation costs for the development and support of new products, depreciation expenses for lab and research equipment and testing costs related to our new wireless controls and exterior lighting product initiatives.

*Interest Expense.* Our interest expense increased from \$41,000 for the fiscal 2009 second quarter to \$74,000 for the fiscal 2010 second quarter, an increase of \$33,000, or 80%. Our interest expenses increased from \$108,000 for the first half of fiscal 2009 to \$130,000 for the first half of fiscal 2010, an increase of \$22,000, or 20%. The increase in interest expense was due to the elimination of capitalized interest resulting from the completion of our corporate technology center. For the first half of fiscal 2009 and fiscal 2010, we capitalized \$96,000 and \$21,000 of interest for construction in progress, respectively.

*Dividend and Interest Income.* Our dividend and interest income decreased for both the three and six months ended September 30, 2009 from the three and six months ended September 30, 2008 as a result of declining market interest rates and the reduction in our cash balances year over year due to cash used for our common share repurchase.

*Income Taxes.* Our income tax expense decreased for both the three and six months ended September 30, 2009 from the three and six months ended September 30, 2008 due to the reduction in our taxable income. Our effective income tax rate for the fiscal 2009 first half was 44.0%, compared to (16.5)% for the fiscal 2010 first half. The change in our effective tax rate was due to a reduction of benefits for non-deductible stock compensation expense, a mix change in state rates and an increase in federal tax credits available.

## **Liquidity and Capital Resources**

### **Overview**

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

We had approximately \$33.4 million in cash and cash equivalents and \$1.0 million in short-term investments as of September 30, 2009, compared to \$36.2 million and \$6.5 million at March 31, 2009. Our cash equivalents are invested in money market accounts, bank certificates of deposit and a high-grade government agency bond with maturities of less than 90 days and an average yield of 0.7%. Our short-term investment account consists of a single bank certificate of deposit with an expiration date of June 2010 and a yield of 1.0%.



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### **Cash Flows**

The following table summarizes our cash flows for the six months ended September 30, 2008 and 2009 (in thousands):

	Six Months Ended September 30,	
	2008	2009
Operating activities	\$ (371)	\$ (3,890)
Investing activities	(24,855)	1,456
Financing activities	(6,679)	(316)
Decrease in cash and cash equivalents	<u>\$ (31,905)</u>	<u>\$ (2,750)</u>

*Cash Flows Related to Operating Activities.* Cash used in operating activities primarily consists 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 used in operating activities for the first half of fiscal 2010 was \$3.9 million and consisted of net cash of \$0.5 million used for working capital purposes and net loss adjusted non-cash expense items of \$3.4 million. Cash used for working capital purposes consisted of an increase of \$1.3 million in trade receivables and a \$2.3 million decrease in accounts payable resulting from payments to vendors. These amounts were offset by a decrease of \$0.6 million in inventories resulting from reduced inventory purchases, a \$1.8 million decrease in prepaids resulting from refunds of deposits held under construction projects and for operating leases and the amortization of expenses and a \$0.7 million increase in accrued expenses resulting from increases in accrued severance costs, increases in accrued legal expenses and increased deposit payments for OVPP contracts.

Cash used in operating activities for the first half of fiscal 2009 was \$0.4 million and consisted of net cash of \$2.8 million used for working capital purposes partially offset by net income adjusted for non-cash expense items of \$2.4 million. Cash used for working capital consisted of an increase of \$2.1 million in inventory to provide safety stock inventories on key components, a \$0.6 million increase in prepaids due to advanced payments for income taxes and services, a \$0.4 million increase in deferred costs due to incomplete projects where revenue has not yet been recognized, a \$0.5 million increase for interest receivable on short-term investments and a \$0.5 million decrease in accrued expenses due to payments of accrued contractors for project services performed. This amount was offset by a decrease in trade receivables of \$1.3 million as a result of timing of cash receipts.

*Cash Flows Related to Investing Activities.* For the first half of fiscal 2010, cash provided by investing activities was \$1.5 million. This included \$5.6 million provided from the maturation of short-term investments, offset by cash flows used in investing activities of \$2.5 million for capital expenditures related to the technology center, operating software systems, and processing equipment for capacity and cost improvement measures and \$1.5 million for investment into OVPP assets installed and operating at customer locations.

Cash used in investing activities for the first half of fiscal 2009, was \$24.9 million. This included \$17.4 million for short-term investments with maturity dates ranging from 91 to 360 days, \$6.9 million for capital expenditures related to the technology center, operating software systems and processing equipment for capacity and cost improvement measures, \$1.0 million for the purchase of intellectual property rights from an executive, offset by net proceeds from the sale of an investment of \$0.9 million.

*Cash Flows Related to Financing Activities.* For the first half of fiscal 2010, cash flows used in financing activities was \$0.3 million. This included \$0.4 million for common share repurchases and \$0.4 million used for the repayment of long-term debt, offset by cash flows provided by financing activities, which included proceeds of \$0.5 million received from stock option and warrant exercises.

