ENERGY FOCUS, INC/DE
Form 10-Q
August 08, 2018
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, 2018

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 001-36583

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

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

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

The number of outstanding shares of the registrant's Common Stock, $0.0001 par value, as of August 3, 2018 was 12,047,272.

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PART I - FINANCIAL INFORMATION

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 subsidiary, 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 “wou 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 Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2017 and Part II, Item 1A of this Quarterly 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;
- our reliance on a limited number of customers, in particular our historical sales of products for the U.S. Navy, for a significant portion of our revenue, and our ability to maintain or grow such sales levels;
- the entrance of new competitors in our target markets;
- general economic conditions in the United States and in other markets in which we operate or secure products;
- our ability to implement and manage our growth plans to increase sales and control expenses;
- our ability to increase demand in our targeted markets and to manage sales cycles that are difficult to predict and may span several quarters;
- the timing of large customer orders and significant expenses, and fluctuations between demand and capacity, as we invest in growth opportunities;
- our dependence on military maritime customers and on the levels of government funding available to such customers, as well as the funding resources of our other customers in the public sector and commercial markets;
- market acceptance of LED lighting technology;
- our ability to respond to new lighting technologies and market trends, and fulfill our warranty obligations with safe and reliable products;

- any delays we may encounter in making new products available or fulfilling customer specifications;
- our ability to compete effectively against companies with greater resources, lower cost structures, or more rapid development efforts;
- our ability to protect our intellectual property rights and other confidential information, and manage infringement claims by others;
- the impact of any type of legal inquiry, claim, or dispute;

- our reliance on a limited number of third-party suppliers, our ability to obtain critical components and finished products from such suppliers on acceptable terms, and the impact of our fluctuating demand on the stability of such suppliers;
- our ability to timely and efficiently transport products from our third-party suppliers to our facility by ocean marine channels;
- our ability to successfully scale our network of sales representatives, agents, and distributors to match the sales reach of larger, established competitors;
- any flaws or defects in our products or in the manner in which they are used or installed;
- our compliance with government contracting laws and regulations, through both direct and indirect sale channels, as well as other laws, such as those relating to the environment and health and safety;
- risks inherent in international markets, such as economic and political uncertainty, changing regulatory and tax requirements and currency fluctuations, including tariffs and other potential barriers to international trade;
- our ability to attract and retain qualified personnel, and to do so in a timely manner; and
- our ability to maintain effective internal controls and otherwise comply with our obligations as a public company.

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® is our registered trademark. 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, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$8,619	$ 10,761
Trade accounts receivable, less allowances of $31 and $42, respectively	3,369	3,595
Inventories, net	5,739	5,718
Prepaid and other current assets	1,042	596
Assets held for sale	—	225
Total current assets	18,769	20,895
Property and equipment, net	847	1,097
Other assets	147	159
Total assets	$19,763	$ 22,151
LIABILITIES		
Current liabilities:		
Accounts payable	$3,021	$ 1,630
Accrued liabilities	197	130
Accrued payroll and related benefits	393	394
Accrued sales commissions	167	124
Accrued restructuring	93	170
Accrued warranty reserve	196	174
Deferred revenue	12	5
Total current liabilities	4,079	2,627
Other liabilities	176	232
Total liabilities	4,255	2,859
STOCKHOLDERS' EQUITY		
Preferred stock, par value $0.0001 per share:		
Authorized: 2,000,000 shares in 2018 and 2017		
Issued and outstanding: no shares in 2018 and 2017	—	—
Common stock, par value $0.0001 per share:		
Authorized: 30,000,000 shares in 2018 and 2017		
Issued and outstanding: 12,047,272 at June 30, 2018 and 11,868,896 at December 31, 2017	1	1
Additional paid-in capital	127,906	127,493
Accumulated other comprehensive income	(1)	2
Accumulated deficit	(112,398)	(108,204)
Total stockholders' equity	15,508	19,292
Total liabilities and stockholders' equity	$19,763	$ 22,151

