# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# Form 10-Q

**(Mark One)**

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

**For the quarterly period ended September 30, 2015**

**or**

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

**For the transition period from to**

**Commission File Number: 001-15957**

# Capstone Turbine Corporation

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Delaware** | **95-4180883** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| **21211 Nordhoff Street, Chatsworth, California** | **91311** |
| (Address of principal executive offices) | (Zip Code) |

**818-734-5300**

(Registrant s telephone number, including area code)

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 o

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

| | |
|---|---|
| Large accelerated filer o | Accelerated filer x |
| Non-accelerated filer o<br>(Do not check if a smaller reporting company) | Smaller reporting company o |

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

The number of shares outstanding of the registrant s common stock as of October 30, 2015 was 342,373,255.

Table of Contents

**CAPSTONE TURBINE CORPORATION**

**INDEX**

Table of Contents

## PART I FINANCIAL INFORMATION

**Item 1.** ***Financial Statements***

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**(In thousands, except share amounts)**
**(Unaudited)**

| | September 30, 2015 | March 31, 2015 |
|---|---|---|
| **ASSETS** | | |
| Current Assets: | | |
| Cash and cash equivalents | $ 10,599 | $ 32,221 |
| Restricted cash | 5,000 | |
| Accounts receivable, net of allowances of $10,496 at September 30, 2015 and $11,041 at March 31, 2015 | 16,164 | 13,120 |
| Inventories | 28,688 | 23,097 |
| Prepaid expenses and other current assets | 3,179 | 3,063 |
| Total current assets | 63,630 | 71,501 |
| Property, plant and equipment, net | 4,132 | 3,523 |
| Non-current portion of inventories | 2,298 | 2,258 |
| Intangible assets, net | 1,200 | 1,337 |
| Other assets | 283 | 308 |
| Total | $ 71,543 | $ 78,927 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current Liabilities: | | |
| Accounts payable and accrued expenses | $ 25,101 | $ 22,266 |
| Accrued salaries and wages | 2,067 | 2,113 |
| Accrued warranty reserve | 2,474 | 3,183 |
| Deferred revenue | 3,427 | 3,051 |
| Revolving credit facility | 15,164 | 12,953 |
| Current portion of notes payable and capital lease obligations | 142 | 407 |
| Total current liabilities | 48,375 | 43,973 |
| Long-term portion of notes payable and capital lease obligations | 101 | 89 |
| Other long-term liabilities | 184 | 161 |
| Commitments and contingencies (Note 15) | | |
| Stockholders Equity: | | |
| Preferred stock, $.001 par value; 10,000,000 shares authorized; none issued | | |
| Common stock, $.001 par value; 515,000,000 shares authorized; 336,533,685 shares issued and 335,159,966 shares outstanding at September 30, 2015; 331,635,840 shares issued and 330,379,962 shares outstanding at March 31, 2015 | 337 | 332 |
| Additional paid-in capital | 839,743 | 837,650 |
| Accumulated deficit | (815,621) | (801,764) |
| | (1,576) | (1,514) |

| | | | | |
|---|---|---|---|---|
| Treasury stock, at cost; 1,373,719 shares at September 30, 2015 and 1,255,878 shares at March 31, 2015 | | | | |
| Total stockholders equity | | 22,883 | | 34,704 |
| Total | $ | 71,543 | $ | 78,927 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**(In thousands, except per share data)**
**(Unaudited)**

| | Three Months Ended September 30, 2015 | Three Months Ended September 30, 2014 | Six Months Ended September 30, 2015 | Six Months Ended September 30, 2014 |
|---|---|---|---|---|
| Revenue: | | | | |
| Product, accessories and parts | $ 14,689 | $ 29,808 | $ 38,835 | $ 50,763 |
| Service | 3,216 | 2,440 | 6,050 | 4,745 |
| Total revenues | 17,905 | 32,248 | 44,885 | 55,508 |
| Cost of goods sold: | | | | |
| Product, accessories and parts | 13,147 | 24,941 | 33,061 | 42,700 |
| Service | 2,830 | 2,064 | 5,211 | 4,149 |
| Total cost of goods sold | 15,977 | 27,005 | 38,272 | 46,849 |
| Gross margin | 1,928 | 5,243 | 6,613 | 8,659 |
| Operating expenses: | | | | |
| Research and development | 2,872 | 2,055 | 5,288 | 4,382 |
| Selling, general and administrative | 6,705 | 9,543 | 14,794 | 17,307 |
| Total operating expenses | 9,577 | 11,598 | 20,082 | 21,689 |
| Loss from operations | (7,649) | (6,355) | (13,469) | (13,030) |
| Other (expense) income | (36) | (16) | (38) | 81 |
| Interest expense | (197) | (144) | (347) | (287) |
| Loss before income taxes | (7,882) | (6,515) | (13,854) | (13,236) |
| Provision for income taxes | | 14 | 3 | 64 |
| Net loss | $ (7,882) | $ (6,529) | $ (13,857) | $ (13,300) |
| | | | | |
| Net loss per common share basic and diluted | $ (0.02) | $ (0.02) | $ (0.04) | $ (0.04) |
| | | | | |
| Weighted average shares used to calculate net loss per common share | 331,544 | 329,865 | 331,048 | 325,942 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In thousands)**

**(Unaudited)**

| | Six Months Ended September 30, 2015 | Six Months Ended September 30, 2014 |
|---|---|---|
| **Cash Flows from Operating Activities:** | | |
| Net loss | $ (13,857) | $ (13,300) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 785 | 880 |
| Amortization of deferred financing costs | 85 | 112 |
| Accounts receivable allowances | (30) | 3,057 |
| Inventory provision | 539 | 770 |
| Provision for warranty expenses | 331 | 1,510 |
| Loss on disposal of equipment | 11 | 4 |
| Stock-based compensation | 848 | 1,223 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (3,014) | 1,746 |
| Inventories | (6,170) | (1,691) |
| Prepaid expenses and other current assets | (187) | (1,009) |
| Accounts payable and accrued expenses | 2,934 | (7,456) |
| Accrued salaries and wages and long term liabilities | (23) | 5 |
| Accrued warranty reserve | (1,040) | (1,593) |
| Deferred revenue | 376 | 1,084 |
| Net cash used in operating activities | (18,412) | (14,658) |
| **Cash Flows from Investing Activities:** | | |
| Expenditures for property and equipment | (1,272) | (954) |
| Net cash used in investing activities | (1,272) | (954) |
| **Cash Flows from Financing Activities:** | | |
| Net proceeds from (repayments of) revolving credit facility | 2,211 | (1,032) |
| Changes in restricted cash | (5,000) | |
| Repayment of notes payable and capital lease obligations | (337) | (312) |
| Net cash (used in) provided by employee stock-based transactions | (56) | 118 |
| Net proceeds from issuance of common stock at-the-market offering program | 1,244 | |
| Net proceeds from issuance of common stock | | 29,772 |
| Net cash (used in) provided by financing activities | (1,938) | 28,546 |
| Net (decrease) increase in Cash and Cash Equivalents | (21,622) | 12,934 |
| Cash and Cash Equivalents, Beginning of Period | 32,221 | 27,859 |
| Cash and Cash Equivalents, End of Period | $ 10,599 | $ 40,793 |
| **Supplemental Disclosures of Cash Flow Information:** | | |
| Cash paid during the period for: | | |
| Interest | $ 243 | $ 181 |
| Income taxes | $ 5 | $ 79 |
| **Supplemental Disclosures of Non-Cash Information:** | | |
| Acquisition of property and equipment through accounts payable | $ 139 | $ 118 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

### 1. Business and Organization

Capstone Turbine Corporation ( Capstone or the Company ) develops, manufactures, markets and services microturbine technology solutions for use in stationary distributed power generation applications, including cogeneration (combined heat and power ( CHP ), and combined cooling, heat and power ( CCHP )), renewable energy, natural resources, critical power supply, transportation and marine. In addition, the Company s microturbines can be used as battery charging generators for hybrid electric vehicle applications. The Company was organized in 1988 and has been producing its microturbine generators commercially since 1998.

The Company has incurred significant operating losses since its inception. Management anticipates incurring additional losses until the Company can produce sufficient revenue and gross profit to cover its operating costs. To date, the Company has funded its activities primarily through private and public equity offerings.

### 2. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ( generally accepted accounting principles or GAAP ) for interim financial information and the instructions to Form 10-Q and Regulation S-X promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act ). They do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The condensed consolidated balance sheet at March 31, 2015 was derived from audited financial statements included in the Company s Annual Report on Form 10-K for the year ended March 31, 2015. In the opinion of management, the interim condensed consolidated financial statements include all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the financial condition, results of operations and cash flows for such periods. Results of operations for any interim period are not necessarily indicative of results for any other interim period or for the full year. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended March 31, 2015. This Quarterly Report on Form 10-Q (this Form 10-Q ) refers to the Company s fiscal years ending March 31 as its Fiscal years.

The condensed consolidated financial statements have been prepared assuming the Company will continue as a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. The Company continues to be negatively impacted by the continuing softness of the global oil and gas markets, a substantially stronger U.S. dollar (making our products more expensive overseas) and ongoing geopolitical tensions in Russia, North Africa and the Middle East. The Company s net loss from operations for the second quarter of Fiscal 2016 was $7.6 million. The Company s cash and cash equivalents as of September 30, 2015 and March 31, 2015 were $10.6 million ($15.6 million when combined with restricted cash related to the Credit Facility) and $32.2 million, respectively. See Note 11 Revolving Credit Facility for discussion of the line of credit with Wells Fargo Bank, National Association ( Wells Fargo ). Cash and cash equivalents and restricted cash, less the amount outstanding under the Credit Facility, was $0.4 million and $19.3 million as of September 30, 2015 and March 31, 2015, respectively. The Company s working capital requirements during the second quarter of Fiscal 2016 were higher than planned primarily as a result of lower than expected revenue, slower collection of accounts receivable and lower than anticipated inventory turns primarily because of finished goods that did not ship in the quarter.

Management believes that the Company will make progress on its path to profitability by improving its net loss from operations by lowering its operating costs and the continued development of other geographical and vertical markets. In addition, management has the ability to manage certain operating assets and liabilities, specifically the procurement of inventory and timing of payments of accounts payable, capital expenditures and certain operating expenses depending on the results of its operations to preserve its cash and cash equivalents. Additionally, the Company has an at-the-market offering program in place pursuant to which the Company may offer and sell, from time to time at its sole discretion, shares of its common stock. See Note 9 Underwritten and Registered Direct Placement of Common Stock for disclosure with respect to the at-the-market offering program. Management also believes that the Company will maintain compliance with the covenants contained in the amended Credit Facility agreements through the end of Fiscal 2016. If a covenant violation were to occur, the Company would attempt to negotiate a waiver of non-compliance from Wells Fargo.

If the Company is unable to manage its cash flows in the areas discussed above, the Company may need to raise additional capital in the near term. The Company may seek to raise funds by selling additional securities (through the at-the-market offering discussed above or some other offering) to the public or to selected investors or by obtaining additional debt financing. There is no assurance that the Company will be able to obtain additional funds on commercially favorable terms or at all. If the

Table of Contents

Company raises additional funds by issuing additional equity or convertible debt securities, the fully diluted ownership percentages of existing stockholders will be reduced. In addition, any equity or debt securities that the Company would issue may have rights, preferences or privileges senior to those of the holders of its common stock. Should the Company be unable to execute its plans (including raising funds through the at-the-market offering program and maintaining availability under its Credit Facility) or obtain additional financing that may be needed, the Company may need to significantly reduce its operations or it may be unable to continue as a going concern. The unaudited condensed consolidated financial statements do not include any adjustments that might result from the outcome of these uncertainties.

The condensed consolidated financial statements include the accounts of the Company, Capstone Turbine Singapore, Pte. Ltd., its wholly owned subsidiary that was formed in February 2011, and Capstone Turbine International, Inc., its wholly owned subsidiary that was formed in June 2004, after elimination of inter-company transactions.

**3. Recently Issued Accounting Standards**

In July 2015, the Financial Accounting Standards Board (the FASB ) issued Accounting Standards Update (ASU) 2015-11, Simplifying the Measurement of Inventory. ASU 2015-11 requires inventory that is recorded using the first-in, first-out method to be measured at the lower of cost or net realizable value. ASU 2015-11 is effective for annual and interim periods beginning after December 15, 2016, and should be applied prospectively with early adoption permitted at the beginning of an interim or annual reporting period. The Company is currently evaluating the potential impact the new standard will have on our financial position and results of operations.

In April 2015, the FASB issued ASU 2015-03, Interest Imputation of Interest (Subtopic 835-30). The ASU was issued as part of FASB s current plan to simplify overly complex standards. This ASU requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. The recognition and measurement guidance for debt issuance costs are not affected by this ASU. The update requires retrospective application to all prior period amounts presented. This update is effective for annual and interim periods beginning on or after December 15, 2015, with early application permitted for financial statements that have not been issued. The adoption of this standard would result in the reclassification of debt issuance costs from prepaid expenses and other current assets to the amount outstanding under the Credit Facility. The net amount of such costs at September 30, 2015 was approximately $0.2 million.

