

ENERGY FOCUS, INC/DE  
Form 10-Q  
August 05, 2015

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

Form 10-Q

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

For the quarterly period ended June 30, 2015

OR  
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 0-24230

ENERGY FOCUS, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or  
organization)

94-3021850

(I.R.S. Employer Identification No.)

32000 Aurora Road, Suite B, Solon, OH  
(Address of principal executive offices)

44139

(Zip Code)

(Registrant's telephone number, including area code): (440) 715-1300

None

(Former Name, Former Address and Former Fiscal Year, If Changed Since Last Report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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

Accelerated filer

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Non-accelerated filer (do not check if a smaller reporting company)  Smaller reporting company

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

The number of outstanding shares of the registrant's Common Stock, \$0.0001 par value, as of July 31, 2015 was 10,042,050.

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## PART I - FINANCIAL INFORMATION

### Forward-looking statements

Unless the context otherwise requires, all references to “Energy Focus,” “we,” “us,” “our,” “our company,” or “the Company” to Energy Focus, Inc., a Delaware corporation, and its subsidiaries, and their respective predecessor entities for the applicable periods, considered as a single enterprise.

This Quarterly Report on Form 10-Q (“Quarterly Report”) includes statements that express our opinions, expectations, beliefs, plans, objectives, assumptions or projections regarding future events or future results and therefore are, or may be deemed to be, “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements can generally be identified by the use of forward-looking terminology, including the terms “believes,” “estimates,” “anticipates,” “expects,” “feels,” “seeks,” “forecasts,” “projects,” “intends,” “plans,” “may,” “will,” “should,” “could” or “would” and their negative or other variations or comparable terminology. These forward-looking statements include all matters that are not historical facts. They appear in a number of places throughout this Quarterly Report and include statements regarding our intentions, beliefs, or current expectations concerning, among other things, our results of operations, financial condition, liquidity, prospects, growth, strategies, capital expenditures, and the industry in which we operate.

By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future. Although we base these forward-looking statements on assumptions that we believe are reasonable when made, we caution you that forward-looking statements are not guarantees of future performance and that our actual results of operations, financial condition and liquidity, and industry developments may differ materially from statements made in or suggested by the forward-looking statements contained in this Quarterly Report. In addition, even if our results of operations, financial condition and liquidity, and industry developments are consistent with the forward-looking statements contained in this Quarterly Report, those results or developments may not be indicative of results or developments in subsequent periods.

We believe that important factors that could cause our actual results to differ materially from forward-looking statements include, but are not limited to, the risks and uncertainties outlined under “Risk Factors” under Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2014 (“2014 Annual Report”) and other matters described in this Quarterly Report generally. Some of these factors include:

- our history of operating losses and our ability to generate sufficient cash from operations or receive sufficient financing, on acceptable terms, to continue our operations,
- general economic conditions in the United States and in other markets in which we operate,
- our dependence on government customers, in particular the U.S. Navy, and on the levels of funding available to such customers and our ability to satisfactorily fulfill our contractual obligations to such customers,
- our ability to implement and manage our growth plans and control expenses to increase sales and improve margins,
- market acceptance of LED lighting technology,
- our ability to respond to new lighting technologies and market trends with safe and reliable products,
- our ability to compete effectively against companies with greater resources,
- our ability to protect our intellectual property rights and the impact of any type of legal claim or dispute,
  - our reliance on a limited number of customers for a significant portion of our revenue,
- our ability to obtain critical components and finished products from third-party suppliers on acceptable terms,
- risks inherent in international markets, such as economic and political uncertainty, changing regulatory and tax requirements and currency fluctuations, and
- our ability to maintain effective internal controls.

In light of the foregoing, we caution you not to place undue reliance on our forward-looking statements. Any forward-looking statement that we make in this Quarterly Report speaks only as of the date of such statement, and we undertake no obligation to update any forward-looking statement or to publicly announce the results of any revision to any of those statements to reflect future events or developments. Comparisons of results for current and any prior periods are not intended to express any future trends or indications of future performance, unless specifically expressed as such, and should only be viewed as historical data.

Energy Focus® and Intellitube® are our registered trademarks. We may also refer to trademarks of other corporations and organizations in this document.

## ITEM 1. FINANCIAL STATEMENTS

## ENERGY FOCUS, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

(Unaudited)

|  | June 30,<br>2015 | December 31,<br>2014 |
|--|------------------|----------------------|
| <b>ASSETS</b>  |                  |                      |
| Current assets:  |                  |                      |
| Cash and cash equivalents  | \$10,173         | \$7,531              |
| Trade accounts receivable less allowances of \$200 and \$323, respectively             | 2,506            | 3,113                |
| Inventories, net   | 9,847            | 7,283                |
| Prepaid and other current assets   | 1,084            | 1,002                |
| Total current assets   | 23,610           | 18,929               |
| Property and equipment, net  | 732              | 479                  |
| Other assets   | 111              | 88                   |
| Total assets   | \$24,453         | \$19,496             |
| <b>LIABILITIES</b>   |                  |                      |
| Current liabilities:   |                  |                      |
| Accounts payable   | \$4,911          | \$7,601              |
| Accrued liabilities  | 1,462            | 1,209                |
| Accrued federal and state income taxes   | 923              | —                    |
| Accrued warranty reserve   | 471              | 188                  |
| Deferred revenue   | 200              | 133                  |
| Billings in excess of costs and estimated earnings on uncompleted contracts            | —                | 23                   |
| Credit line borrowings   | 455              | 453                  |
| Total current liabilities  | 8,422            | 9,607                |
| Other liabilities  | 87               | 46                   |
| Long-term debt   | 70               | 70                   |
| Total liabilities  | 8,579            | 9,723                |
| <b>STOCKHOLDERS' EQUITY</b>  |                  |                      |
| Preferred stock, par value \$0.0001 per share:   |                  |                      |
| Authorized: 2,000,000 shares in 2015 and 2014  |                  |                      |
| Issued and outstanding: no shares in 2015 and 2014                                     | —                | —                    |
| Common stock, par value \$0.0001 per share:  |                  |                      |
| Authorized: 15,000,000 shares in 2015 and 2014   |                  |                      |
| Issued and outstanding: 10,025,790 at June 30, 2015 and 9,423,975 at December 31, 2014 | 1                | 1                    |
| Additional paid-in capital   | 101,003          | 98,133               |
| Accumulated other comprehensive income   | 460              | 469                  |
| Accumulated deficit  | (85,590          | ) (88,830            |
| Total stockholders' equity   | 15,874           | 9,773                |
| Total liabilities and stockholders' equity   | \$24,453         | \$19,496             |

