

ORION ENERGY SYSTEMS, INC.
Form 10-Q
August 04, 2017
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 June 30, 2017

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 (I.R.S. Employer
incorporation or organization) 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 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, 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. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Smaller reporting company
Emerging growth company

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.

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 28,763,663 shares of the Registrant's common stock outstanding on July 28, 2017.

ORION ENERGY SYSTEMS, INC.
 QUARTERLY REPORT ON FORM 10-Q
 FOR THE QUARTER ENDED JUNE 30, 2017
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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)

| | June 30, 2017 | March 31, 2017 |
|---|------------------|-------------------|
| Assets | | |
| Cash and cash equivalents | \$8,485 | \$17,307 |
| Accounts receivable, net | 7,040 | 9,171 |
| Inventories, net | 12,266 | 13,593 |
| Deferred contract costs | 1,704 | 935 |
| Prepaid expenses and other current assets | 3,093 | 2,877 |
| Total current assets | 32,588 | 43,883 |
| Property and equipment, net | 13,638 | 13,786 |
| Other intangible assets, net | 4,065 | 4,207 |
| Other long-term assets | 118 | 175 |
| Total assets | \$50,409 | \$62,051 |
| Liabilities and Shareholders' Equity | | |
| Accounts payable | \$9,608 | \$11,635 |
| Accrued expenses and other | 5,128 | 5,988 |
| Deferred revenue, current | 823 | 621 |
| Current maturities of long-term debt | 110 | 152 |
| Total current liabilities | 15,669 | 18,396 |
| Revolving credit facility | 3,853 | 6,629 |
| Long-term debt, less current maturities | 164 | 190 |
| Deferred revenue, long-term | 945 | 944 |
| Other long-term liabilities | 560 | 442 |
| Total liabilities | 21,191 | 26,601 |
| Commitments and contingencies | | |
| Shareholders' equity: | | |
| Preferred stock, \$0.01 par value: Shares authorized: 30,000,000 at June 30, 2017 and March 31, 2017; no shares issued and outstanding at June 30, 2017 and March 31, 2017 | — | — |
| Common stock, no par value: Shares authorized: 200,000,000 at June 30, 2017 and March 31, 2017; shares issued: 38,161,796 at June 30, 2017 and 37,747,227 at March 31, 2017; shares outstanding: 28,732,979 at June 30, 2017 and 28,317,490 at March 31, 2017 | — | — |
| Additional paid-in capital | 154,230 | 153,901 |
| Treasury stock, common shares: 9,428,817 at June 30, 2017 and 9,429,737 at March 31, 2017 | (36,082) | (36,081) |
| Shareholder notes receivable | — | (4) |
| Retained deficit | (88,930) | (82,366) |
| Total shareholders' equity | 29,218 | 35,450 |
| Total liabilities and shareholders' equity | \$50,409 | \$62,051 |

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 | |
|--|--------------------|------------|
| | June 30, | |
| | 2017 | 2016 |
| Product revenue | \$11,781 | \$ 15,352 |
| Service revenue | 777 | 282 |
| Total revenue | 12,558 | 15,634 |
| Cost of product revenue | 8,813 | 11,419 |
| Cost of service revenue | 1,034 | 189 |
| Total cost of revenue | 9,847 | 11,608 |
| Gross profit | 2,711 | 4,026 |
| Operating expenses: | | |
| General and administrative | 5,335 | 3,901 |
| Sales and marketing | 3,354 | 2,895 |
| Research and development | 524 | 481 |
| Total operating expenses | 9,213 | 7,277 |
| Loss from operations | (6,502) | (3,251) |
| Other income (expense): | | |
| Other income | — | 100 |
| Interest expense | (67) | (70) |
| Interest income | 5 | 10 |
| Total other (expense) income | (62) | 40 |
| Loss before income tax | (6,564) | (3,211) |
| Income tax benefit | — | (271) |
| Net loss | \$(6,564) | \$(2,940) |
| Basic net loss per share attributable to common shareholders | \$(0.23) | \$(0.11) |
| Weighted-average common shares outstanding | 28,455,434 | 27,885,588 |
| Diluted net loss per share | \$(0.23) | \$(0.11) |
| Weighted-average common shares and share equivalents outstanding | 28,455,434 | 27,885,588 |

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)

| | Three Months Ended June 30, | |
|---|--------------------------------|-----------|
| | 2017 | 2016 |
| Operating activities | | |
| Net loss | \$(6,564) | \$(2,940) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation | 353 | 389 |
| Amortization | 162 | 243 |
| Stock-based compensation | 320 | 329 |
| Provision for inventory reserves | 130 | 254 |
| Provision for bad debts | 33 | (375) |
| Other | 12 | 56 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, current and long-term | 2,103 | (1,805) |
| Inventories | 1,196 | 1,280 |
| Deferred contract costs | (770) | (200) |
| Prepaid expenses and other assets | (163) | 2,203 |
| Accounts payable | (2,028) | (1,516) |
| Accrued expenses and other | (743) | (285) |
| Deferred revenue, current and long-term | 204 | 52 |
| Net cash used in operating activities | (5,755) | (2,315) |
| Investing activities | | |
| Purchase of property and equipment | (204) | (53) |
| Additions to patents and licenses | (20) | — |
| Proceeds from sales of property, plant and equipment | — | 2,600 |
| Net cash (used in) provided by investing activities | (224) | 2,547 |
| Financing activities | | |
| Payment of long-term debt and capital leases | (67) | (381) |
| Proceeds from revolving credit facility | 16,307 | 16,658 |
| Payment of revolving credit facility | (19,083) | (17,889) |
| Payments to settle employee tax withholdings on stock-based compensation | — | (4) |
| Net proceeds from employee equity exercises | — | 2 |
| Net cash used in financing activities | (2,843) | (1,614) |
| Net decrease in cash and cash equivalents | (8,822) | (1,382) |
| Cash and cash equivalents at beginning of period | 17,307 | 15,542 |
| Cash and cash equivalents at end of period | \$8,485 | \$14,160 |

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; Chicago, Illinois; and Houston, Texas. Orion also leases warehouse space in Manitowoc, Wisconsin and Augusta, Georgia.

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. 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 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. 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, 2018 or other interim periods.

The condensed consolidated balance sheet at March 31, 2017 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, 2017 filed with the Securities and Exchange Commission on June 13, 2017.

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, allowance for doubtful accounts, accruals for warranty and loss contingencies, income taxes 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 months ended June 30, 2017 and 2016, no supplier accounted for more than 10% of total cost of revenue.

For the three months ended June 30, 2017, one customer accounted for 16.2% of total revenue. For the three months ended June 30, 2016, no customer accounted for more than 10% of revenue.

As of June 30, 2017, no customer accounted for more than 10% of accounts receivable. As of March 31, 2017, one customer accounted for 11.6% of accounts receivable.

Recent Accounting Pronouncements

Issued: Not Yet Adopted

In August 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-15, "Classification of Certain Cash Receipts and Cash Payments," which provides clarification and additional guidance as to the presentation and classification of certain cash receipts and cash payments in the statement of cash flows. The ASU provides 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. The new standard will be effective for Orion in the first quarter of fiscal 2019 and will be applied through retrospective adjustment to all periods presented. Orion does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases (Subtopic 842)." This ASU 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 this ASU, 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. This ASU also provides guidance on the presentation of the effects of leases in the income statement and statement of cash flows. This guidance will be effective for Orion on April 1, 2019. Early adoption of the standard is permitted and a modified retrospective transition approach is required for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company has not yet completed its review of the full provisions of this standard 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 consolidated balance sheets upon adoption of the standard. In addition, management continues to assess the impact of adoption of this standard on its consolidated statements of operations, cash flows, and the related footnote disclosures. In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers." This ASU is a comprehensive new revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. In addition, the ASU requires enhanced and expanded financial statement disclosures. Since the issuance of this ASU, the FASB has issued further ASU's to provide additional guidance and clarification as to the application of ASU 2014-09 and delaying its original effective date. The ASU allows companies to elect either a full retrospective or modified retrospective approach to adoption.

Orion will adopt ASU 2014-09 and the related updates with their effective date on April 1, 2018. Orion has begun the process of implementing this standard, including performing a review of its revenue streams to identify any differences in the timing, measurement, or presentation of revenue recognition. The Company continues to review the provisions of these standards against its customer contracts, including evaluating and identifying distinct performance obligations and variable consideration in the form of customer rebates. The Company has selected a representative sample of customer contracts from each of its major revenue streams and is in the process of evaluating these contracts against the standards to determine any impact on the timing and presentation of revenue. In addition, the Company has identified necessary changes in its ongoing process for the review of new customer contracts and the identification of key terms impacting revenue recognition. The Company is also evaluating the necessary changes to its systems, revenue related processes and controls as a result of the new standard, including the related footnote disclosures. Under ASU 2014-09 incremental contract costs, including sales commissions, may be required to be capitalized and expensed over the period these costs are recovered. Although Orion incurs commission costs, its contracts are typically completed within one year. As such, the Company will elect to apply the practical expedient for

contract costs recovered within one year and will continue to recognize commissions as cost of sales immediately rather than capitalizing and expensing these costs over the contract period. Orion currently plans to elect the modified retrospective adoption method but continues to evaluate both of the available transition methods. 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 standard are effective for Orion beginning on April 1, 2018. The adoption of this standard is not expected to have a material impact on Orion's consolidated condensed financial statements.

