ORION ENERGY SYSTEMS, INC.
Form 10-Q
August 07, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended June 30, 2018
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number 001-33887

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

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

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.   Yes x   No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405) during the preceding 12 months (or for shorter period that the registrant was required to submit and post such files).   Yes x   No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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	o	Accelerated filer	o
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	ý
		Emerging growth company	o

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

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

There were 29,421,892 shares of the Registrant’s common stock outstanding on July 31, 2018.

ORION ENERGY SYSTEMS, INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2018
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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, 2018	March 31, 2018
Assets		
Cash and cash equivalents	$7,835	$9,424
Accounts receivable, net	7,183	8,736
Revenue earned but not billed	1,055	—
Inventories, net	8,597	7,826
Deferred contract costs	—	1,000
Prepaid expenses and other current assets	408	2,467
Total current assets	25,078	29,453
Property and equipment, net	12,571	12,894
Other intangible assets, net	2,747	2,868
Other long-term assets	105	110
Total assets	$40,501	$45,325
Liabilities and Shareholders' Equity		
Accounts payable	$10,215	$11,675
Accrued expenses and other	4,909	4,171
Deferred revenue, current	89	499
Current maturities of long-term debt	80	79
Total current liabilities	15,293	16,424
Revolving credit facility	2,302	3,908
Long-term debt, less current maturities	85	105
Deferred revenue, long-term	847	940
Other long-term liabilities	615	524
Total liabilities	19,142	21,901
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, $0.01 par value: Shares authorized: 30,000,000 at June 30, 2018 and March 31, 2018; no shares issued and outstanding at June 30, 2018 and March 31, 2018	—	—
Common stock, no par value: Shares authorized: 200,000,000 at June 30, 2018 and March 31, 2018; shares issued: 38,838,329 at June 30, 2018 and 38,384,575 at March 31, 2018; shares outstanding: 29,403,485 at June 30, 2018 and 28,953,183 at March 31, 2018	—	—
Additional paid-in capital	155,231	155,003
Treasury stock, common shares: 9,434,844 at June 30, 2018 and 9,431,392 at March 31, 2018	(36,087)	(36,085)
Retained deficit	(97,785)	(95,494)
Total shareholders' equity	21,359	23,424
Total liabilities and shareholders' equity	$40,501	$45,325

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

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

	Three Months Ended June 30,	
	2018	2017
Product revenue	$12,808	$ 11,781
Service revenue	1,014	777
Total revenue	13,822	12,558
Cost of product revenue	9,724	8,813
Cost of service revenue	642	1,034
Total cost of revenue	10,366	9,847
Gross profit	3,456	2,711
Operating expenses:		
General and administrative	3,076	5,335
Sales and marketing	2,578	3,354
Research and development	405	524
Total operating expenses	6,059	9,213
Loss from operations	(2,603)	(6,502)
Other income (expense):		
Other income	19	—
Interest expense	(89)	(67)
Interest income	3	5
Total other expense	(67)	(62)
Loss before income tax	(2,670)	(6,564)
Income tax expense	22	—
Net loss	$(2,692)	$ (6,564)
Basic net loss per share attributable to common shareholders	$(0.09)	$ (0.23)
Weighted-average common shares outstanding	29,070,193	28,455,434
Diluted net loss per share	$(0.09)	$ (0.23)
Weighted-average common shares and share equivalents outstanding	29,070,193	28,455,434

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

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

	Three Months Ended June 30,	
	2018	2017
Operating activities		
Net loss	$(2,692)	$(6,564)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation	347	353
Amortization	121	162
Stock-based compensation	228	320
Provision for inventory reserves	17	130
Provision for bad debts	82	33
Other	3	12
Changes in operating assets and liabilities:		
Accounts receivable, current and long-term	1,756	2,103
Revenue earned but not billed	1,300	—
Inventories	(102)	1,196
Deferred contract costs	—	(770)
Prepaid expenses and other assets	150	(163)
Accounts payable	(575)	(2,028)
Accrued expenses and other	(553)	(743)
Deferred revenue, current and long-term	(21)	204
Net cash provided by (used in) operating activities	61	(5,755)
Investing activities		
Purchases of property and equipment	(23)	(204)
Additions to patents and licenses	—	(20)
Net cash used in investing activities	(23)	(224)
Financing activities		
Payment of long-term debt and capital leases	(19)	(67)
Proceeds from revolving credit facility	17,188	16,307
Payment of revolving credit facility	(18,794)	(19,083)
Payments to settle employee tax withholdings on stock-based compensation	(3)	—
Net proceeds from employee equity exercises	1	—
Net cash used in financing activities	(1,627)	(2,843)
Net decrease in cash and cash equivalents	(1,589)	(8,822)
Cash and cash equivalents at beginning of period	9,424	17,307
Cash and cash equivalents at end of period	$7,835	$8,485

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

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

NOTE 1 — DESCRIPTION OF BUSINESS

Organization

Orion includes Orion Energy Systems, Inc., a Wisconsin corporation, and all consolidated subsidiaries. Orion is a developer, manufacturer and seller of lighting and energy management systems to commercial and industrial businesses, and federal and local governments, predominantly in North America.

Orion's corporate offices and leased primary manufacturing operations are located in Manitowoc, Wisconsin. Orion leases office space in Jacksonville, Florida. Orion had leased office space in Chicago, Illinois, and Houston, Texas, but as of June 30, 2018, Orion had vacated these locations. Orion also leases warehouse space in Manitowoc, Wisconsin. During fiscal 2018, Orion had leased warehouse space in Augusta, Georgia, but as of March 31, 2018, Orion had vacated this storage location.

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The Condensed Consolidated Financial Statements include the accounts of Orion Energy Systems, Inc. and its wholly-owned subsidiaries.

Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements of Orion have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation have been included. Interim results are not necessarily indicative of results that may be expected for the fiscal year ending March 31, 2019 or other interim periods.

The Condensed Consolidated Balance Sheet at March 31, 2018 has been derived from the audited consolidated financial statements at that date but does not include all of the information required by GAAP for complete financial statements.

The accompanying unaudited Condensed Consolidated Financial Statements should be read in conjunction with the audited consolidated financial statements and footnotes thereto included in Orion's Annual Report on Form 10-K for the fiscal year ended March 31, 2018 filed with the Securities and Exchange Commission on June 13, 2018.

Use of Estimates

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

Concentration of Credit Risk and Other Risks and Uncertainties

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

Orion purchases components necessary for its lighting products, including ballasts, lamps and LED components, from multiple suppliers. For the three months ended June 30, 2018, one supplier accounted for 11.4% of total cost of revenue. For the three months ended June 30, 2017, no supplier accounted for more than 10% of total cost of revenue. For the three months ended June 30, 2018, no customer accounted for more than 10.0% of total revenue. For the three months ended June 30, 2017, one customer accounted for 16.2% of total revenue.