In August 2014, the FASB issued ASU 2014-15, Disclosure of Uncertainties About an Entity s Ability to Continue as a Going Concern ( ASU 2014-15 ). ASU 2014-15 requires management to perform interim and annual assessments of an entity s ability to continue as a going concern within one year of the date the financial statements are issued and provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. Certain disclosures will be required if conditions give rise to substantial doubt about an entity s ability to continue as a going concern. ASU 2014-15 applies to all entities and is effective for annual and interim reporting periods ending after December 15, 2016, with early adoption permitted. The Company is evaluating the potential impacts the new standard will have on its reporting process.

In June 2014, the FASB issued ASU 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period ( ASU 2014-12 ). ASU 2014-12 requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. ASU 2014-12 is effective for annual reporting periods beginning after December 15, 2015, with early adoption permitted. The Company is evaluating the potential impacts of the new standard on its existing stock-based compensation plans.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers ( ASU 2014-09 ). ASU 2014-09 supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The standard s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The Company is evaluating its existing revenue recognition policies to determine whether any contracts in the scope of the guidance will be affected by the new requirements. The Company will be required to adopt the revenue recognition standard in annual reporting periods beginning after December 15, 2017 (fiscal year ending March 31, 2019) and interim periods within those annual periods.

**4. Customer Concentrations and Accounts Receivable**

Sales to Optimal Group Australia Pty Ltd ( Optimal ), one of the Company s Australian distributors, and Horizon Power Systems ( Horizon ), one of the Company s domestic distributors, accounted for 29% and 12%, respectively, of revenue for the three months ended September 30, 2015. Sales to BPC Engineering ( BPC ), one of the Company s Russian distributors, Horizon and E-Finity Distributed Generation, LLC ( E-Finity ), one of the Company s domestic distributors, accounted for 20%, 18% and 12%, respectively, of revenue for the three months ended September 30, 2014. For the six months ended

Table of Contents

September 30, 2015, Horizon and Optimal accounted for 18% and 13% of revenue, respectively. For the six months ended September 30, 2014, Horizon, BPC and E-Finity accounted for 21%, 17% and 12% of revenue, respectively. Additionally, Optimal, DTC Soluciones Inmobiliarias S.A. de C.V., one of the Company s Mexican distributors, Serba Dinamik Sdn Bhd, one of the Company s Malaysian distributors and RSP Systems, one of the Company s domestic distributors, accounted for 32%, 16%, 14% and 11%, respectively, of net accounts receivable as of September 30, 2015. Optimal accounted for 17% of net accounts receivable as of March 31, 2015.

There were no significant bad debt charges or recoveries for the three and six months ended September 30, 2015, respectively. The Company recorded bad debt expense of $3.0 million and $3.1 million for the three and six months ended September 30, 2014, respectively.

**5. Inventories**

Inventories are valued on a first in first out ( FIFO ) basis and lower of cost or market net of provisions for slow moving, excess, obsolete or otherwise impaired inventories and consisted of the following as of September 30, 2015 and March 31, 2015 (in thousands):

| | September 30, 2015 | March 31, 2015 |
|---|---|---|
| Raw materials | $ 22,247 | $ 19,955 |
| Work in process | 1,269 | |
| Finished goods | 7,470 | 5,400 |
| Total | 30,986 | 25,355 |
| Less non-current portion | (2,298) | (2,258) |
| Current portion | $ 28,688 | $ 23,097 |

The non-current portion of inventories represents that portion of the inventories in excess of amounts expected to be sold or used in the next twelve months. The non-current inventories are primarily comprised of repair parts for older generation products that are still in operation but are not technologically compatible with current configurations. The weighted average age of the non-current portion of inventories on hand as of September 30, 2015 is 1.9 years. The Company expects to use the non-current portion of the inventories on hand as of September 30, 2015 over the periods presented in the following table (in thousands):

| Expected Period of Use | Non-Current Inventory Balance Expected to be Used |
|---|---|
| 13 to 24 months | $ 1,611 |
| 25 to 36 months | 564 |
| 37 to 48 months | 123 |
| Total | $ 2,298 |

**6. Property, Plant and Equipment**

The Company recorded depreciation expense of $0.3 million and $0.6 million for the three and six months ended September 30, 2015, respectively. The Company recorded depreciation expense of $0.3 million and $0.6 million for the three and six months ended September 30, 2014, respectively. Property, plant and equipment consisted of the following (in thousands):

| | September 30, 2015 | March 31, 2015 |
|---|---|---|
| Machinery, rental equipment, equipment, automobiles and furniture | $ 20,185 | $ 20,873 |
| Leasehold improvements | 9,835 | 9,760 |
| Molds and tooling | 3,191 | 3,722 |
| | 33,211 | 34,355 |
| Less, accumulated depreciation | (29,079) | (30,832) |
| Total property, plant and equipment, net | $ 4,132 | $ 3,523 |

Table of Contents

**7. Intangible Assets**

The Company recorded amortization expense of $0.1 million for each of the three and six months ended September 30, 2015. The Company recorded amortization expense of $0.1 million and $0.3 million for the three and six months ended September 30, 2014, respectively. Intangible assets consisted of the following (in thousands):

| | September 30, 2015 | | | |
|---|---|---|---|---|
| | **Weighted Average Amortization Period** | **Intangible Assets, Gross** | **Accumulated Amortization** | **Intangible Assets, Net** |
| Manufacturing license | 17 years | $ 3,700 | $ 3,610 | $ 90 |
| Technology | 10 years | 2,240 | 1,269 | 971 |
| Parts and service customer relationships | 5 years | 1,080 | 1,080 | |
| TA100 customer relationships | 2 years | 617 | 617 | |
| Backlog | Various | 490 | 351 | 139 |
| Trade name | 1.2 years | 69 | 69 | |
| Total | | $ 8,196 | $ 6,996 | $ 1,200 |

| | March 31, 2015 | | | |
|---|---|---|---|---|
| | **Weighted Average Amortization Period** | **Intangible Assets, Gross** | **Accumulated Amortization** | **Intangible Assets, Net** |
| Manufacturing license | 17 years | $ 3,700 | $ 3,585 | $ 115 |
| Technology | 10 years | 2,240 | 1,157 | 1,083 |
| Parts and service customer relationships | 5 years | 1,080 | 1,080 | |
| TA100 customer relationships | 2 years | 617 | 617 | |
| Backlog | Various | 490 | 351 | 139 |
| Trade name | 1.2 years | 69 | 69 | |
| Total | | $ 8,196 | $ 6,859 | $ 1,337 |

Expected future amortization expense of intangible assets as of September 30, 2015 is as follows (in thousands):

| **Year Ending March 31,** | **Amortization Expense** |
|---|---|
| 2016 (remainder of fiscal year) | $ 195 |
| 2017 | 352 |
| 2018 | 242 |
| 2019 | 224 |
| 2020 | 187 |
| Thereafter | |
| Total expected future amortization | $ 1,200 |

The manufacturing license provides the Company with the ability to manufacture recuperator cores previously purchased from Solar Turbines Incorporated ( Solar ). The Company is required to pay a per-unit royalty fee over a seventeen-year period for cores manufactured and sold by the Company using the technology. Royalties of approximately $7,000 and $19,000 were earned by Solar for the three months ended September 30, 2015 and 2014, respectively. Royalties of approximately $19,200 and $33,700 were earned by Solar for the six months ended September 30, 2015 and 2014, respectively. Earned royalties of approximately $7,000 and $19,300 were unpaid as of September 30, 2015 and March 31, 2015, respectively, and are included in accounts payable and accrued expenses in the accompanying balance sheets.

Table of Contents

**8. Stock-Based Compensation**

The following table summarizes, by statement of operations line item, stock-based compensation expense for the three and six months ended September 30, 2015 (in thousands):

| | Three Months Ended September 30, | | | | Six Months Ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | 2015 | | 2014 | |
| Cost of goods sold | $ | 35 | $ | 31 | $ | 69 | $ | 52 |
| Research and development | | 24 | | 83 | | 10 | | 160 |
| Selling, general and administrative | | 326 | | 423 | | 769 | | 1,011 |
| Stock-based compensation expense | $ | 385 | $ | 537 | $ | 848 | $ | 1,223 |

**Stock Plans**

**2000 Equity Incentive Plan**

In June 2000, the Company adopted the 2000 Equity Incentive Plan ( 2000 Plan ). The 2000 Plan provides for a total maximum aggregate number of shares which may be issued of 36,980,000 shares. The 2000 Plan is administered by the Compensation Committee designated by the Board of Directors. The Compensation Committee s authority includes determining the number of incentive awards and vesting provisions. In August 2015, the Board of Directors adopted and the shareholders approved an amendment and restatement of the 2000 Plan. The amendment and restatement includes an increase of 9,000,000 shares of common stock that will be available under the 2000 Plan. As of September 30, 2015, there were 12,033,179 shares available for future grant under the 2000 Plan.

*Stock Options*

The Company issues stock options under the 2000 Plan to employees, non-employee directors and consultants that vest and become exercisable over a four-year period and expire 10 years after the grant date. The Company uses a Black-Scholes valuation model to estimate the fair value of the options at the grant date, and compensation cost is recorded on a straight-line basis over the vesting period. Stock based compensation expense is based on awards that are ultimately expected to vest and accordingly, stock based compensation recognized is reduced by estimated forfeitures. Management s estimate of forfeitures is based on historical forfeitures. All options are subject to the following vesting provisions: one-fourth vest one year after the issuance date and 1/48th vest on the first day of each full month thereafter, so that all options will be vested on the first day of the 48th month after the grant date. Information relating to stock options for the six months ended September 30, 2015 is as follows:

**Shares**

| | | Weighted Average Exercise Price | Weighted-Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Options outstanding at March 31, 2015 | 13,163,363 | $ 1.28 | | |
| Granted | 584,500 | 0.64 | | |
| Exercised | | | | |
| Forfeited, cancelled or expired | (2,414,232) | 1.77 | | |
| Options outstanding at September 30, 2015 | 11,333,631 | $ 1.14 | 4.3 | $ |
| Options fully vested at September 30, 2015 and those expected to vest beyond September 30, 2015 | 11,333,631 | $ 1.14 | 4.3 | $ |
| Options exercisable at September 30, 2015 | 9,459,184 | $ 1.17 | 3.5 | $ |

Table of Contents

*Black-Scholes Model Valuation Assumptions*

There were no stock options granted during either of the three months ended September 30, 2015 and 2014. The Company calculated the estimated fair value of each stock option granted during the six months ended September 30, 2015 and 2014 on the date of grant using the Black-Scholes option-pricing model and the following weighted-average assumptions:

| | Three Months Ended September 30, 2015 | Three Months Ended September 30, 2014 | Six Months Ended September 30, 2015 | Six Months Ended September 30, 2014 |
|---|---|---|---|---|
| Risk-free interest rates | | | 1.5% | 1.8% |
| Expected lives (in years) | | | 5.7 | 5.7 |
| Dividend yield | | | % | % |
| Expected volatility | | | 59.0% | 77.0% |
| Weighted average grant date fair value of options granted during the period | | | $ 0.34 | $ 0.94 |

The Company s computation of expected volatility for the three and six months ended September 30, 2015 and 2014 was based on historical volatility. The expected life, or term, of options granted is derived from historical exercise behavior and represents the period of time that stock option awards are expected to be outstanding. Management has selected a risk-free rate based on the implied yield available on U.S. Treasury Securities with a maturity equivalent to the options expected term.

The following table provides additional information on stock options for the three and six months ended September 30, 2015 and 2014:

| | Three Months Ended September 30, 2015 | Three Months Ended September 30, 2014 | Six Months Ended September 30, 2015 | Six Months Ended September 30, 2014 |
|---|---|---|---|---|
| Stock option compensation expense (in thousands) | $ 135 | $ 237 | $ 274 | $ 595 |
| Cash received for exercise price (in thousands) | $ | $ 295 | $ | $ 295 |
| Intrinsic value (in thousands) | $ | $ 128 | $ | $ 128 |
| Weighted average grant date fair value of options exercised during the period | $ | $ 1.36 | $ | $ 1.36 |

As of September 30, 2015, there was approximately $1.1 million of total compensation cost related to unvested stock option awards that is expected to be recognized as expense over a weighted average period of 2.4 years.