Recently Adopted Standards

In November 2015, the FASB issued ASU 2015-17, "Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes," to simplify the presentation of deferred taxes. The amendments in this update require that deferred tax assets and liabilities be classified as non-current on the balance sheet. This ASU is effective for Orion's annual reporting period, and interim periods therein, as of April 1, 2017. The adoption of this standard had no impact on Orion's condensed consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, "Inventory (Topic 330): Simplifying the Measurement of Inventory," which changes the measurement principle for inventory from the lower of cost or market to the lower of cost or net realizable value for entities that measure inventory using first-in, first-out ("FIFO") or average cost. Net realizable value is defined as the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. Orion adopted this standard as of April 1, 2017. The adoption of this standard had no impact on its condensed consolidated financial statements as the previous measurement and validation of the carrying value of its inventory incorporated market values consistent with the net realizable value measurements of the standard.

In March 2016, the FASB issued ASU 2016-09, "Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting," which changes how companies account for certain aspects of share-based payment awards to employees, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as the classification of related matters in the statement of cash flows. Orion adopted this ASU as of April 1, 2017. As a result of adopting the income tax accounting provisions of this standard, Orion realized an increase in both its deferred tax assets related to stock-based compensation awards and the related valuation allowance. As the Company carries a full valuation allowance against its deferred tax assets, there was no net impact to its condensed consolidated balance sheets or statements of operations. In accordance with the provisions of this standard, the Company elected to prospectively adopt an accounting policy to recognize forfeitures as they occur in lieu of estimating forfeitures. The cashflow presentation provisions of the standard had no impact on Orion's condensed consolidated financial statements. Finally, due to the Company's net loss, the modifications to the calculation of diluted earnings per share as a result of adopting this standard did not impact its diluted earnings per share.

NOTE 3 — ACCOUNTS RECEIVABLE

Orion's accounts receivable and allowance for doubtful accounts balances were as follows (dollars in thousands):

| | June 30, 2017 | March 31, 2017 |
|---------------------------------|------------------|----------------------|
| Accounts receivable, gross | \$7,216 | \$9,315 |
| Allowance for doubtful accounts | (176) | (144) |
| Accounts receivable, net | \$7,040 | \$9,171 |

NOTE 4 — INVENTORIES

As of June 30, 2017 and March 31, 2017, Orion's inventory balances were as follows (dollars in thousands):

| | Cost | Reserve | Net |
|------------------------------|----------|-----------|----------|
| As of June 30, 2017 | | | |
| Raw materials and components | \$8,008 | \$(1,677) | \$6,331 |
| Work in process | 1,693 | (348) | 1,345 |
| Finished goods | 5,981 | (1,391) | 4,590 |
| Total | \$15,682 | \$(3,416) | \$12,266 |

As of March 31, 2017

| | | | |
|------------------------------|----------|-----------|----------|
| Raw materials and components | \$8,104 | \$(1,807) | \$6,297 |
| Work in process | 1,918 | (329) | 1,589 |
| Finished goods | 7,044 | (1,337) | 5,707 |
| Total | \$17,066 | \$(3,473) | \$13,593 |

NOTE 5 — PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expenses and other current assets include the following (dollars in thousands):

| | June 30, 2017 | March 31, 2017 |
|------------------------------|---------------------|----------------------|
| Unbilled accounts receivable | \$2,467 | \$2,226 |
| Other prepaid expenses | 626 | 651 |
| Total | \$3,093 | \$2,877 |

NOTE 6 — PROPERTY AND EQUIPMENT

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

| | June 30, 2017 | March 31, 2017 |
|---|------------------|-------------------|
| Land and land improvements | \$424 | \$424 |
| Buildings and building improvements | 9,245 | 9,245 |
| Furniture, fixtures and office equipment | 7,050 | 7,056 |
| Leasehold improvements | 324 | 324 |
| Equipment leased to customers | 4,997 | 4,997 |
| Plant equipment | 11,633 | 11,627 |
| Construction in progress | 224 | 61 |
| | 33,897 | 33,734 |
| Less: accumulated depreciation and amortization (20,259) | (19,948) | |
| Property and equipment, net | \$13,638 | \$13,786 |

During the three months ended June 30, 2017, the Company began pursuing the potential sale and leaseback of its Tech Center building located in Manitowoc, Wisconsin. The Tech Center building houses Orion's corporate offices. Due to the expected leaseback of more than a minor portion of the facility, it does not meet the criteria to be classified as held for sale as of June 30, 2017. As a result of this action, Orion assessed the facility for impairment as of June 30, 2017 by performing a probability weighted cashflow analysis (a Level 3 fair value measure). As a result of this analysis, and based on the assumptions used, including management's best estimate of the potential sales price, future rent expense, sublease income, and the probability of various scenarios under consideration, the Company concluded that the asset is not impaired as of June 30, 2017.

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

| | June 30, 2017 | March 31, 2017 |
|--|---------------------|----------------------|
| Equipment | \$581 | \$581 |
| Less: accumulated depreciation and amortization (237) | (202) | |
| Equipment, net | \$344 | \$379 |

Orion recorded depreciation expense of \$0.4 million for the three months ended June 30, 2017 and 2016.

NOTE 7 — INTANGIBLE ASSETS

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

| | June 30, 2017 | | | March 31, 2017 | | |
|----------------------------|-----------------------------|-----------------------------|----------|-----------------------------|-----------------------------|----------|
| | Gross Carrying Amount | Accumulated Amortization | Net | Gross Carrying Amount | Accumulated Amortization | Net |
| Patents | \$2,678 | \$ (1,251) | \$ 1,427 | \$2,658 | \$ (1,211) | \$ 1,447 |
| Licenses | 58 | (58) | — | 58 | (58) | — |
| Trade name and trademarks | 1,715 | — | 1,715 | 1,715 | — | 1,715 |
| Customer relationships | 3,600 | (3,131) | 469 | 3,600 | (3,054) | 546 |
| Developed technology | 900 | (466) | 434 | 900 | (426) | 474 |
| Non-competition agreements | 100 | (80) | 20 | 100 | (75) | 25 |
| Total | \$9,051 | \$ (4,986) | \$4,065 | \$9,031 | \$ (4,824) | \$4,207 |

Amortization expense on intangible assets was \$0.2 million for the three months ended June 30, 2017 and 2016.

As of June 30, 2017, the weighted average useful life of intangible assets was 5.90 years.

The estimated amortization expense for the next five years and beyond is shown below (dollars in thousands):

| | |
|-------------|---------|
| Fiscal 2018 | \$461 |
| Fiscal 2019 | 447 |
| Fiscal 2020 | 361 |
| Fiscal 2021 | 287 |
| Fiscal 2022 | 190 |
| Fiscal 2023 | 166 |
| Thereafter | 438 |
| Total | \$2,350 |

NOTE 8 — OTHER LONG-TERM ASSETS

Other long-term assets include the following (dollars in thousands):

| | June 30, 2017 | March 31, 2017 |
|-------------------|---------------------|----------------------|
| Security deposits | \$ 66 | \$ 117 |
| Other | 52 | 58 |
| Total | \$ 118 | \$ 175 |

NOTE 9 — ACCRUED EXPENSES AND OTHER LONG-TERM LIABILITIES

Accrued expenses and other include the following (dollars in thousands):

| | June 30, 2017 | March 31, 2017 |
|-----------------------------|---------------------|----------------------|
| Compensation and benefits | \$ 1,802 | \$ 2,431 |
| Sales tax | 94 | 213 |
| Contract costs | 248 | 223 |
| Legal and professional fees | 2,116 | 2,262 |
| Warranty | 471 | 449 |
| Other accruals | 397 | 410 |
| Total | \$ 5,128 | \$ 5,988 |

Other long term liabilities includes the following (dollars in thousands):

| | June 30, 2017 | March 31, 2017 |
|---------------------------|---------------------|----------------------|
| Warranty | \$ 310 | \$ 310 |
| Medical benefits | 137 | — |
| Unrecognized tax benefits | 113 | 113 |
| Other | — | 19 |
| Total | \$ 560 | \$ 442 |

Orion generally offers a limited warranty of one to ten years on its lighting 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 Orion's lighting products.

Changes in Orion's warranty accrual (both current and long-term) were as follows (dollars in thousands):

| | Three Months Ended June 30, | |
|--------------------------------------|--------------------------------|---------|
| | 2017 | 2016 |
| Beginning of period | \$759 | \$864 |
| Provision to product cost of revenue | 24 | 175 |
| Charges | (2) | (1) |
| End of period | \$781 | \$1,038 |

NOTE 10 — 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.