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



ENERGY FOCUS, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(in thousands, except per share amounts)  
(Unaudited)

|  | Three months ended<br>June 30, |          | Six months ended<br>June 30, |           |
|--|--------------------------------|----------|------------------------------|-----------|
|  | 2015                           | 2014     | 2015                         | 2014      |
| Net sales  | \$16,621                       | \$6,699  | \$29,766                     | \$11,618  |
| Cost of sales  | 8,990                          | 4,525    | 16,733                       | 8,022     |
| Gross profit   | 7,631                          | 2,174    | 13,033                       | 3,596     |
| Operating expenses:  |                                |          |                              |           |
| Product development  | 657                            | 203      | 1,200                        | 394       |
| Selling, general, and administrative                                   | 3,903                          | 2,533    | 7,527                        | 4,837     |
| Total operating expenses   | 4,560                          | 2,736    | 8,727                        | 5,231     |
| Operating income (loss)  | 3,071                          | (562)    | ) 4,306                      | (1,635)   |
| Other expenses (income):   |                                |          |                              |           |
| Interest expense   | 26                             | 28       | 49                           | 2,646     |
| Other (income) expenses  | (25)                           | ) 33     | 32                           | 393       |
| Income (loss) from continuing operations before income taxes           | 3,070                          | (623)    | ) 4,225                      | (4,674)   |
| Provision for (benefit from) income taxes                              | 923                            | (1)      | ) 913                        | (2)       |
| Income (loss) from continuing operations                               | 2,147                          | (622)    | ) 3,312                      | (4,672)   |
| Discontinued operations:   |                                |          |                              |           |
| Loss from discontinued operations                                      | —                              | —        | —                            | (20)      |
| Loss on sale of discontinued operations                                | (36)                           | ) —      | (72)                         | ) —       |
| Loss from discontinued operations                                      | (36)                           | ) —      | (72)                         | ) (20)    |
| Net income (loss)  | \$2,111                        | \$(622)  | ) \$3,240                    | \$(4,692) |
| Net income (loss) per share - basic:                                   |                                |          |                              |           |
| From continuing operations   | \$0.21                         | \$(0.08) | ) \$0.34                     | \$(0.72)  |
| From discontinued operations   | —                              | —        | (0.01)                       | ) —       |
| Net income (loss) per share - basic:                                   | \$0.21                         | \$(0.08) | ) \$0.33                     | \$(0.72)  |
| Net income (loss) per share - diluted:                                 |                                |          |                              |           |
| From continuing operations   | \$0.21                         | \$(0.08) | ) \$0.33                     | \$(0.72)  |
| From discontinued operations   | —                              | —        | (0.01)                       | ) —       |
| Net income (loss) per share - diluted:                                 | \$0.21                         | \$(0.08) | ) \$0.32                     | \$(0.72)  |
| Weighted average shares used in computing net income (loss) per share: |                                |          |                              |           |
| Basic  | 10,019                         | 7,836    | 9,846                        | 6,512     |
| Diluted  | 10,138                         | 7,836    | 10,058                       | 6,512     |

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





ENERGY FOCUS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in thousands)

(Unaudited)

|  | Three months ended |         | Six months ended |           |
|--|--------------------|---------|------------------|-----------|
|  | June 30,           |         | June 30,         |           |
|  | 2015               | 2014    | 2015             | 2014      |
| Net income (loss)                        | \$2,111            | \$(622) | ) \$3,240        | \$(4,692) |
| Other comprehensive (loss) income:       |                    |         |                  |           |
| Foreign currency translation adjustments | (36)               | ) 5     | (9)              | ) 7       |
| Comprehensive income (loss)              | \$2,075            | \$(617) | ) \$3,231        | \$(4,685) |

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

## ENERGY FOCUS, INC.

## CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(in thousands)

(Unaudited)

|   | Common<br>Stock |        | Additional<br>Paid-in<br>Capital | Accumulated<br>Other<br>Comprehensive<br>Income | Accumulated<br>Deficit | Total<br>Stockholders'<br>Equity |
|---|-----------------|--------|----------------------------------|---|------------------------|----------------------------------|
|   | Shares          | Amount |                                  |   |                        |                                  |
| Balance at December 31, 2014  | 9,424           | \$1    | \$98,133                         | \$469   | \$(88,830)             | ) \$9,773                        |
| Issuance of common stock under<br>employee stock option and stock<br>purchase plans | 19              | —      | 83                               |   |                        | 83                               |
| Stock-based compensation  |                 |        | 284                              |   |                        | 284                              |
| Issuance of common stock upon<br>the exercise of warrants                           | 583             | —      | 2,503                            |   |                        | 2,503                            |
| Foreign currency translation<br>adjustment  |                 |        |                                  | (9)   | )                      | (9)                              |
| Net income for the six months<br>ended June 30, 2015                                |                 |        |                                  |   | 3,240                  | 3,240                            |
| Balance at June 30, 2015  | 10,026          | \$1    | \$101,003                        | \$460   | \$(85,590)             | ) \$15,874                       |

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

ENERGY FOCUS, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (amounts in thousands)  
 (Unaudited)

|   | Six months ended |           |
|---|------------------|-----------|
|   | June 30,         |           |
|   | 2015             | 2014      |
| Cash flows from operating activities:   |                  |           |
| Net income (loss)   | \$3,240          | \$(4,692) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:          |                  |           |
| Depreciation  | 107              | 114       |
| Stock-based compensation  | 284              | 258       |
| Provision for doubtful accounts receivable  | 60               | (3)       |
| Amortization of intangible assets   | —                | 27        |
| Amortization of discounts on long-term borrowings and acquisition related liabilities                       | —                | 2,815     |
| Amortization of loan origination fees   | 23               | 83        |
| Changes in operating assets and liabilities:  |                  |           |
| Trade accounts receivable, inventories, and other assets  | (2,106)          | (457)     |
| Accounts payable, accrued liabilities, accrued federal and state income taxes, and accrued warranty reserve | (1,227)          | (428)     |
| Deferred revenue  | 43               | (630)     |
| Total adjustments   | (2,816)          | 1,779     |
| Net cash provided by (used in) operating activities   | 424              | (2,913)   |
| Cash flows from investing activities:   |                  |           |
| Acquisitions of property and equipment  | (360)            | (107)     |
| Proceeds from the sale of property and equipment  | —                | 130       |
| Net cash (used in) provided by investing activities   | (360)            | 23        |
| Cash flows from financing activities:   |                  |           |
| Proceeds from warrants exercised  | 2,503            | —         |
| Proceeds from issuances of common stock, net  | —                | 806       |
| Proceeds from exercises of stock options and employee stock purchase plan purchases                         | 83               | 27        |
| Payments on other borrowings  | —                | (29)      |
| Net proceeds on credit line borrowings  | 2                | 824       |
| Net cash provided by financing activities   | 2,588            | 1,628     |
| Effect of exchange rate changes on cash   | (10)             | (2)       |
| Net increase (decrease) in cash and cash equivalents  | 2,642            | (1,264)   |
| Cash and cash equivalents, beginning of period  | 7,531            | 2,860     |
| Cash and cash equivalents, end of period  | \$10,173         | \$1,596   |
| Classification of cash and cash equivalents:  |                  |           |
| Cash and cash equivalents   | \$9,737          | \$1,122   |
| Restricted cash held  | 136              | 174       |
| Cash held in escrow   | 300              | 300       |
| Cash and cash equivalents, end of period  | \$10,173         | \$1,596   |

Supplemental disclosures for non-cash financing activities:

|   |     |         |
|---|-----|---------|
| Conversion of subordinated convertible debt to equity, net of discount amortization | \$— | \$3,858 |
|---|-----|---------|

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

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ENERGY FOCUS, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2015

(Unaudited)

#### NOTE 1. NATURE OF OPERATIONS

Energy Focus, Inc. and its subsidiaries engage in the design, development, manufacturing, marketing, and installation of energy-efficient lighting systems. Prior to 2015, we provided turnkey, high-quality, energy-efficient lighting application alternatives, primarily to the existing public-sector building market, and reported this business as a separate “solutions” segment. However, in the third quarter of 2014, we began shifting our focus away from the turnkey solutions business to align our resources with developing and selling our energy-efficient LED products into the commercial and government markets. During the first quarter of 2015, we completed all outstanding solutions-based projects and are no longer accepting new solutions-based projects. As such, our management has determined that the Company operates in a single industry segment.

Additionally, product development remains a key focus for us. Our product development team is dedicated to developing and designing leading-edge technology LED lighting products, and we have curtailed our efforts on bidding on research contracts and grants.

