ORION ENERGY SYSTEMS, INC.
Form 10-Q
November 09, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2015

OR

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

Commission file number 001-33887

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

Wisconsin	39-1847269
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification number)
2210 Woodland Drive, Manitowoc, Wisconsin	54220
(Address of principal executive offices)	(Zip code)

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

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

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

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

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

There were 27,649,576 shares of the Registrant's common stock outstanding on November 5, 2015.

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Orion Energy Systems, Inc.
Quarterly Report On Form 10-Q
For The Quarter Ended September 30, 2015
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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 amounts)

	March 31, 2015	September 30, 2015
Assets		
Cash and cash equivalents	$20,002	$13,446
Accounts receivable, net of allowances of $458 and $685 at March 31, 2015 and September 30, 2015, respectively	18,263	15,871
Inventories, net	14,283	15,898
Deferred contract costs	90	150
Prepaid expenses and other current assets	2,407	1,213
Total current assets	55,045	46,578
Property and equipment, net	21,223	19,823
Goodwill	4,409	4,409
Other intangible assets, net	6,335	5,699
Long-term accounts receivable	426	208
Other long-term assets	367	242
Total assets	$87,805	$76,959
Liabilities and Shareholders’ Equity		
Accounts payable	$11,003	$8,694
Accrued expenses and other	5,197	3,937
Deferred revenue, current	287	319
Current maturities of long-term debt and capital leases	1,832	1,581
Total current liabilities	18,319	14,531
Revolving credit facility	2,500	2,463
Long-term debt, less current maturities and capital leases	722	350
Deferred revenue, long-term	1,231	1,061
Other long-term liabilities	522	528
Total liabilities	23,294	18,933
Commitments and contingencies		
Shareholders’ equity:		
Common stock, no par value: Shares authorized: 200,000,000 at March 31, 2015 and September 30, 2015; shares issued: 36,837,864 and 37,034,066 at March 31, 2015 and September 30, 2015; shares outstanding: 27,421,533 and 27,613,046 at March 31, 2015 and September 30, 2015	—	—
Additional paid-in capital	150,516	151,301
Treasury stock: 9,416,331 and 9,421,020 common shares at March 31, 2015 and September 30, 2015	(36,049)	(36,067)
Shareholder notes receivable	(4)	(4)
Retained deficit	(49,952)	(57,204)
Total shareholders’ equity	64,511	58,026
Total liabilities and shareholders’ equity	$87,805	$76,959

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

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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,	
	2014	2015	2014	2015
Product revenue	$12,645	$14,982	$24,888	$30,778
Service revenue	748	746	1,818	1,538
Total revenue	13,393	15,728	26,706	32,316
Cost of product revenue	23,364	12,301	33,219	24,414
Cost of service revenue	584	515	1,430	1,232
Total cost of revenue	23,948	12,816	34,649	25,646
Gross (loss) profit	(10,555)	2,912	(7,943)	6,670
Operating expenses:				
General and administrative	3,842	3,403	7,512	7,274
Sales and marketing	3,367	2,634	6,246	5,703
Research and development	569	441	985	863
Total operating expenses	7,778	6,478	14,743	13,840
Loss from operations	(18,333)	(3,566)	(22,686)	(7,170)
Other income (expense):				
Interest expense	(83)	(60)	(173)	(151)
Interest income	83	32	177	80
Total other income (expense)	—	(28)	4	(71)
Loss before income tax	(18,333)	(3,594)	(22,682)	(7,241)
Income tax expense	13	6	23	11
Net loss	$(18,346)	$(3,600)	$(22,705)	$(7,252)
Basic net loss per share attributable to common shareholders	$(0.84)	$(0.13)	$(1.04)	$(0.26)
Weighted-average common shares outstanding	21,820,365	27,598,492	21,745,156	27,540,378
Diluted net loss per share	$(0.84)	$(0.13)	$(1.04)	$(0.26)
Weighted-average common shares and share equivalents outstanding	21,820,365	27,598,492	21,745,156	27,540,378