*Restricted Stock Units and Performance Restricted Stock Units*

The Company issues restricted stock units under the 2000 Plan to employees, non-employee directors and consultants. The restricted stock units are valued based on the closing price of the Company s common stock on the date of issuance, and compensation cost is recorded on a straight-line basis over the vesting period. The related compensation expense recognized is reduced by estimated forfeitures. The Company s estimate of forfeitures is based on historical forfeitures. The restricted stock units vest in equal installments over a period of four years. For restricted stock units with four year vesting, one-fourth vest annually beginning one year after the issuance date. The restricted stock units issued to non-employee directors vest one year after the issuance date. The following table outlines the restricted stock and performance restricted stock unit ( PRSU ) activity:

| | Shares | | Weighted Average Grant-Date Fair Value |
|---|---|---|---|
| Nonvested restricted stock units outstanding at March 31, 2015 | 1,868,574 | $ | 1.19 |
| Granted | 1,563,256 | | 0.46 |
| Vested and issued | (689,220) | | 1.23 |
| Forfeited | (244,781) | | 1.13 |
| Nonvested restricted stock units outstanding at September 30, 2015 | 2,497,829 | $ | 0.73 |
| Restricted stock units expected to vest beyond September 30, 2015 | 2,283,409 | $ | 0.73 |

Table of Contents

The following table provides additional information on restricted stock units for the three and six months ended September 30, 2015 and 2014:

| | Three Months Ended September 30, 2015 | Three Months Ended September 30, 2014 | Six Months Ended September 30, 2015 | Six Months Ended September 30, 2014 |
|---|---|---|---|---|
| Restricted stock compensation expense (in thousands) | $ 217 | $ 271 | $ 511 | $ 569 |
| Aggregate fair value of restricted stock units vested and issued (in thousands) | $ 142 | $ 503 | $ 340 | $ 1,156 |
| Weighted average grant date fair value of restricted stock units granted during the period | $ 0.36 | $ 1.26 | $ 0.46 | $ 1.43 |

As of September 30, 2015, there was approximately $1.4 million of total compensation cost related to unvested restricted stock units that is expected to be recognized as expense over a weighted average period of 2.0 years.

PRSU activity is included in the above restricted stock units tables. The PRSU Program has a three-year performance measurement period. The performance measurement period will begin on April 1 of the first fiscal year and end on March 31 of the third fiscal year. The program is intended to have overlapping performance measurement periods (e.g., a new three year cycle begins each year on April 1), subject to Compensation Committee approval. The Chief Executive Officer is the only participant for Fiscal 2016 and Fiscal 2015. At the end of each performance measurement period, the Compensation Committee will determine the achievement against the performance objectives. Any earned PRSU awards will vest 50% after the end of the applicable performance measurement period and 50% one year thereafter.

During the first quarter of each of Fiscal 2016 and Fiscal 2015, the Company granted a total of 200,000 PRSUs to the Chief Executive Officer. The weighted average per share grant date fair value of PRSUs granted during the first quarter of Fiscal 2016 and 2015 was $0.78 and $1.56, respectively. Based on the Company s assessment as of March 31, 2015, the PRSU threshold for the first performance measurement of the PRSUs granted in Fiscal 2015 likely will not be met and, as a result, the Chief Executive Officer PRSU awards were adjusted and no compensation expense was recorded or recognized during Fiscal 2015. Any compensation expense will be recognized over the corresponding requisite service period and will be adjusted in subsequent reporting periods if the Company s assessment of the probable level of achievement of the performance goals changes. The Company will continue to periodically assess the likelihood of the PRSU threshold being met until the end of the applicable performance period.

*Non-employee Director Stock Awards*

The Company issues stock awards under the 2000 Plan to non-employee directors who elected to take payment of all or any part of the directors fees in stock in lieu of cash. The following table outlines the non-employee director stock activity for the three and six months ended September 30, 2015 and 2014:

| | Three Months Ended September 30, 2015 | Three Months Ended September 30, 2014 | Six Months Ended September 30, 2015 | Six Months Ended September 30, 2014 |
|---|---|---|---|---|
| Non-employee directors stock awards compensation expense (in thousands) | $ 33 | $ 29 | $ 63 | $ 59 |

| | | | | |
|---|---|---|---|---|
| Non-employee director deferred stock awards granted | 84,450 | 23,877 | 153,628 | 42,821 |
| Weighted average grant date fair value of restricted stock awards granted during the period | $ 0.39 | $ 1.23 | $ 0.41 | $ 1.37 |

For each term of the Board of Directors (beginning on the date of an annual meeting of stockholders and ending on the date immediately preceding the next annual meeting of stockholders), a non-employee director may elect to receive a stock award in lieu of all or any portion of their annual retainer or committee fee cash payment. The shares of stock were valued based on the closing price of the Company s common stock on the date of grant.

Table of Contents

**Grants outside of 2000 Plan**

As of September 30, 2015, the Company had outstanding 3,300,000 non-qualified common stock options and 46,875 restricted stock units issued outside of the 2000 Plan. The Company granted 250,000 of these stock options during Fiscal 2015, 3,050,000 of these stock options prior to Fiscal 2015 and 46,875 of these restricted stock units during Fiscal 2015 as inducement grants to new officers and employees of the Company, with exercise prices equal to the fair market value of the Company s common stock on the grant date.

| Outside of 2000 Plan | Options | RSUs |
|---|---|---|
| Executive Vice President and Chief Executive Officer | 2,000,000 | |
| Executive Vice President of Sales and Marketing | 850,000 | |
| Vice President of Operations | 250,000 | 46,875 |
| Former Senior Vice President of Human Resources | 200,000 | |
| Outstanding stock outside of 2000 Plan | 3,300,000 | 46,875 |

Although the options and restricted stock units were not granted under the 2000 Plan, they are governed by terms and conditions identical to those under the 2000 Plan. All options are subject to the following vesting provisions: one-fourth vest one year after the issuance date and 1/48th vest on the first day of each full month thereafter, so that all options will be vested on the first day of the 48th month after the grant date. All outstanding options have a contractual term of ten years. The restricted stock units vest in equal installments over a period of four years.

**Stockholder Rights Plan**

The Company has entered into a rights agreement (as amended, the Rights Agreement ) with Computershare Inc., successor-in-interest to Mellon Investor Services LLC, as rights agent. In connection with the Rights Agreement, the Company s board of directors authorized and declared a dividend distribution of one preferred stock purchase right for each share of the Company s common stock authorized and outstanding. Each right entitles the registered holder to purchase from the Company a unit consisting of one one-hundredth of a share of Series A Junior Participating Preferred Stock, par value $0.001 per share, at a purchase price of $10.00 per unit, subject to adjustment. The description and terms of the rights are set forth in the Rights Agreement. Initially, the rights are attached to all common stock certificates representing shares then outstanding, and no separate rights certificates are distributed. Subject to certain exceptions specified in the Rights Agreement, the rights will separate from the common stock and will be exercisable upon the earlier of (i) 10 days following a public announcement that a person or group of affiliated or associated persons has acquired, or obtained the right to acquire, beneficial ownership of 20% or more of the outstanding shares of common stock, other than as a result of repurchases of stock by the Company or certain inadvertent actions by institutional or certain other stockholders, or (ii) 10 days (or such later date as the Company s Board of Directors shall determine) following the commencement of a tender offer or exchange offer (other than certain permitted offers described in the Rights Agreement) that would result in a person or group beneficially owning 20% or more of the outstanding shares of the Company s common stock.

On July 1, 2014, the Company s Board of Directors unanimously approved a third amendment to the Rights Agreement pursuant to a sunset provision, which was approved by the stockholders at the 2014 annual meeting of stockholders. The third amendment amends the Rights Agreement to provide that the rights will expire on the 30th day after the 2017 annual meeting of stockholders unless continuation of the Rights Agreement is approved by the stockholders at that meeting. On August 5, 2014, the Company entered into a fourth amendment to the Rights Agreement. The fourth amendment amends the Rights Agreement to clarify that the term of the Rights Agreement may not be continued or extended unless and until such amendment has received the approval of the stockholders of the Company at an annual or special meeting of the stockholders held prior to the termination of the Rights Agreement without taking into account such amendment.

The Rights Agreement is intended to protect the Company s stockholders in the event of an unfair or coercive offer to acquire the Company. Management believes the Rights Agreement, however, should not affect any prospective offeror willing to make an offer at a fair price and otherwise in the best interests of the Company and its stockholders, as determined by the Board of Directors. Also, management believes the Rights Agreement should not interfere with any merger or other business combination approved by the Board of Directors.

**Reverse Stock Split**

The Board of Directors previously approved a Certificate of Amendment to the Company s Second Amended and Restated Certificate of Incorporation to effect a reverse stock split of the issued and outstanding shares of the Company s common stock at a ratio of not less than 1-for-5 nor greater than 1-for-20, with the exact ratio to be determined by the Board of Directors (the Reverse Stock Split ). The Reverse Stock Split was approved by the Company s stockholders at the 2015 annual meeting of the Company s stockholders on August 27, 2015. On October 1, 2015, the Board of Directors approved the Reverse Stock Split and determined the ratio to be 1-for-20. The Reverse Stock Split has not been effected but is expected imminently.

Table of Contents

Upon effectiveness of the Reverse Stock Split, every 20 shares of issued and outstanding common stock will be converted into one share of common stock, without any change in the par value per share. No fractional shares will be issued as a result of the Reverse Stock Split, and any fractional shares that would otherwise have resulted from the Reverse Stock Split will be rounded up to the nearest whole share. After giving effect to the Reverse Stock Split, the number of split-adjusted shares of common stock issued and outstanding as of September 30, 2015 will be approximately 16.8 million and the number of split-adjusted shares of common stock issued and outstanding as of March 31, 2015 will be 16.6 million and 16.5 million, respectively. After giving effect to the Reverse Stock Split, the Company s split-adjusted loss per share will be approximately $0.48 and $0.84 for the three and six months ended September 30, 2015, respectively, and will be approximately $0.40 and $0.82 for the three and six months ended September 30, 2014, respectively. After giving effect to the Reverse Stock Split, the Company s split-adjusted weighted shares outstanding will be approximately 16.6 million for each of the three and six months ended September 30, 2015, and will be approximately 16.5 million and 16.3 million for the three and six months ended September 30, 2014, respectively.

**9. Underwritten and Registered Direct Placement of Common Stock**

Effective May 6, 2014, the Company completed an underwritten public offering in which it sold 18.8 million shares of the Company s common stock at a price of $1.70 per share less underwriting discounts and commissions. The shares were allocated to a single institutional investor. The net proceeds to the Company from the sale of the Common Stock, after deducting fees and other offering expenses, were approximately $29.8 million.

Effective August 28, 2015, the Company entered into a sales agreement with respect to an at-the-market offering program pursuant to which the Company may offer and sell, from time to time at its sole discretion, shares of its common stock, having an aggregate offering price of up to $30.0 million. The Company will set the parameters for sales of the shares, including the number to be sold, the time period during which sales are requested to be made, any limitation on the number that may be sold in one trading day and any minimum price below which sales may not be made. As of September 30, 2015, 4.0 million shares of the Company s common stock were sold and the net proceeds to the Company from the sale of the common stock, after deducting fees and other offering expenses, were approximately $1.2 million.

**10. Fair Value Measurements**

The FASB has established a framework for measuring fair value using generally accepted accounting principles. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy are described as follows:

*Level 1.* Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.

*Level 2.* Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets

- Quoted prices for identical or similar assets or liabilities in inactive markets

- Inputs other than quoted prices that are observable for the asset or liability

- Inputs that are derived principally from or corroborated by observable market data by correlation or other means

If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

*Level 3.* Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability s fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used must maximize the use of observable inputs and minimize the use of unobservable inputs.

Table of Contents

The table below presents our assets and liabilities that are measured at fair value on a recurring basis at September 30, 2015 and are categorized using the fair value hierarchy (in thousands):

| | Total | Fair Value Measurements at September 30, 2015<br>Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Cash Equivalents | $ 5,001 | $ 5,001 | $ | $ |
| Restricted Cash | $ 5,000 | $ 5,000 | $ | $ |

Cash equivalents include cash held in money market and U.S. treasury funds at September 30, 2015.