#### NOTE 2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### Basis of presentation

The condensed consolidated financial statements (“financial statements”) include the accounts of the Company and its subsidiaries, Energy Focus LED Solutions, LLC (“EFLS”) in Solon, Ohio, and Crescent Lighting Limited (“CLL”), and its subsidiary, Energy Focus Europe, Ltd, each located in the United Kingdom. All significant inter-company balances and transactions have been eliminated. Please refer to Note 13. Subsequent Events, for information about our disposition of CLL subsequent to June 30, 2015.

We have prepared the accompanying financial data for the three and six months ended June 30, 2015 and 2014 pursuant to the rules and regulations of the United States Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”) have been condensed or omitted pursuant to such rules and regulations. The accompanying financial data and information should be read in conjunction with our 2014 Annual Report.

In the opinion of management, the accompanying financial statements contain all normal and recurring adjustments necessary to present fairly our Condensed Consolidated Balance Sheets as of June 30, 2015 and December 31, 2014, Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2015 and 2014, Condensed Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended June 30, 2015 and 2014, Condensed Consolidated Statement of Stockholders’ Equity for the six months ended June 30, 2015, and Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2015 and 2014.

##### Use of estimates

The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in our financial statements and accompanying notes. Management bases its estimates on historical experience and various other assumptions believed to be reasonable. Although these estimates are based on management’s best knowledge of current events and actions that may impact us in the future,

actual results may vary from the estimates. Estimates include, but are not limited to, the establishment of reserves for accounts receivable, sales returns, inventory obsolescence and warranty claims; the useful lives of property and equipment; revenues recognized on a percentage-of-completion basis; and stock-based compensation. In addition, estimates and assumptions associated with the determination of the fair value of financial instruments and evaluation of long-lived assets for impairment requires considerable judgment. Actual results could differ from those estimates and such differences could be material.

ENERGY FOCUS, INC.  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2015  
(Unaudited)

Reclassifications

Certain prior period amounts have been reclassified within the financial statements, and related notes thereto, to be consistent with current period presentation.

Certain risks and concentrations

We have certain customers whose net sales individually represented 10 percent or more of our total net sales, or whose net trade accounts receivable balance individually represented 10 percent or more of our total net trade accounts receivable, as follows:

For the three months ended June 30, 2015, one customer accounted for approximately 77 percent of net sales. For the three months ended June 30, 2014, two customers accounted for approximately 43 percent of net sales. For the six months ended June 30, 2015, one customer accounted for approximately 79 percent of net sales. For the six months ended June 30, 2014, two customers accounted for approximately 34 percent of net sales.

At June 30, 2015, one customer accounted for approximately 64 percent of net trade accounts receivable. At December 31, 2014, three customers accounted for approximately 79 percent of net trade accounts receivable.

Recent accounting pronouncements

In January 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-01, Income Statement-Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items, which provides guidance on simplifying income statement presentation by eliminating the concept of extraordinary items from U.S. GAAP. The amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. A reporting entity may apply the amendments prospectively and retrospectively to all periods presented in the financial statements. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. We have evaluated the accounting guidance and determined that there is no impact of this update to our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue Recognition - Revenue from Contracts with Customers, which is a comprehensive revenue recognition standard that will supersede nearly all existing revenue recognition guidance under U.S. GAAP. The standard was to be effective for interim and annual periods beginning after December 15, 2016. However, on July 9, 2015, the FASB decided to delay the effective date of the standard by one year. Either full retrospective adoption or modified retrospective adoption is permitted. We are in the process of evaluating the impact of the standard.

In April 2014, the FASB issued ASU No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, which changes the criteria for reporting discontinued operations while enhancing disclosures in this area. Under the new guidance, only disposals representing a strategic shift in operations should be presented as discontinued operations. Those strategic shifts should have a major effect on the organization's operations and financial results. Examples include a disposal of a major geographic area, a major line of business, or a major equity method investment. Additionally, the new guidance requires expanded disclosures about discontinued operations that



will provide financial statement users with more information about the assets, liabilities, income, expenses of discontinued operations and of the pretax income attributable to a disposal of a significant part of an organization that does not qualify for discontinued operations reporting. The new standard is effective for interim and annual periods beginning after December 15, 2014. We have evaluated the accounting guidance and determined that this update will have no effect on our consolidated financial statements.

Update to significant accounting policies

There have been no material changes to our significant accounting policies, as compared to those described in our 2014 Annual Report.

ENERGY FOCUS, INC.  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2015  
(Unaudited)

Net income (loss) per share

Basic earnings (loss) per share is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding during the period, excluding the effects of any potentially dilutive securities. Diluted earnings (loss) per share gives effect to all dilutive potential common shares outstanding during the period. Dilutive potential common shares consist of incremental shares upon the exercise of stock options and warrants, unless the effect would be anti-dilutive.

The following is a reconciliation of the numerator and denominator of the basic and diluted net income (loss) per share computations for the periods presented below (in thousands):

|   | Three months ended<br>June 30, |         | Six months ended<br>June 30, |           |
|---|--------------------------------|---------|------------------------------|-----------|
|   | 2015                           | 2014    | 2015                         | 2014      |
| Numerator:  |                                |         |                              |           |
| Income (loss) from continuing operations          | \$2,147                        | \$(622) | \$3,312                      | \$(4,672) |
| Loss from discontinued operations                 | (36)                           | —       | (72)                         | (20)      |
| Net income (loss)                                 | \$2,111                        | \$(622) | \$3,240                      | \$(4,692) |
| Denominator:                                      |                                |         |                              |           |
| Basic weighted average common shares outstanding  | 10,019                         | 7,836   | 9,846                        | 6,512     |
| Potential common shares from options and warrants | 119                            | —       | 212                          | —         |
| Diluted weighted average shares                   | 10,138                         | 7,836   | 10,058                       | 6,512     |

As a result of the net loss we incurred for the three and six months ended June 30, 2014, approximately 483 thousand and 1.7 million options, warrants, and convertible securities, respectively, were excluded from the net loss per share calculation, as their inclusion would have been anti-dilutive.

Product warranties

We warrant finished goods against defects in material and workmanship under normal use and service for periods generally between one and five years. Settlement costs consist of actual amounts expensed for warranty which are largely a result of the cost of replacement products. A liability for the estimated future costs under product warranties is maintained for products and services outstanding under warranty. The following table summarizes warranty activity for the periods indicated (in thousands):

|                                | Three months ended<br>June 30, |      | Six months ended<br>June 30, |      |
|--------------------------------|--------------------------------|------|------------------------------|------|
|                                | 2015                           | 2014 | 2015                         | 2014 |
| Balance at beginning of period | \$503                          | \$75 | \$188                        | \$75 |
| Accruals for warranties issued | —                              | 4    | 352                          | 20   |
|                                | (32)                           | (11) | (69)                         | (27) |

Settlements made during the period (in cash or in kind)

|                          |       |      |       |      |
|--------------------------|-------|------|-------|------|
| Accrued warranty reserve | \$471 | \$68 | \$471 | \$68 |
|--------------------------|-------|------|-------|------|

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ENERGY FOCUS, INC.  
 NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 JUNE 30, 2015  
 (Unaudited)

NOTE 3. DISCONTINUED OPERATIONS

In November 2013, we sold our pool products business for a cash purchase price of \$5.2 million. The Purchase Agreement provided for an escrow of \$500 thousand of the purchase price to secure customary indemnification obligations with respect to our representations, warranties, covenants and other obligations under the Purchase Agreement. At June 30, 2015, \$300 thousand remained in escrow subject to the resolution of outstanding buyer claims. Additionally, we participated in a mediation meeting with the buyer during the quarter ended June 30, 2015 and continue to engage in settlement discussions, but remain unable to estimate a range of reasonably possible loss. For more information on this matter and the cash remaining in escrow, please refer to Note 17. Legal matters, included under Item 8. of our 2014 Annual Report.