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 June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Net sales	$5,172	$6,011	$9,831	$10,117
Cost of sales	3,876	4,510	7,719	8,055
Gross profit	1,296	1,501	2,112	2,062
Operating expenses:				
Product development	673	763	1,302	1,534
Selling, general, and administrative	2,421	2,778	5,068	6,409
Restructuring	3	1,060	(47)	1,734
Total operating expenses	3,097	4,601	6,323	9,677
Loss from operations	(1,801)	(3,100)	(4,211)	(7,615)
Other expenses (income):				
Interest expense	1	—	2	—
Other (income) expense	2	14	(19)	21
Loss from operations before income taxes	(1,804)	(3,114)	(4,194)	(7,636)
Provision for income taxes	—	—	—	—
Net loss	$(1,804)	$(3,114)	$(4,194)	$(7,636)
Net loss per share - basic and diluted	$(0.15)	$(0.26)	$(0.35)	$(0.65)
Weighted average shares used in computing net loss per share:				
Basic and diluted	11,949	11,791	11,925	11,755

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

ENERGY FOCUS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(in thousands)
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Net loss	$(1,804)	$(3,114)	$(4,194)	$(7,636)
Other comprehensive (loss) income:				
Foreign currency translation adjustments	(4)	(3)	(3)	2
Comprehensive loss	$(1,808)	$(3,117)	$(4,197)	$(7,634)

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

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ENERGY FOCUS, INC.
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(in thousands)
(Unaudited)

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount				
Balance at December 31, 2017	11,869	$ 1	$ 127,493	$ 2	$ (108,204)	$ 19,292
Issuance of common stock under employee stock option and stock purchase plans	193		22			22
Common stock withheld in lieu of income tax withholding on vesting of restricted stock units	(15)		(39)			(39)
Stock-based compensation			430			430
Foreign currency translation adjustment				(3)		(3)
Net loss from continuing operations for the six months ended June 30, 2018					(4,194)	(4,194)
Balance at June 30, 2018	12,047	$ 1	$ 127,906	$ (1)	$ (112,398)	$ 15,508

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

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

	Six months ended June 30, 2018	2017
Cash flows from operating activities:		
Net loss	$(4,194)	$(7,636)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	294	348
Stock-based compensation	430	433
Stock-based compensation reversal	—	(270)
Provision for doubtful accounts receivable	(11)	1
Provision for slow-moving and obsolete inventories and valuation reserves	(409)	(271)
Provision for warranties	15	44
(Gain) loss on dispositions of property and equipment	(15)	104
Changes in operating assets and liabilities:		
Accounts Receivable	237	2,180
Inventories	388	1,839
Prepaid and other assets	(435)	(122)
Accounts payable	1,471	(175)
Accrued and other liabilities	(79)	359
Deferred revenue	8	18
Total adjustments	1,894	4,488
Net cash used in operating activities	(2,300)	(3,148)
Cash flows from investing activities:		
Acquisitions of property and equipment	(57)	(115)
Proceeds from the sale of property and equipment	240	72
Net cash provided by (used in) investing activities	183	(43)
Cash flows from financing activities:		
Proceeds from exercises of stock options and employee stock purchase plan purchases	21	105
Common stock withheld to satisfy income tax withholding on vesting of restricted stock units	(39)	(49)
Net cash (used in) provided by financing activities	(18)	56
Effect of exchange rate changes on cash	(7)	(7)
Net decrease in cash and cash equivalents	(2,142)	(3,142)
Cash and cash equivalents, beginning of period	10,761	16,629
Cash and cash equivalents, end of period	$8,619	$13,487
Classification of cash and cash equivalents:		
Cash and cash equivalents	$8,277	$13,145
Restricted cash held	$342	$342
Cash and cash equivalents, end of period	$8,619	$13,487

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

ENERGY FOCUS, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2018
(Unaudited)

NOTE 1. NATURE OF OPERATIONS

Energy Focus, Inc. and its subsidiary engage in the design, development, manufacturing, marketing, and sale of energy-efficient lighting systems. We operate in a single industry segment, developing and selling our energy-efficient light-emitting diode ("LED") lighting products into the general commercial, industrial and military maritime markets. Our mission is to enable our customers to run their facilities with greater energy efficiency, productivity, and wellness through advanced LED retrofit solutions. Our goal is to be the retrofit technology and market leader for the most demanding applications where performance, quality, and health really matter. We specialize in LED lighting retrofit by replacing fluorescent lamps in institutional buildings and high-intensity discharge ("HID") lighting in low-bay and high-bay applications with our innovative, high-quality commercial and military tubular LED ("TLED") and other LED products.