The table below presents our assets and liabilities that are measured at fair value on a recurring basis during the fiscal year ended March 31, 2015 and are categorized using the fair value hierarchy (in thousands):

| | Total | Fair Value Measurements at March 31, 2015<br>Quoted Prices in Active Markets for Identical Assets (Level 1) | Quoted Prices in Active Markets for Identical Assets (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Cash Equivalents | $ 13,737 | $ 13,737 | $ | $ |

*Basis for Valuation*

The carrying values reported in the consolidated balance sheets for cash and cash equivalents, restricted cash, accounts receivable and accounts payable approximate fair values because of the immediate or short-term maturities of these financial instruments. As the Company s obligations under the Credit Facility (as defined below) are based on adjustable market rates reflective of what would currently be available to the Company, the Company has determined that the carrying value approximates the fair value. The carrying values and estimated fair values of these obligations are as follows (in thousands):

| | As of September 30, 2015 | | As of March 31, 2015 | |
|---|---|---|---|---|
| | Carrying Value | Estimated Fair Value | Carrying Value | Estimated Fair Value |
| Obligations under credit facility | $ 15,164 | $ 15,164 | $ 12,953 | $ 12,953 |

**11. Revolving Credit Facility**

The Company maintains two Credit and Security Agreements, as amended (the Agreements ), with Wells Fargo, which provide the Company with a line of credit of up to $20.0 million in the aggregate. As previously disclosed, the twelfth amendment to the Agreements provided the Company the right, under certain circumstances, to increase the borrowing capacity available under the Company s revolving lines of credit to an aggregate maximum of $20.0 million from an aggregate maximum of $15.0 million (the Accordion Feature ). In addition, Wells Fargo has provided the Company with a non-revolving capital expenditure line of credit up to $0.5 million to acquire additional eligible equipment for use in the Company s business. Effective as of June 30, 2015, the Company exercised the Accordion Feature, thereby increasing the maximum borrowing capacity available to a maximum of $20.0 million. The amount actually available to the Company may be less and may vary from time to time depending on, among other factors, the amount of its eligible inventory and accounts receivable. As security for the payment and performance of the Credit Facility, the Company granted a security interest in favor of Wells Fargo in substantially all of the assets of the Company. One of the Agreements will terminate in accordance with its terms on September 1, 2017 and the other one will terminate on September 30, 2017.

The Agreements include affirmative covenants as well as negative covenants that prohibit a variety of actions without Wells Fargo s consent, including covenants that limit the Company s ability to (a) incur or guarantee debt, (b) create liens, (c) enter into any merger, recapitalization or similar transaction or purchase all or substantially all of the assets or stock of another entity, (d) pay dividends on, or purchase, acquire, redeem or retire shares of, the Company s capital stock, (e) sell, assign, transfer or otherwise dispose of all or substantially all of the Company s assets, (f) change the Company s accounting method or (g) enter into a different line of business. Furthermore, the Agreements contain financial covenants, including (i) a requirement not to exceed specified levels of losses, (ii) a requirement to maintain a substantial minimum cash balance relative to the outstanding line of credit advances, which was $12.9 million as of September 30, 2015, and (iii) limitations on the Company s annual capital expenditures. The Agreements also define an event of default to include a material adverse effect on the Company s business, as determined by Wells Fargo. An event of default for this or any other reason, if not waived, would have a material adverse effect on the Company.

Table of Contents

Several times since entering into the Agreements the Company was not in compliance with certain covenants under the Credit Facility. In connection with each event of noncompliance, Wells Fargo waived the event of default and, on several occasions, the Company amended the Agreements in response to the default and waiver. The following summarizes the recent events, amendments and waivers:

- As of March 31, 2015, the Company determined that it was not in compliance with the financial covenant contained in the amended Agreements regarding the Company s annual net income for Fiscal 2015. On June 10, 2015, the Company received from Wells Fargo a waiver of such noncompliance, and the Company and Wells Fargo entered into an amendment to the Agreements which set the financial covenants for Fiscal 2016. As a condition of the amended Agreements, the Company has restricted $5.0 million of cash equivalents effective June 10, 2015 as additional security for the Credit Facility.

- As of September 30, 2015, the Company determined that it was not in compliance with a financial covenant contained in the amended Agreements regarding the Company s annual net income for Fiscal 2016. On November 2, 2015, the Company received from Wells Fargo a waiver of such noncompliance and entered into an amendment to amend the financial covenants regarding net income for Fiscal 2016.

If the Company had not obtained the waivers and amended the Agreements as described above, the Company would not have been able to draw additional funds under the Credit Facility. In addition, the Company has pledged its accounts receivables, inventories, equipment, patents and other assets as collateral for its Agreements, which would be subject to seizure by Wells Fargo if the Company were in default under the Agreements and unable to repay the indebtedness. Wells Fargo also has the option to terminate the Agreements or accelerate the indebtedness during a period of noncompliance. Based on the Company s current forecasts, the Company believes it will maintain compliance with the covenants contained in the amended Agreements through the end of Fiscal 2016. If a covenant violation were to occur, the Company would attempt to negotiate a waiver of non-compliance from Wells Fargo.

The Company is required to maintain a Wells Fargo collection account for cash receipts on all of its accounts receivable. These amounts are immediately applied to reduce the outstanding amount on the Credit Facility. The floating rate for line of credit advances is the sum of daily three month London Inter Bank Offer Rate ( LIBOR ), which interest rate shall change whenever daily three month LIBOR changes, plus applicable margin. Based on the revolving nature of the Company s borrowings and payments, the Company classifies all outstanding amounts as current liabilities. The applicable margin varies based on net income and the minimum interest floor is set at $66,000 each calendar quarter. The Company s borrowing rate was 4.1% and 4.0% at September 30, 2015 and March 31, 2015, respectively.

The Company is required to pay an annual unused line fee of one-quarter of one percent of the daily average of the maximum line amount and 1.5% interest with respect to each letter of credit issued by Wells Fargo. These amounts, if any, are also recorded as interest expense by the Company. As of September 30, 2015 and March 31, 2015, $15.2 million and $13.0 million in borrowings were outstanding, respectively, under the Credit Facility. There was no additional amount available under the Credit Facility as of September 30, 2015. Interest expense related to the Credit Facility during the three months ended September 30, 2015 was $0.2 million, which includes $42,000 in amortization of deferred financing costs. Interest expense related to the Credit Facility during the three months ended September 30, 2014 was $0.1 million, which includes $56,000 in amortization of deferred financing costs. Interest expense related to the Credit Facility during the six months ended September 30, 2015 was $0.3 million, which includes $0.1 million in amortization of deferred financing costs. Interest expense related to the Credit Facility during the six months ended September 30, 2014 was $0.3 million, which includes $0.1 million in amortization of deferred financing costs.

**12. Accrued Warranty Reserve**

The Company provides for the estimated costs of warranties at the time revenue is recognized. The specific terms and conditions of those warranties vary depending upon the microturbine product sold and geography of sale. The Company s product warranties generally start from the delivery date and continue for up to eighteen months. Factors that affect the Company s warranty obligation include product failure rates, anticipated hours of product operations and costs of repair or replacement in correcting product failures. These factors are estimates that may change based on new information that becomes available each period. Similarly, the Company also accrues the estimated costs to address reliability repairs on products no longer in warranty when, in the Company s judgment, and in accordance with a specific plan developed by the Company, it is prudent to provide such repairs. The Company assesses the adequacy of recorded warranty liabilities quarterly and makes adjustments to the liability as necessary. When the Company has sufficient evidence that product changes are altering the historical failure occurrence rates, the impact of such changes is then taken into account in estimating future warranty liabilities.

Table of Contents

Changes in accrued warranty reserve during the six months ended September 30, 2015 are as follows (in thousands):

| | | |
|---|---|---|
| Balance, beginning of the period | $ | 3,183 |
| Standard warranty provision | | 347 |
| Changes for accrual related to reliability repair programs | | (16) |
| Deductions for warranty claims | | (1,040) |
| Balance, end of the period | $ | 2,474 |

**13. Deferred Revenue**

Changes in deferred revenue during the six months ended September 30, 2015 are as follows (in thousands):

| | | |
|---|---|---|
| FPP Balance, beginning of the period | $ | 2,491 |
| FPP Billings | | 5,542 |
| FPP Revenue recognized | | (5,442) |
| Balance attributed to FPP contracts | | 2,591 |
| Deposits | | 836 |
| Deferred revenue balance, end of the period | $ | 3,427 |

Comprehensive Factory Protection Plan ( FPP ) deferred revenue represents the unearned portion of our billed agreements. FPP agreements are generally paid quarterly in advance with revenue recognized on a straight line basis over the contract period. Deposits are primarily non-refundable cash payments from distributors for future orders.

**14. Other Current Liabilities**

The Company is a party to a Development and License Agreement with Carrier Corporation ( Carrier ) regarding the payment of royalties on the sale of each of the Company s 200 kilowatt ( C200 ) microturbines. Carrier earned $0.2 million and $0.5 million in royalties for C200 and C1000 Series system sales during the three months ended September 30, 2015 and 2014, respectively. Carrier earned $0.6 million and $0.8 million in royalties for C200 and C1000 system sales during the six months ended September 30, 2015 and 2014, respectively. Earned royalties of approximately $0.2 million and $0.4 million were unpaid as of September 30, 2015 and March 31, 2015, respectively, and are included in accrued expenses in the accompanying balance sheets.

**15. Commitments and Contingencies**

**Purchase Commitments**

As of September 30, 2015, the Company had firm commitments to purchase inventories of approximately $25.9 million through Fiscal 2018. Certain inventory delivery dates and related payments are not firmly scheduled; therefore, amounts under these firm purchase commitments will be payable upon the receipt of the related inventories.

**Lease Commitments**

The Company leases offices and manufacturing facilities under various non-cancelable operating leases expiring at various times through the fiscal year ending March 31, 2020. All of the leases require the Company to pay maintenance, insurance and property taxes. The lease agreements for primary office and manufacturing facilities provide for rent escalation over the lease term and renewal options for five-year periods. Rent expense is recognized on a straight-line basis over the term of the lease. The difference between rent expense recorded and the amount paid is credited or charged to deferred rent, which is included in other long-term liabilities in the accompanying balance sheets. The balance of deferred rent was approximately $0.2 million as of each of September 30, 2015 and March 31, 2015. Rent expense was approximately $0.6 million during each of the three months ended September 30, 2015 and 2014. Rent expense was approximately $1.2 million during each of the six months ended September 30, 2015 and 2014.

**Other Commitments**

In September 2010, the Company was awarded a grant from the U.S. Department of Energy ( DOE ) for the research, development and testing of a more efficient microturbine CHP system. Part of the improved efficiency will come from an improved microturbine design, with a projected electrical efficiency of 42% and power output of 370 kW. The contract was over a five-year period and was completed on September 2015. The project was estimated to cost approximately $11.7 million. The DOE was to contribute $5.0 million toward the project, and the Company was to incur approximately $6.7 million in research and development expense. The Company billed the DOE under the contract for this project a cumulative amount of $4.2 million through September 30, 2015.

Table of Contents

In May 2014, the Company began working with the DOE through Oak Ridge National Laboratory ( ORNL ) on an advanced Alumina Forming Austenitic stainless steel material program. ORNL will contribute 100% of the $0.2 million project cost. The contract has a term of 27 months and is expected to be completed by July 31, 2016. The Company billed ORNL a cumulative amount of $0.1 million under the contract for this project through September 30, 2015.

The Company has agreements with certain of its distributors requiring that if the Company renders parts obsolete in inventories the distributors own and hold in support of their obligations to serve fielded microturbines, then the Company is required to replace the affected stock at no cost to the distributors. While the Company has never incurred costs or obligations for these types of replacements, it is possible that future changes in the Company s product technology could result and yield costs to the Company if significant amounts of inventory are held at distributors. As of September 30, 2015, no significant inventories were held at distributors.

**Legal Matters**

From time to time, the Company may become subject to certain legal proceedings, claims and litigation arising in the ordinary course of business. In the opinion of management, the Company is not currently a party to any material legal proceedings, nor is the Company aware of any other pending or threatened litigation that would have a material effect on the Company s operating results, cash flows, financial position or results of operations should such litigation be resolved unfavorably.

## 16. Net Loss Per Common Share

Basic loss per share of common stock is computed using the weighted average number of common shares outstanding for the period. Diluted loss per share is computed without consideration to potentially dilutive instruments because the Company incurred losses in the three months ended September 30, 2015 which would make these instruments anti-dilutive. As of September 30, 2015 and 2014, the number of anti-dilutive stock options and restricted stock units excluded from diluted net loss per common share computations was approximately 13.8 million and 15.5 million, respectively.

Table of Contents

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

The following discussion should be read in conjunction with the condensed consolidated financial statements and notes included in this Form 10-Q and in our Annual Report on Form 10-K for the year ended March 31, 2015. When used in this Form 10-Q, and in the following discussion, the words believes , anticipates , intends , expects and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties which could cause actual results to differ materially from those projected. These risks include those under Risk Factors in our Annual Report on Form 10-K for Fiscal 2015 and in other reports we file with the SEC. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date hereof. We assume no obligation to update any of the forward-looking statements contained herein after the filing of this Form 10-Q to conform such statements to actual results or changes in expectations except as may be required by law. All dollar amounts are approximate.

**Overview**

Capstone is the market leader in microturbines based on the number of microturbines sold. Generally, power purchased from the electric utility grid is less costly than power produced by distributed generation technologies. Utilities may also charge fees to interconnect to their power grids. However, we can provide economic benefits to end users in instances where the waste heat from our microturbine has value (combined heat and power ( CHP ) and combined cooling, heat and power ( CCHP )), where fuel costs are low (renewable energy/renewable fuels), where the costs of connecting to the grid may be high or impractical (such as remote power applications), where reliability and power quality are of critical importance, or in situations where peak shaving could be economically advantageous because of highly variable electricity prices. Because Capstone microturbines can provide a reliable source of power and can operate on multiple fuel sources, management believes they offer a level of flexibility not currently offered by other technologies such as reciprocating engines.