NOTE 4. INVENTORIES

Inventories are stated at the lower of standard cost (which approximates actual cost determined using the first-in, first-out cost method) or market, and consist of the following, net of reserves (in thousands):

|                  | June 30,<br>2015 | December 31,<br>2014 |
|------------------|------------------|----------------------|
| Raw materials    | \$3,904          | \$3,183              |
| Finished goods   | 5,943            | 4,100                |
| Inventories, net | \$9,847          | \$7,283              |

NOTE 5. PROPERTY AND EQUIPMENT

Property and equipment are stated at cost and depreciated using the straight-line method over the estimated useful lives of the related assets and consist of the following (in thousands):

|   | June 30,<br>2015 | December 31,<br>2014 |
|---|------------------|----------------------|
| Equipment (useful life 3 to 15 years)                             | \$1,608          | \$1,495              |
| Tooling (useful life 2 to 5 years)                                | 865              | 865                  |
| Furniture and fixtures (useful life 5 years)                      | 102              | 92                   |
| Computer software (useful life 3 years)                           | 452              | 452                  |
| Leasehold improvements (the shorter of useful life or lease life) | 573              | 572                  |
| Construction in progress  | 257              | 18                   |
| Property and equipment at cost                                    | 3,857            | 3,494                |
| Less: accumulated depreciation                                    | (3,125           | ) (3,015             |
| Property and equipment, net                                       | \$732            | \$479                |

Depreciation expense was \$55 thousand and \$57 thousand for the three months ended June 30, 2015 and 2014, respectively. For the six months ended June 30, 2015 and 2014, depreciation expense was \$107 thousand and \$114 thousand, respectively.



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NOTE 6. CONTRACTS IN PROGRESS

Billings in excess of costs and estimated earnings on contracts in progress are summarized in the following table for the periods indicated (in thousands):

|   | June 30,<br>2015 | December 31,<br>2014 |
|---|------------------|----------------------|
| Costs incurred on uncompleted contracts | \$—              | \$6,707              |
| Estimated earnings                      | —                | 1,507                |
| Total revenues                          | —                | 8,214                |
| Less: billings to date                  | —                | 8,237                |
| Total                                   | \$—              | \$(23 )              |

Balance sheet classification:

|   |     |      |
|---|-----|------|
| Billings in excess of costs and estimated earnings on uncompleted contracts | \$— | \$23 |
|---|-----|------|

As a result of completing all outstanding solutions-based projects during the first quarter of 2015, there were no remaining contracts in progress as of June 30, 2015.

NOTE 7. DEBT

Credit facilities

On December 22, 2011, we entered into a \$4.5 million revolving line of credit (“credit facility”) with Rosenthal & Rosenthal. The total loan amount available to us under the line of credit is equal to 85 percent of our net, eligible receivables, plus available inventory (50 percent of the lower of cost or market value of eligible inventory, or \$250 thousand, whichever is less). The credit facility is secured by a lien on our domestic assets. The interest rate for borrowing on accounts receivable is 8.5 percent, on inventories 10 percent, and on overdrafts 13 percent. Additionally, there is an annual 1 percent facility fee on the entire \$4.5 million amount of the credit facility payable at the beginning of the year. The agreement automatically renews from year to year each December 31st unless we provide requisite notice to Rosenthal 60 days in advance of the renewal date. Additionally, Rosenthal has the right to terminate the agreement at any time by providing 60 days written notice to us. As defined in the agreement, we are required to comply with certain financial covenants, measured quarterly, including a tangible net worth amount and a working capital amount. We were in compliance with the financial covenants as of June 30, 2015. Borrowings under the revolving line of credit were \$455 thousand and \$453 thousand at June 30, 2015 and December 31, 2014, respectively, and were recorded in the Condensed Consolidated Balance Sheets as a current liability under the caption “Credit line borrowings.” At June 30, 2015, there was approximately \$1.7 million available for us to borrow under this line of credit.

In January 2015, the invoice discounting arrangement we had in place for our subsidiary in the United Kingdom was terminated. As of June 30, 2015, we had not entered into any new financing arrangements for the subsidiary. Under the terms of the old arrangement, the amount available for borrowing was based at 80 percent of their eligible sales ledger. The interest rate for borrowing under the arrangement was 3.02 percent. While the arrangement was still in effect as of December 31, 2014, there were no borrowings outstanding.



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Borrowings

The components of debt at June 30, 2015 and December 31, 2014 were as follows (in thousands):

|   | June 30,<br>2015 | December 31,<br>2014 |
|---|------------------|----------------------|
| Unsecured promissory note - Quercus Trust (1) | \$ 70            | \$ 70                |
| Long-term debt                                | \$ 70            | \$ 70                |

(1) Note matures on June 1, 2109 and bears interest at 1 percent.

For a full description of our debt financing, please refer to Note 9. Debt, included under Item 8. of our 2014 Annual Report.

NOTE 8. GEOGRAPHIC INFORMATION

The following provides a geographic summary of net sales for the periods indicated (in thousands):

|               | Three months ended |          | Six months ended |           |
|---------------|--------------------|----------|------------------|-----------|
|               | June 30,<br>2015   | 2014     | June 30,<br>2015 | 2014      |
| United States | \$ 16,219          | \$ 5,590 | \$ 28,822        | \$ 9,873  |
| International | 402                | 1,109    | 944              | 1,745     |
| Net sales     | \$ 16,621          | \$ 6,699 | \$ 29,766        | \$ 11,618 |

A geographic summary of long-lived, fixed assets is presented as follows (in thousands):

|                        | June 30,<br>2015 | December 31,<br>2014 |
|------------------------|------------------|----------------------|
| United States          | \$ 715           | \$ 456               |
| International          | 17               | 23                   |
| Long-lived assets, net | \$ 732           | \$ 479               |

NOTE 9. INCOME TAXES

At June 30, 2015, we had \$923 thousand recorded in the Condensed Consolidated Balance Sheets under the caption, "Accrued federal and state income taxes" for U.S. federal and various states income tax after the application of the annual limitation set forth under Section 382 of the Internal Revenue Code ("IRC").



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The following table provides a detailed breakout of the provision for (benefit from) income taxes for the periods indicated (in thousands):

|   | Three months ended |      | Six months ended |      |   |
|---|--------------------|------|------------------|------|---|
|   | June 30,<br>2015   | 2014 | June 30,<br>2015 | 2014 |   |
| Current:                                  |                    |      |                  |      |   |
| U.S. federal                              | \$ 813             | \$—  | \$ 813           | \$—  |   |
| State                                     | 110                | (1   | ) 110            | (2   | ) |
| Foreign                                   | —                  | —    | (10              | ) —  | ) |
| Provision for (benefit from) income taxes | \$ 923             | \$(1 | ) \$ 913         | \$(2 | ) |

For the three months ended June 30, 2015, we had \$923 thousand recorded to the provision for income taxes for U.S. federal and various states income tax after the application of the annual limitation set forth under Section 382 of the IRC. For the three months ended June 30, 2014, benefit from income taxes was \$1 thousand, and resulted from state and local tax credits received by what was formerly known as our "Solutions" segment.

For the six months ended June 30, 2015, provision for income taxes was \$913 thousand for U.S. federal and various states income tax after the application of the annual limitation set forth under Section 382 of the IRC. For the six months ended June 30, 2014, benefit from income taxes was \$2 thousand, and resulted from state and local tax credits received by what was formerly known as our "Solutions" segment.

At June 30, 2015, we had a full valuation allowance recorded against our deferred tax assets. The valuation allowance was recorded due to uncertainties related to our ability to utilize the deferred tax assets; primarily consisting of certain net operating losses carried forward. The valuation allowance is based upon management's estimates of taxable income by jurisdiction and the periods over which the deferred tax assets will be recoverable.