Product development is a key focus for us. Our product development teams, including our teams located in our Solon, Ohio headquarters, at our San Jose, California technology center, and at our product development center in Taipei, Taiwan, are dedicated to developing and designing leading-edge technology LED lighting products.

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 subsidiary Energy Focus Europe, Ltd. located in the United Kingdom, which is not active. Unless indicated otherwise, the information in the accompanying financial statements and Notes to the condensed consolidated financial statements relates to our continuing operations.

We have prepared the accompanying financial data for the three and six months ended June 30, 2018 and 2017 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 Annual Report on Form 10-K for the year ended December 31, 2017 ("2017 Annual Report"). The Condensed Consolidated Balance Sheet as of December 31, 2017 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

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, 2018 and December 31, 2017, Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2018 and 2017, Condensed Consolidated Statements of Comprehensive Loss for the three and six months ended June 30, 2018 and 2017, Condensed Consolidated Statements of Changes in Stockholders' Equity for the six months ended June 30, 2018, and Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2018 and 2017.

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; valuation allowance for net deferred taxes; the cost and offsetting income related to subleased property; 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.

Reclassifications

Certain amounts related to warranty accruals and settlements were reclassified to conform to current period reporting presentation with no impact on financial position, loss from operations, or cash used in operations.

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, 2018, sales to our primary distributor for the U.S. Navy, a global healthcare system located in Northeast Ohio and a regional commercial lighting retrofit company located in Texas accounted for approximately 29 percent, 15 percent and 11 percent of net sales respectively. When sales to our primary distributor for the U.S. Navy are combined with sales to a shipbuilder for the U.S. Navy, sales of products for the U.S. Navy comprised approximately 33 percent of net sales for the same period. For the three months ended June 30, 2017, sales to the global healthcare system located in Northeast Ohio and our primary distributor for the U.S. Navy each individually accounted for approximately 11 percent of net sales for the period. When sales to our primary distributor for the U.S. Navy are combined with sales to a shipbuilder for the U.S. Navy, sales of products for the U.S. Navy comprised approximately 12 percent of net sales.

For the six months ended June 30, 2018, sales to our primary distributor for the U.S. Navy and a global healthcare system located in Northeast Oho accounted for approximately 37 percent and 12 percent, respectively. When sales to our primary distributor for the U.S. Navy are combined with sales to a shipbuilder for the U.S. Navy, sales of products for the U.S. Navy comprised approximately 41 percent of net sales for the same period. For the six months ended June 30, 2017, sales to a global healthcare system located in Northeast Ohio and our primary distributor for the U.S. Navy accounted for approximately 15 percent and 12 percent, respectively. When sales to our primary distributor for the U.S. Navy are combined with sales to a shipbuilder for the U.S. Navy, sales of products for the U.S. Navy comprised approximately 17 percent of net sales.

Our primary distributor for the U.S. Navy, the global healthcare system located in Northeast Ohio and a regional commercial lighting retrofit company located in Texas accounted for approximately 30 percent, 17 percent, and 12 percent of net trade accounts receivable, respectively, at June 30, 2018. At December 31, 2017, our primary distributor for the U.S. Navy, the global healthcare system located in Northeast Ohio, and a regional commercial lighting retrofit company located in Texas accounted for approximately 39 percent, 21 percent, and 17 percent of net trade accounts receivable, respectively.

Recent accounting pronouncements

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, which significantly changes the accounting for credit losses on instruments within its scope. The new guidance introduces an approach based on expected losses to estimate credit losses on certain financial instruments, including trade receivables, and requires an entity to recognize an allowance based on its estimate of expected credit losses rather than incurred losses. This standard will be effective for interim and annual periods beginning after December 15, 2019, and will generally require adoption on a modified retrospective basis. We are in the process of evaluating the impact of the standard.

In February 2016, the FASB issued ASU No. 2016-02, Leases, which supersedes the current lease accounting requirements. This standard requires a lessee to record on the balance sheet the assets and liabilities for the rights and obligations created by leases with lease terms of more than 12 months. In addition, this standard requires lessees to disclose certain key information about lease transactions. Upon implementation, an entity’s lease payment obligations will be recognized at their estimated

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present value along with a corresponding right-of-use asset. Lease expense recognition will be generally consistent with current practice. This standard will be effective for interim and annual periods beginning after December 15, 2018, and will require adoption on a modified retrospective basis. We are in the process of evaluating the impact of the standard.