As of June 30, 2018, no customer accounted for more than 10% of Accounts receivable. As of March 31, 2018, one customer accounted for 13.2% of Accounts receivable.

Recent Accounting Pronouncements

Issued: Not Yet Adopted

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-02, "Leases" (Subtopic 842). The pronouncement, and subsequent amendments, which is included in the Accounting Standards Codification as Subtopic 842 (“ASC 842”), requires that lessees recognize right-of-use assets and liabilities on the balance sheet for the rights and obligations created by long-term leases and disclose additional quantitative and qualitative information about leasing arrangements. Under ASU 842, leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition. Similarly, lessors will be required to classify leases as sales-type, finance or operating leases, with classification affecting the pattern of income recognition. Classification for both lessees and lessors will be based on an assessment of whether risks and rewards, as well as substantive control, have been transferred through the lease contract. ASU 842 also provides guidance on the presentation of the effects of leases in the income statement and statement of cash flows. 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. Orion 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.

Recently Adopted Standards

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

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

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

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NOTE 3 — REVENUE

Changes in Accounting Policies

Orion adopted ASC 606 and ASC 340-40 (the "new standards") as of April 1, 2018 for contracts with customers that were not fully complete as of April 1, 2018 using the modified retrospective transition method. The cumulative effect of initially applying the new standards was recorded as an immaterial adjustment to the opening balance of retained deficit within Orion's condensed consolidated statement of shareholders' equity.

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

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

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

Revenue Recognition

Periods prior to April 1, 2018

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

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

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

Deferred contract costs consist primarily of the costs of products delivered, and services performed, that are subject to additional performance obligations or customer acceptance. These Deferred contract costs are expensed at the time the related revenue is recognized.

Deferred revenue relates to advance customer billings and investment tax grants received related to Power Purchase Agreement contracts still outstanding related to Orion's legacy solar business.

Period Commencing April 1, 2018

General Information

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

amounts paid to customers in conjunction with fulfilling a performance obligation.
If there are multiple performance obligations in a single contract, the contract’s total sales price is allocated to each individual performance obligation based on their relative standalone selling price. A performance obligation’s standalone selling price is the

price at which Orion would sell a promised good or service separately to a customer. Orion uses an observable price to determine the stand-alone selling price for separate performance obligations or a cost-plus margin approach when one is not available. The cost-plus margin approach is used to determine the stand-alone selling price for the installation performance obligation and is based on average historical installation margin.

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

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

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

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

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

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

Orion also records revenue in conjunction with several limited Power Purchase Agreement ("PPA") contracts still outstanding. Those PPA's outstanding are supply side agreements for the generation of electricity. The last PPA contact expires in 2031. Revenue associated with the sale of energy generated by the solar facilities under these PPA contracts is in the scope of ASC 606. Revenues are recognized over-time and are equal to the amount billed to the customer which is calculated by applying the fixed rate designated in contract to the variable amount of electricity generated each month. This approach is in accordance with the "right to invoice" practical expedient provided for in

ASC 606. Orion also recognizes revenue upon the sale to third parties of tax credits received from operating the solar facilities and from amortizing a grant received from the Federal government during the period starting when the power generating facilities were constructed until the expiration of the PPA contracts; these revenues are not derived from contracts with customers and therefore not under the scope of ASC 606.

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

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

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

Disaggregation of Revenue
Orion's Product revenue includes revenue from contracts with customers accounted for under the scope of ASC 606 and revenue which is accounted for under other guidance. For the three months ended June 30, 2018, Product revenue included $0.7 million derived from sales-type leases for light fixtures, $30,875 derived from the sale of tax credits generated from Orion's legacy operation for distributing solar energy, and $18,889 derived from the amortization of federal grants received in 2010 and 2011 as reimbursement for a portion of the costs to construct the legacy solar facilities which are not under the scope of ASC 606. All remaining Product revenue, and all Service revenue, are derived from contracts with customers as defined in ASC 606.
The primary end users of Orion's lighting products and services are (a) the federal government, and (b) commercial or industrial companies.
The federal government obtains Orion products and services primarily through turnkey project sales that Orion makes to a select group of contractors who focus on the federal government. Revenues associated with government end users are primarily included in the Orion Engineered Systems Division segment.
Commercial or industrial end users obtain Orion products and services through turnkey project sales or by purchasing products either direct from Orion or through distributors or energy service companies ("ESCOs"). Revenues associated with commercial and industrial end users therefore are included within each of Orion's segments, dependent on the sales channel.
See Footnote 17, Segments, for additional discussion concerning Orion's reportable segments.
The following table provides detail of Orion's total revenues for the three months ended June 30, 2018 (dollars in thousands):

	Product	Services	Total
Revenue from contracts with customers:			
Lighting revenues, by end user			
Federal government	$97	$ —	$97
Commercial and industrial	11,901	1,014	12,915
Total lighting	11,998	1,014	13,012
Solar energy related revenues	20	—	20
Total revenues from contracts with customers	12,018	1,014	13,032
Revenue accounted for under other guidance	790	—	790
Total revenue	$12,808	$ 1,014	$13,822

Cash Flow Considerations
Customer payments for material only orders are due shortly after shipment.
Turnkey projects where the end user is the federal government typically span a three to six-month period. The contracts for these sales often provide for monthly progress payments equal to ninety percent (90%) of the value provided by Orion during the month.

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

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

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

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

The total amount received from the sales of these receivables during the three months ended June 30, 2018 was $2.0 million. Orion’s losses on these sales aggregated $54,046 and is included in Interest expense in the Condensed Consolidated Statement of Operations.

Practical Expedients and Exemptions

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

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

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

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

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

Contract Balances

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

Revenue earned but not billed represents revenue that has been recognized in advance of billing the customer, which is a common practice in Orion turnkey contracts. Once Orion has an unconditional right to consideration under a turnkey contract, Orion typically bills the customer accordingly and reclassifies the amount to Accounts receivable, net. Revenue earned but not billed as of April 1, 2018 and June 30, 2018 includes $0.6 million and $0.1 million, respectively, which was not derived from contracts with customers and therefore not classified as a contract asset as defined by the new standards.

Deferred revenue, current includes $13,425 of contract liabilities which represents consideration received from customers prior to the point that Orion has fulfilled the promises included in a performance obligation and recorded revenue.

Deferred revenue, long-term consists of the unamortized portion of the funds received from the Federal government in 2010 and 2011 as reimbursement for the costs to build the two facilities related to the PPAs. As the transaction is not considered a contract with a customer, this value is not a contract liability as defined by the new standards.
The following chart shows the balance of Orion's receivables arising from contracts with customers, contract assets and contract liabilities as of April 1, 2018, after the adoption of the new standards, and as of June 30, 2018 (dollars in thousands).