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

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

	Six Months Ended September 30,	
	2014	2015
Operating activities		
Net loss	$(22,705)	$(7,252)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	1,503	1,561
Amortization of long-term assets	697	704
Stock-based compensation expense	785	738
Impairment on assets	12,130	—
(Gain) loss on sale of property and equipment	(20)	18
Provision for inventory reserves	32	12
Provision for bad debts	142	227
Other	68	38
Changes in operating assets and liabilities, net of effects of acquisition:		
Accounts receivable, current and long-term	930	2,383
Inventories	154	(1,627)
Deferred contract costs	(384)	(60)
Prepaid expenses and other assets	1,957	1,262
Accounts payable	537	(2,309)
Accrued expenses and other	(660)	(877)
Deferred revenue	(253)	(138)
Net cash used in operating activities	(5,087)	(5,320)
Investing activities		
Purchase of property and equipment	(1,031)	(179)
Purchase of short-term investments	(1)	—
Additions to patents and licenses	(61)	(11)
Proceeds from sales of property, plant and equipment	1,040	—
Net cash used in investing activities	(53)	(190)
Financing activities		
Payment of long-term debt and capital leases	(1,585)	(1,000)
Proceeds from revolving credit facility	—	27,088
Payment of revolving credit facility	—	(27,125)
Proceeds from issuance of common stock, net of offering costs	—	(1)
Proceeds from repayment of shareholder notes	11	—
Repurchase of common stock into treasury	—	(20)
Deferred financing costs	(75)	—
Net proceeds from the exercise of warrants and employee stock options	351	12
Net cash used in financing activities	(1,298)	(1,046)
Net decrease in cash and cash equivalents	(6,438)	(6,556)
Cash and cash equivalents at beginning of period	17,568	20,002
Cash and cash equivalents at end of period	$11,130	$13,446
Supplemental cash flow information:		
Cash paid for interest	$155	$99
Cash paid for income taxes	$12	$19

Supplemental disclosure of non-cash investing and financing activities:		
Vendor financed capital lease addition	$—	$377

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

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ORION ENERGY SYSTEMS, INC. AND SUBSIDIARIES
UNAUDITED NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
NOTE A — DESCRIPTION OF BUSINESS
Organization
The Company includes Orion Energy Systems, Inc., a Wisconsin corporation, and all consolidated subsidiaries. The Company is a developer, manufacturer and seller of lighting and energy management systems to commercial and industrial businesses, predominantly in North America.

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

The Company's corporate offices and primary manufacturing operations are located in Manitowoc, Wisconsin. The operations facility in Plymouth, Wisconsin was classified as an asset held for sale as of March 31, 2014 and was sold in May 2014. The Company leases office space in Jacksonville, Florida and Chicago, Illinois. The Company leases office space for a sales office located in Houston, Texas.
NOTE B — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
Principles of Consolidation
The condensed consolidated financial statements include the accounts of Orion Energy Systems, Inc. and its wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.
Reclassifications
Where appropriate, certain reclassifications have been made to prior years' financial statements to conform to the current year presentation.
Basis of Presentation
The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation have been included. Interim results are not necessarily indicative of results that may be expected for the year ending March 31, 2016 or other interim periods.
The condensed consolidated balance sheet at March 31, 2015 has been derived from the audited and adjusted consolidated financial statements at that date but does not include all of the information required by GAAP for complete financial statements.
The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2015 filed with the Securities and Exchange Commission on June 12, 2015.
Use of Estimates
The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during that reporting period. Areas that require the use of significant management estimates include revenue recognition, inventory obsolescence and bad debt reserves, accruals for warranty expenses, income taxes and certain equity transactions. Accordingly, actual results could differ from those estimates.
Cash and Cash Equivalents
The Company considers all highly liquid, short-term investments with original maturities of three months or less to be cash equivalents.
Fair Value of Financial Instruments

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

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

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

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

Accounts Receivable

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

Also included in current receivables are amounts due from a third party finance company to which the Company has sold, without recourse, the future cash flows from its Orion Throughput Agreements, or OTAs, entered into with customers. Such receivables are recorded at the present value of the future cash flows discounted at 11%. As of September 30, 2015, the following amounts were due from the third party finance company in future periods (in thousands):

Fiscal 2016	$262
Fiscal 2017	9
Less: amount representing interest	(1)
Total gross financed receivable	$270

Financing Receivables

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

Aging Analysis as of September 30, 2015 (in thousands):

