ORION ENERGY SYSTEMS, INC.
Form 10-Q
November 13, 2018
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, 2018
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 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, smaller reporting company, or an "emerging growth company". See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

| | | | |
|---|---|---|---|
| Large accelerated filer | o | Accelerated filer | o |
| Non-accelerated filer | ý | Smaller reporting company | ý |
| | | Emerging growth company | o |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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 29,570,086 shares of the Registrant’s common stock outstanding on October 31, 2018.

ORION ENERGY SYSTEMS, INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2018
TABLE OF CONTENTS

PART I – FINANCIAL INFORMATION
Item 1: Financial Statements
ORION ENERGY SYSTEMS, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)

| | September 30, 2018 | March 31, 2018 |
|---|---|---|
| Assets | | |
| Cash and cash equivalents | $ 5,665 | $ 9,424 |
| Accounts receivable, net | 5,778 | 8,736 |
| Revenue earned but not billed | 703 | — |
| Inventories, net | 8,327 | 7,826 |
| Deferred contract costs | — | 1,000 |
| Prepaid expenses and other current assets | 417 | 2,467 |
| Total current assets | 20,890 | 29,453 |
| Property and equipment, net | 12,281 | 12,894 |
| Other intangible assets, net | 2,664 | 2,868 |
| Other long-term assets | 102 | 110 |
| Total assets | $ 35,937 | $ 45,325 |
| Liabilities and Shareholders' Equity | | |
| Accounts payable | $ 8,850 | $ 11,675 |
| Accrued expenses and other | 4,828 | 4,171 |
| Deferred revenue, current | 117 | 499 |
| Current maturities of long-term debt | 81 | 79 |
| Total current liabilities | 13,876 | 16,424 |
| Revolving credit facility | 1,419 | 3,908 |
| Long-term debt, less current maturities | 64 | 105 |
| Deferred revenue, long-term | 828 | 940 |
| Other long-term liabilities | 621 | 524 |
| Total liabilities | 16,808 | 21,901 |
| Commitments and contingencies | | |
| Shareholders' equity: | | |
| Preferred stock, $0.01 par value: Shares authorized: 30,000,000 at September 30, 2018 and March 31, 2018; no shares issued and outstanding at September 30, 2018 and March 31, 2018 | — | — |
| Common stock, no par value: Shares authorized: 200,000,000 at September 30, 2018 and March 31, 2018; shares issued: 38,974,961 at September 30, 2018 and 38,384,575 at March 31, 2018; shares outstanding: 29,537,474 at September 30, 2018 and 28,953,183 at March 31, 2018 | — | — |
| Additional paid-in capital | 155,442 | 155,003 |
| Treasury stock, common shares: 9,437,487 at September 30, 2018 and 9,431,392 at March 31, 2018 | (36,090 ) | (36,085 ) |
| Retained deficit | (100,223 ) | (95,494 ) |
| Total shareholders' equity | 19,129 | 23,424 |
| Total liabilities and shareholders' equity | $ 35,937 | $ 45,325 |

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, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Product revenue | $11,590 | $14,109 | $24,398 | $25,890 |
| Service revenue | 1,608 | 1,313 | 2,622 | 2,090 |
| Total revenue | 13,198 | 15,422 | 27,020 | 27,980 |
| Cost of product revenue | 9,367 | 10,593 | 19,091 | 19,406 |
| Cost of service revenue | 1,289 | 1,208 | 1,931 | 2,243 |
| Total cost of revenue | 10,656 | 11,801 | 21,022 | 21,649 |
| Gross profit | 2,542 | 3,621 | 5,998 | 6,331 |
| Operating expenses: | | | | |
| General and administrative | 2,336 | 3,157 | 5,412 | 8,491 |
| Impairment of intangible assets | — | 710 | — | 710 |
| Sales and marketing | 2,135 | 2,906 | 4,713 | 6,260 |
| Research and development | 354 | 380 | 759 | 904 |
| Total operating expenses | 4,825 | 7,153 | 10,884 | 16,365 |
| Loss from operations | (2,283) | (3,532) | (4,886) | (10,034) |
| Other income (expense): | | | | |
| Other income | 15 | — | 34 | — |
| Interest expense | (169) | (139) | (258) | (206) |
| Interest income | 3 | 3 | 6 | 7 |
| Total other expense | (151) | (136) | (218) | (199) |
| Loss before income tax | (2,434) | (3,668) | (5,104) | (10,233) |
| Income tax expense | 4 | — | 26 | — |
| Net loss | $(2,438) | $(3,668) | $(5,130) | $(10,233) |
| Basic net loss per share attributable to common shareholders | $(0.08) | $(0.13) | $(0.18) | $(0.36) |
| Weighted-average common shares outstanding | 29,488,363 | 28,834,868 | 29,280,421 | 28,646,188 |
| Diluted net loss per share | $(0.08) | $(0.13) | $(0.18) | $(0.36) |
| Weighted-average common shares and share equivalents outstanding | 29,488,363 | 28,834,868 | 29,280,421 | 28,646,188 |

The accompanying notes are an integral part of these Condensed Consolidated Statements.