Update to significant accounting policies

Revenue

On January 1, 2018, we adopted ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), as amended by subsequently issued additional guidance (together, "ASC 606") using the modified retrospective method. The adoption of ASC 606 did not have a material impact on our consolidated financial position or results of operations, as our revenue arrangements generally consist of a single performance obligation to transfer promised goods at a fixed price.

Net sales include revenues from sales of products and shipping and handling charges, net of estimates for product returns. Revenue is measured at the amount of consideration we expect to receive in exchange for the transferred products. We recognize revenue at the point in time when we transfer the promised products to the customer and the customer obtains control over the products. We recognize revenue for shipping and handling charges at the time the goods are shipped to the customer, and the costs of outbound freight are included in cost of sales, as we have elected the practical expedient included in ASC 606. We provide for product returns based on historical return rates. While we incur costs for sales commissions to our sales employees and outside agents, we recognize commission costs concurrent with the related revenue, as the amortization period is less than one year and we have elected the practical expedient included in ASC 606. We do not incur incremental costs to obtain contracts with our customers. Our product warranties are assurance-type warranties, which promise the customer that the products are as specified in the contract. Therefore, the product warranties are not a separate performance obligation and are accounted for as described below. Sales taxes assessed by governmental authorities are accounted for on a net basis and are excluded from net sales.

The following table provides a disaggregation of product net sales for the periods presented:

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Net sales:				
Commercial	$2,972	$5,178	5,177	8,257
Military maritime	2,200	833	4,654	1,860
Total net sales	$5,172	$6,011	$9,831	$10,117

Accounts Receivable

Our trade accounts receivable consists of amounts billed to and currently due from customers. Credit is extended to customers based upon an evaluation of the customer's financial condition and the amounts due are stated at their estimated net realizable value. We maintain an allowance for doubtful accounts receivable to provide for the estimated amount of receivables that will not be collected. The allowance is based on an assessment of customer creditworthiness and historical payment experience, the age of outstanding receivables, and performance guarantees to the extent applicable. Past due amounts are written off when our internal collection efforts have been unsuccessful. Our standard payment terms with customers are net 30 days, and we do not generally offer extended payment terms to our customers. Accordingly, we do not adjust trade accounts receivable for the effects of financing, as we expect the period between the transfer of product to the customer and the receipt of payment from the customer to be in line with our standard payment terms.

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There have been no other material changes to our significant accounting policies, as compared to those described in our 2017 Annual Report.

Geographic information

Approximately 98 percent of our long-lived fixed assets are located in the United States, with the remainder located in our product development center in Taiwan. Net sales attributable to customers outside the United States accounted for approximately five percent and one percent of our net sales for the three months ended June 30, 2018 and 2017, respectively. Net sales attributable to customers outside the United States accounted for approximately three percent and one percent of our total net sales for the six months ended June 30, 2018 and 2017, respectively. The geographic location of our net sales is derived from the destination to which we ship the product.

Net loss per share

Basic loss per share is computed by dividing net 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 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 or release of restricted stock units unless the effect would be anti-dilutive.

As a result of the net loss we incurred for the three and six months ended June 30, 2018, approximately 87 thousand and 83 thousand potentially dilutive equity awards, respectively, were excluded from the net loss per share calculation, as their inclusion would have been anti-dilutive. As a result of the net loss we incurred for the three and six months ended June 30, 2017, approximately 64 thousand and 99 thousand potentially dilutive equity awards, respectively, were excluded from the net loss per share calculation for this same reason. Therefore, for the three and six months ended June 30, 2018 and 2017, the basic weighted average shares outstanding were used in calculating diluted loss per share.

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

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Numerator:				
Net loss	$(1,804)	$(3,114)	$(4,194)	$(7,636)
Denominator:				
Basic weighted average common shares outstanding	11,949	11,791	11,925	11,755
Potential common shares from equity awards and warrants	—	—	—	—
Diluted weighted average shares	11,949	11,791	11,925	11,755

