

CAPSTONE TURBINE Corp  
Form 10-Q/A  
November 08, 2018  
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

---

Form 10-Q/A

Amendment No.1

---

(Mark One)

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

For the quarterly period ended September 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: 001-15957

---

Capstone Turbine Corporation

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	95-4180883 (I.R.S. Employer Identification No.)
16640 Stagg Street Van Nuys, California (Address of principal executive offices)	91406 (Zip Code)

818-734-5300

(Registrant's telephone number, including area code)

---

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit 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	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 shares outstanding of the registrant's common stock as of November 2, 2018 was 68,415,345.

---

Table of Contents

EXPLANATORY NOTE

Capstone Turbine Corporation (the “Company”) is filing this Amendment No. 1 on Form 10-Q/A (this “Amendment”) to the Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2018, originally filed with the U.S. Securities and Exchange Commission (the “SEC”) on November 6, 2018 (the “Original Filing”). This Amendment is solely to correct a clerical error regarding net product orders contained within Part I, Item 2, “Management’s Discussion and Analysis of Financial Condition and Results of Operations”. The Original Filing incorrectly stated that the Company had net product orders of approximately \$19.4 million for the three months ended September 30, 2018. The correct net product orders for the three months ended September 30, 2018 was \$8.8 million.

The Company is including with this Amendment new certifications by its Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. Because this Amendment does not contain or amend any disclosure with respect to Items 307 and 308 of Regulation S-K, paragraphs 4 and 5 of the certifications have been omitted.

Except as described above, no other changes have been made to the Original Filing. The Original Filing continues to speak as of the date of the Original Filing, and the Company has not updated the disclosures contained therein to reflect any events which occurred at a date subsequent to the filing of the Original Filing other than as expressly indicated in this Amendment.

Table of Contents

CAPSTONE TURBINE CORPORATION

INDEX

	Page Number
<u>PART I — FINANCIAL INFORMATION</u>	4
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	4
<u>PART II — OTHER INFORMATION</u>	22
<u>Item 6. Exhibits</u>	22
<u>Signatures</u>	24

Table of Contents

PART I — FINANCIAL INFORMATION

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

The following discussion should be read in conjunction with the condensed consolidated financial statements and notes included in this Form 10-Q and in our Annual Report on Form 10-K for Fiscal 2018. When used in this Form 10-Q, and in the following discussion, the words “believes”, “anticipates”, “intends”, “expects” and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties which could cause actual results to differ materially from those projected. These risks include those under Risk Factors in our Annual Report on Form 10-K for Fiscal 2018 and in other reports we file with the Securities and Exchange Commission (“SEC”). Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date hereof. We assume no obligation to update any of the forward-looking statements contained herein after the filing of this Form 10-Q to conform such statements to actual results or changes in expectations except as may be required by law. All dollar amounts are approximate.

Overview

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

Our goals for Fiscal 2019 are to achieve EBITDA breakeven; significantly grow gross margin and revenue for our accessories, parts and service; strengthen our core market verticals, while diversifying into additional market verticals and geographies; and drive towards 100% aftermarket sales absorption. During the second quarter Fiscal 2019 our net loss increased by 19% to \$4.4 million and our basic and diluted loss per share improved by 22% to \$0.07 compared to \$3.7 million and \$0.09, respectively, in the same period of the previous year. The increase in the net loss during the second quarter of Fiscal 2019 was primarily the result of not recognizing revenue on certain service contracts because of the reassignment of those service contracts from Capstone’s legacy California distributor to Cal Microturbine. In addition, our net loss was negatively impacted because of an increase in our warranty provision during the second quarter of Fiscal 2019 as a result of a supplier defect identified during the first quarter of Fiscal 2019. The improvement in the net loss per share during the second quarter of Fiscal 2019 was primarily the result of an increase in weighted average shares outstanding to 65.1 million for the second quarter of Fiscal 2019 from 42.9 million for the

second quarter of Fiscal 2018. Total revenue increased 12% during the second quarter of Fiscal 2019 primarily because of an increase in revenue from the United States and Canada and Middle East and Africa geographic markets compared to the same period last year. The first half of Fiscal 2019 was characterized by a growth of 11% in our total revenue, strengthening of the natural resources market while diversifying into Latin America, Russia and Middle East and Africa, compared to the first half of Fiscal 2018. Additionally, though the U.S. dollar has somewhat weakened against other currencies, it still continues to be an issue in select markets as the strong dollar makes our products more expensive in those markets as we sell in U.S. dollars.