4

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

| | Six Months Ended September 30, | |
|---|---|---|
| | 2018 | 2017 |
| Operating activities | | |
| Net loss | $(5,130) | $(10,233) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation | 679 | 701 |
| Amortization | 232 | 324 |
| Stock-based compensation | 439 | 618 |
| Impairment of intangible assets | — | 710 |
| Provision for inventory reserves | (159) | 301 |
| Provision for bad debts | 85 | 21 |
| Other | 8 | 12 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, current and long-term | 3,157 | 1,014 |
| Revenue earned but not billed | 1,652 | — |
| Inventories | 345 | 3,981 |
| Deferred contract costs | — | 751 |
| Prepaid expenses and other assets | 141 | 1,156 |
| Accounts payable | (1,941) | (3,816) |
| Accrued expenses and other | (628) | (438) |
| Deferred revenue, current and long-term | (12) | 237 |
| Net cash used in operating activities | (1,132) | (4,661) |
| Investing activities | | |
| Purchases of property and equipment | (66) | (283) |
| Additions to patents and licenses | (28) | (30) |
| Net cash used in investing activities | (94) | (313) |
| Financing activities | | |
| Payment of long-term debt and capital leases | (39) | (111) |
| Proceeds from revolving credit facility | 33,011 | 34,176 |
| Payment of revolving credit facility | (35,501) | (37,722) |
| Payments to settle employee tax withholdings on stock-based compensation | (6) | (8) |
| Net proceeds from employee equity exercises | 2 | 3 |
| Net cash used in financing activities | (2,533) | (3,662) |
| Net decrease in cash and cash equivalents | (3,759) | (8,636) |
| Cash and cash equivalents at beginning of period | 9,424 | 17,307 |
| Cash and cash equivalents at end of period | $5,665 | $8,671 |

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 1 — DESCRIPTION OF BUSINESS
Organization
Orion includes Orion Energy Systems, Inc., a Wisconsin corporation, and all consolidated subsidiaries. Orion is a developer, manufacturer and seller of lighting and energy management systems to commercial and industrial businesses, and federal and local governments, predominantly in North America.
Orion’s corporate offices and leased primary manufacturing operations are located in Manitowoc, Wisconsin. Orion leases office space in Jacksonville, Florida. Orion had leased office space in Chicago, Illinois, and Houston, Texas, but as of June 30, 2018, Orion had vacated these locations. During fiscal 2018, Orion had leased warehouse space in Manitowoc, Wisconsin and Augusta, Georgia, but as of March 31, 2018, Orion had vacated these storage locations.
NOTE 2 — 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.
Basis of Presentation
The accompanying unaudited Condensed Consolidated Financial Statements of Orion 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 ("SEC"). 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 fiscal year ending March 31, 2019 or other interim periods.
The Condensed Consolidated Balance Sheets at March 31, 2018 has been derived from the audited consolidated financial statements at that date but does not include all of the information required by GAAP for complete financial statements.
The accompanying unaudited Condensed Consolidated Financial Statements should be read in conjunction with the audited consolidated financial statements and footnotes thereto included in Orion’s Annual Report on Form 10-K for the fiscal year ended March 31, 2018 filed with the SEC on June 13, 2018.
Use of Estimates
The preparation of financial statements in conformity with GAAP requires management to make certain 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, allowance for doubtful accounts, accruals for warranty and loss contingencies, income taxes, impairment analyses, and certain equity transactions. Accordingly, actual results could differ from those estimates.
Concentration of Credit Risk and Other Risks and Uncertainties
Orion's cash is deposited with two financial institutions. At times, deposits in these institutions exceed the amount of insurance provided on such deposits. Orion has not experienced any losses in such accounts and believes that it is not exposed to any significant financial institution viability risk on these balances.
Orion purchases components necessary for its lighting products, including ballasts, lamps and LED components, from multiple suppliers. For the three and six months ended September 30, 2018, no supplier accounted for more than 10.0% of total cost of revenue. For the three and six months ended September 30, 2017, no supplier accounted for more than 10.0% of total cost of revenue.
For the three months ended September 30, 2018, one customer accounted for 14.0% of total revenue. For the six months ended September 30. 2018, no customers accounted for more than 10.0% of total revenue. For the three months ended

September 30, 2017, one customer accounted for 13.7% of total revenue. For the six months ended September 30, 2017, one customer accounted for 11.9% of total revenue.

As of September 30, 2018, no customer accounted for more than 10.0% of Accounts receivable. As of March 31, 2018, one customer accounted for 13.2% of Accounts receivable.