During the second quarter of Fiscal 2016 our net loss increased by 22% to $7.9 million and our net loss per share remained at $.02 compared to the prior year period. Our gross margin was 11% for the second quarter of Fiscal 2016, which represents a decrease of approximately 500 basis points from our gross margin of 16% for the second quarter of Fiscal 2015. Capstone experienced a significant slowdown in both product shipments and new order flow during the second quarter of Fiscal 2016 compared to the same period last year. We had 72 microturbines totaling 12.7 megawatts for customers in finished goods as of September 30, 2015 that were expected to ship during the second quarter of Fiscal 2016. The first half of Fiscal 2016 was characterized by lower revenue and megawatts shipped compared to the first half of Fiscal 2015 because of the continuing softness of the global oil and gas markets, a substantially stronger U.S. dollar (making our products more expensive overseas) and ongoing geopolitical tensions in Russia, North Africa and the Middle East. Please see Results of Operations on page 22 for further discussion on the lower revenue.

Capstone products continue to gain interest in all six of the major vertical markets (energy efficiency, renewable energy, natural resources, critical power supply, transportation and marine). In the energy efficiency market, we continue to expand our market presence in hotels, office buildings, hospitals, retail and industrial applications globally. The renewable energy market is fueled by landfill gas, biodiesel, and biogas from sources such as food processing, agricultural waste and cow, pig and chicken manure. Our success in the oil and gas and other natural resources market, which continues to be a growing market worldwide, is driven by our microturbines reliability, emissions profile and ease of installation. We have also seen increased interest in critical power supply applications as customers want solutions that can handle both primary and backup power. Capstone s transportation market, which utilizes microturbines for the electric vehicle industry, is gaining interest as liquid natural gas becomes more readily available as a transportation fuel and emission regulations continue to be tightened on the diesel engine industry.

We continue to focus on improving our products based on customer input, building brand awareness and new channels to market by developing a diversified network of strategic distribution partners. Our focus is on products and solutions that provide near-term opportunities to drive repeatable business rather than discrete projects for niche markets. In addition, management closely manages operating expenses and strives to improve manufacturing efficiencies while simultaneously lowering direct material costs and increasing average selling prices. The key drivers to Capstone s success are continued revenue growth, higher average selling prices, lower direct material costs, positive new order flow and reduced cash usage.

To support our opportunities to grow in our targeted markets, we continue to enhance the reliability and performance of our products by regularly developing new processes and enhancing training to assist those who apply, install and use our products.

An overview of our direction, targets and key initiatives follows:

*1.* ***Focus on Vertical Markets*** Within the distributed generation markets that we serve, we focus on vertical markets that we identify as having the greatest near-term potential. In our primary products and applications (energy efficiency, renewable energy, natural resources, critical power supply, marine and transportation products), we identify specific targeted vertical market segments. Within each of these segments, we identify what we believe to be the critical factors to success and base our plans on those factors.

Table of Contents

*Energy Efficiency CHP/CCHP*

Energy efficiency maximizes the use of energy produced by the microturbines, reduces emissions compared with traditional power generation and enhances the economic advantage to customers. Energy efficiency applications use both the heat and electric energy produced in the power generation process. Using the heat and electricity created from a single combustion process increases the efficiency of the system from approximately 30% to 75% or more. The increased operating efficiency reduces overall greenhouse gas emissions compared with traditional independent sources such as power generation and local thermal generation and, through displacement of other separate systems, can reduce variable production costs.

*Renewable Energy*

Our microturbines can use renewable methane gases from landfills, wastewater treatment facilities and biogas from sources such as food processing, agricultural waste and cow, pig and chicken manure. Capstone s microturbines can burn these renewable waste gases with minimal emissions, thereby, in some cases, avoiding the imposition of penalties incurred for pollution while simultaneously producing electricity from this free renewable fuel for use at the site or in the surrounding area. Capstone s microturbines have demonstrated effectiveness in these applications and outperform conventional combustion engines in a number of situations, including when the gas contains a high amount of sulfur.

*Natural Resources Oil, Natural Gas, Shale Gas & Mining*

On a worldwide basis, there are thousands of locations where the drilling, production, compression and transportation of natural resources and other extraction and production processes create fuel byproducts, which traditionally have been released or burned into the atmosphere. Our microturbines are installed in the natural resource market to be used in oil and gas exploration, production, compression and transmission sites both onshore and offshore as a highly reliable critical source of power generation. In addition, our microturbines can use flare gas as a fuel to provide prime power. Typically these oil and gas or mining operations have no access to an electric utility grid and rely solely on Capstone s microturbines for a reliable low emission power supply.

*Critical Power Supply*

Because of the potentially catastrophic consequences of even momentary system failure, certain power users, such as high technology and information systems companies, require particularly high levels of reliability in their power service. Management believes that Capstone s critical power supply offerings are the world s only microturbine powered Uninterruptible Power Source solutions that can offer clean, IT-grade power produced from microturbines, the utility or a combination of both.

*Transportation*

Our technology is also used in hybrid electric vehicle ( HEV ) applications. Our customers have applied our products in hybrid electric mobile applications, including transit buses and trucks. In these applications the microturbine acts as an onboard battery charger to recharge the battery system as needed. The benefits of microturbine hybrids include extended range, fuel economy gains, quieter operation, reduced emissions and higher reliability compared with traditional internal combustion engines.

*Marine*

Our technology is also used in marine applications. Our customers have applied our products in the commercial vessel and luxury yacht markets. The most immediate market for our marine products is for use as ship auxiliaries. In this application, the microturbines provide power to the vessel s electrical loads and, in some cases, the vessel is able to utilize the exhaust energy to increase the overall efficiency of the application, reducing overall fuel consumption and emissions. The other application is similar to our HEV application where the vessel is driven by an electric propulsion system and the microturbine serves as an on board range extender.

*Backlog*

During the three months ended September 30, 2015, we booked total orders of $8.4 million for 45 units, or 7.6 megawatts, compared to $23.8 million for 198 units, or 25.1 megawatts, during the three months ended September 30, 2014. We shipped 58 units with an aggregate of 11.6 megawatts, generating microturbine product revenue of $11.6 million compared to 166 units with an aggregate of 28.5 megawatts, generating microturbine product revenue of $26.7

Table of Contents

million during the three months ended September 30, 2014. Total backlog as of September 30, 2015 decreased $67.5 million, or 39%, to $104.8 million from $172.3 million as of September 30, 2014. As of September 30, 2015, we had 579 units, or 108.0 megawatts, in total backlog compared to 884 units, or 186.8 megawatts, at the same date last year. Ending backlog as of September 30, 2015, includes the removal of approximately $52.4 million for 200 units, or 64.5 megawatts, from BPC Engineering ( BPC ), one of the Company s Russian distributors. This removal is a proactive measure to align our backlog to management s expectations because of the current macroeconomic headwinds, such as the continued softness of the global oil and gas market, a substantially stronger U.S. dollar (making our products more expensive overseas) and on-going geopolitical tensions in Russia, as experienced during Fiscal 2015. A significant portion of our backlog is concentrated in the international oil and gas market which may impact the overall timing of shipments or the conversion of backlog to revenue. The timing of the backlog is based on the requirement date indicated by our customers. However, based on historical experience, management expects that a significant portion of our backlog may not be shipped within the next 18 months. The timing of shipments is subject to change based on several variables (including customer deposits, payments, availability of credit and customer delivery schedule changes), most of which are not in our control and can affect the timing of our revenue. Our product shipments during the three months ended September 30, 2015 were: 68% for use in energy efficiency applications, 26% for use in natural resources applications and 6% for use in renewable energy applications. Our product shipments during the six months ended September 30, 2015 were: 47% for use in energy efficiency applications, 44% for use in natural resources applications and 9% for use in renewable energy applications.

The following table summarizes our backlog:

| | As of September 30, | | | |
|---|---|---|---|---|
| | 2015 | | 2014 | |
| | Megawatts | Units | Megawatts | Units |
| C30 | 1.7 | 58 | 3.2 | 108 |
| C65 | 26.0 | 400 | 38.1 | 586 |
| TA100 | 1.9 | 19 | 1.9 | 19 |
| C200 | 3.0 | 15 | 3.6 | 18 |
| C600 | 5.4 | 9 | 7.2 | 12 |
| C800 | 4.0 | 5 | 4.8 | 6 |
| C1000 | 65.0 | 65 | 127.0 | 127 |
| Waste heat recovery generator | 1.0 | 8 | 1.0 | 8 |
| Total Backlog | 108.0 | 579 | 186.8 | 884 |

2. ***Sales and Distribution Channels*** We seek out distributors that have business experience and capabilities to support our growth plans in our targeted markets. We have a total of 102 distributors and Original Equipment Manufacturers ( OEMs ). In North America, we currently have 30 distributors and OEMs. Outside of North America, we currently have 72 distributors and OEMs. We continue to refine the distribution channels to address our specific targeted markets.

3. ***Service*** We provide service primarily through our global distribution network. Together with our global distribution network, we offer new and remanufactured parts as well as a comprehensive FPP. Through our global distribution network, we offer a comprehensive FPP for a fixed annual fee to perform regularly scheduled and unscheduled maintenance as needed. Capstone provides factory and onsite training to certify all personnel that are allowed to perform service on our microturbines. FPPs are generally paid quarterly in advance. Our FPP backlog as of September 30, 2015 was $65.3 million, which represents the value of the contractual agreement for FPP services that has not been earned and extends through Fiscal 2031. Our FPP backlog as of March 31, 2015 was $61.2 million.

*4.* ***Product Robustness and Life Cycle Maintenance Costs*** We continue to invest in enhancements that relate to high performance and high reliability. An important element of our continued innovation and product strategy is to focus on the engineering of our product hardware and electronics to make them work together more effectively and deliver improved microturbine performance, reliability and low maintenance cost to our customers.

*5.* ***New Product Development*** Our new product development is targeted specifically to meet the needs of our selected vertical markets. We expect that our existing product platforms, the C30, C65, TA100, C200 and C1000 Series microturbines, will be our foundational product lines for the foreseeable future. Our research and development project portfolio is centered on enhancing the features of these base products. We are currently focusing efforts on enhancing our products to improve reliability and reduce direct material costs. During the three months ended September 30, 2015 our C200 and C1000 Series microturbines became Verband der Elektrotechnik ( VDE ) and Bundesverband der

Table of Contents

Energie - und Wasserwirtschaft ( BDEW ) and Comitato Electtrotecnico Italiano ( CEI ) certified. These new standards were attained following the development and implementation of new microturbine system software architecture. We are also developing a more efficient microturbine CHP system with the DOE. The first phase of the development program has successfully achieved 270 kW with a prototype C250 engine. We plan to continue development of the engine as well as power electronics and software controls required for successful commercialization. The DOE awarded us a grant of $5.0 million in support of this development program of which $4.2 million was used through September 30, 2015. The contract was completed on September 30, 2015.

*6.* ***Cost and Core Competencies*** We believe that the core competencies of Capstone products are air-bearing technology, advanced combustion technology and sophisticated power electronics to form efficient and ultra-low emission electricity and cooling and heat production systems. Our core intellectual property is contained within our air-bearing technology. We continue to review avenues for cost reduction by sourcing to the best value supply chain option. In order to utilize manufacturing facilities and technology more effectively, we are focused on continuous improvements in manufacturing processes. Additionally, considerable effort is being directed to manufacturing cost reduction through process improvement, product design, advanced manufacturing technology, supply management and logistics. Management expects to be able to leverage our costs as product volumes increase.

Management believes that effective execution in each of these key areas will be necessary to leverage Capstone s promising technology and early market leadership into achieving positive cash flow with growing market presence and improving financial performance. Management believes our manufacturing facilities located in Chatsworth and Van Nuys, California have a combined production capacity of approximately 2,000 units per year, depending on product mix. Excluding working capital requirements, management believes we can expand our combined production capacity to approximately 4,000 units per year, depending on product mix, with approximately $10 to $15 million of capital expenditures. We have not committed to this expansion nor identified a source for its funding.

**Critical Accounting Policies and Estimates**

The preparation of our condensed consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. Management believes the most complex and sensitive judgments, because of their significance to the condensed consolidated financial statements, result primarily from the need to make estimates about the effects of matters that are inherently uncertain. Actual results could differ from management s estimates. Management believes the critical accounting policies listed below affect our more significant accounting judgments and estimates used in the preparation of the condensed consolidated financial statements. These policies are described in greater detail in our Annual Report on Form 10-K for Fiscal 2015 and continue to include the following areas:

- Impairment of long-lived assets, including intangible assets with finite lives;

- Inventory write-downs and classification of inventories;

- Estimates of warranty obligations;
- Accounts receivable allowances;
- Deferred tax assets and valuation allowance; and
- Stock-based compensation expense.