	April 1, 2018	June 30, 2018
Accounts receivable, net	$9,020	$7,183
Contract assets	$1,773	$960
Contract liabilities	$13	$13

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

Impact on Financial Statements

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

	As Reported June 30, 2018	Adjustments	Balances without application of ASC 606	
Assets				
Cash and cash equivalents	$7,835	$ —	$7,835	
Accounts receivable, net	7,183	(133)	7,050	
Revenue earned but not billed	1,055	(1,055) (163)		(139)
Other income and (expense), net	9	15	38	256
Consolidated income before provision for income taxes	$ 3,427	$ 3,327	$ 6,750	$ 6,166

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Note 19   Contingencies

The Company conducts the design and manufacture of its microwave products in several locations, including a 26,000 square foot, leased facility, in Marlborough, Massachusetts (the   Facility). On January 1, 2009, the Facility sustained certain wind damage to its roof which, in turn, resulted in water damage to certain machinery, equipment, and building improvements. The Company has completed its assessment of the damage, and information is currently being accumulated to determine the costs associated with repairing the building and replacing the damaged equipment. After this cost data is accumulated, the Company s insurance carrier will perform its review of the claim information submitted by the Company. Currently, the Company is unable to reasonably estimate the total cost of the claim or the aggregate amount of the insurance carrier s reimbursement. Based on its current assessment, however, the Company does not expect the amount of the uninsured loss, if any, to have a material impact on its consolidated financial position, results of operations, or cash flows. During the six month period ended May 31, 2009, the Company received an advance payment of $500,000 from its insurance carrier in connection with this claim.

The Company is subject to certain legal proceedings and claims arising in the ordinary course of business. In the opinion of management, the amount of any ultimate liability with respect to these actions will not materially affect the Company s consolidated financial position, results of operations, or cash flows.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 20 Recent Accounting Pronouncements Not Yet Adopted

In April 2009, the Financial Accounting Standards Board (FASB) issued FASB Staff Position FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP 157-4). FSP 157-4 amends FASB Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS No. 157), and provides additional guidance for estimating fair value in accordance with SFAS No. 157 when the volume and level of activity for the asset or liability have significantly decreased and also includes guidance on identifying circumstances that indicate a transaction is not orderly for fair value measurements. FSP 157-4 is to be applied prospectively, with retrospective application not permitted, and is effective for interim and annual periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Company is currently evaluating the disclosure requirements of this new accounting guidance.

In April 2009, the FASB also issued FASB Staff Position FAS 107-1 / APB 28-1, Interim Disclosures about Fair Value of Financial Instruments (the FSP). This FSP amends FASB Statement of Financial Accounting Standards No. 107, Disclosures about Fair Value of Financial Instruments (SFAS No. 107), to require disclosures about fair value of financial instruments not measured on the balance sheet at fair value in interim financial statements as well as in annual financial statements. Prior to this FSP, fair values for these assets and liabilities were only disclosed annually. This FSP applies to all financial instruments within the scope of SFAS No. 107 and requires all entities to disclose the method and significant assumptions used to estimate the fair value of financial instruments. The FSP is effective for interim periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. An entity may early adopt this FSP only if it also elects to early adopt FSP 157-4. The Company is currently evaluating the disclosure requirements of this new accounting guidance.

In April 2008, the FASB issued FASB Staff Position No. 142-3, Determination of the Useful Life of Intangible Assets (the Position). This Position amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, Goodwill and Other Intangible Assets . The intent of this Position is to improve the consistency between the useful life of a recognized intangible asset and the period of expected cash flows used to measure the fair value of the asset under FASB Statement No. 141 (revised 2007), Business Combinations (SFAS No. 141R), and other U.S. generally accepted accounting principles. This Position is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2008 (the Company s 2010 fiscal year). The Company is currently assessing the impact of this Position on its consolidated financial condition, results of operations, and cash flows.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In December 2007, the FASB issued SFAS No. 141R. The objective of SFAS No. 141R is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. Specifically, it establishes principles and requirements over how the acquirer (1) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; (2) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase, and (3) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141R will change the accounting treatment for certain specific items, including acquisition-related costs, acquired contingent liabilities, and restructuring costs associated with the acquisition. SFAS No. 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008 (the Company s 2010 fiscal year), with early adoption prohibited. Once adopted, the Company believes SFAS No. 141R will have an impact on accounting for business combinations, but the effect is dependent upon the nature and terms of the acquisitions made at that time.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results Of Operations

The following discussion and analysis may be understood more fully by reference to the consolidated financial statements, notes to the consolidated financial statements, and management s discussion and analysis contained in the Spectrum Control, Inc. and Subsidiaries annual report on Form 10-K for the fiscal year ended November 30, 2008. All references to we , us , our , or the Company in the following discussion and analysis mean Spectrum Control, Inc. and its Subsidiaries.

Overview

We design, develop and manufacture custom electronic components and systems. Although our components and systems are used in many industries worldwide, our largest individual markets are military/defense and communications equipment which represented 61% and 16%, respectively, of our sales for the six months ended May 31, 2009. Military/defense applications for our products include secure communications, smart weapons and munitions, countermeasures for improvised explosive devices, radar systems, military aircraft and vehicles, and simulation equipment. In communications, our products are used in numerous systems including wireless base stations, broadband switching equipment, global positioning systems, Wi-Fi, and optical networks. Other markets for our products include medical instrumentation, industrial equipment, commercial aerospace, computers, and storage devices.

Our operations are currently conducted in four reportable segments: advanced specialty products (formerly referred to as signal and power integrity components); microwave components and systems; power management systems; and sensors and controls. Our Advanced Specialty Products Business designs and manufactures a broad range of products including antennas, specialty connectors, advanced ceramics, and electromagnetic interference (EMI) filters and interconnects. Our Microwave Components and Systems Business designs and manufactures microwave filters and components, high power amplifiers, oscillators, synthesizers, switched filter banks, and related systems and integrated assemblies. The Power Management Systems Business designs and manufactures custom AC and DC power distribution units, power outlet strips, power monitoring equipment, and our Smart Start power management systems. Our Sensors and Controls Business designs and manufactures rotary and linear precision potentiometers, temperature sensing probes, thermistors, resistance temperature detector sensors, and related assemblies.

We recognize revenue when all significant contractual obligations have been met, the sales price is fixed and determinable, and the collection of the resulting receivable is reasonably assured. As a result, product sales are generally recorded at the time of shipment when title passes under the terms FOB shipping point or Ex Works. Payments received from customers in advance of products shipped are recorded as deferred revenue until earned.

Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Acquisition

On September 26, 2008, we acquired substantially all of the assets and assumed certain liabilities of SatCon Electronics, Inc. (SatCon). SatCon, based in Marlborough, Massachusetts, designs and manufactures high performance microelectronic components used in numerous military and commercial applications, including secure communication systems and high frequency wireless devices. These sophisticated products include hybrid components and subsystems, signal converters, and a full line of thin and thick film circuits. The aggregate cash purchase price for SatCon was $5.6 million, which was primarily funded by borrowings under our domestic line of credit.

SatCon s results of operations have been included in our consolidated financial statements since the September 26, 2008 acquisition date. Accordingly, SatCon net sales of $3.3 million are included in the accompanying condensed consolidated statement of income for the three months ended May 31, 2009 and SatCon net sales of $6.4 million are included for the six month period ended May 31, 2009.

Forward-Looking Information

The following discussion includes certain forward-looking statements within the meaning of the federal securities laws, including statements regarding: (1) our belief as to future market conditions, (2) our anticipated capital expenditures, and (3) our expected future operating requirements and financing needs. The words believe , expect , anticipate and similar expressions identify forward-looking statements. These forward-looking statements are subject to certain risks and uncertainties which could cause actual results to differ materially from historical results or those anticipated. Factors that could cause or contribute to such differences include those discussed in Risk Factors That May Affect Future Results , as well as those discussed elsewhere herein. Readers are cautioned not to place undue reliance on these forward-looking statements.

Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Executive Summary

During the second quarter of fiscal 2009, our sales were $33.6 million, an increase of $1.0 million or 3.2% from the comparable period last year. The increase in sales primarily reflects $3.3 million of SatCon product shipments, along with additional shipment volumes for many of our products used in military/defense applications. In the current quarter, excluding the impact of our SatCon acquisition, sales of our microwave products increased $2.5 million or 24.2% from a year ago. Virtually all of these sales were driven by military/defense applications, with sales to military/defense customers comprising 63% of our total consolidated sales in the current quarter, compared to 47% for the same period a year ago. These shipment increases were partially offset by a $3.4 million reduction in shipments for our advanced specialty products and a $1.4 million reduction in shipments of our power management systems, sensors, and control products reflecting the global recession and its impact on most of our commercial customers.

In the current quarter, our gross margin was $8.9 million or 26.6% of sales, compared to $8.1 million or 24.8% of sales for the same quarter last year. The increase in gross margin percentage principally reflects reductions in material costs, as well as certain operating efficiencies from higher production volumes. At the end of the current period, we had a total workforce of 1,336 employees, down 11.9% from the end of last fiscal year. We expect to continuously review our organization and cost structure to enhance efficiencies, while maintaining flexibility for additional production requirements.

Overall, we generated net income of $2.2 million or 18 cents per dilutive share in the second quarter of fiscal 2009, compared to net income of $2.2 million or 16 cents per dilutive share for the same period last year.

Our Board of Directors has authorized the Company to repurchase up to $16.0 million of the Company s Common Stock at market prices. The amount and timing of the shares to be repurchased are at the discretion of management. During the six month period ended May 31, 2009, the Company did not repurchase any of its Common Stock. Since the inception of the stock buyback program, the Company has repurchased 1,677,479 shares at an aggregate cost of $11.8 million.

Net cash provided by operating activities was $8.1 million in the first six months of fiscal 2009, compared to $3.1 million for the first six months of 2008. The $5.0 million increase in operating cash flow was generated, in part, by improved accounts receivable and inventory turnover rates. In the first half of fiscal 2009, our positive operating cash flow and existing cash reserves enabled us to repay $7.0 million of our short-term bank borrowings and fund capital expenditures of $1.9 million.

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Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Results of Operations

The following table sets forth certain financial data, as a percentage of net sales, for the periods ended May 31, 2009 and 2008:

	Three Months Ended May 31,		Six Months Ended May 31,	
	2009	2008	2009	2008
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of products sold	73.4	75.2	74.2	76.6
Gross margin	26.6	24.8	25.8	23.4
Selling, general and administrative expense	16.2	14.3	15.5	13.9
Income from operations	10.4	10.5	10.3	9.5
Other income (expense)				
Interest expense	(0.2)	(0.3)	(0.2)	(0.2)
Other income and expense, net	-	-	-	0.4
Income before provision for income taxes	10.2	10.2	10.1	9.7
Provision for income taxes	3.6	3.5	3.5	3.5
Net income	6.6%	6.7%	6.6%	6.2%

The following table sets forth the Company s net sales by reportable operating segments for the periods ended May 31, 2009 and 2008 (in thousands):

	Three Months Ended May 31,		Six Months Ended May 31,	
	2009	2008	2009	2008
Advanced Specialty Products	$ 10,218	$ 13,665	$ 20,819	$ 26,815
Microwave Components and Systems	16,236	10,355	30,242	20,747
Power Management Systems	2,047	2,942	4,841	5,390
Sensors and Controls	5,122	5,612	10,838	10,776
	$ 33,623	$ 32,574	$ 66,740	$ 63,728

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Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Second Quarter 2009 Versus Second Quarter 2008

Net Sales

Our consolidated net sales were $33.6 million in the second quarter of fiscal 2009, an increase of $1.0 million or 3.2% from the comparable period last year. This increase reflects $3.3 million of SatCon product shipments, as well as additional shipment volumes for many of our products used in military/defense applications. These shipment increases were partially offset by a $3.4 million reduction in shipments for our advanced specialty products and a $1.4 million reduction in shipments of our power management systems, sensors, and control products reflecting the worldwide recession and its impact on most of our commercial customers.

Sales of our advanced specialty products were $10.2 million in the current quarter, compared to $13.6 million in the second quarter of fiscal 2008. Our advanced specialty products are used in numerous industries including military/defense, medical equipment and instrumentation, industrial controls, and communication equipment. Although sales of these products for military/defense applications were up approximately $42,000 from the same period a year ago, shipments in support of virtually all commercial applications decreased with very soft market demand.

Sales of our microwave components and systems were $16.2 million in the current quarter, compared to $10.4 million in the second quarter of fiscal 2008. Excluding the impact of our current period SatCon product sales of $3.3 million, sales of our microwave products grew $2.5 million or 24.2% from the same quarter of last year. This increase reflects additional shipments of our microwave products in support of numerous military/defense programs, including applications in secure communications, radar systems, and countermeasures for improvised explosive devices.

Sales of our power management systems decreased by $895,000 or 30.4%, with sales of $2.0 million in the current quarter and $2.9 million in the comparable period last year. Sales of these advanced systems for data storage, networking systems and other commercial applications decreased reflecting the soft market demand in our commercial markets. Sales of our sensors and controls amounted to $5.1 million in the second quarter of fiscal 2009, down $490,000 or 8.7% from the same period a year ago. Demand for our custom position sensors remained strong, particularly in applications supporting military aircraft and vehicles, while demand for our commercial temperature sensors decreased with poor market conditions.