Recent Accounting Pronouncements

Issued: Not Yet Adopted

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-02, "Leases" (Subtopic 842). The pronouncement, and subsequent amendments, which is included in the Accounting Standards Codification as Subtopic 842 (“ASC 842”), requires that lessees recognize right-of-use assets and liabilities on the balance sheet for the rights and obligations created by long-term leases and disclose additional quantitative and qualitative information about leasing arrangements. Under ASU 842, leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition. Similarly, lessors will be required to classify leases as sales-type, finance or operating leases, with classification affecting the pattern of income recognition. Classification for both lessees and lessors will be based on an assessment of whether risks and rewards, as well as substantive control, have been transferred through the lease contract. ASU 842 also provides guidance on the presentation of the effects of leases in the income statement and statement of cash flows. Orion will adopt this ASU and subsequent amendments on April 1, 2019 and expects to elect certain practical expedients permitted under the transition guidance. Additionally, Orion expects to elect the optional transition method that allows for a cumulative-effect adjustment in the period of adoption and will not restate prior periods. Orion has not yet completed its review of the full provisions of this ASU against its outstanding lease arrangements and is in the process of quantifying the lease liability and related right of use asset which will be recorded to its condensed consolidated balance sheets upon adoption of the ASU. In addition, management continues to assess the impact of adoption of this ASU on its condensed consolidated statements of operations, cash flows, and the related footnote disclosures.

Recently Adopted Standards

On April 1, 2018, Orion adopted ASU 2014-09 and subsequent amendments, which is included in the Accounting Standards Codification as "Revenue from Contracts with Customers" (Topic 606) (“ASC 606”) and Sub-Topic 340-40 (“ASC 340-40”), using the modified retrospective approach. ASC 606 supersedes the revenue recognition requirements in “Revenue Recognition” (Topic 605) ("ASC 605") and provides guidance on the accounting for other assets and deferred costs associated with contracts with customers. ASC 606 requires entities to recognize revenue when control of the promised goods or services is transferred to customers at an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. ASC 340-40 limits the circumstances that an entity can recognize an asset from the costs incurred to obtain or fulfill a contract that are not subject to the guidance in other portions in the Accounting Standards Codification, such as those related to inventory. The provisions of ASC 606 and ASC 340-40 require entities to use more judgments and estimates than under previous guidance when allocating the total consideration in a contract to the individual promises to customers (“performance obligations”) and determining when a performance obligation has been satisfied and revenue can be recognized. The adoption of ASC 606 did not have a material effect on Orion's financial statements. Orion has updated its processes and controls necessary for implementing ASC 606, including the increased disclosure requirements.

In August 2016, the FASB issued ASU 2016-15, "Classification of Certain Cash Receipts and Cash Payments," which provided clarification and additional guidance as to the presentation and classification of certain cash receipts and cash payments in the statement of cash flows. This ASU provided guidance as to the classification of a number of transactions including: contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance policies, and distributions received from equity method investees. This new ASU was effective for Orion in the first quarter of fiscal 2019 and has been applied through retrospective adjustment to all periods presented. The adoption of this ASU did not have a material impact on Orion’s condensed consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, “Compensation-Stock Compensation: Scope of Modification Accounting” which provides guidance about which changes to the terms or conditions of a share-based payment award would require an entity to apply modification accounting. The provisions of this ASU were effective for Orion beginning on April 1, 2018. The adoption of this ASU did not have a material impact on Orion’s condensed consolidated financial statements.

NOTE 3 — REVENUE

Changes in Accounting Policies

Orion adopted ASC 606 and ASC 340-40 (the “new standards”) as of April 1, 2018 for contracts with customers that were not fully complete as of April 1, 2018 using the modified retrospective transition method. The cumulative effect of initially applying the new standards was recorded as an immaterial adjustment to the opening balance of retained deficit within Orion’s Condensed Consolidated Statement of Shareholders’ Equity.

The new standards are applied separately for each contract between Orion and a customer. While the impact of the new standards vary for each contract based on its specific terms, in general, the new standards result in Orion (a) delaying the recognition of some of its Product revenue from the point of shipment until a later date during the installation period, (b) recording Service revenue associated with installing lighting fixtures as such fixtures are installed instead of recording all Services revenue at the completion of the installation, and (c) recording costs associated with installing lighting fixtures as they are incurred instead of deferring such costs and recognizing them at the time Service revenue was recorded.

The adoption of the new standards also resulted in reclassifications (a) between Product revenue and Service revenue, and between Cost of service revenue and Sales and marketing expenses in Orion’s Condensed Consolidated Statement of Operations, and (b) between Accounts receivable, net, Revenue earned but not billed, Inventories, net, Deferred contract costs, Prepaid expenses and other current assets, Accounts payable, Accrued expenses and other, Deferred revenue, current, Deferred revenue, long-term, and Other long-term liabilities in Orion’s Condensed Consolidated Balance Sheets.

For all adjustments and changes as a result of adopting the new standards for the current period, refer to the section “Impacts on Financial Statements” below. In accordance with the modified retrospective transition method, the historical information within the financial statements has not been restated and continues to be reported under the accounting standard in effect for those periods. As a result, Orion has disclosed the accounting policies in effect prior to April 1, 2018, as well as the policies applied starting April 1, 2018.

Revenue Recognition

Periods prior to April 1, 2018

Revenue is recognized in accordance with ASC 605 when the following criteria are met:

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

Revenue is recorded net of estimated provisions for returns, early payment discounts and rebates and other consideration paid to Orion’s customers. Revenues are presented net of sales tax and other sales related taxes.

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.

Deferred revenue relates to advance customer billings and investment tax grants received related to power purchase agreement contracts still outstanding related to Orion’s legacy solar business.

