ENERGY FOCUS, INC/DE
Form 10-Q
May 12, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
Form 10-Q

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

For the quarterly period ended March 31, 2011

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 0-24230

ENERGY FOCUS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**94-3021850**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

32000 Aurora Rd., Solon, OH
(Address of principal executive offices)
44139
(Zip Code)
(Registrant s telephone number, including area code): **(440) 715-1300**
(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 þ 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 þ 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 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 o	Non-accelerated filer þ (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 þ

The number of outstanding shares of the registrant s Common Stock, $0.0001 par value, as of April 28, 2011 was 24,756,517.

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Item 1. Financial Statements

ENERGY FOCUS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(amounts in thousands except share and per share data)

	March 31, 2011 (unaudited)	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,446	$ 3,979
Restricted cash	125	128
Accounts receivable trade, net of allowances of $237 in 2011 and $446 in 2010	3,604	5,483
Retainage receivable	721	731
Inventories, net	3,415	2,543
Costs in excess of billings	67	22
Prepaid and other current assets	598	632
Total current assets	9,976	13,518
Property and equipment, net	2,391	2,446
Goodwill	672	672
Intangible assets, net	1,514	1,677
Collateralized assets	2,000	2,000
Other assets	53	61
Total assets	$ 16,606	$ 20,374
LIABILITIES		
Current liabilities:		
Accounts payable	$ 5,579	$ 7,167
Accrued liabilities	2,428	2,358
Deferred revenue	1,389	1,214
Billings in excess of costs	182	297
Current portion of long-term borrowings	498	481
Total current liabilities	10,076	11,517
Other deferred liabilities	34	28
Acquisition-related contingent liabilities	730	827
Long-term borrowings	1,383	1,344
Total liabilities	12,223	13,716
SHAREHOLDERS EQUITY		
Preferred stock, par value $0.0001 per share:		
Authorized: 2,000,000 shares in 2011 and 2010		

Issued and outstanding: no shares in 2011 and 2010				
Common stock, par value $0.0001 per share:				
Authorized: 60,000,000 shares in 2011 and 30,000,000 in 2010				
Issued and outstanding: 24,647,000 at March 31, 2011 and 23,962,000 at December 31, 2010		1		1
Additional paid-in capital		75,585		75,094
Accumulated other comprehensive income		470		423
Accumulated deficit		(71,673)		(68,860)
Total shareholders equity		4,383		6,658
Total liabilities and shareholders equity	$	16,606	$	20,374

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

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

	Three months ended March 31, 2011	Three months ended March 31, 2010
Net sales	$ 5,460	$ 8,357
Cost of sales	4,301	6,962
Gross profit	1,159	1,395
Operating expenses:		
Research and development	265	55
Sales and marketing	1,935	1,619
General and administrative	1,578	1,679
Valuation of equity instruments	56	1,421
Restructuring charges		26
Total operating expenses	3,834	4,800
Loss from operations	(2,675)	(3,405)
Other income (expense):		
Other income (expense)	49	(65)
Interest expense	(182)	(99)
Loss before income taxes	(2,808)	(3,569)
Provision for income taxes	(5)	(1)
Net loss	$ (2,813)	$ (3,570)
Net loss per share basic and diluted	$ (0.12)	$ (0.17)
Shares used in computing net loss per share basic and diluted	24,224	21,270

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

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ENERGY FOCUS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(amounts in thousands)
(unaudited)

	Three months ended March 31,	
	2011	**2010**
Net loss	$ (2,813)	$ (3,570)
Other comprehensive income (loss):		
Foreign currency translation adjustments	47	(77)
Comprehensive loss	$ (2,766)	$ (3,647)