Cash used in financing activities for the first half of fiscal 2009, was \$6.7 million. This included \$8.1 million used for common share repurchases and \$0.4 million for repayment of long-term debt. Cash flows provided by financing activities included proceeds of \$1.4 million received from stock option and warrant exercises and \$0.5 million in deferred tax benefits from non-qualified stock option exercises.

### **Working Capital**

Our net working capital as of September 30, 2009 was \$60.0 million, consisting of \$69.1 million in current assets and \$9.1 million in current liabilities. Our net working capital as of March 31, 2009 was \$67.5 million, consisting of \$78.4 million in current assets and \$10.9 million in current liabilities. Our inventories have decreased from our prior fiscal year-end by \$0.6 million as a result of efforts

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to reduce purchases and carrying levels of our HIF inventory components. We have been increasing the level of our wireless control inventories based upon our Phase 2 initiatives. The vast majorities of these components are assembled overseas, require longer delivery lead times and suppliers require deposit payments at time of purchase order. We generally attempt to maintain a three-month supply of on-hand inventory of purchased components and raw materials to meet anticipated demand, as well as to reduce our risk of unexpected raw material or component shortages or supply interruptions. Our accounts receivables, inventory and payables may increase to the extent our revenue and order levels increase.

We believe that our existing cash and cash equivalents and our anticipated cash flows from operating activities will be sufficient to meet our anticipated cash needs for at least the next 12 months.

### ***Indebtedness***

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

On March 18, 2008, we entered into a credit agreement to replace a previous agreement between us and Wells Fargo Bank, N.A. The credit agreement provides for a revolving credit facility that matures on August 31, 2010. The initial maximum aggregate amount of availability under the line of credit is \$25.0 million. We have a one-time option to increase the maximum aggregate amount of availability under the Line of Credit to up to \$50.0 million, although any advance from the line of credit over \$25.0 million is discretionary to Wells Fargo even if no event of default has occurred. In December 2008, we briefly drew \$4.0 million on the line of credit due to the timing of treasury repurchases and funds available in our operating account. In May 2009, we completed an amendment to the credit agreement, effective as of March 31, 2009, which formalized Wells Fargo's prior consent to our treasury repurchase program, increased the capital expenditures covenant for fiscal 2009 and revised certain financial covenants by adding a minimum requirement for unencumbered liquid assets, increasing the quarterly rolling net income requirement and modifying the merger and acquisition covenant exemption. As of September 30, 2009, there was no outstanding balance due on the line of credit.

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

The credit agreement provides that we have the option to select the interest rate applicable to all or a portion of the outstanding principal balance of the line of credit either (i) at a fluctuating rate per annum one percent (1.00%) below the prime rate in effect from time to time, or (ii) at a fixed rate per annum determined by Wells Fargo to be one and one quarter percent (1.25%) above LIBOR. Interest is payable on the last day of each month. The credit agreement contains certain financial covenants including minimum net income requirements, fixed charge coverage ratio and requirements that we maintain a net worth ratio 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 its stock, redeem or repurchase shares of its stock, or pledge assets.

At the end of our fiscal 2010 second quarter, even though we had no borrowings outstanding under our line of credit, we were not in technical compliance with our rolling quarterly net income and our fixed charge coverage ratio covenants in our credit agreement. We are currently in discussions with Wells Fargo, as well as other banks, on a further amended or new credit facility.

Since we have over \$34 million of cash, cash-equivalents and short-term investments on hand, and because we have no borrowings outstanding under our credit agreement and no currently foreseeable intention to borrow under our line of credit, we do not believe that such covenant violations or any subsequently obtained credit agreement amendment is material to our current or future financial condition or our current or future access to capital or liquidity.

### ***Capital Spending***

We expect to incur approximately \$1.4 million in capital expenditures during the remainder of fiscal 2010. We spent approximately \$2.5 million of capital expenditure in the first half of fiscal 2010 on the completion of our corporate technology center, implementation of an ERP system, software development for our wireless controls technology and other tooling and equipment for new products and cost improvements in our manufacturing facility. Our capital spending plans predominantly consist of the completion of projects that have been in place for several months and for which we have already invested significant capital. We consider the completion of our ERP systems critical to our long-term success and our ability to ensure a strong control environment over financial reporting and operations. We expect to finance the information technology and manufacturing improvements primarily through equipment secured loans and leases, long-term debt financing, using cash on hand or by using our available capacity under our revolving credit facility.

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### **Contractual Obligations and Commitments**

The following table is a summary of our long-term contractual obligations as of September 30, 2009 (dollars in thousands):

	<u>Total</u>	<u>Less than 1 Year</u>	<u>1-3 Years</u>	<u>3-5 Years</u>	<u>More than 5 Years</u>
Bank debt obligations	\$ 4,030	\$ 693	\$ 1,200	\$ 926	\$ 1,211
Cash interest payments on debt	1,063	208	316	189	350
Operating lease obligations	3,660	938	1,914	601	207
Purchase order and cap-ex commitments (1)	11,637	10,462	1,175	—	—
<b>Total</b>	<b>\$ 20,390</b>	<b>\$ 12,301</b>	<b>\$ 4,605</b>	<b>\$ 1,716</b>	<b>\$ 1,768</b>

- (1) Reflects non-cancellable purchase order commitment in the amount of \$10.7 million for certain inventory items entered into in order to secure better pricing and ensure materials on hand and capital expenditure commitments in the amount of \$0.9 million for improvements to information technology systems and manufacturing equipment and tooling.