For the three months ended June 30, 2017 and 2016, Orion was in a net loss position; therefore, the basic and diluted weighted average shares outstanding are equal because any increase to the basic shares would be anti-dilutive. Net loss per common share is calculated based upon the following:

| | Three Months Ended June 30, | |
|---|--------------------------------|------------|
| | 2017 | 2016 |
| Numerator: | | |
| Net loss (in thousands) | \$(6,564) | \$(2,940) |
| Denominator: | | |
| Weighted-average common shares outstanding | 28,455,432 | 27,885,588 |
| Weighted-average common shares and common share equivalents outstanding | 28,455,432 | 27,885,588 |
| Net loss per common share: | | |
| Basic | \$(0.23) | \$(0.11) |
| Diluted | \$(0.23) | \$(0.11) |

The following table indicates the number of potentially dilutive securities excluded from the calculation of diluted net loss per common share because their inclusion would have been anti-dilutive. The number of shares are as of the end of each period:

| | June 30, 2017 | June 30, 2016 |
|----------------------|------------------|------------------|
| Common stock options | 1,442,153 | 1,949,846 |
| Restricted shares | 1,706,445 | 1,482,208 |
| Total | 3,148,598 | 3,432,054 |

NOTE 11 — RELATED PARTY TRANSACTIONS

During the three months ended June 30, 2017, Orion did not have any related party transactions. During the three months ended June 30, 2016, Orion purchased goods and services from an entity in the amount of approximately two thousand dollars, at which time a director of Orion served as a minority owner and as the president and chairman of the board of directors.

NOTE 12 — LONG-TERM DEBT

Long-term debt consisted of the following (dollars in thousands):

| | June 30, 2017 | March 31, 2017 |
|--|------------------|----------------------|
| Revolving credit facility | \$3,853 | \$6,629 |
| Equipment lease obligations | 268 | 321 |
| Customer equipment finance notes payable | 6 | 7 |
| Other long-term debt | — | 14 |
| Total long-term debt | 4,127 | 6,971 |
| Less current maturities | (110) | (152) |
| Long-term debt, less current maturities | \$4,017 | \$6,819 |

Revolving Credit Agreement

Orion has an amended credit agreement ("Credit Agreement") that provides for a revolving credit facility ("Credit Facility") subject to a borrowing base requirement based on eligible receivables and inventory. As of June 30, 2017 Orion's borrowing base was approximately \$4.1 million. The Credit Facility has a maturity date of February 6, 2019 and includes a \$2.0 million sublimit for the issuance of letters of credit. As of June 30, 2017, Orion had no outstanding letters of credit. Borrowings outstanding as of June 30, 2017, amounted to approximately \$3.9 million and are included in non-current liabilities in the accompanying condensed consolidated balance sheet. Orion estimates that as of June 30, 2017, it was eligible to borrow an additional \$0.2 million under the Credit Facility based upon current levels of eligible inventory and accounts receivable.

Subject in each case to Orion's applicable borrowing base limitations, the Credit Agreement otherwise provides for a \$15.0 million Credit Facility. This limit may increase to \$20.0 million based on a borrowing base requirement, if Orion satisfies certain conditions. Orion did not meet the requirements to increase the borrowing limit to \$20.0 million as of July 31, 2017, the most recent measurement date.

From and after any increase in the Credit Facility limit from \$15.0 million to \$20.0 million, the Credit Agreement requires that Orion maintain, as of the end of each month, a minimum ratio for the trailing twelve-month period of (i) earnings before interest, taxes, depreciation and amortization, subject to certain adjustments, to (ii) the sum of cash interest expense, certain principal payments on indebtedness and certain dividends, distributions and stock redemptions, equal to at least 1.10 to 1.00. The Credit Agreement contains additional customary covenants, including certain restrictions on Orion's ability to incur additional indebtedness, consolidate or merge, enter into acquisitions, guarantee obligations of third parties, make loans or advances, declare or pay any dividend or distribution on Orion's stock, redeem or repurchase shares of Orion's stock, or pledge or dispose of assets. Orion was in compliance with its covenants in the Credit Agreement as of June 30, 2017.

Each subsidiary of Orion is a joint and several co-borrower or guarantor under the Credit Agreement, and the Credit Agreement is secured by a security interest in substantially all of Orion's and each subsidiary's personal property (excluding various assets relating to customer OTAs) and a mortgage on certain real property.

Borrowings under the Credit Agreement bear interest at the daily three-month LIBOR plus 3.0% per annum, with a minimum interest charge for each year or portion of a year during the term of the Credit Agreement of \$0.1 million, regardless of usage. As of June 30, 2017, the interest rate was 4.30%. Orion must pay an unused line fee of 0.25% per annum of the daily average unused amount of the Credit Facility and a letter of credit fee at the rate of 3.0% per annum on the undrawn amount of letters of credit outstanding from time to time under the Credit Facility.

Harris Seller's Note

On July 1, 2013, Orion issued an unsecured and subordinated promissory note in the principal amount of \$3.1 million to partially fund the acquisition of Harris Manufacturing, Inc. and Harris LED, LLC (collectively, "Harris"). The note's interest rate was 4% per annum. Principal and interest were payable quarterly. The note matured in July 2016 and was paid in full upon maturity.

Equipment Lease Obligation

In March 2016 and June 2015, Orion entered into lease agreements with a financing company in the principal amount of nineteen thousand dollars and \$0.4 million, respectively, to fund certain equipment. The leases are secured by the

related equipment. The leases bear interest at a rate of 5.9% and 3.6%, respectively, and mature in February 2018 and June 2020. Both leases contain a one dollar buyout option.

Customer Equipment Finance Notes Payable

In December 2014, Orion entered into a secured borrowing agreement with a financing company in the principal amount of \$0.4 million to fund completed customer contracts under its OTA finance program that were previously funded under a different OTA credit agreement. The loan amount is secured by the OTA-related equipment and the expected future monthly payments under the supporting 25 individual OTA customer contracts. The borrowing agreement bears interest at a rate of 8.36% and matures in April 2018.

In June 2011, Orion entered into a note agreement with a financial institution that provided Orion with \$2.8 million to fund completed customer contracts under Orion's OTA finance program. The note bore interest at 7.85%. The note matured in April 2016 and was paid in full upon maturity.

Other Long-Term Debt

In September 2010, Orion entered into a note agreement with the Wisconsin Department of Commerce that provided Orion with \$0.3 million to fund Orion's rooftop solar project at its Manitowoc facility. This note is included in the table above as other long-term debt. The note is collateralized by the related solar equipment. The note allowed for two years without interest accruing or principal payments due. Beginning in July 2012, the note bears interest at 2% and requires monthly payments of four thousand six hundred. The note matured in June 2017 and was paid in full upon maturity.

NOTE 13 — INCOME TAXES

The income tax provision for the three months ended June 30, 2017 was determined by applying an estimated annual effective tax rate of 0.0% to loss before income tax. The estimated effective tax rate for the three month period ended June 30, 2016 was (0.3)%. The estimated effective income tax rate was determined by applying statutory tax rates to pretax loss adjusted for certain permanent book to tax differences and tax credits.

Orion is eligible for tax benefits associated with the excess of the tax deduction available for exercises of non-qualified stock options (NQSOs) over the amount recorded at grant. The amount of the benefit is based upon the ultimate deduction reflected in the applicable income tax return.

As of June 30, 2017, Orion had federal net operating loss carryforwards of approximately \$75.7 million. Orion also has state net operating loss carryforwards of approximately \$65.2 million. Orion also had federal tax credit carryforwards of approximately \$1.4 million and state tax credits of \$0.7 million. Orion's net operating loss and tax credit carryforwards will begin to expire in varying amounts between 2020 and 2036. As of June 30, 2017, Orion had recorded a valuation allowance of \$34.0 million equaling the net deferred tax asset due to the uncertainty of its realization value in the future. Orion considers future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance. In the event that Orion determines that the deferred tax assets are able to be realized, an adjustment to the deferred tax asset would increase income in the period such determination is made.

Uncertain Tax Positions

As of June 30, 2017, the balance of gross unrecognized tax benefits was approximately \$0.1 million, all of which would reduce Orion's effective tax rate if recognized.

Orion 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. Orion 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.

NOTE 14 — COMMITMENTS AND CONTINGENCIES

Operating Leases

Orion leases office space and equipment under operating leases expiring at various dates through 2020. Rent expense under operating leases was \$0.2 million and \$0.1 million for the three months ended June 30, 2017 and 2016, respectively.

On April 28, 2017, Orion renewed the lease for its Jacksonville, Florida office space for an additional three-year term with annual rent expense of approximately \$0.1 million.

On March 31, 2016, Orion entered into a purchase and sale agreement ("Agreement") with a third party to sell and leaseback Orion's manufacturing and distribution facility for a gross cash proceeds of \$2.6 million. The transaction closed on June 30, 2016.

Litigation

Orion is subject to various claims and legal proceedings arising in the ordinary course of business. As of the date of this report, Orion is unable to currently assess whether the final resolution of any of such claims or legal proceedings may have a material adverse effect on our future results of operations. In addition to ordinary-course litigation, Orion is a party to the proceedings described below.

On March 27, 2014, Orion was named as a defendant in a civil lawsuit filed by Neal R. Verfuert, a Former Chief Executive Officer who was terminated for cause in November 2012, in the United States District Court for the Eastern District of Wisconsin (Green Bay Division). The plaintiff alleged, among other things, that Orion breached certain agreements entered into with the plaintiff, including the plaintiff's employment agreement, and violated certain laws. The complaint sought, among other relief, unspecified pecuniary and compensatory damages, fees and such other relief as the court may deem just and proper. On November 4, 2014, the court granted Orion's motion to dismiss six of the plaintiff's claims. On January 9, 2015, the plaintiff filed an amended complaint re-alleging claims that were dismissed by the court, including, among other things, a retaliation claim and certain claims with respect to prior management agreements and certain intellectual property rights. On January 22, 2015, Orion filed a motion to dismiss and a motion to strike certain of the claims made in the amended complaint. On May 18, 2015, the court dismissed the intellectual property claims re-alleged in the January 9, 2015 amended complaint. At the court's direction, the parties attempted to mediate the matter in May 2016, but were unsuccessful in resolving the matter.