**Results of Operations**

***Three Months Ended September 30, 2015 and 2014***

***Revenue*** Revenue for the three months ended September 30, 2015 decreased $14.3 million, or 44%, to $17.9 million from $32.2 million for the three months ended September 30, 2014. The change in revenue for the three months ended September 30, 2015 compared to the three months ended September 30, 2014 included decreases in revenue of approximately $8.7 million from the North American market, $8.1 million from the European market, $1.2 million from the African market and $1.0 million from the Asian market. The decrease in the North American market was because of volume reductions in microturbines shipped, resulting from continued headwinds in the oil and gas market and a shift in customers project timelines. The decreases in the European, African and Asian markets were primarily the result of ongoing geopolitical tensions in Russia and Ukraine and a substantially stronger U.S. dollar (making our products more expensive overseas) compared to the three months ended September 30, 2014. This overall decrease in revenue was offset by an increase in revenue of $4.7 million from the Australian market. The increase in the Australian market during the three months ended September 30, 2015 compared to the same period last year was primarily the result of our continuing efforts to improve and expand our maturing distribution channel to better serve our customers.

Table of Contents

For the three months ended September 30, 2015, revenue from microturbine products decreased $15.1 million, or 57%, to $11.6 million from $26.7 million for the three months ended September 30, 2014. Megawatts shipped during the three months ended September 30, 2015 decreased 16.9 megawatts, or 59%, to 11.6 megawatts from 28.5 megawatts during the three months ended September 30, 2014. The decrease in revenue and megawatts shipped was because of volume reductions in microturbines shipped, resulting from no microturbine product shipments to Russia, continued challenges in the oil and gas market and shifts in customers project timelines during the three months ended September 30, 2015 compared to the same period last year. Average revenue per megawatt shipped was approximately $1.0 million and $0.9 million during the three months ended September 30, 2015 and 2014, respectively.

The following table provides additional information on our shipments (revenue amounts in millions):

| | Three Months Ended September 30, | | | |
|---|---|---|---|---|
| | 2015 | | 2014 | |
| | Revenue | Megawatts | Revenue | Megawatts |
| North America | $ 4.8 | 4.9 | $ 14.7 | 14.2 |
| Europe | 1.8 | 2.0 | 10.0 | 12.5 |
| Asia | 0.1 | 0.1 | 1.1 | 1.1 |
| Australia | 4.9 | 4.6 | 0.5 | 0.4 |
| South America | | | 0.2 | 0.1 |
| Africa | | | 0.2 | 0.2 |
| Total from Microturbine Products | $ 11.6 | 11.6 | $ 26.7 | 28.5 |

The timing of shipments is subject to change based on several variables (including customer deposits, payments, availability of credit and delivery schedule changes), most of which are not within our control and can affect the timing of our revenue.

The following table summarizes our revenue (revenue amounts in millions):

| | Three Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | | 2014 | | |
| | Revenue | Megawatts | Units | Revenue | Megawatts | Units |
| C30 | $ 0.4 | 0.3 | 10 | $ 0.4 | 0.2 | 7 |
| C65 | 2.2 | 2.3 | 36 | 9.9 | 8.9 | 136 |
| C200 | 0.2 | 0.2 | 1 | 0.6 | 0.6 | 3 |
| C600 | 3.1 | 3.0 | 5 | 1.8 | 1.8 | 3 |
| C800 | 0.7 | 0.8 | 1 | | | |
| C1000 | 5.0 | 5.0 | 5 | 14.0 | 17.0 | 17 |
| Total from Microturbine Products | $ 11.6 | 11.6 | 58 | $ 26.7 | 28.5 | 166 |
| Accessories and Parts | 3.1 | | | 3.1 | | |
| Total Product, Accessories and Parts | $ 14.7 | | | $ 29.8 | | |
| Service | 3.2 | | | 2.4 | | |
| Total | $ 17.9 | 11.6 | 58 | $ 32.2 | 28.5 | 166 |

Revenue from our accessories and parts was $3.1 million for each of the three months ended September 30, 2015 and 2014.

Service revenue for the three months ended September 30, 2015 increased $0.8 million, or 33%, to $3.2 million from $2.4 million for the three months ended September 30, 2014. The increase in revenue resulted primarily from higher FPP contract enrollment and microturbine service work.

Sales to Optimal Group Australia Pty Ltd ( Optimal ), one of the Company s Australian distributors, and Horizon Power Systems ( Horizon ), one of the Company s domestic distributors, accounted for 29% and 12%, respectively, of revenue for the three months ended September 30, 2015. Sales to BPC, Horizon and E-Finity Distributed Generation, LLC ( E-Finity ), one of the Company s domestic distributors, accounted for 20%, 18% and 12%, respectively, of revenue for the three months ended September 30, 2014.

Table of Contents

***Gross Margin*** Cost of goods sold includes direct material costs, production and service center labor and overhead, inventory charges and provision for estimated product warranty expenses. The gross margin was $1.9 million, or 11% of revenue, for the three months ended September 30, 2015 compared to a gross margin of $5.2 million, or 16% of revenue, for the three months ended September 30, 2014. The decrease in the gross margin during the three months ended September 30, 2015 compared to the three months ended September 30, 2014 was primarily the result of lower volume of microturbines shipped and a shift in product mix of $5.4 million. The reduction in microturbine shipments was partially offset by decreases in warranty expense of $1.0 million, production and service center overhead expenses of $0.5 million, royalty expense of $0.3 million and inventory charges of $0.3 million. Management continues to implement initiatives to improve gross margin by further reducing manufacturing overhead and fixed and direct material costs as we work to achieve profitability and improving product performance.

Warranty expense is a combination of a standard warranty provision recorded at the time revenue is recognized and changes, if any, in estimates for reliability repair programs. Reliability repair programs are estimates that are recorded in the period that new information becomes available, including design changes, cost of repair and product enhancements, which can include both in-warranty and out-of-warranty systems. The decrease in warranty expense of $1.0 million reflects a decrease in the standard warranty provision primarily because of a decrease in the number of units covered under warranty as a result of lower microturbine shipments during the three months ended September 30, 2015 compared to the prior year. Management expects warranty expense to decline as a result of lower shipments of microturbine products for the remainder of Fiscal 2016.

Production and service center labor and overhead expense decreased $0.5 million during the three months ended September 30, 2015 compared to the three months ended September 30, 2014 primarily as the result of the increase in the amount of overhead allocated to finished goods inventory of $0.4 million and a decrease in salaries expense of $0.1 million.

Royalty expense decreased $0.3 million during the three months ended September 30, 2015 compared to the three months ended September 30, 2014 as a result of lower sales of our C1000 Series systems. We pay a predetermined fixed rate royalty for each microturbine system covered by our Development and License Agreement with Carrier.

Inventory charges decreased approximately $0.3 million during the three months ended September 30, 2015 compared to the three months ended September 30, 2014 as a result of a decrease in provision for excess and obsolete inventory.

Accessories and parts revenue gross margin is included in the gross margin discussion above. Accessories and parts revenue gross margin was $1.0 million, or 34% of revenue, for the three months ended September 30, 2015 compared to accessories and parts revenue gross margin of $1.1 million, or 35% of revenue, for the three months ended September 30, 2014.

Service revenue gross margin is included in the gross margin discussion above. Service revenue gross margin was $0.4 million, or 13% of revenue, for the three months ended September 30, 2015 compared to a service revenue gross margin of $0.4 million, or 15% of revenue, for the three months ended September 30, 2014.

***Research and Development ( R&D ) Expenses*** R&D expenses include compensation, engineering department expenses, overhead allocations for administration and facilities, and materials costs associated with development. R&D expenses for the three months ended September 30, 2015 increased $0.8 million, or 38%, to $2.9 million from $2.1 million for the three months ended September 30, 2014. R&D expenses are reported net of benefits from cost-sharing programs, such as DOE grants. The overall increase in R&D expenses of approximately $0.8 million resulted from increases in supplies expense of approximately $0.4 million and consulting expenses of $0.2 million and a decrease in cost-sharing benefits of $0.2 million. There were no cost-sharing benefits during the three months ended September 30, 2015 and $0.2 million of such benefits during the three months ended September 30, 2014. Cost-sharing programs vary from period to period depending on the phase of the programs. Management expects R&D expenses in Fiscal 2016 to be slightly higher than in Fiscal 2015 as a result of lower benefits from cost-sharing programs and as we continue product robustness and direct material cost reduction initiatives.

***Selling, General, and Administrative ( SG&A ) Expenses*** SG&A expenses for the three months ended September 30, 2015 decreased approximately $2.8 million, or 29%, to $6.7 million from $9.5 million for the three months ended September 30, 2014. The net decrease in SG&A expenses was comprised of a decrease of approximately $3.1 million in bad debt expense, offset by increases of $0.2 million in marketing expense and $0.1 million in consulting expense. The decrease in bad debt expense was primarily the result of an accounts receivable allowance recorded for a single customer during the three months ended September 30, 2014. Excluding bad debt expense, management expects SG&A expenses in Fiscal 2016 to be slightly lower than in Fiscal 2015, primarily as a result of our initiatives to lower expenses in response to lower than expected revenues.

***Interest Expense*** Interest expense for the three months ended September 30, 2015 increased approximately $0.1 million, or 100% to approximately $0.2 million from approximately $0.1 million for the three months ended September 30, 2014. Interest expense is primarily from the average balances outstanding under the Credit Facility (as defined below). As of September 30, 2015, we had total debt of $15.2 million outstanding under the Credit Facility.

***Income Taxes*** There was no income tax expense for the three months ended September 30, 2015. Income tax expense for the three months ended September 30, 2014 was approximately $14,000. The decrease in income tax expense was primarily related to local tax payments compared to the three months ended September 30, 2014.

Table of Contents

***Six Months Ended September 30, 2015 and 2014***

***Revenue*** Revenue for the six months ended September 30, 2015 decreased $10.6 million, or 19%, to $44.9 million from $55.5 million for the six months ended September 30, 2014. The change in revenue for the six months ended September 30, 2015 compared to the six months ended September 30, 2014 included decreases in revenue of $10.6 million from the European market, $2.7 million from the North American market, $1.2 million from the African market and $0.5 million from the Asian market. The decreases in the European, African and Asian markets were primarily the result of ongoing geopolitical tensions in Russia and Ukraine and a substantially stronger U.S. dollar (making our products more expensive overseas) compared to the six months ended September 30, 2014. The decrease in the North American market was the effects of volume reductions in microturbines shipped, resulting from continued headwinds in the oil and gas market and a shift in customers project timelines. This overall decrease in revenue was offset by an increase in revenue of $4.2 million from the Australian market and $0.2 million from the South American market. The increases in the Australian and South American markets were primarily the result of our continuing efforts to improve and expand our maturing distribution channel to better serve our customers.

For the six months ended September 30, 2015, revenue from microturbine products decreased $12.4 million, or 28%, to $31.9 million from $44.3 million for the six months ended September 30, 2014. Megawatts shipped during the six months ended September 30, 2015 decreased 13.9 megawatts, or 30%, to 32.5 megawatts from 46.4 megawatts during the six months ended September 30, 2014. The decrease in revenue and megawatts shipped was because of volume reductions in microturbines shipped, resulting from no microturbine product shipments to Russia, continued challenges in the oil and gas market and shift in customers project timelines during the six months ended September 30, 2015 compared to the same period last year. Average revenue per megawatt shipped was approximately $1.0 million during each of the six months ended September 30, 2015 and 2014.

The following table provides additional information on our shipments (revenue amounts in millions):

| | Six Months Ended September 30, | | | |
|---|---|---|---|---|
| | 2015 | | 2014 | |
| | Revenue | Megawatts | Revenue | Megawatts |
| North America | $ 18.7 | 19.1 | $ 24.0 | 23.0 |
| Europe | 5.6 | 5.8 | 16.3 | 19.9 |
| Asia | 2.1 | 2.5 | 2.3 | 2.3 |
| Australia | 5.1 | 4.7 | 1.2 | 0.9 |
| South America | 0.4 | 0.4 | 0.3 | 0.1 |
| Africa | | | 0.2 | 0.2 |
| Total from Microturbine Products | $ 31.9 | 32.5 | $ 44.3 | 46.4 |

The timing of shipments is subject to change based on several variables, including customer deposits, payments, availability of credit and delivery schedule changes, most of which are not within our control and can affect the timing of our revenue.