At December 31, 2014, we had a net operating loss carry-forward of approximately \$75.4 million for U.S. federal, state, and local income tax purposes. However, due to changes in our capital structure, approximately \$23.9 million of this amount is available to offset future taxable income after the application of the limitations found under Section 382 of the IRC. If not utilized, these carry-forwards will begin to expire in 2021 for federal purposes and in 2021 or sooner for state and local purposes. Additionally, the changes to our capital structure have subjected, and will continue to subject our net operating loss carry-forward to an annual limitation. This limitation will significantly restrict our ability to utilize the carry-forward to offset taxable income in future periods. At December 31, 2014, we had a foreign net operating loss carry-forward of approximately \$1.6 million denominated in British pounds and based on the exchange rate at that date, related to our operations in the United Kingdom. Based on current tax law in the United Kingdom, net operating losses may be carried forward to offset future profits of the same trade for an indefinite period of time until fully utilized. For a full discussion of the estimated restrictions on our utilization of net operating loss carry-forwards, please refer to Note 14. Income taxes, included under Item 8. of our 2014 Annual Report.

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NOTE 10. STOCKHOLDERS' EQUITY

Warrants

A summary of warrant activity for the six months ended June 30, 2015 is shown as follows:

|                                  | Warrants<br>Outstanding | Weighted<br>Average<br>Exercise<br>Price During<br>Period |
|----------------------------------|-------------------------|---|
| Outstanding at December 31, 2014 | 969,549                 | \$4.61  |
| Exercised                        | (582,549)               | ) 4.30  |
| Canceled/forfeited               | (55,000)                | ) 4.30  |
| Expired                          | (240,000)               | ) 5.34  |
| Outstanding at June 30, 2015     | 92,000                  | \$4.86  |

Stock-based compensation

Stock-based compensation expense is attributable to stock options and restricted stock unit awards. For all stock-based awards, we recognize expense using a straight-line amortization method.

The following table summarizes stock-based compensation expense and the impact it had on operations for the periods indicated (in thousands):

|                                      | Three months ended |        | Six months ended |        |
|--------------------------------------|--------------------|--------|------------------|--------|
|                                      | June 30,<br>2015   | 2014   | June 30,<br>2015 | 2014   |
| Cost of sales                        | \$ 15              | \$ 4   | \$ 18            | \$ 6   |
| Product development                  | 13                 | 3      | 16               | 2      |
| Selling, general, and administrative | 144                | 128    | 250              | 250    |
| Total stock-based compensation       | \$ 172             | \$ 135 | \$ 284           | \$ 258 |

Total unearned stock-based compensation was \$1.1 million at June 30, 2015, compared to \$494.5 thousand at June 30, 2014. These costs will be charged to expense and amortized on a straight-line basis in subsequent periods. The weighted average period over which the unearned compensation at June 30, 2015 is expected to be recognized is approximately 2.3 years.

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Stock options

The fair value of each stock option is estimated on the date of grant using the Black-Scholes option pricing model. Estimates utilized in the calculation include the expected life of the option, risk-free interest rate, and expected volatility, and are further comparatively detailed as follows:

|                                    | Six months ended |           |   |
|------------------------------------|------------------|-----------|---|
|                                    | June 30,         |           |   |
|                                    | 2015             | 2014      |   |
| Fair value of options issued       | \$4.11           | \$3.34    |   |
| Exercise price                     | \$5.54           | \$4.34    |   |
| Expected life of option (in years) | 5.8 years        | 5.6 years |   |
| Risk-free interest rate            | 1.7              | % 1.8     | % |
| Expected volatility                | 88.3             | % 98.1    | % |
| Dividend yield                     | 0.0              | % 0.0     | % |

A summary of option activity under all plans for the six months ended June 30, 2015 is shown as follows:

|  | Number of<br>Option | Weighted<br>Average<br>Exercise<br>Price Per<br>Share | Weighted<br>Average<br>Remaining<br>Contractual<br>Life (in years) |
|--|---------------------|---|--|
| Outstanding at December 31, 2014             | 459,271             | \$ 8.95   |  |
| Granted                                      | 223,500             | 5.54  |  |
| Exercised                                    | (10,393             | ) 3.71  |  |
| Canceled/forfeited                           | (78,008             | ) 6.02  |  |
| Expired                                      | (5,900              | ) 96.00   |  |
| Outstanding at June 30, 2015                 | 588,470             | \$ 7.26   | 8.3 years  |
| Vested and expected to vest at June 30, 2015 | 531,671             | \$ 7.45   | 8.2 years  |
| Exercisable at June 30, 2015                 | 303,011             | \$ 9.00   | 7.4 years  |

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Restricted stock units

A summary of restricted stock unit activity under all plans for the six months ended June 30, 2015 is shown as follows:

|                                  | Restricted<br>Stock Units | Weighted<br>Average<br>Grant<br>Date<br>Fair Value | Weighted<br>Average<br>Remaining<br>Contractual<br>Life (in years) |
|----------------------------------|---------------------------|--|--|
| Outstanding at December 31, 2014 | —                         | \$—  |  |
| Granted                          | 62,750                    | 5.50   |  |
| Canceled/forfeited               | (5,500                    | ) 5.47   |  |
| Outstanding at June 30, 2015     | 57,250                    | \$5.51   | 1.7 years  |

NOTE 11. RELATED PARTY TRANSACTIONS

On December 12, 2012, our Board of Directors appointed James Tu to serve as our non-executive Chairman. On April 30, 2013, Mr. Tu became the Executive Chairman assuming the duties of the Principal Executive Officer. On October 30, 2013 Mr. Tu was appointed Executive Chairman and Chief Executive Officer by the Board of Directors. Mr. Tu is also the Founder, Chief Executive Officer and Chief Investment Officer of 5 Elements Global Advisors, an investment advisory and management company managing the holdings of 5 Elements Global Fund LP, which was a beneficial owner of more than 5 percent of our common stock prior to the August 2014 registered offering. 5 Elements Global Advisors focuses on investing in clean energy companies with breakthrough, commercialized technologies, and near-term profitability potential. Mr. Tu is also Co-Founder and Managing Partner of Communal International Ltd. (“Communal”), a British Virgin Islands company dedicated to assisting clean energy, solutions-based companies, maximizing technology and product potential and gaining them access to global marketing, distribution licensing, manufacturing and financing resources. Communal has a 50 percent ownership interest in 5 Elements Energy Efficiencies (BVI) Ltd., a beneficial owner of more than 5 percent of our common stock. Yeh-Mei Cheng controls 5 Elements Energy Efficiencies (BVI) Ltd. and owns the other 50 percent. She is Co-Founder of Communal International Ltd. with Mr. Tu and the mother of Simon Cheng, a current member of our Board of Directors and an employee of the Company.

On February 27, 2012, we entered into an Asian Business Development/Collaboration Agreement with Communal. The agreement has a term of 60 months. Additionally, during the term of the agreement, we will pay Communal a 5 percent commission on the net sales that occur within the territory, as defined by the agreement. We have incurred no commissions due under this agreement through June 30, 2015.

Effective January 1, 2013, the Asian Business Development/Collaboration Agreement with Communal was amended to reflect the extension of the terms of the Agreement for an additional 12 months, and the addition of certain services and countries in the territory covered by the Agreement. In connection with the amended and restated Agreement, nothing was paid during the first three and six months of 2015 and 2014, respectively. We recorded expenses of \$56 thousand and \$113 thousand under this agreement during the first three and six months of 2015 and 2014, respectively. At June 30, 2015, we had \$113 thousand relating to this agreement included under the caption, “Prepaid and other current assets” in the Condensed Consolidated Balance Sheets.