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

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

	Three months ended March 31, 2011	Three months ended March 31, 2010
Cash flows from operating activities:		
Net loss	$ (2,813)	$ (3,570)
Adjustments to reconcile net loss from continuing operations to net cash used in operating activities:		
Depreciation	183	208
Stock-based compensation	183	202
Valuation of equity instruments	56	1,421
Provision for doubtful accounts receivable	14	7
Amortization of intangible assets	162	268
Amortization of discounts on long-term borrowings	123	36
Deferred revenue	60	296
Gain on disposal of fixed assets	(10)	
Changes in assets and liabilities:		
Accounts receivable, inventories, and other assets	992	(2,118)
Accounts payable and accrued liabilities	(1,799)	2,867
Total adjustments	(36)	3,187
Net cash used in operations activities	(2,849)	(383)
Cash flows from investing activities:		
Acquisition of fixed assets	(126)	(16)
Proceeds from the sale of fixed assets	9	
Net cash used investing activities	(117)	(16)
Cash flows from financing activities:		
Proceeds from issuances of common stock, net	413	
Proceeds from other borrowings		1,150
Net cash provided by financing activities	413	1,150
Effect of exchange rate changes on cash	17	(3)
Net (decrease) increase in cash and cash equivalents	(2,536)	748
Cash and cash equivalents at beginning of period	4,107	1,062

Cash and cash equivalents at end of period	$ 1,571	$ 1,810
Classification of cash and cash equivalents:		
Cash and cash equivalents	$ 1,446	$ 1,682
Restricted cash held	125	128
Cash and cash equivalents at end of period	$ 1,571	$ 1,810

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

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ENERGY FOCUS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2011
(Unaudited)

NOTE 1. NATURE OF OPERATIONS

Energy Focus, Inc. and its subsidiaries (the Company) engage in the design, development, manufacturing, marketing, and installation of energy-efficient lighting systems and solutions where the Company serves two segments:

solutions-based sales providing turnkey, high-quality, energy-efficient lighting application alternatives primarily to the existing public-sector building market; and

product-based sales providing military, general commercial and industrial lighting and pool lighting offerings, each of which markets and sells energy-efficient lighting systems.

The Company continues to evolve its business strategy to include providing its customers with turnkey, comprehensive energy-efficient lighting solutions, which use, but are not limited to, its patented and proprietary technology. Company product-based solutions include light-emitting diode (LED), fiber optic, high-intensity discharge (HID), fluorescent tube and other highly energy-efficient lighting technologies. Typical savings related to the current technology of the Company approximates 80% in electricity costs, while providing full-spectrum light closely simulating daylight colors. The Company s strategy also incorporates continued investment into the research of new and emerging energy sources including, but not limited to, LED and solar energy applications.

The Company s development of solar technology continues through its role in the United States Government s Very High Efficiency Solar Cell (VHESC) Consortium sponsored by the Defense Advanced Research Projects Agency (DARPA). The goal of the VHESC project is to develop a 40% or greater efficient solar cell for United States military applications, which would also ultimately become available to the public for commercial application.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies of the Company, which are summarized below, are consistent with generally accepted accounting principles and reflect practices appropriate to the business in which it operates.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates include, but are not limited to, the establishment of reserves for accounts receivable, sales returns, inventory obsolescence, and warranty claims; the useful lives for property, equipment, and intangible assets; revenues recognized on a percentage-of-completion basis; and stock-based compensation. In addition, estimates and assumptions associated with the determination of fair value of financial instruments and evaluation of goodwill and long-lived assets for impairment requires considerable judgment. Actual results could differ from those estimates and such differences could be material.

Reclassifications

Certain prior year amounts have been reclassified within the Condensed Consolidated Financial Statements (financial statements), and related notes thereto, to be consistent with the current year presentation.

Basis of Presentation

The financial statements include the accounts of the Company and its subsidiaries, Stones River Companies, LLC (SRC) in Nashville, Tennessee, and Crescent Lighting Limited (CLL) located in the United Kingdom. All significant inter-company balances and transactions have been eliminated.

Interim Financial Statements (unaudited)

Although unaudited, the interim financial statements in this report reflect all adjustments, consisting only of all normal recurring adjustments, which are, in the opinion of management, necessary for a fair statement of financial position, results of operations, and cash flows for the interim periods covered and of the financial condition of the Company at the interim balance sheet date. The results of operations for the interim periods presented are not necessarily indicative of the results expected for the entire year.