### **Off-Balance Sheet Arrangements**

We have no off-balance sheet arrangements.

### **Inflation**

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

### **Critical Accounting Policies and Estimates**

The discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of our consolidated financial statements requires us to make certain estimates and judgments that affect our reported assets, liabilities, revenue and expenses, and our related disclosure of contingent assets and liabilities. We re-evaluate our estimates on an ongoing basis, including those related to revenue recognition, inventory valuation, the collectability of receivables, stock-based compensation, warranty reserves and income taxes. We base our estimates on historical experience and on various assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates. A summary of our critical accounting policies is set forth in the “Critical Accounting Policies and Estimates” section of our Management’s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended March 31, 2009. There have been no material changes in any of our accounting policies since March 31, 2009.

### **Recent Accounting Pronouncements**

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

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our exposure to market risk was discussed in the “Quantitative and Qualitative Disclosures About Market Risk” section contained in our Annual Report on Form 10-K for the year ended March 31, 2009. There have been no material changes to such exposures since March 31, 2009.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **Evaluation of Disclosure Controls and Procedures**

We maintain a system of disclosure controls and procedures designed to provide reasonable assurance as to the reliability of our published financial statements and other disclosures included in this report. Our management evaluated, with the participation of our

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Chief Executive Officer and our Chief Financial Officer, the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) as of the end of the quarter ended September 30, 2009 pursuant to the requirements of the Exchange Act. Based upon their evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the quarter ended September 30, 2009.

There was no change in our internal control over financial reporting that occurred during the quarter ended September 30, 2009 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

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

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

On August 1, 2008, the court-appointed lead plaintiff filed a consolidated amended complaint in the United States District Court for the Southern District of New York. On September 15, 2008, the Company and the other director and officer defendants filed a motion to dismiss the consolidated complaint, and the underwriters filed a separate motion to dismiss the consolidated complaint on January 16, 2009. After oral argument on August 19, 2009, the Court granted in part and denied in part the motions to dismiss. The plaintiff filed a second consolidated amended complaint on September 4, 2009, and the defendants filed an answer to the complaint on October 9, 2009.

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

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

We operate in a rapidly changing environment that involves a number of risks that could materially affect our business, financial condition or future results, some of which are beyond our control. In addition to the other information set forth in this Quarterly Report on Form 10-Q, the risks and uncertainties that we believe are most important for you to consider are discussed in Part I — Item 1A under the heading “Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended March 31, 2009. Other than as set forth below, during the three months ended September 30, 2009, there were no material changes to the risk factors that were disclosed in Part I — Item 1A under the heading “Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended March 31, 2009.

***Our potential addition of new renewable energy technologies into our product, application or service offerings involves many risks and uncertainties. Many technologies do not become commercially profitable products, applications or services despite extensive development and commercialization efforts.***

In August 2009, we created Orion Technology Ventures (“OTV”) as a new operating division to explore whether we should offer our customers additional alternative renewable energy systems, such as those using wind and solar technologies. OTV is conducting

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research on, and developing commercialization strategies with respect to, various renewable energy technologies that we may decide to add to our product, application and service offerings.

The process of developing and commercializing new products, applications and services, particularly relating to alternative renewable energy systems, is expected to be both time-consuming and costly and will involve 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 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.

***OTV may not be able to identify suitable new technologies, we may invest too much in new technologies, our management could be distracted by new technologies and we could fail to develop any 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, then 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.

***We may not be able to obtain additional equity capital or debt financing necessary to effectively introduce and commercialize any new alternative renewable energy technologies identified by OTV 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 OTV into our product, application and service offerings. We may not be able to obtain sufficient additional equity capital and/or debt financing required to do so or we may not be able to obtain such additional equity capital or debt financing on acceptable terms or conditions. Although we have been successful in the past in raising equity capital and debt financing, recent trends in the equity and debt markets and our recent financial performance may pose significant challenges for us. 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, including our recent losses generated from operations.
- 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.

*We have no operating history in the solar photovoltaic or wind energy industries that can be used to evaluate our potential prospects for success in these industries.*

Our OTV division is currently researching three test solar photovoltaic electricity generating projects. These projects are expected to help us answer technological, installation and commercial feasibility questions before determining whether and/or how this technology may fit into our overall business plan. OTV is also exploring potential wind energy projects and applications.

We have no history in the solar photovoltaic or wind energy industries. If we choose to further pursue adding these technologies into our product, application or service offerings, there can be no assurance that our venture into these industries will prove successful. We have no history of developing or commercializing solar photovoltaic or wind energy technologies that can be used to evaluate our potential prospects for success. As a result, our prospects for success in being able to introduce new products, applications or services using these technologies must be considered in the context of a new company in a developing industry. The risks we face include the possibility that we will not be successful in developing or commercializing any such technologies, that we will not be able to do so without incurring unexpected and/or substantial costs and expenses and/or failing to generate any substantial incremental revenues, that we will not be able to rely on third-party manufacturers or providers of such technologies, and that we will not be able to operate successfully in the competitive environment of the solar photovoltaic and/or wind energy industries. If we are unable to address all of these risks, our business, results of operations and financial condition may be materially adversely affected.