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Product warranties

Through March 31, 2016, we warranted finished goods against defects in material and workmanship under normal use and service for periods generally between one and five years. Beginning April 1, 2016, we warrant our commercial LED tubes, globes, and troffer luminaires for a period of ten years. Warranty settlement costs consist of actual amounts expensed for warranty, which are largely a result of the cost of replacement products provided to our customers. A liability for the estimated future costs under product warranties is maintained for products outstanding under warranty based on the actual claims incurred to date and the estimated nature, frequency, and costs of future claims. These estimates are inherently uncertain and changes to our historical or projected experience may cause material changes to our warranty reserves in the future. We continuously review the assumptions related to the adequacy of our warranty reserve, including product failure rates, and make adjustments to the existing warranty liability when there are changes to these estimates or the underlying replacement product costs, or the warranty period expires. Extending the warranty did not have a material impact on our condensed consolidated financial statements in 2017 or for the three and six months ended June 30, 2018. The following table summarizes warranty activity for the periods presented (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Balance at beginning of period	$141	$258	$174	$331
Warranty accruals for current period sales	7	31	15	44
Adjustments to existing warranties	55	(16)	54	(66)
In kind settlements made during the period	(7)	(94)	(47)	(130)
Accrued warranty reserve	$196	$179	$196	$179

NOTE 3. RESTRUCTURING

During the first quarter of 2017, we announced a restructuring initiative with a goal of significantly reducing annual operating costs from 2016 levels. The initiative included an organizational consolidation of management and oversight functions in order to streamline and better align the organization into more focused, efficient, and cost effective reporting relationships, and involved headcount reductions and office closures. This initiative was designed to return the Company to profitability and mitigate the substantial doubt that existed at December 31, 2016 about our ability to continue as a going concern. For additional information regarding the restructuring actions taken in the 2017, please refer to Note 3., “Restructuring,” included under Item 8 of our 2017 Annual Report.

During the six months ended June 30, 2018, we recorded net restructuring credits totaling approximately $50 thousand, primarily related to the revision of our initial estimates of the cost for the remaining lease obligation for our former Arlington, Virginia office. Restructuring adjustments recorded during the three months ended June 30, 2018 related to the accretion of the remaining lease obligations for the former New York, New York and Arlington, Virginia offices.

For the three months ended June 30, 2017, we recorded restructuring charges totaling approximately $1.1 million, consisting of approximately $0.9 million in facilities costs related to the remaining lease obligations for the former

New York and Arlington offices, $0.1 million in severance and related benefits, and $0.1 million in other restructuring costs primarily related to fixed asset and prepaid expenses write-offs. For the six months ended June 30, 2017, we recorded restructuring charges totaling approximately $1.7 million, consisting of approximately $0.7 million in severance and related benefits, $0.9 million in facilities costs related to the termination of the Rochester, Minnesota lease obligation and the remaining lease obligations for the former New York and Arlington offices, and $0.1 million in other restructuring costs primarily related to fixed asset and prepaid expenses write-offs.

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Our restructuring liabilities consist of one-time termination costs for severance and benefits to former employees and estimated ongoing costs related to long-term operating lease obligations. The recorded value of the termination severance and benefits to employees approximates fair value, as the remaining obligation is based on the arrangements made with the former employees, and these obligations will be completely satisfied in less than 12 months. The recorded value of the ongoing lease obligations is based on the remaining lease term and payment amount, net of estimated sublease income, discounted to present value. Changes in subsequent periods resulting from a revision to either the timing or the amount of estimated cash flows over the future period are measured using the credit adjusted, risk-free rate that was used to measure the restructuring liabilities initially. We expect to incur insignificant additional costs over the remaining life of our lease obligations, but we do not anticipate further major restructuring activities in the near future. The following is a reconciliation of the beginning and ending balances of our restructuring liability:

	Severance and Related Benefits	Facilities	Total
Balance at January 1, 2018	$ 62	$ 340	$402
Accretion of lease obligations	—	6	6
Adjustment of lease obligations	—	(56)	(56)
Payments	(62)	(6)	(68)
Balance at March 31, 2018	$ —	$ 284	$284
Accretion of lease obligations	—	3	3
Payments	—	(25)	(25)
Balance at June 30, 2018	$ —	$ 262	$262

While substantial doubt about our ability to continue as a going concern continued to exist at June 30, 2018, we had $8.6 million in cash and no debt obligations at the end of the quarter. In addition, the restructuring actions taken in 2017 resulted in a decrease in total operating expenses, including restructuring charges, of approximately $3.4 million in the first half of 2018 compared to the first half of 2017. Consequently, considering both quantitative and qualitative information, we continue to believe that the combination of our restructuring actions, current financial position, liquid resources, obligations due or anticipated within the next year, executive reorganization, and implementation of our sales channel strategy will return us to break-even levels in 2019 and effectively mitigates the substantial doubt about our ability to continue as a going concern.