	Not Past Due	1-90 days past due	Greater than 90 days past due	Total past due	Total sales-type leases
Lease balances included in consolidated accounts receivable—current	$785	$34	$185	$219	$1,004
Lease balances included in consolidated accounts receivable—long-term	195	—	—	—	195
Total gross sales-type leases	980	34	185	219	1,199
Allowance	(6)	(2)	(178)	(180)	(186)
Total net sales-type leases	$974	$32	$7	$39	$1,013

Allowance for Credit Losses on Financing Receivables

The Company’s allowance for credit losses is based on management’s assessment of the collectability of customer accounts. A considerable amount of judgment is required in order to make this assessment, including a detailed analysis of the aging of the lease receivables and the current credit worthiness of the Company's customers and an analysis of historical bad debts and other adjustments. If there is a deterioration of a major customer's credit worthiness or if actual defaults are higher than historical experience, the estimate of the recoverability of amounts due could be adversely affected. The Company reviews, in detail, the allowance for doubtful accounts on a quarterly basis and adjusts the allowance estimate to reflect actual portfolio performance and any changes in future portfolio performance expectations. The Company believes that there is no impairment of the receivables for the sales-type leases. The Company incurred no write-offs against its OTA sales-type lease receivable balances in fiscal 2015 or for the six months ended September 30, 2015.

Inventories

Inventories consist of raw materials and components, such as ballasts and drivers, light emitting diode (LED) chips, metal sheet and coil stock and molded parts; work in process inventories, such as frames and reflectors; and finished goods, including completed fixtures and accessories, such as lamps, sensors and power supplies. All inventories are stated at the lower of cost or market value with cost determined using the first-in, first-out (FIFO) method. The Company reduces the carrying value of its inventories for differences between the cost and estimated net realizable value, taking into consideration usage in the preceding 9 to 24 months, expected demand, and other information indicating obsolescence. The Company records as a charge to cost of product revenue the amount required to reduce the carrying value of inventory to net realizable value. As of March 31, 2015 and September 30, 2015, the Company had inventory obsolescence reserves of $1.6 million and $1.8 million, respectively.

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

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

	March 31, 2015	September 30, 2015
Raw materials and components	$8,474	$9,187
Work in process	1,588	1,447
Finished goods	4,221	5,264
	$14,283	$15,898

Deferred Contract Costs

Deferred contract costs consist primarily of the costs of products delivered, and services performed, that are subject to additional performance obligations or customer acceptance. These deferred contract costs are expensed at the time the related revenue is recognized. Current deferred costs amounted to $0.1 million and $0.2 million as of March 31, 2015 and September 30, 2015, respectively.

Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist primarily of prepaid insurance premiums, prepaid license fees, purchase deposits, advance payments to contractors, unbilled revenue, prepaid taxes and miscellaneous receivables. Prepaid expenses and other current assets included $1.7 million and $0.5 million of unbilled revenue as of March 31, 2015 and September 30, 2015, respectively.

Long-Lived Assets

The Company evaluates the recoverability of long-lived assets with finite lives in accordance with Accounting Standards Codification, or ASC, Subtopic 360-10-35 which requires recognition of impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. When events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable based on estimated undiscounted cash flows, the impairment loss would be measured as the difference between the carrying amount of the assets and its fair value based on the present value of estimated future cash flows. The Company's long-lived assets include property, plant and equipment and intangible assets. For the three months ended September 30, 2015, the Company determined that events and circumstances indicated that the assets might be impaired due to the current period operating cash flow and a history of operating cash flow losses. The Company performed a quantitative assessment of these assets for all business units and its estimated of undiscounted cash flows indicated that such carrying amounts were expected to be recovered. Nonetheless, it is reasonably possible that the estimate of undiscounted cash flows may change in the near term resulting in the need to write down the long-lived assets to fair value.

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Property and Equipment

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

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

	March 31, 2015	September 30, 2015
Land and land improvements	$1,511	$1,515
Buildings	14,441	14,439
Furniture, fixtures and office equipment	8,600	8,996
Leasehold improvements	148	148
Equipment leased to customers under Power Purchase Agreements	4,997	4,997
Plant equipment	11,084	11,050
Construction in progress	379	51
	41,160	41,196
Less: accumulated depreciation and amortization	(19,937)	(21,373)
Net property and equipment	$21,223	$19,823

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

	March 31, 2015	September 30, 2015
Equipment	$—	$389
Less: accumulated depreciation and amortization	—	(26)
Net Equipment	$—	$363

Depreciation expense related to capital leased equipment was $20 thousand and $26 thousand for the three and six months ended September 30, 2015, respectively.