On August 25, 2016, the Chief Judge of the United States District Court for the Eastern District of Wisconsin (Green Bay Division) dismissed all claims against Orion brought by the plaintiff, including his claims that Orion had allegedly breached the plaintiff's employment agreement and had allegedly violated the plaintiff's whistleblower rights. On September 22, 2016, the plaintiff filed an appeal to the United States Court of Appeals challenging the judgment rendered on August 25, 2016. After the court-mandated mediation was unsuccessful, the plaintiff moved forward with his appeal focusing only on the District Court's dismissal of his whistleblower claims.

Orion intends to continue to defend against the claims vigorously. Orion believes it has substantial legal and factual defenses to the claims and allegations remaining in the case and that Orion will prevail in this proceeding. Based upon the current status of the lawsuit, Orion does not believe that it is reasonably possible that the lawsuit will have a material adverse impact on its future continuing results of operations.

State Tax Assessment

Orion negotiated a settlement with the Wisconsin Department of Revenue with respect to an assessment regarding the proper classification of its products for tax purposes under Wisconsin law. Orion resolved this matter with the Wisconsin Department of Revenue in June 2016 for \$0.5 million.

NOTE 15 — SHAREHOLDERS' EQUITY

Employee Stock Purchase Plan

In August 2010, Orion's board of directors approved a non-compensatory employee stock purchase plan, or ESPP. As of June 30, 2017, Orion issued 2,150 shares under the ESPP plan at a closing market price of \$1.28.

In prior years, Orion issued loans to non-executive employees to purchase shares of its stock. The loan program has been discontinued and new loans are no longer issued. As of March 31, 2017, four thousand dollars of such loans remained outstanding and were reflected on Orion's balance sheet as a contra-equity account. During the quarter ended June 30, 2017, Orion entered into agreements with the counterparties to these loans. In exchange for the forgiveness of their outstanding loan balance, the employees returned their shares to Orion. As a result of this transaction, 1,230 shares were recorded within treasury stock and the loan balances have been eliminated.

NOTE 16 — STOCK OPTIONS AND RESTRICTED SHARES

At Orion's 2016 Annual Meeting of Shareholders held on August 3, 2016, Orion's shareholders approved the Orion Energy Systems, Inc. 2016 Omnibus Incentive Plan (the "Plan"). The Plan authorizes grants of equity-based and incentive cash awards to eligible participants designated by the Plan's administrator. Awards under the Plan may consist of stock options, stock appreciation rights, performance shares, performance units, shares of Orion's common stock ("Common Stock"), restricted stock, restricted stock units, incentive awards or dividend equivalent units. Prior to shareholder approval of the Plan, the Company maintained its 2004 Stock and Incentive Awards Plan, as amended, which authorized the grant of cash and equity awards to employees (the "Former Plan"). No new awards are being granted under the Former Plan, however, all awards granted under the Former Plan that were outstanding as of

August 3, 2016 will continue to be governed by the Former Plan.

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Certain non-employee directors have elected to receive stock awards in lieu of cash compensation pursuant to elections made under Orion's non-employee director compensation program. The plans also permit accelerated vesting in the event of certain changes of control of Orion as well as under other special circumstances.

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

| | Three Months Ended June 30, 2017 2016 | |
|----------------------------|---|-------|
| Cost of product revenue | \$6 | \$14 |
| General and administrative | 267 | 267 |
| Sales and marketing | 41 | 31 |
| Research and development | 6 | 17 |
| Total | \$320 | \$329 |

During the first three months of fiscal 2018, Orion had the following activity related to its stock based compensation:

| | Restricted Shares | Stock Options |
|-------------------------------------|----------------------|------------------|
| Balance at March 31, 2017 | 1,704,543 | 1,520,953 |
| Awards granted | 659,272 | — |
| Awards vested | (414,569) |)— |
| Awards forfeited | (242,801) |)(78,800) |
| Awards outstanding at June 30, 2017 | 1,706,445 | 1,442,153 |
| Per share price on grant date | \$1.38 - \$1.95 | — |

As of June 30, 2017, the amount of deferred stock-based compensation expense to be recognized, over a remaining period of 2.3 years, was approximately \$2.2 million.

NOTE 17 — SEGMENTS

Orion has the following business segments: Orion U.S. Markets Division ("USM"), Orion Engineered Services Division ("OES") and Orion Distribution Services Division ("ODS"). The accounting policies are the same for each business segment as they are on a consolidated basis.

Orion U.S. Markets Division ("USM")

The USM segment sells commercial lighting systems and energy management systems to the wholesale contractor markets. USM customers include ESCOs and electrical contractors. A significant portion of the historic sales of this division migrated to distribution channel sales as a result of the implementation of Orion's distribution sales strategy. The migrated sales are included in Orion's ODS Division. This migration is expected to continue during fiscal 2018.

Orion Engineered Systems Division ("OES")

The OES segment develops and sells lighting products and provides construction and engineering services for Orion's commercial lighting and energy management systems. OES provides turnkey solutions for large national accounts, governments, municipalities and schools.

Orion Distribution Services Division ("ODS")

The ODS segment focuses on selling lighting products through manufacturer representative agencies and a network of broadline North American distributors. This segment expanded in fiscal 2018 as a result of the expansion of sales through distributors after the implementation of our distribution sales strategy. This expansion included the migration of customers from direct sales previously included in our USM division.

Corporate and Other

Corporate and Other is comprised of operating expenses not directly allocated to Orion's segments and adjustments to reconcile to consolidated results (dollars in thousands).

| | Revenues | | Operating Income (Loss) | |
|-----------------------------|---|----------|---|-----------|
| | For the Three Months Ended June 30, 2017 | 2016 | For the Three Months Ended June 30, 2017 | 2016 |
| Segments: | | | | |
| Orion U.S. Markets | \$1,390 | \$5,901 | \$(1,532) | \$(57) |
| Orion Engineered Systems | 5,408 | 6,800 | (1,891) | (769) |
| Orion Distribution Services | 5,760 | 2,933 | (741) | (728) |
| Corporate and Other | — | — | (2,338) | (1,697) |
| | \$12,558 | \$15,634 | \$(6,502) | \$(3,251) |

NOTE 18 — REORGANIZATION OF BUSINESS

During the three months ended June 30, 2017, Orion implemented a reorganization and targeted cost savings plan. As a result, the Company entered into separation agreements with 17 employees and recognized \$1.9 million of restructuring expense consisting of severance, outplacement services, and continued medical benefits for terminated employees for a limited post-employment period. The restructuring expense for the three months ended June 30, 2017 is reflected within Orion's condensed statement of operations as follows (dollars in thousands):

| | Three Months Ended June 30, 2017 |
|--|--|
| Cost of product revenue | \$ 40 |
| General and administrative | 1,767 |
| Sales and marketing | 97 |
| Total | \$ 1,904 |
| Total restructuring expense by segment was recorded as follows (dollars in thousands): | |
| | Three Months Ended June 30, 2017 |
| Orion U.S. Markets | \$ — |
| Orion Engineered Systems | — |
| Orion Distribution Systems | 75 |
| Corporate and Other | 1,829 |
| Total | \$ 1,904 |

The following table displays a rollforward of the reorganization of business accruals established for employee separation costs from March 31, 2017 to June 30, 2017 (dollars in thousands):

| | March 31, 2017 | Additions | Amounts Used | June 30, 2017 |
|--------------------------------------|----------------------|-----------|-----------------|---------------------|
| Employee separation costs | \$ | -\$ 1,763 | \$(1,304) | \$ 459 |
| Post-employment medical benefits (1) | — | 141 | — | 141 |
| Total | \$ | -\$ 1,904 | \$(1,304) | \$ 600 |

The severance agreement with one executive included a long-term post-employment medical benefit which will be paid over a period of approximately twelve years. The Company recorded a liability for the net present value of (1) this obligation based on the current cost of premiums for this individual's medical coverage increased by an estimated health care cost trend of 6.8% decreasing to 5% in nine years. This benefit is reflected in Orion's condensed consolidated balance sheet within accrued expenses and other and other long-term liabilities. The remaining accrual of \$0.5 million for employee separation costs is expected to be paid within the next twelve months.

NOTE 19 — SUBSEQUENT EVENTS

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Non-recognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management has reviewed events occurring through the date the financial statements were issued and noted no subsequent event requiring accrual or disclosure.

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 in this Form 10-Q, as well as our audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2017.

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", "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 Annual Report on Form 10-K for the fiscal year ended March 31, 2017. We urge you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. We do not undertake any obligation to release publicly any revisions to such forward-looking statements to reflect events or uncertainties after the date hereof or to reflect the occurrence of unanticipated events.

Overview

We are a leading designer and manufacturer of high-performance, energy-efficient LED and other lighting platforms. We research, develop, design, manufacture, market, sell and implement energy management systems consisting primarily of high-performance, energy-efficient commercial and industrial interior and exterior lighting systems and related services. Our products are targeted for applications in three primary market segments: commercial office and retail, area lighting and industrial applications, although we do sell and install products into other markets. Virtually all of our sales occur within North America.