Total customer orders received in the second quarter of fiscal 2009 amounted to $36.1 million, compared to $42.2 million received during the same period of fiscal 2008. This reduction reflects the global recession s impact on substantially all of our commercial markets.

Overall, average selling prices remained relatively stable throughout all of our major product lines.

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Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Gross Margin

In the second quarter of fiscal 2009, gross margin was $8.9 million or 26.6% of sales, compared to $8.1 million or 24.8% of sales for the same quarter last year. The increase in gross margin percentage principally reflects reductions in material costs, as well as certain operating efficiencies from higher production volumes.

Aggregate material costs were $7.9 million or 23.5% of sales in the second quarter of fiscal 2009, compared to $7.8 million or 23.9% of sales in the second quarter of fiscal 2008. This decrease in material costs, as a percentage of sales, reflects numerous factors including changes in sales mix. Labor costs remained relatively stable throughout the period, amounting to $4.1 million or 12.3% of sales in the current quarter and $4.1million or 12.5% of sales in the comparable period last year. Total manufacturing overhead was $12.6 million or 37.5% of sales in the current quarter, versus $12.6 million or 38.7% of sales for the same period a year ago. The reduction in manufacturing overhead, as a percentage of sales, primarily reflects economies of scale realized with greater sales volume.

At the end of the current period, we had a total workforce of 1,336 employees, down 11.9% from the end of last fiscal year. We expect to continuously review our organization and cost structure to enhance efficiencies, while maintaining flexibility for additional production requirements.

Selling, General and Administrative Expense

During the current quarter, selling expense amounted to $3.0 million or 8.8% of sales, compared to $2.7 million or 8.1% of sales for the same period last year. The increase in selling expense primarily reflects changes in sales mix and related increases to our effective sales commission rate. Aggregate general and administrative expense was $2.5 million in the second quarter of fiscal 2009, versus $2.0 million in the comparable period of fiscal 2008. The increase in general and administrative expense principally reflects higher personnel costs, along with numerous other operating expense increases.

Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Six Months 2009 Versus Six Months 2008

Net Sales

For the first half of fiscal 2009, our net sales increased by $3.0 million or 4.7%, with consolidated sales of $66.7 million compared to $63.7 million in the first half of fiscal 2008. This increase in sales primarily reflects $6.4 million of SatCon product shipments, along with additional shipment volumes for many of our products used in military/defense applications. In the first half of fiscal 2009, excluding the impact of our SatCon acquisition, sales of our microwave products increased by $3.1 million or 14.7% from a year ago. This increase was driven by numerous military / defense applications and programs. These shipment increases were partially offset by a $6.0 million reduction in sales for our advanced specialty products, and a $549,000 decrease in sales of our power management systems, reflecting the global recession and its impact on many of our commercial markets.

Total consolidated customer orders received in the first half of fiscal 2009 amounted to $67.6 million, compared to $74.1 million for the same period of 2008. Overall, average selling prices remained relatively stable throughout all of our major product lines.

Gross Margin

For the first six months of fiscal 2009, gross margin was $17.2 million or 25.8% of sales, compared to $14.9 million or 23.4% of sales for the same period last year. In addition to the impact of leveraging fixed manufacturing overhead with increased sales volume, the increase in gross margin primarily reflects lower material costs.

Total material costs amounted to $15.4 million or 23.1% of sales in the first half of fiscal 2009, versus $15.6 million or 24.4% for the same period last year. This decrease in material costs reflects numerous factors including: changes in sales mix; improved product yields at our ceramic manufacturing facility in State College, Pennsylvania; greater utilization of vertical manufacturing capabilities throughout all four of our business segments; and continued global sourcing of raw material requirements. As a percentage of sales, our labor costs remained relatively stable. Direct labor costs were $8.5 million or 12.7% of sales in the first six months of fiscal 2009, compared to $8.2 million or 12.8% of sales for the first six months of fiscal 2008. Manufacturing overhead costs amounted to $25.6 million or 38.4% of sales in the first half of fiscal 2009, versus $25.0 million or 39.3% of sales in the comparable period of fiscal 2008. The decrease in manufacturing overhead, as a percentage of sales, principally reflects the impact of certain fixed manufacturing costs being absorbed over greater sales volume.

Selling, General and Administrative Expense

Total selling expenses amounted to $5.9 million or 8.8% of sales in the first half of fiscal 2009, compared to $5.2 million or 8.2% of sales in the same period last year. The increase in selling expense primarily reflects changes in sales mix and related increases to our effective sales commission rate. Aggregate general and administrative expense was $4.4 million in the first half of fiscal 2009, versus $3.7 million in the comparable period of fiscal 2008. The increase in general and administrative expense principally reflects higher personnel costs, including incentive-based and equity-based compensation.

Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Interest Expense

For the first half of fiscal 2009, interest expense increased by $24,000 to $163,000, compared to $139,000 for the same period a year ago. For the first six months of fiscal 2009, interest expense on borrowings under our domestic line of credit amounted to $73,000, with weighted average borrowings of $6.8 million and a weighted average interest rate of 2.14%. For the first half of fiscal 2008, interest expense on our line of credit borrowings was $52,000, with weighted average borrowings of $2.6 million and a weighted average interest rate of 3.91%.

Other Income and Expense

We hold several United States and foreign patents relating to polymer multilayer (PML) technology, and we have granted several licenses to other entities for the use of PML technology. In the first half of fiscal 2009, no PML license fee or royalty income was realized. We received $217,000 of PML license fees and royalty income in the first half of fiscal 2008. It is not known what remaining commercial value, if any, our PML licenses may have.

Income Taxes

For the first six months of fiscal 2009 and 2008, our effective income tax rate was 35.2% and 35.7%, respectively, compared to an applicable federal and state statutory income tax rate of approximately 40.0%. The difference between the effective tax rates and statutory tax rate principally reflects state tax provisions, research activities tax credits, U.S. domestic production activities deductions, and foreign income tax rates.

Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Risk Factors That May Affect Future Results

Military aircraft, naval vessels, and certain military vehicles contain extensive communications systems, electronic countermeasure equipment for defense against enemy weapons, smart weapons and munitions, and radar systems. We provide low pass EMI filters, multisection assemblies, power products, and various microwave components and integrated assemblies to major equipment manufacturers for installation into these systems. In addition, our precision position sensors are used in numerous military vehicles and aircraft. Through the first six months of fiscal year 2009, military/defense sales represented approximately 61% of our total consolidated sales. In recent years, demand for our products has been favorably impacted by an upward trend in U.S. defense spending. Future defense budgets, however, may be impacted by numerous economic and political factors. In addition, the specific programs in which we participate, or in which we may seek to participate in the future, must compete with other programs for consideration during the budget formulation and appropriation processes. While we believe many of our products are used in high priority military/defense programs, one or more of the programs that we currently serve could be phased-out or terminated. Reductions in these existing programs, unless offset by other programs and opportunities, would adversely affect our future revenues and profitability.