*OTV'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 elect to further pursue adding solar photovoltaic and/or wind electricity generating technologies into our product, application or service offerings, such business pursuits will involve risks specifically associated with the solar photovoltaic and/or wind industry, including:

- The market for photovoltaic and wind electricity generating technologies has been adversely affected by the recessionary economic conditions over the past year, and we cannot guarantee that demand will return or increase in the future.
- 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 will be 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.

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

### **(b) Use of Proceeds**

Our IPO was declared effective by the SEC on December 18, 2007. The net offering proceeds received by us, after deducting underwriting discounts and commissions and expenses incurred in connection with the offering, were approximately \$78.6 million. Through September 30, 2009, approximately \$14.8 million of the proceeds from our IPO have been used to fund operations of our business and for general corporate purposes and approximately \$29.7 million was used for the repurchase of common shares. The remainder of the net proceeds from the IPO are invested in short-term investment grade securities, bank certificates of deposit and money market accounts. Other than for our share repurchases, there has been no material change in the planned use of proceeds from our IPO as described in our final prospectus filed with the SEC on December 18, 2007 pursuant to Rule 424(b).

### **(c) Purchases of Equity Securities**

The table below summarizes stock repurchases for the three-month period ended September 30, 2009.

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Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(1)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs(1)
July 1 — July 31, 2009	46,667	\$3.75	46,667	\$335,000
August 1 — August 31, 2009	0	\$ 0	0	\$335,000
September 1 — September 30, 2009	23,962	\$3.13	23,962	\$260,000
	70,629		70,629	

- (1) On December 15, 2008, we announced that our board of directors had authorized the repurchase of up to an additional \$10 million of our outstanding common stock. The action supplemented the \$20 million share repurchase authorization announced on July 17, 2008. Unless terminated earlier by resolution of our board of directors, this repurchase program will expire when we have repurchased all shares authorized for repurchase thereunder.

## ITEM 5. OTHER INFORMATION

### Statistical Data

The following table presents certain statistical data, cumulative from December 1, 2001 through September 30, 2009, regarding sales of our HIF lighting systems, total units sold (including HIF lighting systems), customer kilowatt demand reduction, customer kilowatt hours saved, customer electricity costs saved, indirect carbon dioxide emission reductions from customers' energy savings, and square footage we have retrofitted. The assumptions behind our calculations are described in the footnotes to the table below.

	Cumulative From December 1, 2001 Through September 30, 2009 (in thousands, unaudited)
HIF lighting systems sold(1)	1,572
Total units sold (including HIF lighting systems)	2,037
Customer kilowatt demand reduction(2)	477
Customer kilowatt hours saved(2)(3)	9,230,379
Customer electricity costs saved(4)	\$ 710,739
Indirect carbon dioxide emission reductions from customers' energy savings (tons)(5)	6,135
Square footage retrofitted(6)	806,946

- (1) "HIF lighting systems" includes all HIF units sold under the brand name "Compact Modular" and its predecessor, "Illuminator."
- (2) A substantial majority of our HIF lighting systems, which generally operate at approximately 224 watts per six-lamp fixture, are installed in replacement of HID fixtures, which generally operate at approximately 465 watts per fixture in commercial and industrial applications. We calculate that each six-lamp HIF lighting system we install in replacement of an HID fixture generally reduces electricity consumption by approximately 241 watts (the difference between 465 watts and 224 watts). In retrofit projects where we replace fixtures other than HID fixtures, or where we replace fixtures with products other than our HIF lighting systems (which other products generally consist of products with lamps similar to those used in our HIF systems, but with varying frames, ballasts or power packs), we generally achieve similar wattage reductions (based on an analysis of the operating wattages of each of our fixtures compared to the operating wattage of the fixtures they typically replace). We calculate the amount of kilowatt demand reduction by multiplying (i) 0.241 kilowatts per six-lamp equivalent unit we install by (ii) the number of units we have installed in the period presented, including products other than our HIF lighting systems (or a total of approximately 2.0 million units).
- (3) We calculate the number of kilowatt hours saved on a cumulative basis by assuming the reduction of 0.241 kilowatts of electricity consumption per six-lamp equivalent unit we install and assuming that each such unit has averaged 7,500 annual operating hours since its installation.

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- (4) We calculate our customers' electricity costs saved by multiplying the cumulative total customer kilowatt hours saved indicated in the table by \$0.077 per kilowatt hour. The national average rate for 2008, which is the most current full year for which this information is available, was \$0.098 per kilowatt hour according to the United States Energy Information Administration.
- (5) We calculate this figure by multiplying (i) the estimated amount of carbon dioxide emissions that result from the generation of one kilowatt hour of electricity (determined using the Emissions and Generation Resource Integration Database, or EGrid, prepared by the United States Environmental Protection Agency), by (ii) the number of customer kilowatt hours saved as indicated in the table. The calculation of indirect carbon dioxide emissions reductions reflects the most recent Environmental Protection Agency eGrid data.
- (6) Based on 2.04 million total units sold, which contain a total of approximately 10.2 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.