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

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

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Goodwill and Other Intangible Assets

The costs of specifically identifiable intangible assets that do not have an indefinite life are amortized over their estimated useful lives. Goodwill and intangible assets with indefinite lives are not amortized and are reviewed for impairment annually, as of January 1, or more frequently if impairment indicators arise. During the quarter ended September 30, 2015, the Company determined that a triggering event occurred due to the decline in the Company's share price when compared to the share price as of March 31, 2015 and due to the the history of operating losses. The Company performed a qualitative assessment of Goodwill and determined that no impairment had occurred.

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

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

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

There was no change in the carrying value of goodwill during fiscal 2015 or for the six months ended September 30, 2015.

Goodwill is allocated to each operating segment during the six months ended September 30, 2015 as follows (in thousands):

	U.S. Markets	Orion Engineered Systems	Orion Distribution Services	Corporate and Other	Total
Goodwill at September 30, 2015	$2,371	$2,038	$—	$—	$4,409

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

	March 31, 2015		September 30, 2015	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Patents	$2,447	$(906)	$2,456	$(975)
Licenses	58	(58)	58	(58)
Trade name and trademarks	1,958	—	1,960	—
Customer relationships	3,600	(1,620)	3,600	(2,111)
Developed technology	900	(109)	900	(186)
Non-competition agreements	100	(35)	100	(45)
Total	$9,063	$(2,728)	$9,074	$(3,375)

As of September 30, 2015, the weighted average useful life of intangible assets was 6.46 years. The estimated amortization expense for each of the next five years is shown below (in thousands):

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Fiscal 2016	$581
Fiscal 2017	883
Fiscal 2018	608
Fiscal 2019	432
Fiscal 2020	346
Fiscal 2021	271
Thereafter	618
Total	$3,739

Long-Term Receivables

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

Other Long-Term Assets

Other long-term assets include long-term security deposits, deferred costs for a long-term contract and deferred financing costs. Deferred financing costs as of March 31, 2015 and September 30, 2015 were $202 thousand and $147 thousand, respectively. Deferred financing costs related to debt issuances are amortized to interest expense over the life of the related debt issue (1 to 3 years) using the effective interest rate method.

Accrued Expenses and Other

Accrued expenses include warranty accruals, accrued wages and benefits, accrued vacation, accrued legal costs, accrued commissions, customer deposits, accrued project costs, sales tax payable and other various unpaid expenses. Accrued expenses include $1.3 million and $0.3 million of accrued project costs as of March 31, 2015 and September 30, 2015, respectively.

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

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2015	2014	2015
Beginning of period	$253	$1,062	$263	$1,015
Provision to product cost of revenue	1	60	33	89
Charges	212	(79)	170	(61)
End of period	$466	$1,043	$466	$1,043

Revenue Recognition

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

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

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

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

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

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

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

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

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

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

Income Taxes

The Company recognizes deferred tax assets and liabilities for the future tax consequences of temporary differences between financial reporting and income tax basis of assets and liabilities, measured using the enacted tax rates and laws expected to be in effect when the temporary differences reverse. Deferred income taxes also arise from the future tax benefits of operating loss and tax credit carryforwards. A valuation allowance is established when management determines that it is more likely than not that all or a portion of a deferred tax asset will not be realized. As of September 30, 2015, the Company had a valuation allowance of $22.5 million against its deferred tax assets.

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

Deferred tax benefits have not been recognized for income tax effects resulting from the exercise of non-qualified stock options. These benefits will be recognized in the period in which the benefits are realized as a reduction in taxes payable and an increase in additional paid-in capital. For the three and six months ended September 30, 2014 and 2015, there were no realized tax benefits from the exercise of stock options.

Stock Based Compensation

The Company accounts for stock-based compensation in accordance with ASC 718, Compensation - Stock Compensation. Under the fair value recognition provisions of ASC718, stock-based compensation is measured at the grant date based on the fair value of the award and is recognized as expense ratably over the requisite service period, net of estimated forfeitures. As more fully described in Note I, the Company awards non-vested restricted stock to employees, executive officers and directors. The Company did not issue any stock options during fiscal 2015 or for the six months ended September 30, 2015.

Net Loss per Common Share

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

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

	Three Months Ended September 30,		Six Months Ended September 30,
	2014	2015	