Period Commencing April 1, 2018

General Information

Orion generates revenues primarily by selling commercial lighting fixtures and components and by installing these fixtures in its customer’s facilities. Orion recognizes revenue in accordance with the guidance in ASC 606 when control of the goods or services being provided (which Orion refers to as a performance obligation) is transferred to a customer at an amount that reflects the consideration that management expects to receive in exchange for those goods or services. Prices are generally fixed at the time of order confirmation. The amount of expected consideration includes estimated deductions and early payment discounts calculated based on historical experience, customer rebates based on agreed upon terms applied to actual and projected sales levels over the rebate period, and any amounts paid to customers in conjunction with fulfilling a performance obligation.

If there are multiple performance obligations in a single contract, the contract's total sales price is allocated to each individual performance obligation based on their relative standalone selling price. A performance obligation's standalone selling price is the price at which Orion would sell a promised good or service separately to a customer. Orion uses an observable price to determine the stand-alone selling price for separate performance obligations or a cost-plus margin approach when one is not available. The cost-plus margin approach is used to determine the stand-alone selling price for the installation performance obligation and is based on average historical installation margin.

Revenue derived from customer contracts which include only performance obligation(s) for lighting fixtures and components is classified as Product revenue in the Condensed Consolidated Statements of Operations. The revenue for these transactions is recorded at the point in time when management believes that the customer obtains control of the products, generally either upon shipment or upon delivery to the customer's facility. This point in time is determined separately for each contract and requires judgment by management of the contract terms and the specific facts and circumstances concerning the transaction.

Revenue from a customer contract which includes both the sale of fixtures and the installation of such fixtures (which Orion refers to as a turnkey project) is allocated between each lighting fixture and the installation performance obligation based on relative standalone selling prices.

Revenue from turnkey projects that is allocated to the sale of the lighting fixtures is recorded at the point in time when management believes the customer obtains control of the product(s) and is reflected in Product revenue. This point in time is determined separately for each customer contract based upon the terms of the contract and the nature and extent of Orion's control of the light fixtures during the installation. Product revenue associated with turnkey projects can be recorded (a) upon shipment or delivery, (b) subsequent to shipment or delivery and upon customer payments for the light fixtures, (c) when an individual light fixture is installed and working correctly, or (d) when the customer acknowledges that the entire installation project is substantially complete. Determining the point in time when a customer obtains control of the lighting fixtures in a turnkey project can be a complex judgment and is applied separately for each individual light fixture included in a contract. In making this judgment, management considers the timing of various factors, including, but not limited to, those detailed below:

- when there is a legal transfer of ownership;
- when the customer obtains physical possession of the products;
- when the customer starts to receive the benefit of the products;
- the amount and duration of physical control that Orion maintains on the products after they are shipped to, and received at, the customer's facility;
- whether Orion is required to maintain insurance on the lighting fixtures when they are in transit and after they are delivered to the customer's facility;
- when each light fixture is physically installed and working correctly;
- when the customer formally accepts the product; and
- when Orion receives payment from the customer for the light fixtures.

Revenue from turnkey projects that is allocated to the single installation performance obligation is reflected in Service revenue. Service revenue is recorded over-time as Orion fulfills its obligation to install the light fixtures. Orion measures its performance toward fulfilling its performance obligations for installations using an output method that calculates the number of light fixtures completely installed as of the measurement date in comparison to the total number of light fixtures to be installed under the contract.

Most products are manufactured in accordance with Orion's standard specifications. However, some products are manufactured to a customer's specific requirements with no alternative use to Orion. In such cases, and when Orion has an enforceable right to payment, Product revenue is recorded on an over-time basis measured using an input methodology that calculates the costs incurred to date as compared to total expected costs. There was no over-time revenue related to custom products recognized in the three and six months ended September 30, 2018.

Orion also records revenue in conjunction with several limited power purchase agreement ("PPA") contracts still outstanding. Those PPA's are supply-side agreements for the generation of electricity. The last PPA contact expires in 2031. Revenue associated with the sale of energy generated by the solar facilities under these PPA contracts is in the scope of ASC 606. Revenues are recognized over-time and are equal to the amount billed to the customer which is calculated by applying the fixed rate designated in contract to the variable amount of electricity generated each month. This approach is in accordance with the "right to invoice" practical expedient provided for in ASC 606. Orion also recognizes revenue upon the sale to third parties of tax credits received from operating the solar facilities and from amortizing a grant received from the federal government during the period starting when the power generating facilities were constructed until the expiration of the PPA contracts; these revenues are not derived from contracts with customers and therefore not under the scope of ASC 606.

When shipping and handling activities are performed after a customer obtains control of the product, Orion has elected to treat shipping and handling costs as an activity necessary to fulfill the performance obligation to transfer product to the customer

and not as a separate performance obligation. Any shipping and handling costs charged to customers are recorded in Product revenue. Shipping and handling costs are accrued and included in Cost of product revenue.
See Note 9, Accrued Expenses and Other for a discussion of Orion's accounting for the warranty it provides to customers for its products and services.
Sales taxes collected from customers and remitted to governmental authorities are accounted for on a net (excluded from revenues) basis.