## ITEM 6. EXHIBITS

### (a) Exhibits

- |      |  |
|------|--|
| 10.1 | Letter Agreement, dated as of August 27, 2009, between Orion Energy Systems, Inc. and John H. Scribante, filed as Exhibit 10.1 to Orion Energy Systems, Inc.'s Form 8-K filed on September 2, 2009, is hereby incorporated by reference as Exhibit 10.1. *             |
| 10.2 | Executive Employment and Severance Agreement, dated September 8, 2009, by and between Stuart L. Ralsky and Orion Energy Systems, Inc. *  |
| 31.1 | Certification of Chief Executive Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(a) or Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.   |
| 31.2 | Certification of Chief Financial Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(a) or Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.   |
| 32.1 | Certification of Chief Executive Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Chief Financial Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

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\* Management contract or compensatory plan or arrangement.



**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on November 9, 2009.

ORION ENERGY SYSTEMS, INC.  
Registrant

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

**Exhibit Index to Form 10-Q for the Period Ended September 30, 2009**

- 10.2 Executive Employment and Severance Agreement, dated September 8, 2009, by and between Stuart L. Ralsky and Orion Energy Systems, Inc.
- 31.1 Certification of Chief Executive Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(a) or Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.
- 31.2 Certification of Chief Financial Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(a) or Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.
- 32.1 Certification of Chief Executive Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Name of Executive:	Stuart L. Ralsky
Position:	Senior Vice President — Human Resources
Fiscal Year 2010 Base Salary:	\$160,000
Effective Date:	September 8, 2009
Initial Term:	Effective Date through March 31, 2010
Renewal Periods are:	1 Year
Post-Change of Control Renewal Period is:	2 Years
Severance Multiplier is:	1.0x
Post-Change of Control Severance Multiplier is:	2.0x

### EXECUTIVE EMPLOYMENT AND SEVERANCE AGREEMENT

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

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

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

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

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

(a) “**Accrued Benefits**” shall mean the following amounts, payable as described herein: (i) all base salary for the time period ending with the Termination Date; (ii) reimbursement for any and all monies advanced in connection with the Executive’s employment for reasonable and necessary expenses incurred by the Executive on behalf of the Company for the time period ending with the Termination Date; (iii) any and all other cash earned through the Termination Date and deferred at the election of the Executive or pursuant to any deferred compensation plan then in effect; and (iv) all other payments and benefits to which the Executive (or in the event of the Executive’s death,

the Executive's surviving spouse or other beneficiary), including those provided pursuant to Exhibit A, is entitled on the Termination Date under the terms of any benefit plan of the Company, excluding severance payments under any Company severance policy, practice or agreement in effect on the Termination Date. Payment of Accrued Benefits shall be made promptly in accordance with the Company's prevailing practice with respect to clauses (i) and (ii) or, with respect to clauses (iii) and (iv), pursuant to the terms of the benefit plan or practice establishing such benefits.

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

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

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

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

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

(ii) the following individuals cease for any reason to constitute a majority of the number of directors of the Company then serving: (A) individuals who, on the date hereof, constituted the Board and (B) any new director (other than a director whose initial assumption of office is in connection with an actual or threatened election contest, including but not limited to a consent solicitation, relating to the election of directors of the Company, as such terms are used in

Rule 14a-11 of Regulation 14A under the Act) whose appointment or election by the Board or nomination for election by the Company's shareholders was approved by a vote of at least two-thirds (2/3) of the directors then still in office who either were directors on the date hereof, or whose appointment, election or nomination for election was previously so approved (collectively the "Continuing Directors"); *provided, however*, that individuals who are appointed to the Board pursuant to or in accordance with the terms of an agreement relating to a merger, consolidation, or share exchange involving the Company (or any direct or indirect subsidiary of the Company) shall not be Continuing Directors for purposes of this Agreement until after such individuals are first nominated for election by a vote of at least two-thirds (2/3) of the then Continuing Directors and are thereafter elected as directors by the shareholders of the Company at a meeting of shareholders held following consummation of such merger, consolidation, or share exchange; *and, provided further*, that in the event the failure of any such persons appointed to the Board to be Continuing Directors results in a Change of Control, the subsequent qualification of such persons as Continuing Directors shall not alter the fact that a Change of Control occurred; or

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

(iv) the consummation of a plan of complete liquidation or dissolution of the Company or a sale or disposition by the Company of all or substantially all of the Company's assets (in one transaction or a series of related transactions within any period of 24 consecutive months), in each case, which requires approval of the shareholders of the Company, other than a sale or disposition by the Company of all or substantially all of the Company's assets to an entity at least seventy-five percent (75%) of the combined voting power of the voting securities of which are owned by Persons in substantially the same proportions as their ownership of the Company immediately prior to such sale.

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

For purposes of this Section 2(e):

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

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

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

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

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

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

c) are beneficially owned, directly or indirectly, by any other Person with which such Person or any of such Person’s Affiliates or Associates has any agreement, arrangement or understanding for the purpose of

acquiring, holding, voting (except pursuant to a revocable proxy as described in clause b) above) or disposing of any voting securities of the Company.