During the first six months of fiscal year 2009, approximately 16% of our consolidated sales were to original equipment manufacturers of communications equipment, with a significant portion of these sales supporting wireless infrastructure equipment. Several years ago, capital expenditures for wireless infrastructure equipment by service providers declined dramatically. Market conditions in the industry remain unpredictable and overall capital spending for wireless infrastructure equipment is still volatile. If the current market conditions deteriorate, it will have a material negative impact on our future operating performance.

Raw materials used in the manufacture of certain ceramic capacitors include silver, palladium, and platinum. Precious metals are available from many sources; however, their prices may be subject to significant fluctuations and such fluctuations may have a material and adverse affect on our operating results.

The markets for our products are extremely competitive and are characterized by rapid technological change, new product development and evolving industry standards. We face competition from component manufacturers which have integration capabilities, as well as from the internal capabilities of large communications original equipment manufacturers and defense prime contractors. Our future success will depend in part upon the extent to which these parties elect to purchase from outside sources rather than manufacture their own components and systems. Many of our current and potential competitors have substantially greater financial, technical, marketing, distribution and other resources than us, and have greater name recognition and market acceptance of their products and technologies. Our competitors may develop new technologies or products that may offer superior price or performance features, and new products or technologies may render our customers products obsolete.

Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

We must also continue to make significant investments in research and development efforts in order to develop necessary product enhancements, new designs and technologies. We may not be able to obtain a sufficient number of engineers, or other technical support staff, or the funds necessary to support our research and development efforts when needed. In additions, our research and development efforts may not be successful, and our new products may not achieve market acceptance. Our customers technologies are complex and new products and enhancements developed by our customers can in turn require long development periods for our new products or for enhancement or adaptation of our existing products. If we are unable to develop and introduce new products or enhancements in a timely manner in response to changing market conditions or customer requirements, or if our new products do not achieve market acceptance, our business, financial condition and operating results could suffer.

The current worldwide economic downturn and credit crisis may have a significant negative impact on our business, financial condition, and future results of operations. Specific risk factors related to these overall economic and credit conditions include the following: customer or potential customers may reduce or delay their new product development and component procurement; key suppliers may become insolvent resulting in delays for our material purchases; vendors and other third parties may fail to perform their contractual obligations; customers may be unable to obtain credit to finance purchases of our products; and certain customers may become insolvent. These risk factors could reduce our product sales, increase our operating costs, impact our ability to manage inventory levels and collect customer receivables, lengthen our cash conversion cycle and increase our need for cash, which would ultimately decrease our profitability and negatively impact our financial condition.

In addition, our results of operations may be negatively affected in the future by a variety of other factors including: competitive pricing pressures; product cost changes; cancellation of existing customer order backlog; unanticipated impairment of assets; difficulties in integrating acquired businesses and product lines; changes in product mix; and litigation involving antitrust, intellectual property, environmental, product warranty, product liability, and other issues.

Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Liquidity, Capital Resources and Financial Condition

We maintain a domestic line of credit with our principal lending institution, PNC Bank, N.A. of Erie, Pennsylvania (the Bank), in the aggregate amount of $25.0 million, with an additional $10.0 million expansion feature. Borrowings under the line of credit are secured by substantially all of our tangible and intangible personal property, and bear interest at rates below the prevailing prime rate. At May 31, 2009, $3.0 million was outstanding under this line of credit arrangement. The line of credit agreement contains certain covenants, the most restrictive of which require us to maintain designated minimum levels of net worth and profitability, and impose certain restrictions on us regarding additional indebtedness. At May 31, 2009, we were in compliance with all debt covenants. The current line of credit agreement expires in December 2010. Our ability to borrow in the future under this credit facility is dependent on our ongoing compliance with the restrictive covenants. Whether we continue to comply with these covenants is largely dependent on our ability to attain certain levels of operating performance and profitability in the future, for which there can be no assurance.

Our wholly-owned German subsidiary maintains an unsecured Euro line of credit with a German financial institution aggregating approximately $1.4 million (Euro 1.0 million). At May 31, 2009, no borrowings were outstanding under this line of credit. Future borrowings, if any, will bear interest at rates below the prevailing prime rate and will be payable upon demand.

Our net working capital and current ratio increased during the first half of fiscal 2009. At May 31, 2009, we had net working capital of $49.2 million, compared to $42.6 million at November 30, 2008. At May 31, 2009, current assets were 4.98 times current liabilities, compared to 2.98 at the end of fiscal 2008. The increase in our net working capital and current ratio primarily reflects our positive operating cash flow which enabled us to repay $7.0 million under our domestic line of credit.

Our capital expenditures for property, plant and equipment amounted to $1.9 million in the first six months of fiscal 2009. Approximately $1.2 million of these capital expenditures were made in our microwave components and systems business segment to support manufacturing expansion and improvements. The balance of our current year capital expenditures primarily consists of routine replacement of older fixed assets. At May 31, 2009, we had not entered into any material commitments for additional capital expenditures.

We have adopted a stock repurchase program. Under this program, we may repurchase up to $16.0 million of the Company s outstanding Common Stock. Acquired shares are to be purchased in the open market or through privately negotiated transactions at prevailing market prices. Funding for these repurchases is expected to come from available cash reserves and borrowings under our revolving line of credit facility. The amount and timing of the shares repurchased are based on our ongoing assessment of the Company s capital structure, liquidity, and the market price of the Company s Common Stock. The repurchased shares are held as treasury stock. During the first half of fiscal 2009, no shares were repurchased. Since the inception of the stock repurchase program, 1,677,479 shares have been repurchased at a total cost of $11.8 million.

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Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

As of May 31, 2009, our obligations and firm commitments are as follows (in thousands):

Contractual obligations	Payments Due by Period						
	Total	2009	2010	2011	2012	2013	Thereafter
Long-term debt	$ 952	$ 407	$ 65	$ 70	$ 75	$ 80	$ 255
Operating leases	2,819	698	1,304	389	321	107	-

Current financial resources, including working capital and existing lines of credit, and anticipated funds from operations are expected to be sufficient to meet operating cash requirements throughout the next twelve months, including scheduled long-term debt repayment, lease commitments, planned capital equipment expenditures and possible stock repurchases. There can be no assurance, however, that unplanned capital replacement or other future events will not require us to seek additional debt or equity financing and, if so required, that it will be available on terms acceptable to us.