Contract Fulfillment Costs
Costs associated with product sales are accumulated in inventory as the fixtures are manufactured and are transferred to Cost of product revenue at the time revenue is recorded. See Note 5, Inventories, Net. Costs associated with installation sales are expensed as incurred.

Disaggregation of Revenue
Orion's Product revenue includes revenue from contracts with customers accounted for under the scope of ASC 606 and revenue which is accounted for under other guidance. For the three and six months ended September 30, 2018, Product revenue included $0.3 million and $1.0 million, respectively, derived from sales-type leases for light fixtures, $0.1 million and $0.2 million, respectively, derived from the sale of tax credits generated from Orion's legacy operation for distributing solar energy, and $18,889 and $37,777, respectively, derived from the amortization of federal grants received in 2010 and 2011 as reimbursement for a portion of the costs to construct the legacy solar facilities which are not under the scope of ASC 606. All remaining Product revenue, and all Service revenue, are derived from contracts with customers as defined in ASC 606.
The primary end-users of Orion's lighting products and services are (a) the federal government, and (b) commercial or industrial companies.
The federal government obtains Orion products and services primarily through turnkey project sales that Orion makes to a select group of contractors who focus on the federal government. Revenues associated with government end-users are primarily included in the Orion Engineered Systems Division segment.
Commercial or industrial end-users obtain Orion products and services through turnkey project sales or by purchasing products either direct from Orion or through distributors or energy service companies ("ESCOs"). Revenues associated with commercial and industrial end-users therefore are included within each of Orion's segments, dependent on the sales channel.
See Footnote 16, Segments, for additional discussion concerning Orion's reportable segments.
The following table provides detail of Orion's total revenues for the three and six months ended September 30, 2018 (dollars in thousands):

| | Three months ended September 30, 2018 | | | Six Months Ended September 30, 2018 | | |
|---|---|---|---|---|---|---|
| | Product | Services | Total | Product | Services | Total |
| Revenue from contracts with customers: | | | | | | |
| Lighting revenues, by end user | | | | | | |
| Federal government | $18 | $— | $18 | $115 | $— | $115 |
| Commercial and industrial | 11,110 | 1,608 | 12,718 | 23,011 | 2,622 | 25,633 |
| Total lighting | 11,128 | 1,608 | 12,736 | 23,126 | 2,622 | 25,748 |
| Solar energy related revenues | 18 | — | 18 | 38 | — | 38 |
| Total revenues from contracts with customers | 11,146 | 1,608 | 12,754 | 23,164 | 2,622 | 25,786 |
| Revenue accounted for under other guidance | 444 | — | 444 | 1,234 | — | 1,234 |
| Total revenue | $11,590 | $ 1,608 | $13,198 | $24,398 | $ 2,622 | $27,020 |

Cash Flow Considerations
Customer payments for material only orders are due shortly after shipment.

Turnkey projects where the end-user is the federal government typically span a three to six-month period. The contracts for these sales often provide for monthly progress payments equal to ninety percent (90%) of the value provided by Orion during the month.

Turnkey projects where the end-user is a commercial or industrial company typically span between two weeks to three months. Customer payment requirements for these projects vary by contract. Some contracts provide for customer payments for products and services as they are delivered, other contracts specify that the customer will pay for the project in its entirety upon completion of the installation.

Orion provides long-term financing to one customer who frequently engages Orion in large turnkey projects that span between three and nine months. The customer executes an agreement providing for monthly payments of the contract price, plus interest, over a five-year period. The total transaction price in these contracts is allocated between product and services in the same manner as all other turnkey projects. The portion of the transaction associated with the installation is accounted for consistently with all other installation related performance obligations. The portion of the transaction associated with the sale of the multiple individual light fixtures is accounted for as sales-type leases in accordance with ASC 840, "Leases". Revenues associated with the sales-type leases are included in Product revenue and recorded for each fixture separately based on the customer’s monthly acknowledgment that specified fixtures have been installed and are operating as specified.

The payments associated with these transactions that are due during the twelve months subsequent to September 30, 2018 are included in Accounts receivable, net in Orion’s Condensed Consolidated Balance Sheets. The remaining amounts due that are associated with these transactions are included in Other long-term assets in Orion’s Condensed Consolidated Balance Sheets.

The customer’s monthly payment obligation commences after completion of the turnkey project. Orion generally sells the receivable from the customer to an independent financial institution either during, or shortly after completion of, the installation period. Upon execution of the receivables purchase / sales agreement, all amounts due from the customer are included in Revenues earned but not billed on Orion’s Condensed Consolidated Balance Sheets until cash is received from the financial institution. The financial institution releases funds to Orion based on the customer’s monthly acknowledgment of the progress Orion has achieved in fulfilling its installation obligation. Orion provides the progress certifications to the financial institution one month in arrears.

The total amount received from the sales of these receivables during the three and six months ended September 30, 2018 was $0.9 million and $2.9 million, respectively. Orion’s losses on these sales aggregated to $0.1 million and $0.2 million for the three and six months ended September 30, 2018 and is included in Interest expense in the Condensed Consolidated Statement of Operations.