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

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

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

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

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

(k) **“Good Reason”** shall mean the occurrence of any of the following without the consent of Executive: (i) a material diminution in the Executive’s Base Salary; (ii) a material diminution in the Executive’s authority, duties or responsibilities; (iii) a material diminution in the budget over which the Executive retains authority; (iv) a material change in the geographic location at which the Executive must perform services; or (v) a material breach by Orion of any provisions of this Agreement or any option agreement with the Company to which the Executive is a party.

(l) **“Separation from Service”** shall mean Executive’s termination of employment from Orion and each entity that is required to be included in Orion’s controlled

group of corporations within the meaning of Code Section 414(b), or that is under common control with Orion within the meaning of Code Section 414(c); *provided* that the phrase “at least 50 percent” shall be used in place of the phrase “ at least 80 percent” each place it appears therein or in the regulations thereunder (collectively, “409A affiliates”). Notwithstanding the foregoing:

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

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

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

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

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

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



### 3. Employment of Executive

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

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

(ii) Executive will devote Executive's full business time and best efforts to the performance of Executive's duties hereunder and will not engage in any other business, profession or occupation for compensation or otherwise which would conflict or interfere with the rendition of such services either directly or indirectly, without the prior written consent of the Board; *provided* that Executive shall be permitted to continue providing third party consulting services for his own account through his existing consulting firm, SLR Consulting; *further provided* that nothing herein shall preclude Executive, subject to the prior approval of the Board, from accepting appointment to or continue to serve on any board of directors or trustees of any business organization or any charitable organization; and *further provided* in each case, and in the aggregate, that such activities do not materially conflict or interfere with the performance of Executive's duties hereunder or conflict with Section 7. In addition, it is mutually agreed that Executive will not use the assets, facilities, goodwill or personnel of Orion in connection with his third party consulting services; the Executive will perform his third party consulting services solely in his personal capacity and not as an employee, affiliate or representative of Orion (and he will not hold himself out to his clients, prospects or to the public as providing any such third party consulting services as an employee, affiliate or representative of Orion); neither Executive nor SLR Consulting will perform any third party consulting services that would violate Section 7 hereof; and Executive will fully indemnify Orion against any claims against Orion arising out of or in connection with his third party consulting services.

(b) **Base Salary.** Orion shall pay Executive a Base Salary at the annual rate set forth above for Fiscal Year 2010, payable in regular installments in accordance with the Company's usual payroll practices. Executive shall be entitled to such increases in Executive's base salary, if any, as may be determined from time to time by the Board.

(c) **Bonus Incentives.** Executive shall be entitled to participate in such annual and/or long-term cash and equity incentive plans and programs of Orion as are generally provided to the senior executives of Orion. On and after a Change of Control, to assure that Executive will have an opportunity to earn incentive compensation, the Executive shall be included in a bonus plan of the Employer which shall satisfy the standards described below (such plan, the "Bonus Plan"). Bonuses under the Bonus Plan shall be payable with respect to achieving such financial or other goals reasonably related to the business of the Company as the Company shall establish (the "Goals"), all of which Goals shall be attainable, prior to the end of the post-Change of Control renewal period (as set forth above), with approximately the same degree of probability as the most attainable goals under the Company's bonus plan or plans as in effect at any time during

the 180-day period immediately prior to the Change of Control (whether one or more, the "Company Bonus Plan") and in view of the Company's existing and projected financial and business circumstances applicable at the time. The amount of the bonus (the "Bonus Amount") that Executive is eligible to earn under the Bonus Plan shall be no less than 100% of the Executive's target award provided in such Company Bonus Plan (such bonus amount herein referred to as the "Targeted Bonus"), and in the event the Goals are not achieved such that the entire Targeted Bonus is not payable, the Bonus Plan shall provide for a payment of a Bonus Amount equal to a portion of the Targeted Bonus reasonably related to that portion of the Goals which were achieved. Payment of the Bonus Amount shall not be affected by any circumstance occurring subsequent to the end of the post-Change of Control renewal period, including termination of Executive's employment.

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

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

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

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

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

(b) If Executive is Disabled, and if within thirty (30) days after Orion notifies the Executive in writing that it intends to terminate the Executive's employment, the Executive shall not have returned to the performance of the Executive's duties hereunder

on a full-time basis, Orion may terminate the Executive's employment, effective immediately following the end of such thirty-day period.