Net cash provided by operating activities was $8.1 million in the first six months of fiscal 2009, compared to $3.1 million for the first six months of 2008. In 2009, net cash provided by operating activities was positively impacted by improved accounts receivable and inventory turnover rates, as well as the timing of certain U.S. corporate income tax payments. In the first six months of fiscal 2009, our positive operating cash flow and existing cash reserves enabled us to repay $7.0 million of our short-term bank borrowings and fully fund all of our required capital expenditures.

In January 2009, one of our manufacturing facilities sustained wind damage to its roof which, in turn, resulted in water damage to certain machinery, equipment, and building improvements. Although a final insurance claim and related reimbursement have not yet been determined, we received a $500,000 advance payment from our insurance carrier in the first half of fiscal 2009.

At May 31, 2009, the aggregate carrying value of goodwill was $36.8 million or 28.2% of our total assets and 34.0% of our total stockholders equity. On an annual basis (as of September 1 of each fiscal year), and when there is reason to suspect that the carrying value of goodwill has been diminished or impaired, goodwill is tested for impairment and a write down of the asset may be necessary. For the six months ended May 31, 2009, no events occurred which would require interim impairment testing and no goodwill impairment losses were recognized.

Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Environmental Matters

In December, 2005, we acquired certain land and ceramic manufacturing facilities in State College, Pennsylvania. The property, which was acquired from Murata Electronics North America (Murata), consists of approximately 53 acres of land and 250,000 square feet of manufacturing facilities. Among other uses, the acquired facilities have become the design and manufacturing center for our ceramic operations, replacing the ceramic operations previously conducted in New Orleans, Louisiana.

The purchase price for the acquired property consisted of: (a) $1.00, plus (b) closing costs of $695,000 including realtor commissions, transfer taxes, and legal fees; plus (c) the assumption of, and indemnification of Murata against, all environmental liabilities related to the property. The acquired property has known environmental conditions that require remediation, and certain hazardous materials previously used on the property have migrated into neighboring third party areas. These environmental issues arose from the use of chlorinated organic solvents including tetrachloroethylene (PCE) and trichloroethylene (TCE). As a condition to the purchase, we entered into an agreement with the Pennsylvania Department of Environmental Protection (PADEP) pursuant to which: (a) we agreed to remediate all known environmental conditions relating to the property to a specified industrial standard, with our costs for remediating such conditions being capped at $4.0 million; (b) PADEP released Murata from further claims by Pennsylvania under specified state laws for the known environmental conditions; and (c) we purchased an insurance policy providing clean-up cost cap coverage (for known and unknown pollutants) with a combined coverage limit of approximately $8.2 million, and pollution legal liability coverage (for possible third party claims) with an aggregate coverage limit of $25.0 million. The total premium cost for the insurance policy, which has a ten-year term and an aggregate deductible of $650,000, was $4.8 million. The cost of the insurance associated with the environmental clean-up ($3.6 million) is being charged to general and administrative expense in direct proportion to the actual remediation costs incurred. The cost of the insurance associated with the pollution legal liability coverage ($1.2 million) is being charged to general and administrative expense on a pro rata basis over the ten-year policy term.

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Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Based upon our environmental review of the property, we recorded a liability of $2.9 million to cover probable future environmental expenditures related to the remediation, the cost of which is expected to be entirely covered by the insurance policy. As of May 31, 2009, remediation expenditures of $1.7 million have been incurred and charged against the environmental liability, with all such expenditures being reimbursed by the insurance carrier. The remaining aggregate undiscounted expenditures of $1.2 million, which are anticipated to be incurred over the next seven years, principally consist of: (a) continued operation and monitoring of the existing on-site groundwater extraction, treatment, and recharge system; (b) implementation of a chemical oxidation system; (c) completion of soil investigations to determine the extent of potential soil contamination; (d) excavation and off-site disposal of soil containing contaminates above acceptable standards; and (e) implementation of soil vapor extraction systems in certain areas. Depending upon the results of future environmental testing and remediation actions, it is possible that the ultimate costs incurred could exceed the current aggregate estimate of $2.9 million. We expect such increase, if any, to be entirely covered by the insurance policy. Insurance recoveries for actual environmental remediation costs incurred are recorded when it is probable that such insurance reimbursement will be received and the related amounts are determinable. Such insurance recoveries are credited to our general and administrative expense.

Based on the current remediation plan, $269,000 of the total remediation costs are expected to be incurred during the next twelve months.

Critical Accounting Policies

The methods, estimates and judgments we use in applying our most critical accounting policies have a significant impact on the results we report in our consolidated financial statements. The U.S. Securities and Exchange Commission has defined the most critical accounting policies as the ones that are most important to the portrayal of our financial condition and results, and require us to make our most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, we believe our most critical accounting policies relate to the valuation and carrying amounts of accounts receivable, inventories, long-lived assets, and deferred tax assets.

We evaluate the collectibility of our accounts receivable based on a combination of factors including an assessment of the customer s financial condition and the length of time a receivable is past due. At May 31, 2009, our allowance for doubtful accounts was $872,000 or 3.8% of our aggregate accounts receivable. In determining the adequacy of this allowance, we have assumed that conditions in our major served markets (military/defense, communications equipment, and medical/industrial instrumentation) will not significantly deteriorate during the second half of fiscal 2009. If current economic and market conditions do significantly deteriorate, our customers may not be able to meet their financial obligations to us. Accordingly, our estimate of the recoverability of amounts due us could be reduced by a material amount.

Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

At May 31, 2009, we had recorded inventory reserves in the aggregate amount of $2.4 million for excess and slow-moving items. In determining the adequacy of these reserves, we considered numerous factors including current customer forecasts and estimated usage. Should these forecasts and estimates change due to market, technological or other factors, the net realizable value of our inventories may be materially less than our current carrying values.

We review goodwill for possible impairment at least annually. Impairment losses are recognized when the implied fair value of goodwill is less than its carrying value. The implied fair value of goodwill is contingent upon many factors, including estimates of future discounted operating cash flows. Long-lived assets other than goodwill are reviewed for impairment whenever indicators of possible impairment exist. Impairments are recognized when the expected future operating cash flows derived from such assets are less than their carrying values. No impairment losses have been recognized in any of the periods presented herein. However, our future cash flow expectations assume that the general economic climate and conditions within our major served markets will improve within the next few years. If these long-term market conditions do not improve, or in fact deteriorate, our long-lived assets may become materially impaired.

We record valuation allowances to reduce deferred tax assets when it is more likely than not that some portion of the asset may not be realized. Presently, we believe that all deferred tax assets will more likely than not be realized and a valuation allowance is not required. We evaluate the need for valuation allowances on a regular basis and make adjustments as needed. These adjustments, when made, may have a materially negative impact on our financial statements.