The following table summarizes our revenue (revenue amounts in millions):

| | Six Months Ended September 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2015 | | | | 2014 | | | |
| | Revenue | | Megawatts | Units | Revenue | | Megawatts | Units |
| C30 | $ | 0.8 | 0.5 | 17 | $ | 1.7 | 1.0 | 34 |
| C65 | | 7.2 | 6.6 | 101 | | 15.0 | 13.6 | 208 |
| TA100 | | | | | | 0.3 | 0.2 | 2 |
| C200 | | 2.1 | 2.0 | 10 | | 3.1 | 3.0 | 15 |
| C600 | | 3.6 | 3.6 | 6 | | 4.6 | 4.8 | 8 |
| C800 | | 4.6 | 4.8 | 6 | | 0.8 | 0.8 | 1 |
| C1000 | | 13.6 | 15.0 | 15 | | 18.8 | 23.0 | 23 |
| Total from Microturbine Products | $ | 31.9 | 32.5 | 155 | $ | 44.3 | 46.4 | 291 |
| Accessories and Parts | | 6.9 | | | | 6.5 | | |
| Total Product, Accessories and Parts | $ | 38.8 | | | $ | 50.8 | | |
| Service | | 6.1 | | | | 4.7 | | |
| Total | $ | 44.9 | 32.5 | 155 | $ | 55.5 | 46.4 | 291 |

Table of Contents

For the six months ended September 30, 2015, revenue from our accessories and parts increased $0.4 million, or 6%, to $6.9 million from $6.5 million for the six months ended September 30, 2014. The increase in revenue resulted primarily from higher sales of microturbine parts, offset by lower accessories revenue.

Service revenue for the six months ended September 30, 2015 increased $1.4 million, or 30%, to $6.1 million from $4.7 million for the six months ended September 30, 2014. The increase in revenue resulted primarily from higher FPP contract enrollment and microturbine service work.

Horizon and Optimal accounted for 18% and 13% of revenue, respectively, for the six months ended September 30, 2015. For the six months ended September 30, 2014, Horizon, BPC and E-Finity accounted for 21%, 17% and 12% of revenue, respectively.

***Gross Margin*** The gross margin was $6.6 million, or 15% of revenue, for the six months ended September 30, 2015 compared to a gross margin of $8.7 million, or 16% of revenue, for the six months ended September 30, 2014. The decrease in the gross margin during the six months ended September 30, 2015 compared to the six months ended September 30, 2014 was primarily the result of lower volume of microturbines shipped and shift in product mix of $4.3 million. The reduction in microturbine shipments was partially offset by decreases in warranty expense of $1.2 million, production and service center overhead expenses of $0.6 million, inventory charges of $0.3 million and royalty expense of $0.1 million. Management continues to implement initiatives to improve gross margin by further reducing manufacturing overhead and fixed and direct material costs as we work to achieve profitability and improving product performance.

Warranty expense is a combination of a standard warranty provision recorded at the time revenue is recognized and changes, if any, in estimates for reliability repair programs. Reliability repair programs are based upon estimates that are recorded in the period that new information becomes available, including design changes, cost of repair and product enhancements, which can include both in-warranty and out-of-warranty systems. The decrease in warranty expense of $1.2 million reflects a decrease in the standard warranty provision primarily because of a decrease in the number of units covered under warranty as a result of lower microturbine shipments during the six months ended September 30, 2015 compared to the prior year. Management expects warranty expense to decline as a result of lower shipments of microturbine products for the remainder of Fiscal 2016.

Production and service center labor and overhead expense decreased $0.6 million during the six months ended September 30, 2015 compared to the six months ended September 30, 2014. The decreases in production and service center labor and overhead expense were comprised of decreases of $0.2 million in travel expense and $0.2 million in salaries expense and an increase in the amount of overhead allocated to finished goods inventory of $0.2 million.

Inventory charges decreased $0.3 million during the six months ended September 30, 2015 compared to the six months ended September 30, 2014 primarily as the result of a decrease in provision for excess and obsolete inventory.

Royalty expense decreased $0.1 million during the six months ended September 30, 2015 compared to the six months ended September 30, 2014 as a result of lower sales of our C1000 Series systems.

Accessories and parts revenue gross margin is included in the gross margin discussion above. Accessories and parts revenue gross margin was $2.4 million, or 35% of revenue, for the six months ended September 30, 2015 compared to accessories and parts revenue gross margin of $2.3 million, or 36% of revenue, for the six months ended September 30, 2014.

Service revenue gross margin is included in the gross margin discussion above. Service revenue gross margin was $0.8 million, or 13% of revenue, for the six months ended September 30, 2015 compared to a service revenue gross margin of $0.6 million, or 13% of revenue, for the six months ended September 30, 2014.

***Research and Development Expenses*** - R&D expenses for the six months ended September 30, 2015 increased $0.9 million, or 20%, to $5.3 million from $4.4 million for the six months ended September 30, 2014. R&D expenses are reported net of benefits from cost-sharing programs, such as DOE grants. The overall increase in R&D expenses of approximately $0.9 million resulted from increases in supplies expense of approximately $0.4 million and consulting expenses of $0.4 million and a decrease in cost-sharing benefits of $0.1 million. There were approximately $0.3 million of cost-sharing benefits for the six months ended September 30, 2015 and $0.4 million of such benefits for the six months ended September 30, 2014. Cost-sharing programs vary from period to period depending on the phase of the programs. Management expects R&D expenses in Fiscal 2016 to be slightly higher than in Fiscal 2015 as a result of lower benefits from cost-sharing programs and as we continue product robustness and direct material cost reduction initiatives.

***Selling, General, and Administrative Expenses*** - SG&A expenses for the six months ended September 30, 2015 decreased $2.5 million, or 14%, to $14.8 million from $17.3 million for the six months ended September 30, 2014. The net decrease in SG&A expenses was comprised of a decrease of $3.1 million in bad debt expense, offset by increases of $0.5 million in salaries expense and $0.1 million in consulting expense. The decrease in the bad debt expense was primarily the result of an accounts receivable allowance recorded for a single customer during the three months ended September 30, 2014. We recorded severance costs of approximately $0.5 million during the three months ended June 30, 2015. The headwinds we faced during Fiscal 2015 led us to flatten our organization which will lower operating costs after severance expenses. Excluding bad debt expense, management expects SG&A expenses in Fiscal 2016 to be slightly lower than in Fiscal 2015 primarily as a result of our initiatives to lower expenses in response to lower than expected revenues.

Table of Contents

***Interest Expense*** Interest expense was approximately $0.3 million for each of the six months ended September 30, 2015 and 2014. Interest expense is primarily from the average balances outstanding under the Credit Facility. As of September 30, 2015, we had total debt of $15.2 million outstanding under the Credit Facility.

***Income Taxes*** - Income tax expense for the six months ended September 30, 2015 was approximately $3,000. Income tax expense for the six months ended September 30, 2014 was approximately $64,000. The decrease in income tax expense was primarily related to local tax payments compared to the six months ended September 30, 2014.

**Liquidity and Capital Resources**

Our cash requirements depend on many factors, including the execution of our plan. We expect to continue to devote substantial capital resources to running our business and creating the strategic changes summarized herein. Our planned capital expenditures for Fiscal 2016 include approximately $2.0 million for plant and equipment costs related to manufacturing and operations. As a result of our initiatives to lower expenses in response to lower than expected revenues, management expects to spend approximately $0.4 million less than planned or $1.6 million for plant and equipment costs related to manufacturing and operations. We have invested our cash in institutional funds that invest in high quality, short-term money market instruments to provide liquidity for operations and capital preservation.

Our cash and cash equivalents as of September 30, 2015 and March 31, 2015 were $10.6 million ($15.6 million when combined with restricted cash related to the Credit Facility) and $32.2 million, respectively. Our cash and cash equivalents balances decreased $21.6 million during the six months ended September 30, 2015, compared to an increase of $12.9 million during the six months ended September 30, 2014. Cash and cash equivalents increased during the six months ended September 30, 2014 primarily related to proceeds from our May 2014 underwritten public offering.

***Operating Activities*** During the six months ended September 30, 2015, we used $18.4 million of cash in our operating activities, which consisted of a net loss for the period of $13.9 million and cash used for working capital of $7.1 million, offset by non-cash adjustments (primarily warranty provision, depreciation and amortization, stock-based compensation and inventory provision) of $2.6 million. During the six months ended September 30, 2014, operating cash usage was $14.6 million, which consisted of a net loss for the period of $13.3 million and cash used for working capital of $8.9 million, offset by non-cash adjustments of $7.6 million.

The following is a summary of the significant sources (uses) of cash from operating activities (amounts in thousands):

| | Six Months Ended September 30, 2015 | Six Months Ended September 30, 2014 |
|---|---|---|
| Net loss | $ (13,857) | $ (13,300) |
| Non-cash operating activities (1) | 2,569 | 7,556 |

| | | | | |
|---|---|---|---|---|
| Changes in operating assets and liabilities: | | | | |
| Accounts receivable | | (3,014) | | 1,746 |
| Inventories | | (6,170) | | (1,691) |
| Accounts payable and accrued expenses | | 2,934 | | (7,456) |
| Other changes in operating assets and liabilities | | (874) | | (1,513) |
| Net cash used in operating activities | $ | (18,412) | $ | (14,658) |

(1) Represents warranty provision, depreciation and amortization, stock-based compensation expense, inventory provision and accounts receivable allowances.

The increase in net cash used in operating activities during the six months ended September 30, 2015 compared to the six months ended September 30, 2014 was primarily related to the change in inventories and accounts receivable, offset by higher accounts payable and accrued expenses. The change in inventory was primarily because of lower than anticipated inventory turns primarily as a result of finished goods that did not ship in the second quarter of Fiscal 2016. The change in accounts receivable was the result of lower than expected revenue and slower collection of accounts receivable. The change in accounts payable and accrued expenses was primarily the result of a deferral of payments of accounts payable and timing and level of inventory receipts.

Table of Contents

***Investing Activities*** Net cash used in investing activities of $1.3 million and $1.0 million during the six months ended September 30, 2015 and 2014, respectively, relates to the acquisition of fixed assets.

***Financing Activities*** During the six months ended September 30, 2015, we used approximately $1.9 million in financing activities compared to cash generated during the six months ended September 30, 2014 of approximately $28.5 million. The funds used in financing activities during the six months ended September 30, 2015 were primarily the result of cash equivalents restricted by Wells Fargo and the repayment of notes payable and capital lease obligations, offset by the net proceeds from the Credit Facility and proceeds from the at-the-market offering program described below. Additionally, employee stock purchases, net of repurchases of shares of our common stock for employee taxes due on vesting of restricted stock units, resulted in approximately $0.1 million and $0.2 million of net cash used during the six months ended September 30, 2015 and 2014, respectively. As a condition of the amended Agreements (as defined below) with Wells Fargo, we have restricted $5.0 million of cash equivalents as additional security for the Credit Facility. During the six months ended September 30, 2014, the funds generated in financing activities were primarily from the proceeds related to our underwritten public offering described below.

Effective May 6, 2014, the Company completed an underwritten public offering in which it sold 18.8 million shares of the Company s common stock at a price of $1.70 per share less underwriting discounts and commissions. The shares were allocated to a single institutional investor. The net proceeds to the Company from the sale of the common stock, after deducting fees and other offering expenses, were approximately $29.8 million.

Effective August 28, 2015, the Company entered into a sales agreement with respect to an at-the-market offering program pursuant to which the Company may offer and sell, from time to time at its sole discretion, shares of its common stock, having an aggregate offering price of up to $30.0 million. The Company will set the parameters for sales of the shares, including the number to be sold, the time period during which sales are requested to be made, any limitation on the number that may be sold in one trading day and any minimum price below which sales may not be made. As of September 30, 2015, 4.0 million shares of the Company s common stock was sold and the net proceeds to the Company from the sale of the common stock, after deducting fees and other offering expenses, were approximately $1.2 million.

***Credit Facility*** The Company maintains two Credit and Security Agreements, as amended (the Agreements ), with Wells Fargo Bank, National Association ( Wells Fargo ), which provide the Company with a line of credit of up to $20.0 million in the aggregate. As previously disclosed, the twelfth amendment to the Agreements provided the Company the right, under certain circumstances, to increase the borrowing capacity available under the Company s revolving lines of credit to an aggregate maximum of $20.0 million from an aggregate maximum of $15.0 million (the Accordion Feature ). In addition, Wells Fargo has provided the Company with a non-revolving capital expenditure line of credit up to $0.5 million to acquire additional eligible equipment for use in the Company s business. Effective as of June 30, 2015, the Company exercised the Accordion Feature, thereby increasing the maximum borrowing capacity available to a maximum of $20.0 million. The amount actually available to the Company may be less and may vary from time to time depending on, among other factors, the amount of its eligible inventory and accounts receivable. As security for the payment and performance of the Credit Facility, the Company granted a security interest in favor of Wells Fargo in substantially all of the assets of the Company. One of the Agreements will terminate in accordance with its terms on September 1, 2017 and the other one will terminate on September 30, 2017. As of September 30, 2015 and March 31, 2015, $15.2 million and $13.0 million in borrowings were outstanding, respectively, under the

Credit Facility.