Our lighting products consist primarily of light emitting diode ("LED") lighting fixtures. Our principal customers include national account end-users, electrical distributors, energy service companies ("ESCOs") and electrical contractors. Currently, substantially all of our products are manufactured at our leased production facility location in Manitowoc, Wisconsin, although we are increasingly sourcing products and components from third parties as the LED market continues to evolve and in order to provide versatility in our product development.

We believe the market for lighting products has shifted to LED lighting systems, and that the customer base for our legacy high intensity fluorescent ("HIF") technology products will continue to decline. Compared to our legacy lighting systems, we believe that LED lighting technology allows for better optical performance, significantly reduced maintenance costs due to performance longevity and reduced energy consumption. Due to their size and flexibility in application, we also believe that LED lighting systems can address opportunities for retrofit applications that cannot be satisfied by fluorescent or other legacy technologies. Our LED lighting technologies have become the primary component of our revenue as we continue to strive to be a leader in the LED market. Although we continue to sell some lighting products using our legacy HIF technology, we do not build to stock HIF products and instead build to committed customer orders as received. We plan to continue to primarily focus on developing and selling innovative LED products.

We do not have long-term contracts with our customers that provide us with recurring revenue from period to period and we typically generate substantially all of our revenue from sales of lighting systems and related services to governmental, commercial and industrial customers on a project-by-project basis. We typically sell our lighting systems in replacement of our customers' existing 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 lighting systems on a wholesale basis, principally to electrical contractors, electrical distributors, and ESCOs to sell to their own customer bases.

Our ability to achieve our desired revenue growth and profitability goals depends on our ability to effectively engage distribution and sales agents, develop recurring revenue streams, implement our cost reduction initiatives, and improve our marketing, new product development, project management, margin enhancement and operating expense management, as well as other factors. In addition, the gross margins of our products can vary significantly depending upon the types of products we sell, with margins ranging from 15% to 50%. As a result, a change in the total mix of our sales toward higher or lower margin products can cause our profitability to fluctuate from period to period.

Our fiscal year ends on March 31. We refer to our prior fiscal year which ended on March 31, 2017 as "fiscal 2017", and our current fiscal year, which ends on March 31, 2018, as "fiscal 2018." Our fiscal first quarter of each fiscal year 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.

Reportable segments are components of an entity that have separate financial data that the entity's chief operating decision maker ("CODM") regularly reviews when allocating resources and assessing performance. Our CODM is our chief executive officer. Orion has three reportable segments: Orion U.S. Markets Division ("USM"), Orion Engineered Systems Division ("OES"), and Orion Distribution Services Division ("ODS").

Market Shift to Light Emitting Diode Products

The rapid market shift in the lighting industry from legacy lighting products to LED lighting products has caused us to adopt new strategies, approaches and processes in order to respond proactively to this industry transition. These changing underlying business fundamentals in this transition include:

• Rapidly declining LED component costs and LED product end user customer pricing pressure.

• Improving LED product performance and reducing customer return on investment payback periods resulting in increased customer preference for LED lighting products compared to legacy lighting products.

• Increasing LED lighting product customer sales compared to decreasing HIF product sales.

• A broader and more diverse customer base and market opportunities compared to our historical commercial and industrial facility customers.

• Increased importance of highly innovative product designs and features and enhanced product research and development capabilities requiring rapid new product introduction and new methods of product and company differentiation.

• Significantly reduced product technology life cycles; significantly shorter product inventory shelf lives and the related increased risk of rapidly occurring product technology obsolescence.

• Increased reliance on international component sources.

• Less internal product fabrication and production capabilities needed to support LED product assembly.

• Different and broader types of components, fabrication and assembly processes needed to support LED product assembly compared to our legacy products.

• Expanding customer bases and sales channels.

• Significantly longer end user product warranty requirements for LED products compared to our legacy products.

As we continue to focus our primary business on selling our LED product lines to respond to the rapidly changing market dynamics in the lighting industry, we face intense competition from an increased number of other LED product companies, a number of which have substantially greater resources and more experience and history with LED lighting products than we do.

Management Restructuring and Focus on Profitability

On May 25, 2017, our Board of Directors restructured our management team. As part of this restructuring, our Chief Executive Officer, John Scribante, left our Company and Mike Altschaefl, our current Board Chair, assumed the role of Chief Executive Officer. In addition, Scott Green, our Executive Vice President, became our new Chief Operating Officer, with ongoing primary responsibility for improving our revenue generation. Mike Potts and Marc Meade, our current Executive Vice Presidents, remained in their positions and were assigned primary responsibility for substantially reducing our cost structure and for streamlining operations. Bill Hull remained in his position as Chief Financial Officer.

On June 30, 2017, Mike Potts agreed to retire as our Chief Risk Officer and Executive Vice President effective as of August 30, 2017. Mr. Potts will continue to serve as a member of our Board of Directors following his retirement, assuming that Mr. Potts is re-elected by the Company's shareholders at the Company's 2017 Annual Meeting of Shareholders. In addition, Mr. Potts will continue to provide consulting services to the Company.

Our market and product strategies are not changing. We are renewing our focus on execution, including a reduction in our cost structure. Our restructured management team has developed a plan to achieve breakeven earnings (excluding employee separation costs) before interest, taxes, depreciation, and amortization, or EBITDA, no later than the fourth quarter of fiscal 2018 through the implementation of the following cost reduction measures:

• Constant monitoring and management of manufacturing overhead costs to ensure we continue to deliver strong gross margins amid an increasingly competitive market landscape;

• Reducing staff positions through a targeted reduction in existing headcount;

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Reductions in the total compensation of our executive management and board of directors;
 Reductions in operating expenses, including better control of legal spending, elimination of our racing program and removal of various non-critical back office programs and initiatives.

We believe the above cost reduction plan will result in annualized cost savings of approximately \$3.5 to \$4.0 million. These cost reductions, coupled with our renewed focus on sales channel execution, will help to drive revenue growth and accelerate our path to profitability.

During the first quarter of fiscal 2018, we executed on the majority of these plans entering into separation agreements with seventeen employees and recognizing \$1.9 million in employee separation related costs. These costs were recorded as \$1.8 million within general and administrative expenses, \$0.1 million in sales and marketing expense and \$40,000 in cost of sales in our condensed consolidated statements of operations. We expect to complete the remaining cost-reduction initiatives in the second quarter of fiscal 2018.

Total restructuring expense by segment was recorded as follows (dollars in thousands):

| | Three Months Ended June 30, 2017 |
|----------------------------|--|
| Orion U.S. Markets | \$ — |
| Orion Engineered Systems | — |
| Orion Distribution Systems | 75 |
| Corporate and Other | 1,829 |
| Total | \$ 1,904 |

Cash payments for employee separation costs in connection with the reorganization of business plans were \$1.3 million in the first quarter of fiscal 2018. The remaining reorganization of business accruals as of June 30, 2017 were \$0.6 million, of which \$0.5 million relates to employee separation costs that are expected to be paid within one year and \$0.1 million represents post-retirement medical benefits for one employee to be paid over several years.

Potential Sale and Leaseback

During the first quarter of fiscal 2018, we began pursuing the potential sale and leaseback of our Tech Center building located in Manitowoc, Wisconsin. This facility houses our corporate offices. Due to the expected leaseback of more than a minor portion of the facility, it does not meet the criteria to be classified as held for sale as of June 30, 2017. As a result of this action, we assessed the facility for impairment as of June 30, 2017 by performing a probability weighted cashflow analysis. As a result of this analysis, and based on the assumptions used, including management's best estimate of the potential sales price, future rent expense, sublease income, and the probability of various scenarios under consideration, we concluded that the asset is not impaired as of June 30, 2017. A change in these assumptions or a change in circumstances could result in an impairment charge in a future period.

Fiscal 2018 Outlook

Despite lower than anticipated first quarter results, we remain optimistic about our near-term and long-term financial performance. We believe that customer purchases of LED lighting systems will continue to increase in the near-term as expected improvements in LED performance and expected decreases in LED product costs make our LED products even more economically compelling to our customers. Our near-term optimism is based upon: (i) our efforts to expand our distribution services customer base; (ii) our intentions to continue to selectively expand our sales force; (iii) our investments into new high-performance LED industrial lighting fixtures; (iv) our recent improvements in gross margin as a result of our cost containment initiatives and development of higher-performance LED products; and (v) the increasing volume of unit sales of our new higher margin products, specifically our LED high bay lighting fixtures. Our long-term optimism is based upon the considerable size of the existing market opportunity for lighting retrofits, including the market opportunities in commercial office, manufacturing, healthcare, government and retail markets, the continued development of our new higher margin products and product enhancements, including our new LED product offerings, our efforts to expand our channels of distribution and our cost reduction initiatives. As we continue to adapt to the rapidly evolving lighting market, we have implemented significant changes to our manufacturing

operations to increase our flexibility, lower our cost structure and remain competitive.

Our outlook for 2018 is positive since other factors lead us to believe that the following will directly or indirectly drive customer spending for LED lighting systems:

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LED adoption continues to grow in all sectors;
 Commercial and industrial economic sentiment is strengthening;
 Utility incentives continue to be available and are increasing as a percent of project costs in many areas;
 Prospects of tax regulatory reform are encouraging;
 Capital spending is increasing;
 Business profits are increasing; and
 Consumer spending remains strong.