(c) Orion may terminate Executive's employment with or without Cause (other than as a result of Disability which is governed by subsection (b)) by providing written notice to Executive that indicates in reasonable detail the facts and circumstances alleged to provide a basis for such termination. If the termination is without Cause, Executive's employment will terminate on the date specified in the written notice of termination. If the termination is for Cause, the Executive shall have thirty (30) days from the date the written notice is provided, or such longer period as Orion may determine to be appropriate, to cure any conduct or act, if curable, alleged to provide grounds for termination of Executive's employment for Cause. If the alleged conduct or act constituting Cause is not curable, Executive's employment will terminate on the date specified in the written notice of termination. If the alleged conduct or act constituting Cause is curable but Executive does not cure such conduct or act within the specified time period, Executive's employment will terminate on the date immediately following the end of the cure period. Notwithstanding the foregoing, a determination of Cause shall only be made in good faith by the Board, and after a Change of Control, by the Board of Directors of the Successor, which may terminate Executive for Cause only after providing Executive (i) written notice as set forth above, (ii) the opportunity to appear before such board and provide rebuttal to such proposed termination, and (iii) written notice following such appearance confirming such termination and certifying that the decision to terminate Executive for Cause was approved in good faith by at least sixty-six percent (66%) of the members of such board, excluding Executive. Unless otherwise directed by Orion, from and after the date of the written notice of proposed termination, Executive shall be relieved of his or her duties and responsibilities and shall be considered to be on a paid leave of absence pending any final action by the Board or the Board of Directors of the Successor confirming such proposed termination.

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

#### **5. Payments upon Termination.**

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

- (i) Executive's employment is terminated by Orion without Cause, except in the case of death or Disability; or

(ii) Executive terminates his or her employment with the Company for Good Reason.

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

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

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

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

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

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

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

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

**6. Limitations on Severance Payments and Benefits.** Notwithstanding any other provision of this Agreement, if any portion of the Severance Payment or any other payment under this Agreement, or under any other agreement with or plan of the Company (in the

aggregate “Total Payments”), would constitute an “excess parachute payment,” then the Total Payments to be made to Executive shall be reduced such that the value of the aggregate Total Payments that Executive is entitled to receive shall be One Dollar (\$1) less than the maximum amount which Executive may receive without becoming subject to the tax imposed by Code Section 4999 or which the Company may pay without loss of deduction under Code Section 280G(a); *provided* that the foregoing reduction in the amount of Total Payments shall not apply if the After-Tax Value to Executive of the Total Payments prior to reduction in accordance herewith is greater than the After-Tax Value to Executive if Total Payments are reduced in accordance herewith. For purposes of this Agreement, the terms “excess parachute payment” and “parachute payments” shall have the meanings assigned to them in Code Section 280G, and such “parachute payments” shall be valued as provided therein. Present value for purposes of this Agreement shall be calculated in accordance with Code Section 1274(b)(2). Within twenty (20) business days following delivery of the notice of termination or notice by Orion to Executive of its belief that there is a payment or benefit due Executive that will result in an excess parachute payment as defined in Code Section 280G, Executive and Orion, at Orion’s expense, shall obtain the opinion (which need not be unqualified) of nationally recognized tax counsel selected by Orion’s independent auditors and acceptable to Executive in Executive’s sole discretion, which opinion sets forth: (A) the amount of the Base Period Income, (B) the amount and present value of Total Payments, (C) the amount and present value of any excess parachute payments without regard to the limitations of this Section 6, (D) the After-Tax Value of the Total Payments if the reduction in Total Payments contemplated under this Section 6 did not apply, and (E) the After-Tax Value of the Total Payments taking into account the reduction in Total Payments contemplated under this Section 6. As used in this Section 6, the term “Base Period Income” means an amount equal to Executive’s “annualized includible compensation for the base period” as defined in Code Section 280G(d)(1). For purposes of such opinion, the value of any noncash benefits or any deferred payment or benefit shall be determined by Orion’s independent auditors in accordance with the principles of Code Sections 280G(d)(3) and (4), which determination shall be evidenced in a certificate of such auditors addressed to Orion and Executive. For purposes of determining the After-Tax Value of Total Payments, Executive shall be deemed to pay federal income taxes and employment taxes at the highest marginal rate of federal income and employment taxation in the calendar year in which the Termination Payment is to be made and state and local income taxes at the highest marginal rates of taxation in the state and locality of Executive’s domicile for income tax purposes on the date the Termination Payment is to be made, net of the maximum reduction in federal income taxes that may be obtained from deduction of such state and local taxes. Such opinion shall be dated as of the Termination Date and addressed to Orion and Executive and shall be binding upon the Company and Executive. If such opinion determines that there would be an excess parachute payment and that the After-Tax Value of the Total Payments taking into account the reduction contemplated under this Section is greater than the After-Tax Value of the Total Payments if the reduction in Total Payments contemplated under this Section did not apply, then the Termination Payment hereunder or any other payment determined by such counsel to be includible in Total Payments shall be reduced or eliminated as specified by Executive in writing delivered to Orion within five business days of Executive’s receipt of such opinion or, if Executive fails to so notify Orion, then as Orion shall reasonably determine, so that under the bases of calculations set forth in such opinion there will be no excess parachute payment. If such legal counsel so requests in connection with the opinion required by this Section, Executive and Orion shall obtain, at Orion’s expense, and the legal counsel may rely on in providing the opinion, the advice of a firm of recognized executive compensation consultants as to the reasonableness of any item of compensation to be received by Executive. Notwithstanding the foregoing, the provisions of this Section 6, including the calculations, notices and opinions provided for herein, shall be based

upon the conclusive presumption that the following are reasonable: (1) the compensation and benefits provided for in Section 3 and (2) any other compensation, including but not limited to the Accrued Benefits, earned prior to the date of Executive's Separation from Service by the Executive pursuant to the Company's compensation programs if such payments would have been made in the future in any event, even though the timing of such payment is triggered by the Change in Control or the Executive's Separation from Service. If the provisions of Code Sections 280G and 4999 are repealed without succession, then this Section 6 shall be of no further force or effect.