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NOTE 12. COMMITMENTS AND CONTINGENCIES

On December 22, 2014, a former employee filed a lawsuit against us in the Superior Court of the State of California, County of San Diego, known as Merl Toyer v. Energy Focus, Inc., et al., alleging wrongful termination and other claims related to his employment with us. We subsequently removed the case to the United States District Court for the Southern District of California. On May 1, 2015, we entered into a settlement agreement with the plaintiff, which assigns no culpability to any party and provides for a payment by us in exchange for full settlement and release of his claims. At June 30, 2015, the total settlement amount had been paid to the plaintiff. For the six months ended June 30, 2015, we had \$330 thousand included in the Condensed Consolidated Statements of Operations under the caption, "Selling, general, and administrative" for this amount.

NOTE 13. SUBSEQUENT EVENTS

On August 4, 2015, we entered into a Share Sale Agreement with John Harris, the managing director of CLL, our wholly-owned subsidiary in the United Kingdom, pursuant to which Mr. Harris acquired CLL from us for nominal consideration. We forgave inter-company balances owed by CLL to the Company in connection with the transaction, but we do not expect the loss on the transaction to be material to our results. Net sales for CLL were \$923 thousand for the six months ended June 30, 2015, and represent an insignificant percentage of our total sales.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the financial statements and related notes thereto, included under Item 1 of this Quarterly Report, as well as the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" included under Item 7 of our 2014 Annual Report.

### Overview

Energy Focus, Inc. and its subsidiaries engage in the design, development, manufacturing, marketing, and installation of energy-efficient lighting systems. Prior to 2015, we provided turnkey, high-quality, energy-efficient lighting application alternatives, primarily to the existing public-sector building market, and reported this business as a separate "solutions" segment. However, in the third quarter of 2014, we began shifting our focus away from the turnkey solutions business to align our resources with developing and selling our energy-efficient LED products into the commercial and government markets. During the first quarter of 2015, we completed all outstanding solutions-based projects and are no longer accepting new solutions-based projects. As such, our management has determined that the Company operates in a single industry segment.

Additionally, product development remains a key focus for us. Our product development team is dedicated to developing and designing leading-edge technology LED lighting products, and we have curtailed our efforts on bidding on research contracts and grants.

### Results of operations

The following table sets forth items in our Condensed Consolidated Statements of Operations as a percentage of net sales for the periods indicated:

|  | Three months ended |         | Six months ended |         |   |
|--|--------------------|---------|------------------|---------|---|
|  | June 30,           |         | June 30,         |         |   |
|  | 2015               | 2014    | 2015             | 2014    | % |
| Net sales  | 100.0              | % 100.0 | % 100.0          | % 100.0 |   |
| Cost of sales  | 54.1               | 67.5    | 56.2             | 69.0    |   |
| Gross profit   | 45.9               | 32.5    | 43.8             | 31.0    |   |
| Operating expenses:  |                    |         |                  |         |   |
| Product development  | 4.0                | 3.0     | 4.0              | 3.4     |   |
| Selling, general, and administrative                         | 23.5               | 37.8    | 25.3             | 41.6    |   |
| Total operating expenses                                     | 27.5               | 40.8    | 29.3             | 45.0    |   |
| Operating income (loss)                                      | 18.4               | (8.3 )  | 14.5             | (14.0 ) |   |
| Other expenses (income):                                     |                    |         |                  |         |   |
| Interest expense   | 0.2                | 0.4     | 0.2              | 22.8    |   |
| Other (income) expenses                                      | (0.2 )             | 0.5     | 0.1              | 3.4     |   |
| Income (loss) from continuing operations before income taxes | 18.4               | (9.2 )  | 14.2             | (40.2 ) |   |
| Provision for income taxes                                   | 5.6                | —       | 3.1              | —       |   |
| Income (loss) from continuing operations                     | 12.8               | (9.2 )  | 11.1             | (40.2 ) |   |

Discontinued operations:

|                                   |      |   |      |      |      |      |       |    |
|-----------------------------------|------|---|------|------|------|------|-------|----|
| Loss from discontinued operations | (0.2 | ) | —    | (0.2 | )    | (0.2 | )     |    |
| Net income (loss)                 | 12.6 | % | (9.2 | )%   | 10.9 | %    | (40.4 | )% |

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## Net sales

A further breakdown of our net sales is presented in the following table (in thousands):

|  | Three months ended |          | Six months ended |           |
|--|--------------------|----------|------------------|-----------|
|  | June 30,           |          | June 30,         |           |
|  | 2015               | 2014     | 2015             | 2014      |
| Government products                                  | \$ 14,086          | \$ 2,715 | \$ 24,888        | \$ 4,193  |
| Commercial products                                  | 2,532              | 2,834    | 4,835            | 4,064     |
| R&D services   | 3                  | 17       | 20               | 40        |
| Turnkey solutions (formerly our "Solutions" segment) | —                  | 1,133    | 23               | 3,321     |
| Total net sales                                      | \$ 16,621          | \$ 6,699 | \$ 29,766        | \$ 11,618 |

Net sales of \$16.6 million for the second quarter of 2015 increased 148.1 percent compared to the second quarter of 2014. The increase was due to continued high-volume sales of our government products to a distributor for the U.S. Navy. Additionally, we shipped our first order for the Royal Australian Navy during the quarter. Net sales of our commercial products decreased 10.7 percent compared to the second quarter of 2014 due to a 64.9 percent decrease in sales from CLL, our U.K. subsidiary. The decrease in CLL sales was offset by a 24.2 percent increase in domestic commercial products sales. We had no turnkey solutions sales for the second quarter of 2015 due to completing our transition out of the turnkey solutions market and shifting our focus onto exclusively developing and selling our LED products.

Net sales of \$29.8 million for the first six months of 2015 increased 156.2 percent compared to the first six months of 2014.

Government products sales increased 493.6 percent due to continued high-volume sales to a distributor for the U.S. Navy, and commercial products sales increased 19.0 percent as we continued to penetrate the commercial, industrial, and Energy Service Company ("ESCO") markets. R&D services sales decreased, as we continued to focus our resources on projects and contracts that only support LED technologies. Additionally, turnkey solutions sales decreased 99.3 percent as a result of completing our transition out of the turnkey solutions market and shifting our focus onto exclusively developing and selling our LED products.

## Gross profit

Gross profit was \$7.6 million, or 45.9 percent of net sales, for the second quarter of 2015, compared to \$2.2 million, or 32.5 percent of net sales for the second quarter of 2014. The increase was due primarily to product mix, as sales for turnkey solutions which have historically carried lower gross margins, decreased for the second quarter of 2015. Additionally, the increase is attributable to engaging new suppliers to lower our product costs, performing value analysis/engineering processes, and our continuous development of operating efficiencies while building economies of scale to support sales volume increases.

Gross profit was \$13.0 million, or 43.8 percent of net sales, for the six months ended June 30, 2015, compared to \$3.6 million, or 30.8 percent of net sales for the six months ended June 30, 2014. The increase resulted primarily from product mix, as sales of our turnkey solutions, which have historically carried lower gross margins, decreased for the six months ended June 30, 2015. Additionally, the increase resulted from engaging new suppliers to lower our product costs, performing value analysis/engineering processes, and continuous development of our operating efficiencies while building economies of scale to support sales volume increases.



## Operating expenses

## Product development

Product development expenses include salaries, contractor and consulting fees, legal fees, supplies and materials, as well as overhead; such as depreciation and facility costs. Product development costs are expensed as they are incurred.