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The accompanying interim financial statements have been prepared assuming the Company will continue to operate as a going concern, which contemplates the realization of assets and the settlement of liabilities in the normal course of business. The interim financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from uncertainty related to the Company s ability to continue as a going concern.

Year-end Balance Sheet

The year-end balance sheet information was derived from audited financial statements but does not include all disclosures required by generally accepted accounting principles. These financial statements should be read in conjunction with the Company s audited financial statements and notes thereto for the year ended December 31, 2010, which are contained in the Company s 2010 Annual Report on Form 10-K.

Recent Accounting Pronouncements

In April 2011, the Financial Accounting Standards Board (FASB) issued revisions to the accounting guidance related to troubled debt restructuring. This new guidance is effective for the first interim or annual period beginning on or after June 15, 2011 and should be applied retrospectively to the beginning of the annual period of adoption. While we are currently evaluating the effect this new guidance may have on our financial statements, we do not believe that it will have a material effect on its consolidated results of operations, cash flows or financial position.

Foreign Currency Translation

The Company s international subsidiary uses its local currency as its functional currency. Assets and liabilities are translated at exchange rates in effect at the balance sheet date and income and expense accounts are translated at average exchange rates during the year. Resulting translation adjustments are recorded directly to Accumulated other comprehensive income within shareholders equity. Foreign currency transaction gains and losses are included as a component of Other income (expense) . Gains and losses from foreign currency translation are included as a separate component of Other comprehensive loss within the Condensed Consolidated Statement of Comprehensive Income (Loss).

Liquidity

Historically, the Company has incurred losses attributable to operational performance which have negatively impacted cash flows. Although management continues to address many of the legacy issues that have historically burdened the Company s financial performance, the Company still faces challenges in order to reach profitability. In order for the Company to attain profitability and growth, the Company will need to successfully address these challenges, including the continuation of cost reductions throughout the organization, execution of its marketing and sales plans for the Company s turnkey energy-efficient lighting solutions business, the development of new technologies into sustainable product lines and continued improvements in supply chain performance.

The Company is optimistic about obtaining the funding necessary to meet on-going tactical and strategic capital requirements. However, there can be no assurances that this objective will be successful. As such, the Company will continue to review and pursue selected external funding sources, if necessary, to execute these objectives including the following:

- obtain financing from traditional and non-traditional investment capital organizations or individuals,
- potential sale or divestiture of one or more operating units, and
- obtain funding from the sale of common stock or other equity or debt instruments.

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

- 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 the Board of Directors, the current economic environment combined with the Company s capital constraints may prevent the Company from being able to obtain any debt financing,

financing may not be available for parties interested in pursuing the acquisition of one or more operating units of the Company, and

ENERGY FOCUS, INC.
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additional equity financing may not be available in the current economic environment and could lead to further dilution of shareholder value for current shareholders of record.

Retainage Receivable

The Company s solutions-based sales are normally subject to a holdback of a percentage of the sale as retainage. This holdback is recorded on the Company s Condensed Consolidated Balance Sheet as Retainage receivable . Retainage is a portion of the total bid price of a project that is held back by the customer until the project is complete and functioning satisfactorily according to the contract terms. Retainage percentages typically range from 5% to 10% and are collected anywhere from three to eighteen months from the inception of the project.

Collateralized Assets

The Company maintains $2,000,000 of cash collateral related to the Company s $10,000,000 surety bonding program associated with SRC. This cash is pledged to the surety carrier through December 2011, unless the Company is able to provide sufficient alternative means of collateralization satisfactory to the surety carrier.

Earnings (Loss) per Share

Basic loss per share is computed by dividing net loss available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted loss per share is computed giving effect to all dilutive potential common shares that were outstanding during the period. Dilutive potential common shares consist of incremental shares upon exercise of stock options and warrants, unless the effect would be anti-dilutive.