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

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

#### **(b) Non-Competition/Non-Solicitation.**

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

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

recruit, solicit or otherwise induce or influence any employee of the Company to discontinue their employment with the Company.

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

(i) Executive agrees to disclose and assign to the Company as the Company's exclusive property, all inventions and technical or business innovations, including but not limited to all patentable and copyrightable subject matter (collectively, the "Innovations") developed, authored or conceived by Executive solely or jointly with others during the period of Executive's employment, including during Executive's employment prior to the date of this Agreement, (1) that are along the lines of the business, work or investigations of the Company to which Executive's employment relates or as to which Executive may receive information due to Executive's employment with the Company, or (2) that result from or are suggested by any work which Executive may do for the Company or (3) that are otherwise made through the use of Company time, facilities or materials. To the extent any of the Innovations is copyrightable, each such Innovation shall be considered a "work for hire."

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

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

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

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

(d) **Remedies Not Exclusive.** In the event that Executive breaches any terms of this Section 7, Executive acknowledges and agrees that said breach may result in the

immediate and irreparable harm to the business and goodwill of the Company and that damages, if any, and remedies of law for such breach may be inadequate and indeterminable. The Company, upon Executive's breach of this Section 7, shall therefore be entitled (in addition to and without limiting any other remedies that the Company may seek under this Agreement or otherwise at law or in equity) to (1) seek from any court of competent jurisdiction equitable relief by way of temporary or permanent injunction and without being required to post a bond, to restrain any violation of this Section 7, and for such further relief as the court may deem just or proper in law or equity, and (2) in the event that the Company shall prevail, its reasonable attorneys fees and costs and other expenses in enforcing its rights under this Section 7.

(e) **Severability of Provisions.** If any restriction, limitation, or provision of this Section 7 is deemed to be unreasonable, onerous, or unduly restrictive by a court of competent jurisdiction, it shall not be stricken in its entirety and held totally void and unenforceable, but shall remain effective to the maximum extent possible within the bounds of the law. If any phrase, clause or provision of this Section 7 is declared invalid or unenforceable by a court of competent jurisdiction, such phrase, clause, or provision shall be deemed severed from this Section 7, but will not affect any other provision of this Section 7, which shall otherwise remain in full force and effect. The provisions of this Section 7 are each declared to be separate and distinct covenants by Executive.

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

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

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



all the terms and provisions of this Agreement by operation of law, and this Agreement shall inure to the benefit of, and be enforceable by, such person. Executive shall, in his or her discretion, be entitled to proceed against any or all of such persons, any person which theretofore was such a successor to Orion, and Orion (as so defined) in any action to enforce any rights of Executive hereunder. Except as provided in this Section 10, this Agreement shall not be assignable by Orion. This Agreement shall not be terminated by the voluntary or involuntary dissolution of Orion.

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

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

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

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

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

16. **Entire Agreement.** This Agreement, together with the employment offer letter dated as of the Effective Date and incorporated herein, contains the entire agreement of the parties with respect to the subject matter of this Agreement except where other agreements are specifically noted, adopted, or incorporated by reference. This Agreement otherwise supersedes any and all other agreements, either oral or in writing, between the parties hereto with respect to the employment of Executive by Company, and all such agreements shall be void and of no effect. Each party to this Agreement acknowledges that no representations, inducements, promises, or agreements, oral or otherwise, have been made by any party, or anyone acting on behalf of any party, which are not embodied herein, and that no other agreement, statement, or promise not contained in this Agreement will be valid or binding.

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

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

*[Signatures on following page]*

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

EXECUTIVE

/s/ Stuart L. Ralsky  
Stuart L. Ralsky

ORION ENERGY SYSTEMS, INC.

By: /s/ James R. Kackley  
James R. Kackley  
President and Chief Operating Officer

*Certification*

I, Neal R. Verfuert, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Orion Energy Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(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: November 9, 2009

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

*Certification*

I, Scott R. Jensen, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Orion Energy Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(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: November 9, 2009

/s/ Scott R. Jensen

Scott R. Jensen  
Chief Financial Officer

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

In connection with the Quarterly Report of Orion Energy Systems, Inc., a Wisconsin corporation (the "Company"), on Form 10-Q for the period ended September 30, 2009, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Neal R. Verfuert, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, based on my knowledge:

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

Date: November 9, 2009

/s/ Neal R. Verfuert

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Neal R. Verfuert

Chief Executive Officer

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

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

In connection with the Quarterly Report of Orion Energy Systems, Inc., a Wisconsin corporation (the "Company"), on Form 10-Q for the period ended September 30, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Scott R. Jensen, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, based on my knowledge:

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

Date: November 9, 2009

/s/ Scott R. Jensen

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Scott R. Jensen

Chief Financial Officer

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