Our products continue to gain interest in all six of the major vertical markets (energy efficiency, renewable energy, natural resources, critical power supply, microgrid and transportation). In the energy efficiency market, we continue to expand our market presence in hotels, office buildings, hospitals, retail and industrial applications globally. The renewable energy market is fueled by landfill gas, biodiesel, and biogas from sources such as food processing, agricultural waste and livestock manure. Our product sales in the oil and gas and other natural resources market is driven by our microturbines' reliability, emissions profile and ease of installation. Given the volatility of the oil and gas market, our business strategy is to target projects within the energy efficiency and renewal energy markets. However, we experienced growth in the natural resources market during the second quarter of Fiscal 2019, which we believe was

Table of Contents

primarily because oil prices continued to be above \$60.00 per barrel. Although we have experienced an improvement in revenue during the second quarter of Fiscal 2019 primarily because of a rebound in oil prices, we continue to be impacted by the volatility of the global oil and gas markets and the ongoing global geopolitical tensions. We also continue to see interest in critical power supply applications as customers want solutions that can handle both primary and backup power.

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

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

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

The following table summarizes our product shipments by vertical markets:

	Three Months Ended September 30, 2018		Six Months Ended September 30, 2017	
	2018	2017	2018	2017
Energy efficiency	53%	66%	40%	61%
Natural resources	44%	15%	51%	27%
Renewable energy	3%	19%	6%	12%
Microgrid	—	—	3%	—

#### Energy Efficiency—CHP/CCHP

Energy efficiency refers to the proper utilization of both electrical and thermal energies in the power production process. In such applications, our microturbines are able to maximize the availability of usable energy to provide a significant economic advantage to customers while reducing their onsite emissions. CHP and CCHP can improve site economics by capturing the waste heat created from a single combustion process to increase the efficiency of the total system, from approximately 30 percent to 80 percent or more. Compared with more traditional, independent generation sources, the increase in operational efficiency also reduces greenhouse gas emissions through the displacement of other separate systems, which can also reduce operating costs.

#### Natural Resources—Oil, Natural Gas, Shale Gas & Mining



Our microturbines are installed in the natural resource market for use in both onshore and offshore applications, including oil and gas exploration, production, and at compression and transmission sites as a highly efficient and reliable source of power. In some cases, these oil and gas or mining operations have no electric utility grid and rely solely on power generated onsite. There are numerous locations, on a global scale, where the drilling, production, compression and transportation of natural resources and other extraction and production processes create fuel byproducts, which are traditionally burned or released into the atmosphere. Our microturbines can turn these fuel byproducts - flare gas, or associated gas, into a useable fuel to provide prime power to these sites.

## Table of Contents

### Renewable Energy

There is a growing transition to renewable energy sources and technologies happening on a global scale. Our microturbines run efficiently on renewable fuels such as methane and other biogases from landfills, wastewater treatment facilities and other small biogas applications like food processing plants, livestock farms and agricultural waste operations. Microturbines can burn these renewable fuels with minimal emissions, thereby, and in some cases, avoiding the imposition of penalties incurred for pollution while simultaneously producing electricity from this “free” fuel source for use at the site or in the surrounding areas. Our microturbines have demonstrated effectiveness in these smaller applications and may outperform conventional combustion engines in some situations, including when the gas contains a high amount of sulfur.

### Critical Power Supply

Because of the potentially catastrophic consequences of system failure, momentary or otherwise, certain high demand power users, including high technology, health care and information systems facilities require higher levels of reliability in their power generation service. To meet these customer requirements, traditional solutions utilize UPS to protect critical loads from power disturbances along with back-up diesel generators for extended outages. We offer an alternative solution that can both meet customer reliability requirements and reduce operating costs. We have seen continued development in the critical market segment as it relates to health care facilities.

### Microgrid

Microgrid is a group of interconnected loads and distributed energy resources that act as a single controllable energy entity with respect to the grid. Distributed energy resources typically include other dual-mode microturbines, reciprocating engines, solar photovoltaic (PV), wind turbine, fuel cells and battery storage. Microgrids can be connected to larger electricity grids; however, in the event of a widespread outage, the microgrid will disconnect from the main grid and continue to operate independently to maintain the electricity supply to the homes and businesses that are connected to the microgrid’s electricity network. Our microturbines have the ability to meet the needs of microgrid end-users by lowering their overall cost to operate and by providing a versatile dispatchable technology that is fuel flexible and scalable enough to fit a wide variety of applications. We have seen continued development in the microgrid market segment.