Practical Expedients and Exemptions

Orion expenses sales commissions when incurred because the amortization period is one year or less. These costs are recorded within Sales and marketing expense. There are no other capitalizable costs associated with obtaining contracts with customers.

Orion’s performance obligations related to lighting fixtures typically do not exceed nine months in duration. As a result, Orion has elected the practical expedient that provides an exemption of the disclosure requirements regarding information about value assigned to remaining performance obligations on contracts that have original expected durations of one year or less.

Orion has also adopted the practical expedient that provides an exemption of the disclosure requirement of the value assigned to performance obligations associated with contracts that were not complete as of April 1, 2018.

Orion also elected the practical expedient that permits companies to not disclose quantitative information about the future revenue when revenue is recognized as invoices are issued to customers for services performed.

Other than the turnkey projects which result in sales-type leases discussed above, Orion generally receives full payment for satisfied performance obligations in less than one year. Accordingly, Orion does not adjust revenues for the impact of any potential significant financing component as permitted by the practical expedients provided in ASC 606.

Contract Balances

A receivable is recognized when Orion has an enforceable right to payment in accordance with contract terms and an invoice has been issued to the customer. Payment terms on invoiced amounts are typically 30 days from the invoice date.

Revenue earned but not billed represents revenue that has been recognized in advance of billing the customer, which is a common practice in Orion turnkey contracts. Once Orion has an unconditional right to consideration under a turnkey contract, Orion typically bills the customer accordingly and reclassifies the amount to Accounts receivable, net. Revenue earned but not

billed as of September 30, 2018 and April 1, 2018 includes $0.1 million and $0.6 million, respectively, which was not derived from contracts with customers and therefore not classified as a contract asset as defined by the new standards.
Deferred revenue, current as of September 30, 2018, included $41,425 of contract liabilities which represented consideration received from customers prior to the point that Orion has fulfilled the promises included in a performance obligation and recorded revenue.
Deferred revenue, long-term consists of the unamortized portion of the funds received from the federal government in 2010 and 2011 as reimbursement for the costs to build the two facilities related to the PPAs. As the transaction is not considered a contract with a customer, this value is not a contract liability as defined by the new standards.
The following chart shows the balance of Orion's receivables arising from contracts with customers, contract assets and contract liabilities as of September 30, 2018, and April 1, 2018, after the adoption of the new standards (dollars in thousands):

| | September 30, 2018 | April 1, 2018 |
|---|---|---|
| Accounts receivable, net | $ 5,778 | $9,020 |
| Contract assets | $ 617 | $1,773 |
| Contract liabilities | $ 41 | $13 |

There were no significant changes in the contract assets outside of standard reclassifications to Accounts receivable, net upon billing. There were no significant changes to contract liabilities.

Impact on Financial Statements

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

| | As Reported September 30, 2018 | Adjustments | Balances without application of ASC 606 |
|---|---|---|---|
| Assets | | | |
| Cash and cash equivalents | $ 5,665 | $ — | $ 5,665 |
| Accounts receivable, net | 5,778 | (113 ) | 5,665 |
| Revenue earned but not billed | 703 | (703 ) | — |
| Inventories, net | 8,327 | (231 ) | 8,096 |
| Deferred contract costs | — | 430 | 430 |
| Prepaid expenses and other current assets | 417 | 485 | 902 |
| Total current assets | 20,890 | (132 ) | 20,758 |
| Property and equipment, net | 12,281 | — | 12,281 |
| Other intangible assets, net | 2,664 | — | 2,664 |
| Other long-term assets | 102 | — | 102 |
| Total assets | $ 35,937 | $ (132 ) | $ 35,805 |
| Liabilities and Shareholders' Equity | | | |
| Accounts payable | $ 8,850 | $ 964 | $ 9,814 |
| Accrued expenses and other | 4,828 | (1,120 ) | 3,708 |
| Deferred revenue, current | 117 | 195 | 312 |
| Current maturities of long-term debt | 81 | — | 81 |
| Total current liabilities | 13,876 | 39 | 13,915 |
| Revolving credit facility | 1,419 | — | 1,419 |
| Long-term debt, less current maturities | 64 | — | 64 |
| Deferred revenue, long-term | 828 | 90 | 918 |
| Other long-term liabilities | 621 | (90 ) | 531 |
| Total liabilities | 16,808 | 39 | 16,847 |
| Commitments and contingencies | | | |
| Shareholders' equity: | | | |
| Preferred stock, $0.01 par value: Shares authorized: 30,000,000 at September 30, 2018 and March 31, 2018; no shares issued and outstanding at September 30, 2018 and March 31, 2018 | — | — | — |
| Common stock, no par value: Shares authorized: 200,000,000 at September 30, 2018 and March 31, 2018; shares issued: 38,974,961 at September 30, 2018 and 38,384,575 at March 31, 2018; shares outstanding: 29,537,474 at September 30, 2018 and 28,953,183 at March 31, 2018 | — | — | — |
| Additional paid-in capital | 155,442 | — | 155,442 |
| Treasury stock, common shares: 9,437,487 at September 30, 2018 and 9,431,392 at March 31, 2018 | (36,090 ) | — | (36,090 ) |
| Retained deficit | (100,223 ) | (171 ) | (100,394 ) |
| Total shareholders' equity | 19,129 | (171 ) | 18,958 |
| Total liabilities and shareholders' equity | $ 35,937 | $ (132 ) | $ 35,805 |