Beyond the benefits of our lighting fixtures, there is also an opportunity to utilize our system platform as a “digital” or “connected ceiling”, or rather a framework or network that can support the installation and integration of other business solutions on our digital platform. This exciting, cutting edge growth opportunity is also known as the “Industrial Internet of Things” or IIoT, and is still early in its development, however, we have already participated in a few compelling applications that deliver cost savings and efficiency in areas outside of lighting.

We expect that, based on the above circumstances, our revenues and gross margins will increase during fiscal 2018, when compared to fiscal 2017, as we continue to recognize the benefits of higher purchase volumes of LED components at lower costs, increasing sales volumes of our newly introduced and higher-margin LED high bay products and increased utilization of our manufacturing facility.

We also expect that our selling and marketing expenditures will increase slightly in fiscal 2018, primarily due to growth in our Orion Distribution Services segment and the resulting increase in commission payments to our manufacturer representative agencies.

Results of Operations - Three Months Ended June 30, 2017 versus Three Months Ended June 30, 2016

The following table sets forth the line items of our condensed consolidated statements of operations 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 (dollars in thousands, except percentages):

| | Three Months Ended June 30, | | | | | |
|-------------------------------------|-----------------------------|-----------|----------|--------------|--------------|--|
| | 2017 | 2016 | | 2017 | 2016 | |
| | Amount | Amount | % Change | % of Revenue | % of Revenue | |
| Product revenue | \$11,781 | \$15,352 | (23.3)% | 93.8% | 98.2% | |
| Service revenue | 777 | 282 | 175.5% | 6.2% | 1.8% | |
| Total revenue | 12,558 | 15,634 | (19.7)% | 100.0% | 100.0% | |
| Cost of product revenue | 8,813 | 11,419 | (22.8)% | 70.2% | 73.0% | |
| Cost of service revenue | 1,034 | 189 | 447.1% | 8.2% | 1.2% | |
| Total cost of revenue | 9,847 | 11,608 | (15.2)% | 78.4% | 74.2% | |
| Gross profit | 2,711 | 4,026 | (32.7)% | 21.6% | 25.8% | |
| General and administrative expenses | 5,335 | 3,901 | 36.8% | 42.5% | 25.0% | |
| Sales and marketing expenses | 3,354 | 2,895 | 15.9% | 26.7% | 18.5% | |
| Research and development expenses | 524 | 481 | 8.9% | 4.2% | 3.1% | |
| Loss from operations | (6,502) | (3,251) | (100.0)% | (51.8)% | (20.8)% | |
| Other income | — | 100 | NM | —% | 0.6% | |
| Interest expense | (67) | (70) | 4.3% | (0.5)% | (0.4)% | |
| Interest income | 5 | 10 | (50.0)% | —% | 0.1% | |
| Loss before income tax | (6,564) | (3,211) | (104.4)% | (52.3)% | (20.5)% | |
| Income tax expense | — | (271) | NM | —% | (1.7)% | |
| Net loss | \$(6,564) | \$(2,940) | (123.3)% | (52.3)% | (18.8)% | |

*NM - Not Meaningful

Revenue. Product revenue decreased 23.3%, or \$3.6 million, for the first quarter of fiscal 2018 versus the first quarter of fiscal 2017. The decrease in product revenue was primarily the result of the continued decline in fluorescent product sales, \$2.3 million quarter over quarter, and a decrease of \$1.2 million in LED lighting revenue. LED lighting revenue decreased by 10.3% from \$11.6 million in the first quarter of fiscal 2017 to \$10.4 million in the first quarter

of fiscal 2018 primarily as a result of the timing of purchases by our direct customers. Product revenue was positively impacted by our expanding network of manufacturer

representative agencies partially offset by the aforementioned decline in sales through our direct channel. Service revenue increased 175.6%, or \$0.5 million, primarily due to more installation project revenue in the first quarter of fiscal 2018 when compared to the first quarter of fiscal 2017. Total revenue decreased by 19.7%, or \$3.1 million, primarily due to the items discussed above.

Cost of Revenue and Gross Margin. Cost of product revenue decreased 22.8%, or \$2.6 million in the first quarter of fiscal 2018 versus the comparable period in fiscal 2017 primarily due to the decline in sales and the resulting lower absorption compared to the prior year period. Cost of service revenue increased 447.1%, or \$0.8 million in the first quarter of fiscal 2018 versus the comparable period in fiscal 2017 primarily due to the timing of completion and costs incurred on large projects. Gross margin decreased from 25.8% of revenue in the first quarter of fiscal 2017 to 21.6% in the first quarter of fiscal 2018. Our product gross margin remained relatively constant period over period. Our service gross margin was negatively impacted by increased delivery costs on large turnkey projects.

Operating Expenses

General and Administrative. General and administrative expenses increased 36.8%, or \$1.4 million in the first quarter of fiscal 2018 compared to the first quarter of fiscal 2017, primarily due to \$1.8 million in employee separation costs, offset by decreases in legal, depreciation and amortization expenses. Excluding the employee separation costs, general and administrative expenses decreased \$0.3 million or 8.5%.

Sales and Marketing. Sales and marketing expenses increased 15.9%, or \$0.5 million in the first quarter of fiscal 2018 compared to the first quarter of fiscal 2017. The increase quarter over quarter was primarily due to employee separation costs of \$0.1 million and increased commissions related to our agency channel.

Research and Development. Research and development expenses increased by 8.9% or \$0.04 million in the first quarter of fiscal 2018 compared to the first quarter of fiscal 2017 primarily due to consulting and recruiting charges.

Interest Expense. Interest expense in the first quarter of fiscal 2018 decreased by 4.3%, or \$3,000 from the first quarter of fiscal 2017. The decrease in interest expense was due to decreased borrowings under our revolving credit facility during the comparative three month period.

Interest Income. Interest income in the first quarter of fiscal 2018 decreased by 50.0%, or \$5,000, from the first quarter of fiscal 2017. Our interest income decreased as a result of the continued run-off of legacy customer financed projects.

Income Taxes. We incurred no income tax expense in the first quarter of fiscal 2018 as a result of our operating losses. Our income tax benefit in the first quarter fiscal 2017 represented federal tax refunds and the release of a valuation reserve. Our normal income tax expense is due primarily to minimum state tax liabilities.

Orion U.S. Markets Division

Our USM segment sells commercial lighting systems and energy management systems to the wholesale contractor markets. USM customers include ESCOs and electrical contractors. A significant portion of the historic sales of this division migrated to distribution channel sales as a result of the implementation of our distribution sales strategy. The migrated sales are included in Orion's ODS Division. We expect this migration to continue during fiscal 2018.

The following table summarizes our USM segment operating results (dollars in thousands):

| | For the Three Months Ended | | |
|------------------|----------------------------|---------|-------------|
| | June 30, | | |
| | 2017 | 2016 | % Change |
| Revenues | \$1,390 | \$5,901 | (76.4)% |
| Operating loss | \$(1,532) | \$(57) | NM |
| Operating margin | (110.2)% | (1.0)% | |

USM segment revenue decreased from the first quarter of fiscal 2017 by 76.4%, or \$4.5 million. The decrease in revenue during the first quarter of fiscal 2018 compared to the first quarter of fiscal 2017 was primarily due to our continued transition to a distribution sales model. Previously direct sales that are now sold through independent manufacturer representative agents are now reflected within Orion's Distribution Services Division.

USM segment operating loss in the first quarter of fiscal 2018 increased from the first quarter of fiscal 2017 by \$1.5 million. The segment's operating loss is the result of the significant decline in sales due to the migration of customers to the direct sales channel resulting in lost operating expense leverage.

Orion Engineered Systems Division

The OES segment develops and sells lighting products and provides construction and engineering services for Orion's commercial lighting and energy management systems. OES provides turnkey solutions for large national accounts, governments, municipalities and schools.

The following table summarizes our OES segment operating results (dollars in thousands):

| | For the Three Months Ended | | |
|------------------|----------------------------|----------|-------------|
| | June 30, | | |
| | 2017 | 2016 | % Change |
| Revenues | \$5,408 | \$6,800 | (20.5)% |
| Operating loss | \$(1,891) | \$(769) | (145.9)% |
| Operating margin | (35.0)% | (11.3)% | |

OES revenue decreased in the first quarter of fiscal 2018 by 20.5%, or \$1.4 million, compared to the first quarter of fiscal 2017 primarily as a result of the timing of delivery of our turnkey projects and reduced florescent purchases by a large retail customer.

OES segment operating loss in the first quarter of fiscal 2018 decreased by \$1.1 million from the first quarter of fiscal 2017. The segment's operating loss is the result of the decline in sales resulting in lost operating expense leverage.

Orion Distribution Services Division

The ODS segment focuses on selling lighting products through manufacturer representative agencies and a network of broadline North American distributors. This segment expanded in fiscal 2018 as a result of the expansion of sales through distributors after the implementation of our distribution sales strategy. This expansion included the migration of customers from direct sales previously included in our USM division.