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 net realizable value, and consist of the following (in thousands):

	June 30, 2018	December 31, 2017
Raw materials	$3,003	$ 3,316
Finished goods	6,523	6,598
Reserves for excess, obsolete, and slow moving inventories and valuation reserves	$(3,787)	$ (4,196)
Inventories, net	$5,739	$ 5,718

NOTE 5. PROPERTY AND EQUIPMENT AND ASSETS HELD FOR SALE

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):

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	June 30, 2018	December 31, 2017
Equipment (useful life 3 to 15 years)	$1,582	$ 1,557
Tooling (useful life 2 to 5 years)	371	371
Vehicles (useful life 5 years)	47	47
Furniture and fixtures (useful life 5 years)	137	137
Computer software (useful life 3 years)	1,043	1,043
Leasehold improvements (the shorter of useful life or lease life)	211	201
Projects in progress	62	55
Property and equipment at cost	3,453	3,411
Less: accumulated depreciation	(2,606)	(2,314)
Property and equipment, net	$847	$ 1,097

Depreciation expense was $0.1 million and $0.2 million the three months ended June 30, 2018 and 2017, respectively. Depreciation expense was $0.3 million for each of the six months ended June 30, 2018 and 2017.

During the first quarter of 2018, we completed the sale of the equipment that we previously classified as held for sale. We received net proceeds from the sale of $0.2 million and recognized a gain on the sale of approximately $15 thousand. The gain on the sale is classified on our Condensed Consolidated Statements of Operations under the caption, “Other (income) expense.”

NOTE 6. INCOME TAXES

As a result of the operating loss incurred during each of the three and six months ended June 30, 2018 and 2017, and after the application of the annual limitation set forth under Section 382 of the Internal Revenue Code (“IRC”), it was not necessary to record a provision for U.S. federal income tax or various states income taxes.

At June 30, 2018 and December 31, 2017, 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 realize the deferred tax assets, primarily consisting of certain net operating loss carry-forwards. The valuation allowance is based on management’s estimates of taxable income by jurisdiction and the periods over which the deferred tax assets will be recoverable.

At December 31, 2017, we had a net operating loss carry-forward of approximately $91.8 million for U.S. federal, state, and local income tax purposes. However, due to changes in our capital structure, approximately $37.3 million of the net operating loss carry-forward is available to offset future taxable income, and after the application of the limitations found under Section 382 of the IRC, we expect to have approximately $37.3 million of this amount available for use in 2018. If not used, these carry-forwards will begin to expire in 2021 for federal and have begun to expire for state and local purposes. For a full discussion of the estimated restrictions on our utilization of net operating loss carry-forwards, please refer to Note 11, “Income Taxes,” included under Item 8 of our 2017 Annual Report.

NOTE 7. STOCKHOLDERS’ EQUITY

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 presented (in thousands):

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	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Cost of sales	$10	$12	$19	$30
Product development	30	16	55	29
Selling, general, and administrative	195	198	356	374
Total stock-based compensation	$235	$226	$430	$433

The table above excludes approximately $0.3 million in stock-based compensation expense from prior periods that was reversed and included as a reduction to restructuring expenses due to the workforce reduction associated with our restructuring actions in the first quarter of 2017.

Total unearned stock-based compensation was $1.3 million at June 30, 2018, compared to $1.1 million at June 30, 2017. These costs will be charged to expense and amortized on a straight-line basis in future periods. The weighted average period over which the unearned compensation at June 30, 2018 is expected to be recognized is approximately 2.1 years.

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,	
	2018	2017
Fair value of options issued	$1.74	$2.72
Exercise price	$2.46	$3.63
Expected life of options (in years)	5.8	5.8
Risk-free interest rate	2.3 %	2.1 %
Expected volatility	84.3 %	91.9 %
Dividend yield	0.0 %	0.0 %

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A summary of option activity under all plans for the six months ended June 30, 2018 is presented as follows:

	Number of Options	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life (in years)
Balance at December 31, 2017	248,512	$ 5.76	
Granted	25,035	2.46	
Exercised	—	—	
Canceled/forfeited	(21,428)	9.94	
Expired	(10,000)	20.00	
Balance at June 30, 2018	242,119	$ 4.46	