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, 2018 | | | Six Months Ended September 30, 2018 | | |
|---|---|---|---|---|---|---|
| | As Reported | Adjustments | Balances without application of ASC 606 | As Reported | Adjustments | Balances without application of ASC 606 |
| Product revenue | $ 11,590 | $ 511 | $ 12,101 | $ 24,398 | $ 1,064 | $ 25,462 |
| Service revenue | 1,608 | (406 ) | 1,202 | 2,622 | (1,131 ) | 1,491 |
| Total revenue | 13,198 | 105 | 13,303 | 27,020 | (67 ) | 26,953 |
| Cost of product revenue | 9,367 | — | 9,367 | 19,091 | 1 | 19,092 |
| Cost of service revenue | 1,289 | (317 ) | 972 | 1,931 | (738 ) | 1,193 |
| Total cost of revenue | 10,656 | (317 ) | 10,339 | 21,022 | (737 ) | 20,285 |
| Gross profit | 2,542 | 422 | 2,964 | 5,998 | 670 | 6,668 |
| Operating expenses: | | | | | | |
| General and administrative | 2,336 | — | 2,336 | 5,412 | — | 5,412 |
| Sales and marketing | 2,135 | 315 | 2,450 | 4,713 | 570 | 5,283 |
| Research and development | 354 | — | 354 | 759 | — | 759 |
| Total operating expenses | 4,825 | 315 | 5,140 | 10,884 | 570 | 11,454 |
| Loss from operations | (2,283 ) | 107 | (2,176 ) | (4,886 ) | 100 | (4,786 ) |
| Other income (expense): | | | | | | |
| Other income | 15 | — | 15 | 34 | — | 34 |
| Interest expense | (169 ) | 3 | (166 ) | (258 ) | 1 | (257 ) |
| Interest income | 3 | — | 3 | 6 | — | 6 |
| Total other expense | (151 ) | 3 | (148 ) | (218 ) | 1 | (217 ) |
| Loss before income tax | (2,434 ) | 110 | (2,324 ) | (5,104 ) | 101 | (5,003 ) |
| Income tax expense | 4 | — | 4 | 26 | — | 26 |
| Net loss | $ (2,438 ) | $ 110 | $ (2,328 ) | $ (5,130 ) | $ 101 | $ (5,029 ) |
| Basic net loss per share attributable to common shareholders | $ (0.08 ) | $ 0.00 | $ (0.08 ) | $ (0.18 ) | $ 0.00 | $ (0.17 ) |
| Weighted-average common shares outstanding | 29,488,363 | — | 29,488,363 | 29,280,421 | — | 29,280,421 |
| Diluted net loss per share | $ (0.08 ) | $ 0.00 | $ (0.08 ) | $ (0.18 ) | $ 0.00 | $ (0.17 ) |
| Weighted-average common shares and share equivalents outstanding | 29,488,363 | — | 29,488,363 | 29,280,421 | — | 29,280,421 |

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

| | Six Months Ended September 30, 2018 | | |
|---|---|---|---|
| | As Reported | Adjustments | Balances without application of ASC 606 |
| Operating activities | | | |
| Net loss | $(5,130) | $ 101 | $ (5,029) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | | |
| Depreciation | 679 | — | 679 |
| Amortization | 232 | — | 232 |
| Stock-based compensation | 439 | — | 439 |
| Provision for inventory reserves | (159) | — | (159) |
| Provision for bad debts | 85 | — | 85 |
| Other | 8 | — | 8 |
| Changes in operating assets and liabilities: | | | |
| Accounts receivable, current and long-term | 3,157 | (171) | 2,986 |
| Revenue earned but not billed | 1,652 | (1,652) | — |
| Inventories | 345 | (456) | (111) |
| Deferred contract costs | — | 564 | 564 |
| Prepaid expenses and other assets | 141 | 1,424 | 1,565 |
| Accounts payable | (1,941) | 80 | (1,861) |
| Accrued expenses and other | (628) | 170 | (458) |
| Deferred revenue, current and long-term | (12) | (60) | (72) |
| Net cash used in operating activities | (1,132) | — | (1,132) |
| Investing activities | | | |
| Purchases of property and equipment | (66) | — | (66) |
| Additions to patents and licenses | (28) | — | (28) |
| Net cash used in investing activities | (94) | — | (94) |
| Financing activities | | | |
| Payment of long-term debt and capital leases | (39) | — | (39) |
| Proceeds from revolving credit facility | 33,011 | — | 33,011 |
| Payment of revolving credit facility | (35,501) | — | (35,501) |
| Payments to settle employee tax withholdings on stock-based compensation | (6) | — | (6) |
| Net proceeds from employee equity exercises | 2 | — | 2 |
| Net cash used in financing activities | (2,533) | — | (2,533) |
| Net decrease in cash and cash equivalents | (3,759) | — | (3,759) |
| Cash and cash equivalents at beginning of period | 9,424 | — | 9,424 |
| Cash and cash equivalents at end of period | $5,665 | $ — | $ 5,665 |