A reconciliation of basic and diluted loss per share is provided as follows (in thousands, except per share amounts):

	Three months ended March 31, 2011	Three months ended March 31, 2010
Basic and diluted loss per share:		
Net loss	$ (2,813)	$ (3,570)
Basic and diluted loss per share:		
Weighted average shares outstanding	24,224	21,270
Basic and diluted net loss per share	$ (0.12)	$ (0.17)

At March 31, 2011 and 2010, options and warrants to purchase 5,619,000 and 7,963,000 shares of common stock, respectively, were outstanding, but were not included in the calculation of diluted net loss per share because their inclusion would have been anti-dilutive.

Stock-Based Compensation

The Company s stock-based compensation plan is described in detail in its Annual Report on Form 10-K for the year ended December 31, 2010. The following table summarizes the Company s stock-based compensation (in thousands):

	Three months ended March 31, 2011	Three months ended March 31, 2010
Stock option expense	$ 23	$ 147
Executive & Director stock-based compensation	54	55
Employee incentive stock-based compensation	106	
Total stock-based compensation	$ 183	$ 202

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Total unearned compensation of $847,000 related to stock options remains at March 31, 2011 compared to $1,444,000 at March 31, 2010. These costs will be charged to expense, amortized on a straight line basis, in future periods through the first quarter of 2015. The remaining weighted average life of the outstanding options is approximately 2.0 years.

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 option, risk-free interest rate, and expected volatility, and are further comparatively detailed as follows:

	Three months ended March 31,	
	2011	**2010**
Fair value of options issued	$ 0.76	$ 0.70
Exercise price	$ 1.07	$ 1.02
Expected life of option	4.0 years	4.0 years
Risk-free interest rate	1.50%	1.86%
Expected volatility	104.52%	97.40%
Dividend yield	0%	0%

At the 2010 Annual Meeting of Shareholders (Annual Meeting) held on June 16, 2010, the shareholders approved an increase in the total number of shares of common stock that may be awarded under the 2008 Incentive Stock Plan from 1,000,000 shares to 3,000,000 shares. Under this plan, the Company granted 615,000 stock options through the three months ended March 31, 2011 and 910,000 during the three months ended March 31, 2010. Of the 910,000 stock options granted in 2010, 900,000 were performance-based stock options exercisable by the grantees if, and only if, the Company achieves required revenue and cash-flow generation targets as reported in the Company s 2010 Form 10-K. The Company s performance in 2010 did not meet most of these established performance goals and, consequently, 850,000 of these performance-based stock options were cancelled on April 1, 2011.

In the third quarter of 2010, the Board of Directors approved a program offering the independent Directors of the Company the option of accepting restricted shares of the Company s common stock in lieu of quarterly cash compensation. Directors who chose to participate and accept restricted shares in lieu of cash compensation would receive the equivalent of two dollars ($2.00) of Company common stock for every one dollar ($1.00) of their normal cash compensation. Directors that chose to accept this program agreed to receive restricted shares as compensation for four consecutive quarters, covering the period of July 2010 until June 2011 with the aforementioned common stock vesting over an equivalent 12 month period. The price of the common stock shares was based on the closing price of the Company s common stock on September 20, 2010. On September 1, 2010, four of the five Directors agreed to participate in this program and, subsequently, the participants were issued 123,000 shares of restricted common stock. Director stock compensation expense under this program amounted to $54,000 for the three months ended March 31, 2011 related to these restricted shares.

On May 29, 2009, the Company s five senior executive officers agreed to accept voluntary salary reductions for the remainder of the 2009 calendar year in exchange for the issuance of restricted shares of common stock as authorized under the Company s 2008 Incentive Stock Plan. Two other key executives of the Company also accepted salary reductions for the balance of the year in exchange for restricted shares. Each officer and key executive voluntarily accepted a ten percent (10%) salary reduction for the remainder of 2009, except for one officer who voluntarily accepted a forty percent (40%) decrease for the remainder of 2009. The number of restricted shares of common stock issued to each officer and executive was equal to the dollar value of the individual s salary reduction divided by the closing price per share of the Company s common stock on May 29, 2009. The total number of restricted shares of common stock issued to these officers and executives was 209,000. The Company reserved the right to extend these salary reductions into the 2010 calendar year and beyond. Additionally, on May 29, 2009, two members of the Company s Board of Directors voluntarily relinquished their directors fee for the balance of 2009 in exchange for restricted shares of common stock on the same terms as the shares granted to the officers. The number of restricted shares of common stock issued to each director was equal to the dollar value of the individual s relinquished director s fee divided by the closing price per share of the Company s common stock on May 29, 2009. The total number of restricted shares of common stock issued to these directors was 19,000.