### Transportation

Our technology is also used in hybrid electric vehicle (“HEV”) applications. Our customers have applied our products in HEV applications such as transit buses and Class 7 and 8 work trucks. In these applications, the microturbine acts as an onboard battery charger to recharge the battery system as needed. The benefits of microturbine-powered HEV hybrids include extended range, fuel economy gains, quieter operation, reduced emissions and higher reliability when compared with traditional internal combustion engines.

Our technology is also used in marine applications. Our customers have applied our products in the commercial vessel and luxury yacht market segments. The application for our marine products is for use as a ship auxiliary engine. In this application, the microturbines provide power to the vessel’s electrical loads and, in some cases, the vessel is able to utilize the exhaust energy to increase the overall efficiency of the application, thereby reducing overall fuel consumption and emissions. Another feasible application is similar to our HEV application where the vessel is driven by an electric propulsion system and the microturbine serves as an on board range extender. Transportation is a developing market segment for us. In Fiscal 2018, transportation products were only for customer demonstrations.

### Backlog

Net product orders were approximately \$8.8 million and \$5.8 million for the three months ended September 30, 2018 and 2017, respectively. Ending backlog was approximately \$78.4 million at September 30, 2018 compared to \$110.9 million at September 30, 2017. Book-to-bill ratio was 0.7:1 and 0.5:1 for the three months ended September 30, 2018 and 2017, respectively. Book-to-bill ratio is the ratio of new orders we received to units shipped and billed during a period.

6

---

Table of Contents

During the first quarter of Fiscal 2019 we removed from product backlog orders related to Regatta Solutions, our former California distributor (“Regatta”) for approximately \$3.8 million. This removal was the result of the reassignment of the California sales territory to Cal Microturbine, our new exclusive distribution partner in California.

On October 13, 2017, we entered into an Accounts Receivable Assignment Agreement (the “Assignment Agreement”) and Promissory Note (the “Note”) with Turbine International, LLC (“TI”).

Pursuant to the terms of the Assignment Agreement, we agreed to assign to TI the right, title and interest to receivables owed to us from BPC Engineering, our former Russian distributor (“BPC”), upon TI’s payment to us of \$2.5 million in three payments by February 1, 2018. We received payments from TI of approximately \$1.0 million under the Assignment Agreement during Fiscal 2018 which was recorded as bad debt recovery. The receivables owed to us from BPC had a balance of \$5.3 million as of March 31, 2018, and this balance was fully reserved. As of March 31, 2018, the right, title and interest to the accounts receivables owed to us from BPC had not been assigned to TI, as TI had not yet made all payments as required under the Assignment Agreement by February 1, 2018.

In connection with the terms of the Note, we granted TI the sole distribution rights for our products and services in the Russian oil and gas sector. As a result of this appointment, TI agreed to pay us \$3.8 million over a three-year period in 35 equal monthly installments starting in August 2018.

On October 13, 2017, we and Hispania Petroleum, S.A. (the “Guarantor”), entered into a Guaranty Agreement (the “Guaranty Agreement”) whereby the Guarantor guarantees TI’s obligations under the Agreement and Note. However, due to our limited business relationship with TI and the missed payments on the Assignment Agreement, we deferred recognition of the Assignment Agreement and Note until collectability is reasonably assured.

On June 5, 2018, we entered into an amendment to the Assignment Agreement (the “Amended Assignment Agreement”) and the Note (the “Amended Note”) with TI. Pursuant to the terms of the Amended Assignment Agreement, the right, title and interest to receivables owed to us from BPC will be contingent upon TI’s payment to us of the remaining approximately \$1.5 million in five payments by September 20, 2019. During the first quarter of Fiscal 2019 no payment was due under these agreements. Under the terms of the Amended Note, TI agreed to pay us \$3.8 million over a three-year period in 13 equal quarterly installments starting in December 20, 2019.

Due to the above amendments, during the three months ended March 31, 2018 we removed product orders related to BPC from backlog for approximately \$7.2 million. This removal was the result of product pricing that we no longer would honor. Additionally, during the three months ended September 30, 2018 we removed product orders related to BPC from backlog for approximately \$10.6 million. This removal was the result of our continuous review of BPC related backlog with TI which resulted in us no longer honoring the product pricing. After removal of the foregoing orders, the remaining backlog related to BPC as of September 30, 2018 comprises up to approximately 39% of our total backlog. This remaining backlog related to BPC continues to be reviewed with TI and the other new distributors in the region, and they have the right to request delivery of those backlog orders if the associated projects proceed. Nonetheless, the remaining backlog related to BPC may be negatively impacted.