The following table summarizes our ODS segment operating results (dollars in thousands):

| | For the Three Months Ended | | |
|------------------|----------------------------|----------|-------------|
| | June 30, | | |
| | 2017 | 2016 | % Change |
| Revenues | \$5,760 | \$2,933 | 96.4 % |
| Operating loss | (741) | (728) | (1.8)% |
| Operating margin | (12.9)% | (24.8)% | |

ODS segment revenue increased in the first quarter of fiscal 2018 from the first quarter of fiscal 2017 by \$2.8 million. The increase in revenue in fiscal 2018 is primarily due to our transition to a distribution channel sales model migrating direct sales through our manufacturer representative agents. In addition, during the first quarter of fiscal 2018 ODS revenue grew as a result of our expanding manufacturer representative agencies and the continued ramp of sales through these agencies. The total manufacturer representative agencies increased from 27 to 48 agencies from the first quarter of fiscal 2017 to the first quarter of fiscal 2018.

ODS segment operating loss remained relatively flat in the first quarter of fiscal 2018 compared to the first quarter of fiscal 2017. The segment recognized \$0.1 million in employee separation costs as part of our cost reduction initiatives which were offset by increased leverage of operating expenses as well as expanded lighting product margins.

Liquidity and Capital Resources

Overview

We had approximately \$8.5 million in cash and cash equivalents as of June 30, 2017, compared to \$17.3 million at March 31, 2017. Our cash position decreased during the quarter ended June 30, 2017 primarily as a result of our net loss, separation payments to terminated employees in conjunction with our management reorganization and cost reduction initiatives and the net repayment of \$2.8 million on our revolving credit facility.

Our future liquidity needs are dependent upon many factors, including our relative revenue, gross margins, cash management practices, cost reduction initiatives, working capital management, capital expenditures, pending or future litigation results and cost containment measures. In addition, we tend to experience high working capital costs when we increase sales from existing levels. Based on our current expectations, while we anticipate realizing improved operating results during fiscal 2018, we also currently believe that we will experience negative working capital cash flows during some quarters of fiscal 2018.

Cash Flows

The following table summarizes our cash flows for the three months ended June 30, 2017 and 2016 (in thousands):

| | Three Months Ended June 30, | |
|--|--------------------------------|-----------|
| | 2017 | 2016 |
| Operating activities | \$(5,755) | \$(2,315) |
| Investing activities | (224) | 2,547 |
| Financing activities | (2,843) | (1,614) |
| Increase (decrease) in cash and cash equivalents | \$(8,822) | \$(1,382) |

Cash Flows Related to Operating Activities. Cash provided by or used in operating activities primarily consisted of a net loss adjusted for certain non-cash items including depreciation and amortization, stock-based compensation expenses, provisions for reserves, and the effect of changes in working capital and other activities.

Cash used in operating activities for the first quarter of fiscal 2018 was \$5.8 million and consisted of a net loss adjusted for non-cash expense items of \$5.6 million and net cash used by changes in operating assets and liabilities of \$0.2 million. Cash used by changes in operating assets and liabilities consisted of a decrease of \$2.0 million in accounts payable due to the timing of payments, a decrease in accrued expenses and other of \$0.7 million primarily due to the timing of payment of commissions and lower accrued bonuses in the current fiscal year, an increase in deferred contract costs of \$0.8 million due to the timing of project completions, and an increase in prepaid expenses and other assets of \$0.2 million due to an increase in unbilled revenue related to the timing of customer billings. Cash provided by changes in operating assets and liabilities included a decrease of \$2.1 million in accounts receivable due to the decline in sales and the timing of customer collections, a decrease in inventory of \$1.2 million as a result of increased focus on inventory management in consideration of the lower sales volume, and an increase of \$0.2 million in deferred revenue due to the timing of project completions.

Cash used in operating activities for the first quarter fiscal 2017 was \$2.3 million and consisted of a net loss adjusted for non-cash expense items of \$2.0 million and net cash used by changes in operating assets and liabilities of \$0.3 million. Cash used by changes in operating assets and liabilities consisted of an increase of \$1.8 million in accounts receivable due to the increase in lighting revenue and the timing of collections from customers at period end, a decrease in accounts payable of \$1.5 million due to the timing of payments on balances from year end, a decrease of \$0.3 million in accrued expenses due to the payment of a state tax liability offset by accrued project installation costs, and a decrease of \$0.2 million in deferred contract costs due to the timing of project completions. Cash provided by changes in operating assets and liabilities included a decrease of \$1.3 million in inventory due to Orion's continued inventory management efforts and reduced LED pricing and a decrease in prepaid and other assets of \$2.2 million primarily due to the timing of project billings.

Cash Flows Related to Investing Activities. Cash used by investing activities was \$0.2 million in the first three months of fiscal 2018 which consisted of purchases of property and equipment and additions to patents and licenses.

Cash provided by investing activities of \$2.5 million in the first quarter fiscal 2017 consisted of \$2.6 million of proceeds from the sale of our Manitowoc manufacturing facility partially offset by purchases of property and equipment.

Cash Flows Related to Financing Activities. Cash used in financing activities was \$2.8 million for the first three months of fiscal 2018 was due almost entirely to the net repayment of our revolving credit facility.

Cash used in financing activities was \$1.6 million for the first quarter fiscal 2017. This included \$0.4 million of cash used for the repayment of long-term debt and net repayments on the revolving credit facility of \$1.2 million.

Working Capital

Our net working capital as of June 30, 2017 was \$16.9 million, consisting of \$32.6 million in current assets and \$15.7 million in current liabilities. Our net working capital as of March 31, 2017 was \$25.5 million, consisting of \$43.9 million in current assets and \$18.4 in current liabilities. Our current accounts receivable balance decreased by \$2.1 million from the fiscal 2017 year end due to the decline in sales and the timing of customer collections. Our inventory decreased from the fiscal 2017 year end by \$1.3 million due to continued management of purchasing activities and inventory management initiatives. Our prepaid and other current assets increased by \$0.2 million due to an increase in unbilled revenue related to the timing of customer billings. Our accounts payable decreased by \$2.0 million due to the timing of purchases and payments during the quarter. Our accrued expenses decreased from our fiscal 2017 year end by \$0.9 million due to the payment of commissions and a decrease in accrued bonuses in the current fiscal year.

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

Indebtedness

Revolving Credit Agreement

We have an amended credit agreement ("Credit Agreement") that provides for a revolving credit facility ("Credit Facility") subject to a borrowing base requirement based on eligible receivables and inventory. As of June 30, 2017 our borrowing base was approximately \$4.1 million. The Credit Facility has a maturity date of February 6, 2019 and includes a \$2.0 million sublimit for the issuance of letters of credit. As of June 30, 2017, we had no outstanding letters of credit. Borrowings outstanding as of June 30, 2017, amounted to approximately \$3.9 million and are included in non-current liabilities in the accompanying condensed consolidated balance sheet. We estimate that as of June 30, 2017, we were eligible to borrow an additional \$0.2 million under the Credit Facility based upon current levels of eligible inventory and accounts receivable.

Subject in each case to our applicable borrowing base limitations, the Credit Agreement otherwise provides for a \$15.0 million Credit Facility. This limit may increase to \$20.0 million based on a borrowing base requirement, if we satisfy certain conditions. We did not meet the requirements to increase the borrowing limit to \$20.0 million as of July 31, 2017, the most recent measurement date.

From and after any increase in the Credit Facility limit from \$15.0 million to \$20.0 million, the Credit Agreement requires that we maintain, as of the end of each month, a minimum ratio for the trailing twelve-month period of (i) earnings before interest, taxes, depreciation and amortization, subject to certain adjustments, to (ii) the sum of cash interest expense, certain principal payments on indebtedness and certain dividends, distributions and stock redemptions, equal to at least 1.10 to 1.00. The Credit Agreement contains additional customary covenants, including certain restrictions on our ability to incur additional indebtedness, consolidate or merge, enter into acquisitions, guarantee obligations of third parties, make loans or advances, declare or pay any dividend or distribution on our stock, redeem or repurchase shares of Orion's stock, or pledge or dispose of assets. We were in compliance with its covenants in the Credit Agreement as of June 30, 2017.

Each of our subsidiaries is a joint and several co-borrower or guarantor under the Credit Agreement, and the Credit Agreement is secured by a security interest in substantially all of our and each subsidiary's personal property (excluding various assets relating to customer OTAs) and a mortgage on certain real property.

Borrowings under the Credit Agreement bear interest at the daily three-month LIBOR plus 3.0% per annum, with a minimum interest charge for each year or portion of a year during the term of the Credit Agreement of \$0.1 million, regardless of usage. As of June 30, 2017, the interest rate was 4.30%. We must pay an unused line fee of 0.25% per annum of the daily average unused amount of the Credit Facility and a letter of credit fee at the rate of 3.0% per annum on the undrawn amount of letters of credit outstanding from time to time under the Credit Facility.

Capital Spending

Our capital expenditures are primarily for general corporate purposes for our corporate headquarters and technology center, production equipment and tooling and for information technology systems. Our capital expenditures totaled

\$0.2 million and \$0.1 million for the three-month periods ended June 30, 2017 and 2016, respectively. We plan to incur approximately \$0.5

million in capital expenditures in fiscal 2018. We expect to finance these capital expenditures primarily through our existing cash, equipment secured loans and leases, to the extent needed, long-term debt financing, or by using our available capacity under our Credit Facility.