Total gross and net product development spending, including revenues and credits from government contracts, is shown in the following table (in thousands):

|                                     | Three months ended |        | Six months ended |        |
|-------------------------------------|--------------------|--------|------------------|--------|
|                                     | June 30,           |        | June 30,         |        |
|                                     | 2015               | 2014   | 2015             | 2014   |
| Gross product development expenses  | \$698              | \$329  | \$1,356          | \$649  |
| Cost recovery through cost of sales | (3                 | ) 4    | (20              | ) (19  |
| Cost recovery and other credits     | (38                | ) (130 | ) (136           | ) (236 |
| Net product development expenses    | \$657              | \$203  | \$1,200          | \$394  |

Gross product development expenses were \$698 thousand for for the second quarter of 2015, a \$369 thousand increase compared to the second quarter of 2014. The increase resulted from higher legal and outside testing fees of approximately \$196 thousand necessary in order for us to launch our proprietary commercial Intellitube® product line, as well as higher purchases of small tooling and equipment used in the development of our LED lighting technology products.

For the six months ended June 30, 2015, gross product development expenses were \$1.4 million, a \$707 thousand increase compared to \$649 thousand for the six months ended June 30, 2014. The increase resulted from higher legal and outside testing fees of approximately \$330 thousand necessary in order for us to launch our proprietary commercial Intellitube® product line, higher salaries and related benefits of approximately \$189 thousand due to hiring additional product engineers as we continue to dedicate resources toward the development of our LED lighting technology products.

## Selling, general and administrative

Selling, general, and administrative expenses were \$3.9 million, or 23.5 percent of net sales, for the second quarter of 2015, compared to \$2.5 million, or 37.8 percent of net sales, for the second quarter of 2014. The dollar increase resulted from higher sales and bonus incentives of approximately \$253 thousand which are tied to our improved financial performance, higher consulting costs of approximately \$215 thousand for various sales and marketing-related services contracted to support our growth, higher severance and settlement charges of approximately \$190 thousand, higher recruiting costs of approximately \$162 thousand due to building our sales and marketing infrastructure, and higher advertising and marketing costs of approximately \$140 thousand due to our increased attendance at industry-related trade shows.

For the six months ended June 30, 2015, selling, general, and administrative expenses were \$7.5 million, or 25.3 percent of net sales, compared to \$4.8 million, or 41.6 percent of net sales, for the six months ended June 30, 2014. The dollar increase resulted from higher severance and settlement charges of approximately \$581 thousand, higher sales and bonus incentives of approximately \$376 thousand which are tied to our improved financial performance, higher recruiting costs of approximately \$368 thousand due to building our sales and marketing infrastructure, higher consulting costs of approximately \$283 thousand for various sales and marketing-related services contracted to support our growth, and higher salaries and related benefits of approximately \$281 thousand due to building our infrastructure to support our continued growth.

Other income and expenses

Interest expense

Interest expense was \$26 thousand for the second quarter of 2015, compared to \$28 thousand for the second quarter of 2014. For the six months ended June 30, 2015 and 2014, interest expense was \$49 thousand and \$2.6 million, respectively. The first six months of 2014 included a \$2.3 million non-cash charge to write-off the remaining unamortized discount associated with the conversion of outstanding convertible notes into common stock in March 2014, as well as interest and other fees related to our line of credit facility.

#### Other income and expenses

Other income was \$25 thousand for the second quarter of 2015, compared to other expenses of \$33 thousand for the second quarter of 2014. For the six months ended June 30, 2015 and 2014, other expenses were \$32 thousand and \$393 thousand, respectively. Other expenses in 2014 included \$293 thousand to write-off the loan origination costs in connection with the conversion of the outstanding convertible notes in March 2014.

#### Provision for (benefit from) income taxes

For the three months ended June 30, 2015, we had \$923 thousand recorded to the provision for income taxes for U.S. federal and various states income tax after the application of the annual limitation set forth under Section 382 of the IRC. For the three months ended June 30, 2014, benefit from income taxes was \$1 thousand, and resulted from state and local tax credits received by what was formerly known as our "Solutions" segment.

For the six months ended June 30, 2015, provision for income taxes was \$913 thousand for U.S. federal and various states income tax after the application of the annual limitation set forth under Section 382 of the IRC. For the six months ended June 30, 2014, benefit from income taxes was \$2 thousand, and resulted from state and local tax credits received by what was formerly known as our "Solutions" segment.

#### Net income (loss)

Net income was \$2.1 million for the second quarter of 2015, compared to net loss of \$622 thousand for the second quarter of 2014. For the six months ended June 30, 2015, net income was \$3.2 million, compared to net loss of \$4.7 million for the six months ended June 30, 2014. Higher net sales, as well as continued operational improvements resulted in the improved financial results. Additionally, the net loss in the first quarter of 2014 included one-time charges of \$2.7 million related to the conversion of the unsecured convertible notes in March 2014 as described above.

#### Financial condition

We have historically incurred substantial losses, and as of June 30, 2015, we had an accumulated deficit of \$85.6 million. We have raised approximately \$20 million between 2013 and 2015 through the issuance of common stock and debt, and the exercise of outstanding warrants, which has been funding our operating expenses and working capital. Although we were profitable for the three and six months ended June 30, 2015, in order for us to continue to be profitable and grow our business, we will need to continue to improve upon executing our marketing and sales plans for our energy-efficient LED lighting products, developing new technologies into sustainable product lines, and continuing operational efficiencies in our supply chain performance and value engineering efforts.

There is a risk that our business may not be as successful as we envision as we work to generate sufficient cash flow to meet obligations and sustain or grow our operations without obtaining additional external financing. We currently have a revolving credit facility that provides funding for our operations. However, the lender may terminate the facility at any time by providing the requisite advance notice. There can be no assurance that we will generate sufficient cash flows to sustain and grow our operations or obtain funding on acceptable terms or in a timely fashion or at all. As such, we will continue to review and pursue selected external funding sources, if necessary, to execute these objectives including, but not limited to, the following:

- renew our existing credit facility on acceptable terms prior to its expiration or termination or obtain funding from other financial institutions on acceptable terms,
- obtain financing from traditional or non-traditional investment capital organizations or individuals, and
-

obtain funding from the sale of our common stock or other equity or debt instruments or the exercise of outstanding warrants.

Obtaining financing through the above-mentioned mechanisms contains risks, including:

additional equity financing may not be available to us in the current capital environment and could lead to further dilution of stockholder value for current stockholders,  
 loans or other debt instruments may have terms and/or conditions, such as interest rate, restrictive covenants and control or revocation provisions, which are not acceptable to management or our Board of Directors, and  
 the current environment in capital markets combined with our capital constraints may prevent us from being able to obtain adequate debt financing.

If we fail to generate cash or obtain additional financing to grow our business, we would need to delay or scale back our business plan, reduce our operating costs, or reduce our headcount, each of which would have a material adverse effect on our business, future prospects, and financial condition.

#### Liquidity and capital resources

##### Cash and cash equivalents

At June 30, 2015, our cash and cash equivalents balance was \$10.2 million, compared to \$7.5 million at December 31, 2014. The balance at June 30, 2015 included restricted cash of \$136 thousand, compared to \$105 thousand at December 31, 2014. The restricted cash balance relates to funds to be used exclusively for a research and development project with the National Shipbuilding Research Program. Additionally, our cash balance at June 30, 2015 and December 31, 2014 included \$300 thousand of the purchase price from the sale of our pool products business that remains in escrow subject to the resolution of outstanding buyer claims. For more information on the cash remaining in escrow, please refer to Note 17. Legal matters, included under Item 8. of our 2014 Annual Report.