A portion of our backlog is concentrated in the international oil and gas market which may impact the overall timing of shipments or the conversion of backlog to revenue. The timing of the backlog is based on the requirement date indicated by our customers. However, based on historical experience, management expects that a significant portion of our backlog may not be shipped within the next 18 months. Additionally, the timing of shipments is subject to change based on several variables (including customer deposits, payments, availability of credit and customer delivery schedule changes), most of which are not in our control and can affect the timing of our revenue. As a result, management believes the book-to-bill ratio demonstrates the current demand for our products in the given period.

2. Sales and Distribution Channels We seek out distributors that have business experience and capabilities to support our growth plans in our targeted markets. A significant portion of our revenue is derived from sales to

7

---

## Table of Contents

distributors who resell our products to end users. We have a total of 104 distributors, Original Equipment Manufacturers (“OEMs”) and national accounts. In the United States and Canada, we currently have 25 distributors, OEMs and national accounts. Outside of the United States and Canada, we currently have 79 distributors, OEMs and national accounts. We continue to refine our distribution channels to address our specific targeted markets.

Effective January 1, 2018, we launched our Distributor Support System (“DSS program”) to provide additional support for distributor business development activities, customer lead generation, brand awareness and tailored marketing services for each of our major geography and market vertical. This new program is funded by our distributors and was developed to provide improved worldwide distributor training, sales efficiency, website development, company branding and provide funding for increased strategic marketing activities. See Note 13—Revenue Recognition for additional discussion of revenue recognition for this program.

3. **Service** We provide service primarily through our global distribution network. Together with our global distribution network, we offer a comprehensive FPP for a fixed annual fee to perform regularly scheduled and unscheduled maintenance as needed. We provide factory and on-site training to certify all personnel that are allowed to perform service on our microturbines. FPPs are generally paid quarterly in advance. Our FPP backlog as of September 30, 2018 was approximately \$73.8 million, which represents the value of the contractual agreement for FPP services that has not been earned and extends through Fiscal 2031. Our FPP backlog as of March 31, 2018 was approximately \$75.6 million. Our FPP backlog as of September 30, 2017 was approximately \$74.7 million. Additionally, we offer new and remanufactured parts through our global distribution network.
4. **Product Robustness and Life Cycle Maintenance Costs** We continue to invest in enhancements that relate to high performance and high reliability. An important element of our continued innovation and product strategy is to focus on the engineering of our product hardware and electronics to make them work together more effectively and deliver improved microturbine performance, reliability and low maintenance cost to our customers.
5. **New Product Development** Our new product development is targeted specifically to meet the needs of our selected vertical markets. We expect that our existing product platforms, the C30, C65, C200 and C1000 Series microturbines, will be our foundational product lines for the foreseeable future. Our research and development project portfolio is centered on enhancing the features of these base products.

During the three months ended September 30, 2018 we received funding from the Department of Energy Technology Commercialization to refine Argonne National Laboratory’s (“Argonne”) high-efficiency, fast-charging and fast-discharging thermal energy-storage system (“TESS”) for use in CHP systems. The new Capstone CHP system will incorporate Argonne’s high-efficiency, fast-charging, and fast-discharging thermal energy system for waste heat recovery and reuse in projects that require process heat and industrial manufacturing environments. This new project focuses on integrating Argonne’s TESS into a C200 CHP system, specifically, using thermal modeling and simulations to optimize system design; fabricating and integrating the TESS into the C200 system; testing the performance of the integrated TESS-C200 CHP system and conducting both a technology and economic analysis to establish performance and cost benefits of the new integrated microturbine and thermal battery solution.

Our product development activities during Fiscal 2018 included the completion of the new family of PowerSync controllers used for Capstone microturbines. We also improved our C65 heat recovery module and launched a new cleanable severe environment air filtration system for our line of microturbine products. In addition, our product development activities during Fiscal 2018 included research in the certification for our C200S microturbine by Underwriters Laboratories Inc. (UL) to the latest UL 1741 interconnection standards that became effective in 2016.

We are also developing a more efficient microturbine CHP system with the support of the Department of Energy, which awarded us a grant of \$5.0 million in support of this development program, of which \$4.2 million was allocated to us and was used through September 30, 2015. We successfully completed the first phase of the development program on September 30, 2015 and achieved 270 kW with a prototype C250

Table of Contents

microturbine in our development test lab. Management intends to continue with the next phase of development and commercialization after we achieve profitability. In Fiscal 2018, we completed the second phase of long-term endurance test. The next phase will be to continue development of the C250 product architecture as well as the associated power electronics and software controls required for successful commercialization.