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On December 31, 2009, the Company s five executive officers, along with two other key executives of the Company, agreed to extend these salary reductions through June 30, 2010. On July 9, 2010, the Company s Chief Executive Officer, with the approval of the Board of Directors, decided to continue the cash salary reductions through December 31, 2010. Each executive officer and key executive voluntarily accepted a 10% salary reduction for 2010, except for one executive officer who voluntarily accepted a 40% decrease for 2010. The number of restricted shares of Common Stock issued to each executive officer and key executive was equal to the dollar value of the individual s salary reduction divided by the closing price per share of the Company s Common Stock on December 30, 2009 and January 3, 2011, respectively. The total number of restricted shares of Common Stock issued to these officers and executives in 2010 was 284,000. The Company recorded compensation expense of $55,000 for the quarter ended March 31, 2010 related to these restricted shares.

Product Warranties

The Company warrants finished goods against defects in material and workmanship under normal use and service for periods of one to three years for products and labor. Settlement costs consist of actual amounts expensed for warranty services which are largely a result of third-party service calls, and the costs of replacement products. A liability for the estimated future costs under product warranties is maintained for products outstanding under warranty and is included in Accrued liabilities in the Condensed Consolidated Balance Sheet. The warranty activity for the respective years is as follows (in thousands):

	Three months ended March 31, 2011	Three months ended March 31, 2010
Balance at the beginning of the period	$ 126	$ 211
Accruals for warranties issued	7	(5)
Settlements made during the period (in cash or in kind)	(17)	(20)
Balance at the end of the period	$ 116	$ 186

NOTE 3. 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 (in thousands):

	March 31, 2011	December 31, 2010
Raw materials	$ 2,605	$ 2,164
Inventory reserve	(958)	(972)
Finished goods	1,768	1,351
Inventories	$ 3,415	$ 2,543

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ENERGY FOCUS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2011
(Unaudited)

NOTE 4. PROPERTY AND EQUIPMENT

Property and equipment is 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):

	March 31, 2011	December 31, 2010
Equipment (useful life 3 - 15 years)	$ 5,831	$ 6,328
Tooling (useful life 2 - 5 years)	2,507	2,507
Furniture and fixtures (useful life 5 years)	143	161
Computer software (useful life 3 years)	375	373
Leasehold improvements (the shorter of useful life or lease life)	626	909
Construction in progress	87	14
Property and equipment at cost	9,569	10,292
Less: accumulated depreciation	(7,178)	(7,846)
Property and equipment, net	$ 2,391	$ 2,446

NOTE 5. GOODWILL AND INTANGIBLE ASSETS

The following table summarizes information related to net carrying value of intangible assets (in thousands):

	Amortization Life (in years)	March 31, 2011	December 31, 2010
Goodwill	n/a	$ 672	$ 672
Definite-lived intangible assets:			
Tradenames	10	437	450
Customer relationships	5	1,077	1,227
Total definite-lived intangible assets		1,514	1,677
Total intangible assets, net		$ 2,186	$ 2,349

Amortization expense for intangible assets subject to amortization was $162,000 and 268,000 for the three months ended March 31, 2011 and 2010, respectively. The Company amortizes Tradenames on a straight-line basis over the estimated useful lives of the intangible assets. Customer relationships are amortized over their expected useful lives on an accelerated method that approximates the cash flows associated with those relationships. Based on the carrying value of amortized intangible assets the Company estimates amortization expense for future years to be as follows (in thousands):

Year ending December 31,	Amount
2012	$ 420
2013	253
2014	105
2015	