The following summarizes cash flows from operating, investing, and financing activities, as reflected in the Condensed Consolidated Statements of Cash Flows (in thousands):

|   | Six months ended |           |
|---|------------------|-----------|
|   | June 30,         |           |
|   | 2015             | 2014      |
| Net cash provided by (used in) operating activities | \$424            | \$(2,913) |
| Net cash (used in) provided by investing activities | \$(360)          | ) \$23    |
| Net cash provided by financing activities           | \$2,588          | \$1,628   |

##### Net cash provided by (used in) operating activities

Net cash provided by operating activities was \$424 thousand for the six months ended June 30, 2015, and resulted primarily from the net income earned of \$3.2 million, offset by higher purchases of inventory to meet the increased demand for our LED products, and accrued federal and state income taxes that were not incurred for the same period in 2014. Net cash used in operating activities was \$2.9 million for the six months ended June 30, 2014, and resulted from the net loss incurred, adjusted for non-cash items.

##### Net cash (used in) provided by investing activities

Net cash used in investing activities was \$360 thousand for the six months ended June 30, 2015, and resulted from acquisitions of property and equipment, primarily implementation costs of our new ERP system that we began using effective July 1, 2015. Net cash provided by investing activities was \$23 thousand for the six months ended June 30, 2014, and resulted from receiving the proceeds on assets held for sale, offset by lower cash expended for acquisitions of property and equipment.





### Net cash provided by financing activities

Net cash provided by financing activities was \$2.6 million for the six months ended June 30, 2015, compared to \$1.6 million provided for the six months ended June 30, 2014. Net cash provided by financing activities for the six months ended June 30, 2015 included \$2.5 million received in proceeds for exercises of outstanding warrants and issuances of our common stock.

### Credit facilities

On December 22, 2011, we entered into a \$4.5 million revolving line of credit (“credit facility”) with Rosenthal & Rosenthal. The total loan amount available to us under the line of credit is equal to 85 percent of our net, eligible receivables, plus available inventory (50 percent of the lower of cost or market value of eligible inventory, or \$250 thousand, whichever is less). The credit facility is secured by a lien on our domestic assets. The interest rate for borrowing on accounts receivable is 8.5 percent, on inventories 10 percent, and on overdrafts 13 percent. Additionally, there is an annual 1 percent facility fee on the entire \$4.5 million amount of the credit facility payable at the beginning of the year. The agreement automatically renews from year to year each December 31st unless we provide requisite notice to Rosenthal 60 days in advance of the renewal date. Additionally, Rosenthal has the right to terminate the agreement at any time by providing 60 days written notice to us. As defined in the agreement, we are required to comply with certain financial covenants, measured quarterly, including a tangible net worth amount and a working capital amount. We were in compliance with the financial covenants as of June 30, 2015. Borrowings under the revolving line of credit were \$455 thousand and \$453 thousand at June 30, 2015 and December 31, 2014, respectively, and were recorded in the Condensed Consolidated Balance Sheets as a current liability under the caption “Credit line borrowings.” At June 30, 2015, there was approximately \$1.7 million available for us to borrow under this line of credit.

In January 2015, the invoice discounting arrangement we had in place for our subsidiary in the United Kingdom was terminated. As of June 30, 2015, we had not entered into any new financing arrangements for the subsidiary. Under the terms of the old arrangement, the amount available for borrowing was based at 80 percent of their eligible sales ledger. The interest rate for borrowing under the arrangement was 3.02 percent. While the arrangement was still in effect as of December 31, 2014; there were no borrowings outstanding.

### Critical accounting policies

There have been no material changes to our critical accounting policies as compared to those included in our 2014 Annual Report.

### Certain risks and concentrations

We had certain customers whose net sales individually represented 10 percent or more of our total net sales, or whose net trade accounts receivable balance individually represented 10 percent or more of our total net trade accounts receivable, as follows:

For the three months ended June 30, 2015, one customer accounted for approximately 77 percent of net sales. For the three months ended June 30, 2014, two customers accounted for approximately 43 percent of net sales. For the six months ended June 30, 2015, one customer accounted for approximately 79 percent of net sales. For the six months ended June 30, 2014, two customers accounted for approximately 34 percent of net sales.

At June 30, 2015, one customer accounted for approximately 64 percent of net trade accounts receivable. At December 31, 2014, three customers accounted for approximately 79 percent of net trade accounts receivable.

Recent accounting pronouncements

In January 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2015-01, Income Statement-Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items, which provides guidance on simplifying income statement presentation by eliminating the concept of extraordinary items from U.S. GAAP. The amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. A reporting entity may apply the amendments prospectively and retrospectively to all periods presented in the financial statements. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. We have evaluated the accounting guidance and determined that there is no impact of this update to our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue Recognition - Revenue from Contracts with Customers, which is a comprehensive revenue recognition standard that will supersede nearly all existing revenue recognition guidance under U.S. GAAP. The standard was to be effective for interim and annual periods beginning after December 15, 2016. However, on July 9, 2015, the FASB decided to delay the effective date of the standard by one year. Either full retrospective adoption or modified retrospective adoption is permitted. We are in the process of evaluating the impact of the standard.

In April 2014, the FASB issued ASU No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, which changes the criteria for reporting discontinued operations while enhancing disclosures in this area. Under the new guidance, only disposals representing a strategic shift in operations should be presented as discontinued operations. Those strategic shifts should have a major effect on the organization's operations and financial results. Examples include a disposal of a major geographic area, a major line of business, or a major equity method investment. Additionally, the new guidance requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, expenses of discontinued operations and of the pretax income attributable to a disposal of a significant part of an organization that does not qualify for discontinued operations reporting. The new standard is effective for interim and annual periods beginning after December 15, 2014. We have evaluated the accounting guidance and determined that this update will have no effect on our consolidated financial statements.

#### ITEM 4. CONTROLS AND PROCEDURES

##### (a) Evaluation of disclosure controls and procedures

We maintain "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act"), that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Our disclosure controls and procedures have been designed to meet reasonable assurance standards. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. Any design of disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer have concluded that, subject to the limitations noted above, our disclosure controls and procedures were effective as of June 30, 2015.

##### (b) Changes in internal control over financial reporting

There were no changes in our internal controls over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the quarter.



PART II – OTHER INFORMATION

ITEM 1A. RISK FACTORS

Reference is made to the Risk Factors included under Part I, Item 1A of our 2014 Annual Report, as there have been no significant changes to those risk factors.

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

None.

ITEM 5. OTHER INFORMATION

On August 4, 2015, we entered into a Share Sale Agreement with John Harris, the managing director of CLL, our wholly-owned subsidiary in the United Kingdom, pursuant to which Mr. Harris acquired CLL from us for nominal consideration. We forgave inter-company balances owed by CLL to the Company in connection with the transaction, but we do not expect the loss on the transaction to be material to our results. Net sales for CLL were \$923 thousand for the six months ended June 30, 2015, and represent an insignificant percentage of our total sales.

ITEM 6. EXHIBITS

The information required by this Item is set forth on the Exhibit Index that follows the signature page of this report.

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.

ENERGY FOCUS, INC.

Date: August 5, 2015

By: /s/ James Tu  
James Tu  
Executive Chairman and Chief Executive  
Officer

By: /s/ Marcia J. Miller  
Marcia J. Miller  
Chief Financial Officer

ENERGY FOCUS, INC.  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2015  
(Unaudited)

EXHIBIT INDEX

| Exhibit Number | Description of Documents   |
|----------------|--|
| 31.1           | Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2           | Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 32.1           | Certification of Principal Executive Officer and Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| *101           | The following financial information from our Quarterly Report for the quarter ended June 30 2015, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets at June 30, 2015 and December 31, 2014, (ii) Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2015 and 2014, (iii) Condensed Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended June 30, 2015 and 2014, (iv) Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2015 and 2014, (vi) the Notes to Condensed Consolidated Financial Statements. |

Pursuant to Regulation S-T, this interactive data file is deemed not filed or part of a registration statement or \*prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.