Backlog

Backlog represents the amount of revenue that we expect to realize in the future as a result of firm, committed orders. Backlog totaled \$6.5 million and \$7.3 million as of June 30, 2017 and March 31, 2017, respectively. We generally expect our backlog to be recognized as revenue within one year.

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, 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, 2017. For the three months ended June 30, 2017, there were no material changes in our accounting policies.

Recent Accounting Pronouncements

For a complete discussion of recent accounting pronouncements, refer to Note 2 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, 2017. There have been no material changes to such exposures since March 31, 2017.

ITEM 4. CONTROLS AND PROCEDURES

Material Weaknesses on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act). Internal control over financial reporting is a process designed by, or under the supervision of, the Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, and effected by the board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP and includes those policies and procedures that:

- i. pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
- ii. provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and
- iii. provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

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

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, our management has assessed the effectiveness of our internal control over financial reporting based on the criteria set forth in the Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

As previously disclosed under "Item 9A. Controls and Procedures" in our Annual Report on Form 10-K for our fiscal year ended March 31, 2017, we identified the following material weaknesses that existed as of March 31, 2017 and continued to exist at June 30, 2017. A material weakness is a control deficiency or a combination of control deficiencies that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

Information & Communication. We determined that our controls pertaining to information and communication did not operate effectively, resulting in a material weakness pertaining to these COSO components. Specifically, we did not have sufficient communication of the status and evolution of a project to ensure timely and accurate recognition of project costs. In addition, we did not have sufficient communication and resolution of matters identified through management's review impacting the accounting close as noted in the Control Activities discussion below.

Control Activities - Accounting Close. The operating effectiveness of our controls were inadequate to ensure that project costs were identified and recorded to expense in a timely manner. In addition, matters identified through management review controls were not brought to a timely resolution.

Because of the material weaknesses described above, in consultation with management, our Chief Executive Officer and Chief Financial Officer have concluded that we did not maintain effective internal control over financial reporting and our disclosure controls and procedures were not effective as of March 31, 2017 and June 30, 2017, based on the criteria in Internal Control - Integrated Framework (2013) issued by COSO.

For the year ended March 31, 2017 and subsequent interim periods, we enhanced our closing procedures to ensure that, in all material respects, our financial statements are presented in conformity with GAAP and free of material misstatement as of and for the periods ended March 31, 2017 and June 30, 2017.

Plans for Remediation of March 31, 2017 Material Weaknesses

Our Board, our Audit & Finance Committee and management have identified additional resources to assist in the remediation effort and are developing and implementing new processes, procedures and internal controls to remediate the material weakness that existed in our internal control over financial reporting as it related to project cost accounting and the accounting close, and our disclosure controls and procedures, as of March 31, 2017 and June 30,

2017.

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

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

The following are steps we have taken or are in the process of taking toward the remediation plan:

- Developed a regular method for the evaluation of actual project costs incurred against budgeted costs and for the communication of such costs and project status.
- Revisited the method in which projects are reviewed and evaluated by the accounting department to ensure the accurate and timely recording of necessary adjustments.
- Formalize and strengthen management review controls as they pertain to the accounting close.
- Enhance documentation of policies and procedures related to project accounting, account reconciliations, and other key areas within the accounting close.
- Provide training to key process owners.
- Enhance information technology reporting capabilities, where possible, to ensure consistent, accurate data to support accounting close processes in a timely and efficient manner.

The Remediation Plan is being administered by our Chief Financial Officer and involves key leaders from across the organization. The Chief Financial Officer is providing regular updates on the status of the remediation to our Audit and Finance Committee. While progress has been made, there are additional controls that we need to continue to refine and implement, some existing controls may require further enhancement to prevent or detect a material misstatement in our financial statements, and additional training may need to be provided to our employees. These enhanced controls have not yet operated for a sufficient period of time to conclude they are operating effectively, therefore the material weakness may continue to exist.

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

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended June 30, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting, other than with respect to the implementation of remediation efforts, as described above.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are subject to various claims and legal proceedings arising in the ordinary course of business. As of the date hereof, we are unable to currently assess whether the final resolution of any of such claims or legal proceedings may have a material adverse effect on Orion's future results of operations.

See Note 6, "Commitments and Contingencies - Litigation", to the Condensed Consolidated Financial Statements in Item 1 of this Quarterly Report on Form 10-Q.

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, 2017, which we filed with the SEC on June 13, 2017 and in Part 1 - Item 2 under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Form 10-Q.

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

Information about our repurchases of common stock in the quarter ended June 30, 2017 were as follows:

Issuer Purchases of Equity Securities

| Period | Total Number of Shares Purchased (1) (2) | Average Price Per Share (2) | Total | Dollar |
|---------------------|--|---|---|--|
| | | | Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Value of Shares that May Yet be Purchased Under the Plans or Programs |
| April 1 to April 30 | — | \$ | — | \$ |
| May 1 to May 31 | — | — | — | — |
| June 1 to June 30 | 1,230 | 1.28 | — | \$ |
| Total | 1,230 | — | — | — |

(1) Represents shares of our common stock.

In prior years, we have issued loans to certain of our non-executive employees to purchase shares of our common stock. The loan program has been discontinued and new loans are no longer issued. As of March 31, 2017, \$4,000 of such loans remained outstanding. During the quarter ended June 30, 2017, we entered into agreements with the counterparty to these loans. In exchange for the forgiveness of their outstanding loan balance, the employees returned their shares to us. As a result of this transaction, 1,230 shares were recorded within treasury stock and the loan balances have been eliminated.

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

(a) Exhibits

- 10.1 Executive Employment and Severance Agreement, dated April 1, 2017, by and between Orion Energy Systems, Inc. and Michael J. Potts [Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 3, 2017 (File No. 001-33887)]
- 10.2 Orion Energy Systems, Inc. Non-Employee Director Compensation Plan, updated and effective as of June 6, 2017 [Incorporated by reference to Exhibit 10.14 to the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on June 13, 2017 (File No. 001-33887)]
- 10.3 Executive Employment and Severance Agreement, dated as of June 8, 2017, by and between Orion Energy Systems, Inc. and Michael W. Altschaeffl [Incorporated by reference to Exhibit 10.16 to the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on June 13, 2017 (File No. 001-33887)]
- 10.4 Mutual Termination and Severance Agreement and Complete and Permanent Release of All Claims, dated June 8, 2017, by and between Orion Energy Systems, Inc. and John H. Scribante [Incorporated by reference to Exhibit 10.27 to the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on June 13, 2017 (File No. 001-33887)]
- 10.5 Letter Agreement effective June 13, 2017 between Orion and William T. Hull [Incorporated by reference to Exhibit 10.19 to the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on June 13, 2017 (File No. 001-33887)]
- 10.6 Mutual Retirement and Severance Agreement and Complete and Permanent Release of All Claims, dated June 30, 2017, by and between Orion Energy Systems, Inc. and Michael J. Potts [Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 30, 2017 (File No. 001-33887)]
- 31.1 Certification of Chief Executive Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(a) or Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.
- 31.2 Certification of Chief Financial Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(a) or Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.
- 32.1 Certification of Chief Executive Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document
- 101.SCH Taxonomy extension schema document
- 101.CAL Taxonomy extension calculation linkbase document

101.LAB Taxonomy extension label linkbase document

101.PRE Taxonomy extension presentation linkbase document

+Filed herewith

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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 August 4, 2017.

ORION ENERGY SYSTEMS, INC.

Registrant

By /s/ William T. Hull

William T. Hull

Chief Financial Officer

(Principal Financial Officer and Authorized Signatory)

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Exhibit Index to Form 10-Q for the Period Ended June 30, 2017

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- 10.2 Orion Energy Systems, Inc. Non-Employee Director Compensation Plan, updated and effective as of June 6, 2017 [Incorporated by reference to Exhibit 10.14 to the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on June 13, 2017 (File No. 001-33887)]
- 10.3 Executive Employment and Severance Agreement, dated as of June 8, 2017, by and between Orion Energy Systems, Inc. and Michael W. Altschaeffl [Incorporated by reference to Exhibit 10.16 to the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on June 13, 2017 (File No. 001-33887)]
- 10.4 Mutual Termination and Severance Agreement and Complete and Permanent Release of All Claims, dated June 8, 2017, by and between Orion Energy Systems, Inc. and John H. Scribante [Incorporated by reference to Exhibit 10.27 to the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on June 13, 2017 (File No. 001-33887)]
- 10.5 Letter Agreement effective June 13, 2017 between Orion and William T. Hull [Incorporated by reference to Exhibit 10.19 to the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on June 13, 2017 (File No. 001-33887)]
- 10.6 Mutual Retirement and Severance Agreement and Complete and Permanent Release of All Claims, dated June 30, 2017, by and between Orion Energy Systems, Inc. and Michael J. Potts [Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 30, 2017 (File No. 001-33887)]
- 31.1 Certification of Chief Executive Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(a) or Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.
- 31.2 Certification of Chief Financial Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(a) or Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.
- 32.1 Certification of Chief Executive Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer of Orion Energy Systems, Inc. pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document
- 101.SCH Taxonomy extension schema document
- 101.CAL Taxonomy extension calculation linkbase document
- 101.LAB Taxonomy extension label linkbase document

101.PRE Taxonomy extension presentation linkbase document

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