NOTE 4 — ACCOUNTS RECEIVABLE, NET

As of September 30, 2018, and March 31, 2018, Orion's Accounts receivable and Allowance for doubtful accounts balances were as follows (dollars in thousands):

| | September 30, 2018 | March 31, 2018 |
|---|---|---|
| Accounts receivable, gross | $ 6,013 | $8,886 |
| Allowance for doubtful accounts | (235 ) | (150 ) |
| Accounts receivable, net | $ 5,778 | $8,736 |

NOTE 5 — INVENTORIES, NET

As of September 30, 2018, and March 31, 2018, Orion's Inventory balances were as follows (dollars in thousands):

| | Cost | Reserve | Net |
|---|---|---|---|
| As of September 30, 2018 | | | |
| Raw materials and components | $6,920 | $(1,260) | $5,660 |
| Work in process | 1,016 | (282 ) | 734 |
| Finished goods | 3,386 | (1,453 ) | 1,933 |
| Total | $11,322 | $(2,995) | $8,327 |
| | | | |
| As of March 31, 2018 | | | |
| Raw materials and components | $6,073 | $(1,363) | $4,710 |
| Work in process | 1,190 | (263 ) | 927 |
| Finished goods | 3,934 | (1,745 ) | 2,189 |
| Total | $11,197 | $(3,371) | $7,826 |

NOTE 6 — PREPAID EXPENSES AND OTHER CURRENT ASSETS

As of September 30, 2018, and March 31, 2018, Prepaid expenses and other current assets included the following (dollars in thousands):

| | September 30, 2018 | March 31, 2018 |
|---|---|---|
| Unbilled accounts receivable (1) | $ — | $1,910 |
| Other prepaid expenses | 417 | 557 |
| Total | $ 417 | $2,467 |

(1) As of April 1, 2018, in conjunction with the adoption of ASC 606, the balance of unbilled Accounts receivable was included in Revenue earned but not billed on the Condensed Consolidated Balance Sheets.

NOTE 7 — PROPERTY AND EQUIPMENT, NET

As of September 30, 2018, and March 31, 2018, Property and equipment, net, included the following (dollars in thousands):

| | September 30, 2018 | March 31, 2018 |
|---|---|---|
| Land and land improvements | $433 | $424 |
| Buildings and building improvements | 9,245 | 9,245 |
| Furniture, fixtures and office equipment | 7,117 | 7,096 |
| Leasehold improvements | 324 | 324 |
| Equipment leased to customers | 4,997 | 4,997 |
| Plant equipment | 11,999 | 12,106 |
| | 34,115 | 34,192 |
| Less: accumulated depreciation and amortization | (21,834 ) | (21,298 ) |
| Property and equipment, net | $12,281 | $12,894 |

As of September 30, 2018, a triggering event occurred requiring Orion to evaluate its long-lived assets for impairment. Due to the central nature of its operations, Orion's tangible and intangible definite-lived assets support its full operations, are utilized by all three of its reportable segments, and do not generate separately identifiable cash flows. As such, these assets together represent a single asset group. In reviewing the asset group for impairment, Orion elected to bypass the qualitative impairment assessment and went directly to performing the Step 1 recoverability test. Orion performed the Step 1 recoverability test for the asset group comparing its carrying value to the group's expected future undiscounted cash flows. Orion concluded that the undiscounted cash flows of the definite lived asset group exceeded its carrying value. As such the asset group was deemed recoverable and no impairment was recorded.

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

| | September 30, 2018 | March 31, 2018 |
|---|---|---|
| Equipment | $ 581 | $581 |
| Less: accumulated depreciation and amortization | (415 ) | (344 ) |
| Equipment, net | $ 166 | $237 |

Orion recorded depreciation expense of $0.4 and $0.7 million for the three and six months ended September 30, 2018, respectively, and $0.3 and $0.7 million for the three and six months ended September 30, 2017, respectively.

NOTE 8 —OTHER INTANGIBLE ASSETS, NET

As of September 30, 2018, and March 31, 2018, the components of, and changes in, the carrying amount of Other intangible assets, net, were as follows (dollars in thousands):

| | September 30, 2018 | | | March 31, 2018 | | |
|---|---|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Net | Gross Carrying Amount | Accumulated Amortization | Net |
| Patents | $2,664 | $ (1,451 ) | $1,213 | $2,636 | $ (1,370 ) | $1,266 |
| Licenses | 58 | (58 ) | — | 58 | (58 ) | — |
| Trade name and trademarks | 1,005 | — | 1,005 | 1,005 | — | 1,005 |
| Customer relationships | 3,600 | (3,401 ) | 199 | 3,600 | (3,326 ) | 274 |
| Developed technology | 900 | (653 ) | 247 | 900 | (582 ) | 318 |
| Non-competition agreements | 100 | | | | | |