The Agreements include affirmative covenants as well as negative covenants that prohibit a variety of actions without Wells Fargo s consent, including covenants that limit our ability to (a) incur or guarantee debt, (b) create liens, (c) enter into any merger, recapitalization or similar transaction or purchase all or substantially all of the assets or stock of another entity, (d) pay dividends on, or purchase, acquire, redeem or retire shares of, our capital stock, (e) sell, assign, transfer or otherwise dispose of all or substantially all of our assets, (f) change our accounting method or (g) enter into a different line of business. Furthermore, the Agreements contain financial covenants, including (i) a requirement not to exceed specified levels of losses, (ii) a requirement to maintain a substantial minimum monthly cash balance to outstanding line of credit advances based upon the Company s financial performance, and (iii) limitations on our annual capital expenditures.

Several times since entering into the Agreements we were not in compliance with certain covenants under the Credit Facility. In connection with each event of noncompliance, Wells Fargo waived the event of default and, on several occasions, the Company amended the Agreements in response to the default and waiver. The following summarizes the recent events, amendments and waivers:

- As of March 31, 2015, the Company determined that it was not in compliance with the financial covenant contained in the amended Agreements regarding the Company s annual net income for Fiscal 2015. On June 10, 2015, the Company received from Wells Fargo a waiver of such noncompliance, and the Company and Wells Fargo entered into an amendment to the Agreements which set the financial covenants for Fiscal 2016. As a condition of the amended Agreements, the Company has restricted $5.0 million of cash equivalents effective June 10, 2015 as additional security for the Credit Facility.

Table of Contents

- As of September 30, 2015, the Company determined that it was not in compliance with a financial covenant contained in the amended Agreements regarding the Company s annual net income for Fiscal 2016. On November 2, 2015, the Company received from Wells Fargo a waiver of such noncompliance and entered into an amendment to amend the financial covenants regarding net income for Fiscal 2016.

If we had not obtained the waivers and amended the Agreements as described above, we would not be able to draw additional funds under the Credit Facility. In addition, the Company has pledged its accounts receivables, inventories, equipment, patents and other assets as collateral for its Agreements, which would be subject to seizure by Wells Fargo if the Company were in default under the Agreements and unable to repay the indebtedness. Wells Fargo also has the option to terminate the Agreements or accelerate the indebtedness during a period of noncompliance. Based on our current forecasts, management believes we will maintain compliance with the covenants contained in the amended Agreements through the end of Fiscal 2016. If a covenant violation were to occur, management would attempt to negotiate a waiver of non-compliance from Wells Fargo.

***Working Capital*** Our cash and cash equivalents as of September 30, 2015 and March 31, 2015 were $10.6 million ($15.6 million when combined with restricted cash related to the Credit Facility) and $32.2 million, respectively. Cash and cash equivalents and restricted cash, less the amount outstanding under the Credit Facility, was $0.4 million and $19.3 million as of September 30, 2015 and March 31, 2015, respectively. Our cash and cash equivalents were primarily impacted by cash equivalents restricted by Wells Fargo and by higher than planned working capital requirements during the six months ended September 30, 2015. Our working capital requirements were higher than planned primarily as a result of lower than expected revenue, slower collection of accounts receivable and lower than anticipated inventory turns primarily because of finished goods that did not ship in the quarter. We continue to be negatively impacted by the continuing softness of the global oil and gas markets, a substantially stronger U.S. dollar (making our products more expensive overseas) and ongoing geopolitical tensions in Russia, North Africa and the Middle East.

Management has the ability to manage certain operating assets and liabilities, specifically the procurement of inventory and timing of payments of accounts payable, capital expenditures and certain operating expenses depending on the results of its operations to preserve its cash and cash equivalents. Additionally, we have an at-the-market offering program in place pursuant to which the Company may offer and sell, from time to time at its sole discretion, shares of its common stock. Management also believes that we will maintain compliance with the covenants contained in the amended Credit Facility agreements through the end of Fiscal 2016. If a covenant violation were to occur, the Company would attempt to negotiate a waiver of compliance from Wells Fargo.

If we are unable to manage its cash flows in the areas discussed above, the Company may need to raise additional capital in the near term. We could seek to raise funds by selling additional securities (through the at-the-market offering discussed above or some other offering) to the public or to selected investors, or by obtaining additional debt financing. There is no assurance that we will be able to obtain additional funds on commercially favorable terms, or at all. If the Company raises additional funds by issuing additional equity or convertible debt securities, the fully diluted ownership percentages of existing stockholders will be reduced. In addition, the equity or debt securities that the Company would issue may have rights, preferences or privileges senior to those of the holders of its common stock. Should we be unable to execute our plans (including raising funds through the at-the-market offering program and maintaining availability under our Credit Facility) or obtain additional financing that may be needed, the Company may need to significantly reduce its operations or it may be unable to continue as a going concern. The unaudited condensed consolidated financial statements do not include any adjustments that might result from the outcome of these uncertainties.

Depending on the timing of our future sales and collection of related receivables, managing inventory costs and the timing of inventory purchases and deliveries required to fulfill the backlog, our future capital requirements may vary materially from those now planned. The amount of capital that we will need in the future will require us to achieve significantly increased sales volume which is dependent on many factors, including:

- the market acceptance of our products and services;
- our business, product and capital expenditure plans;
- capital improvements to new and existing facilities;
- our competitors response to our products and services;
- our relationships with customers, distributors, dealers and project resellers; and
- our customers ability to afford and/or finance our products.

Table of Contents

Our accounts receivable balance, net of allowances, was $16.2 and $13.1 million as of September 30, 2015 and March 31, 2015, respectively. Days sales outstanding in accounts receivable ( DSO ) increased by 17 days to 82 days at the end of the second quarter of Fiscal 2016 compared to 65 days at the end of the second quarter of Fiscal 2015. The change in DSO was largely the result of lower than expected revenue and slower collection of accounts receivable during the six months ended September 30, 2015 compared to the six months ended September 30, 2014. There were no significant bad debt charges or recoveries during the six months ended September 30, 2015. We recorded bad debt expense of approximately $3.1 million during the six months ended September 30, 2014. During the three months ended March 31, 2015, we recorded an accounts receivable allowance of approximately $7.1 million with respect to BPC.

No assurances can be given that future bad debt expense will not increase above current operating levels. Increased bad debt expense or delays in collecting accounts receivable could have a material adverse effect on cash flows and results of operations. In addition, our ability to access the capital markets may be severely restricted or made very expensive at a time when we need, or would like, to do so, which could have a material adverse impact on our liquidity and financial resources. Certain industries in which our customers do business and certain geographic areas may have been and could continue to be adversely affected by the current economic environment.

**Contractual Obligations and Commercial Commitments**

Except for scheduled payments made on operating leases during the six months ended September 30, 2015, there have been no material changes in our remaining commitments under non-cancelable operating leases disclosed in our Annual Report on Form 10-K for Fiscal 2015.

**New Accounting Pronouncements**

In July 2015, the Financial Accounting Standards Board (the FASB ) issued Accounting Standards Update (ASU) 2015-11, Simplifying the Measurement of Inventory. ASU 2015-11 requires inventory that is recorded using the first-in, first-out method to be measured at the lower of cost or net realizable value. ASU 2015-11 is effective for annual and interim periods beginning after December 15, 2016, and should be applied prospectively with early adoption permitted at the beginning of an interim or annual reporting period. We are currently evaluating the potential impact the new standard will have on our financial position and results of operations.

In April 2015, the FASB issued ASU 2015-03, Interest Imputation of Interest (Subtopic 835-30). The ASU was issued as part of FASB s current plan to simplify overly complex standards. This ASU requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. The recognition and measurement guidance for debt issuance costs are not affected by this ASU. The update requires retrospective application to all prior period amounts presented. This update is effective for annual and interim periods beginning on or after December 15, 2015, with early application permitted for financial statements that have not been issued. The adoption of this standard would result in the reclassification of debt issuance costs from prepaid expenses and other current assets to the amount outstanding under the Credit Facility. The net amount of such costs at September 30, 2015 was approximately $0.2 million.

In August 2014, the FASB issued ASU 2014-15, Disclosure of Uncertainties About an Entity s Ability to Continue as a Going Concern ( ASU 2014-15 ). ASU 2014-15 requires management to perform interim and annual assessments of an entity s ability to continue as a going concern within one year of the date the financial statements are issued and provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. Certain disclosures will be required if conditions give rise to substantial doubt about an entity s ability to continue as a going concern. ASU 2014-15 applies to all entities and is effective for annual and interim reporting periods ending after December 15, 2016, with early adoption permitted. We are currently evaluating the potential impacts the new standard will have on our reporting process.

In June 2014, the FASB issued ASU 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period ( ASU 2014-12 ). ASU 2014-12 requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. ASU 2014-12 is effective for annual reporting periods beginning after December 15, 2015, with early adoption permitted. We are evaluating the potential impacts of the new standard on our existing stock-based compensation plans.

In May 2014, FASB issued ASU 2014-09, Revenue from Contracts with Customers ( ASU 2014-09 ). ASU 2014-09 supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The standard s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. We are evaluating our existing revenue recognition policies to determine whether any contracts in the scope of the guidance will be affected by the new requirements. We will be required to adopt the revenue recognition standard in annual reporting periods beginning after December 15, 2017 (fiscal year ending March 31, 2019), and interim periods within those annual periods.

Table of Contents

**Item 3.** ***Quantitative and Qualitative Disclosures About Market Risk***

No material changes have occurred in the quantitative and qualitative market risk disclosure of the Company as presented in its Annual Report on Form 10-K for Fiscal 2015.

**Item 4. Controls and Procedures**

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

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act ), as of the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are effective. The term disclosure controls and procedures means controls and other procedures of the Company that are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within required time periods. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

***Changes in Internal Control Over Financial Reporting***

There was no change in the Company s internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the Company s most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

**PART II OTHER INFORMATION**

**Item 1.** ***Legal Proceedings***

From time to time, the Company may become subject to certain legal proceedings, claims and litigation arising in the ordinary course of business. In the opinion of management, we are not a party to any material legal proceedings, nor are we aware of any other pending or threatened litigation that would have a material effect on our operating results, cash flows, financial position or results of operations should such litigation be resolved unfavorably.

**Item 1A.** ***Risk Factors***

There have been no material changes to the risk factors disclosed in the Company s Annual Report on Form 10-K for Fiscal 2015.

**Item 2.** ***Unregistered Sales of Equity Securities and Use of Proceeds***

None

**Item 3.** ***Defaults Upon Senior Securities***

None

**Item 4.** ***Mine Safety Disclosures***

Not applicable

**Item 5.** ***Other Information***

None

Table of Contents

**Item 6.** ***Exhibits***

The following exhibits are filed with, or incorporated by reference into, this Form 10-Q:

| Exhibit Number | Description |
|---|---|
| 3.1 | Second Amended and Restated Certificate of Incorporation of Capstone Turbine Corporation (a) |
| 3.2 | Certificate of Amendment to the Second Amended and Restated Certificate of Incorporation of Capstone Turbine Corporation (b) |
| 3.3 | Amended and Restated Bylaws of Capstone Turbine Corporation (c) |
| 10.1 | Amendment to the Capstone Turbine Corporation Amended and Restated 2000 Equity Incentive Plan, effective August 27, 2015 (d) |
| 10.2 | Sales Agreement, dated August 28, 2015, by and between Capstone Turbine Corporation and Cowen & Company, LLC (e) |
| 10.3 | Fifteenth Amendment to the Credit and Security Agreements and Waiver of Default between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated November 2, 2015 |
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002 |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002 |
| 32 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes Oxley Act of 2002 |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Schema Document |
| 101.CAL | XBRL Calculation Linkbase Document |
| 101.LAB | XBRL Label Linkbase Document |
| 101.PRE | XBRL Presentation Linkbase Document |
| 101.DEF | XBRL Definition Linkbase Document |

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(a) Incorporated by reference to Capstone Turbine Corporation s Registration Statement on Form S-1/A, dated May 8, 2000 (File No. 333-33024)

(b) Incorporated by reference to Appendix B to Capstone Turbine Corporation s Definitive Proxy Statement, filed on July 17, 2012 (File No. 001-15957)

(c) Incorporated by reference to Capstone Turbine Corporation s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2005 (File No. 001-15957)

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(e) Incorporated by reference to Capstone Turbine Corporation s Current Report on Form 8-K, filed on August 28, 2015 (File No. 001-15957)

Table of Contents

## SIGNATURES

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.

CAPSTONE TURBINE CORPORATION

By: /s/ JAYME L. BROOKS
Jayme L. Brooks
*Chief Financial Officer & Chief Accounting Officer*
*(Principal Financial and Accounting Officer)*

Date: November 5, 2015

Table of Contents

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