Recent Accounting Pronouncements Not Yet Adopted

In April 2009, the Financial Accounting Standards Board (FASB) issued FASB Staff Position FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP 157-4). FSP 157-4 amends FASB Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS No. 157), and provides additional guidance for estimating fair value in accordance with SFAS No. 157 when the volume and level of activity for the asset or liability have significantly decreased and also includes guidance on identifying circumstances that indicate a transaction is not orderly for fair value measurements. FSP 157-4 is to be applied prospectively, with retrospective application not permitted, and is effective for interim and annual periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. We are currently evaluating the disclosure requirements of this new accounting guidance.

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Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

In April 2009, the FASB also issued FASB Staff Position FAS 107-1 / APB 28-1, Interim Disclosures about Fair Value of Financial Instruments (the FSP). This FSP amends FASB Statement of Financial Accounting Standards No. 107, Disclosures about Fair Value of Financial Instruments (SFAS No. 107), to require disclosures about fair value of financial instruments not measured on the balance sheet at fair value in interim financial statements as well as in annual financial statements. Prior to this FSP, fair values for these assets and liabilities were only disclosed annually. This FSP applies to all financial instruments within the scope of SFAS No. 107 and requires all entities to disclose the methods and significant assumptions used to estimate the fair value of financial instruments. The FSP is effective for interim periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. An entity may early adopt this FSP only if it also elects to early adopt FSP 157-4. We are currently evaluating the disclosure requirements of this new accounting guidance.

In April 2008, the FASB issued FASB Staff Position No. 142-3, Determination of the Useful Life of Intangible Assets (the Position). This Position amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, Goodwill and Other Intangible Assets . The intent of this Position is to improve the consistency between the useful life of a recognized intangible asset and the period of expected cash flows used to measure the fair value of the asset under FASB Statement No. 141 (revised 2007), Business Combinations (SFAS No. 141R), and other U.S. generally accepted accounting principles. This Position is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2008 (the Company s 2010 fiscal year). We are currently assessing the impact of this Position on our financial condition, results of operations, and cash flows.

In December 2007, the FASB issued SFAS No. 141R. The objective of SFAS No. 141R is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. Specifically, it established principles and requirements over how the acquirer (1) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; (2) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase, and (3) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141R will change the accounting treatment for certain specific items, including acquisition-related costs, acquired contingent liabilities, and restructuring costs associated with the acquisition. SFAS No. 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008 (the Company s 2010 fiscal year), with early adoption prohibited. Once adopted, we believe SFAS No. 141R will have an impact on accounting for business combinations, but the effect is dependent upon the nature and terms of the acquisitions made at that time.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Foreign Currency

Certain of our European sales and related selling expenses are denominated in Euros, British Pounds Sterling, and other local currencies. In addition, certain of our operating expenses are denominated in Mexican Pesos and Chinese Yuan. As a result, fluctuations in currency exchange rates may affect our operating results and cash flows. To manage our exposure to these foreign currencies, we occasionally enter into forward currency exchange contracts. At May 31, 2009, no forward currency exchange contracts were outstanding. For each of the periods presented herein, currency exchange rate gains and losses were not material.

Interest Rate Exposure

We have market risk exposure relating to possible fluctuations in interest rates. From time to time, we utilize interest rate swap agreements to minimize the risks and costs associated with variable rate debt. We do not enter into derivative financial instruments for trading or speculative purposes. The interest rate swap agreements are entered into with major financial institutions, and we have never experienced nonperformance by any counterparties to these agreements. At May 31, 2009, no interest rate swap agreements were outstanding.

ITEM 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

The Company s management, with the participation of the Company s Chief Executive Officer and Chief Financial Officer, has reviewed and evaluated the effectiveness of the Company s disclosure controls and procedures as defined in the Securities Exchange Act of 1934 Rules 13a-15 (e) and 15d-15 (e), as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that review and evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures are adequate and effective to ensure that material information relating to the Company and its consolidated subsidiaries are made known to them by others within those entities in a timely manner, particularly during the period in which this quarterly report on Form 10-Q was being prepared, and that no changes are required at this time.

(b) Change in Internal Controls

There were no changes in the Company s internal controls over financial reporting during the quarter ended May 31, 2009, that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

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Part II   Other Information

Item 1A.   Risk Factors

The Company is exposed to certain risk factors that may affect future consolidated operating and financial results. In addition to the risk factors discussed within this quarterly report Form 10-Q, significant risk factors are described in the Company s most recently filed annual report on Form 10-K. There have been no significant changes in the Company s risk factors since November 30, 2008.

ITEM 4.   SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Annual Meeting of Shareholders of the Company was held on April 6, 2009 at the Bel-Aire Clarion Hotel and Conference Center, 2800 West Eighth Street, Erie, Pennsylvania at 9:00 A.M. All proposals as described in the Company s Proxy Statement dated March 2, 2009 were approved. Below are details in the matters voted upon at the meeting.

Proposal 1   Election of Directors

Elections were held for two directors (each to hold office for a term of three years). The results of the votes are as follows:

Name	Votes For	Votes Withheld
J. Thomas Gruenwald	11,263,567	376,452
Gerald A. Ryan	11,031,836	608,183

The terms of the following five directors extend beyond the time of the meeting: Bernard C. Bailey; George J. Behringer; John P. Freeman; Richard A. Southworth; and James F. Toohey.

Proposal 2   Appointment of Independent Registered Public Accounting Firm

Upon recommendation of the Audit Committee, the Board of Directors resolved to appoint Ernst & Young LLP as the Company s independent registered public accounting firm for the fiscal year ending November 30, 2009; subject only to ratification by the shareholders. The results of the votes are as follows:

Votes For	Votes Against	Abstentions
11,318,813	312,383	8,825

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Item 6. Exhibits and Reports

(a) Exhibits
Articles of Incorporation of the Company, as amended, previously filed on February 25, 1981, as Exhibit 3.1 to Form S-1 registration, and incorporated herein by reference.

By-laws of the Company, as amended, previously filed on February 25, 1981, as Exhibit 3.2 to Form S-1 registration, and incorporated herein by reference.

Certification of Chief Executive Officer pursuant to Rule 13a 14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended (31.1).

Certification of Chief Financial Officer pursuant to Rule 13a 14 (a) and Rule 15d- 14(a) of the Securities Exchange Act, as amended (31.2)

Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (32.1)

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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.

		Spectrum Control, Inc. (Registrant)
Date: June 30, 2009	By:	/s/ John P. Freeman John P. Freeman,
		Senior Vice President and Chief Financial Officer
		(Principal Accounting and Financial Officer)

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