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

Our manufacturing designs include the use of conventional technology, which has been proven in high volume automotive and turbocharger production for many years. Many components used in the manufacture of our products are readily fabricated from commonly available raw materials or off the shelf items available from multiple supply sources; however, certain items are custom made to meet our specifications that require longer lead time. We believe that in most cases, adequate capacity exists at our suppliers and that alternative sources of supply are available or could be developed within a reasonable period of time. However, single source suppliers with long lead times may be more challenging to transition to another supplier. We have an ongoing program to develop alternative back up suppliers for sole source parts wherever possible, however this has been challenging with low production volumes and increased pricing. We regularly reassess the adequacy and abilities of our suppliers to meet our future needs. During the fourth quarter of Fiscal 2018, we received notification from one of our single source suppliers that they were at maximum capacity and would require prepayment and a significant increase in the price of multiple components in order to fulfill our supply requirements for Fiscal 2019. Due to their capacity issues, it is uncertain if we will experience an interruption in parts from this supplier or be able to fully offset or recover any resulting component price increases. This could impact margins or sales in future quarters. During the first quarter of Fiscal 2019 we issued a prepayment of approximately \$2.2 million to this single source supplier.

We believe that effective execution in each of these key areas will be necessary to leverage Capstone's promising technology and early market leadership into achieving positive cash flow with growing market presence and improving financial performance. Based on our recent progress and assuming achievement of targeted cost reductions and product mix, pricing and performance and our increasing accessories, parts and service revenue with improved gross margins, our financial model indicates that we will achieve positive cash flow when we generate \$25 million in quarterly revenue with a 20% gross margin. We expect to have costs increase in certain areas in Fiscal 2019, including sales and marketing, which if not offset by an increase in revenue, would reduce margins and profitability as we have limited ability to further reduce costs.

During the third quarter of Fiscal 2018, we consolidated our operations and offices into our Van Nuys location and we believe that our production capacity is approximately 2,000 units per year, depending on product mix. We believe we will be able to support this production capacity level by adding additional shifts, which would increase working capital requirements, and making some additional capital expenditures when necessary.



## Critical Accounting Policies and Estimates

The preparation of our condensed consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. Management believes the most complex and sensitive judgments, because of their significance to the condensed consolidated financial statements, result primarily from the need to make estimates about the effects of matters that are inherently uncertain. Actual results could differ from management's estimates. Management believes the critical accounting policies listed below affect our more significant accounting judgments and estimates used in the preparation of the condensed consolidated financial

9

---

Table of Contents

statements. These policies are described in greater detail in our Annual Report on Form 10-K for Fiscal 2017 and continue to include the following areas:

- Impairment of long-lived assets, including intangible assets with finite lives;
- Inventory write-downs and classification of inventories;
- Estimates of warranty obligations;
- Accounts receivable allowances;
- Deferred tax assets and valuation allowance; and
- Stock-based compensation expense.

Except for the accounting policy for revenue recognition that was updated, as set forth above, as a result of adopting Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606), there have been no changes to our significant accounting policies described in the Annual Report on Form 10-K for the Fiscal Year 2018 filed with the SEC on June 7, 2018, that have had a material impact on our condensed consolidated financial statements and related notes.

Results of Operations

Three Months Ended September 30, 2018 and 2017

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

	Three Months Ended	
	September 30,	
	2018	2017
	Revenue	Revenue
United States and Canada	\$ 11.1	\$ 9.2
Europe and Russia	4.4	4.5
Latin America	1.8	1.4
Asia and Australia	2.7	3.6
Middle East and Africa	2.2	1.1
Total	\$ 22.2	\$ 19.8

Revenue Revenue for the three months ended September 30, 2018 increased \$2.4 million, or 12%, to \$22.2 million from \$19.8 million for the three months ended September 30, 2017. The change in revenue for the three months ended September 30, 2018 compared to the three months ended September 30, 2017 included increases in revenue of \$1.9 million from the United States and Canadian markets, \$1.1 million from the Middle East and African markets and \$0.4 million from the Latin American market. These overall increases in revenue were offset by decreases in revenue of \$0.9 million from the Asian and Australian markets and \$0.1 million from the European and Russian markets. The increase in revenue in the United States and Canadian markets during the three months ended September 30, 2018 compared to the same period last year was primarily because the natural resources and energy efficiency vertical markets continue to improve. The increase in revenue in the Middle East and African markets was primarily the result of our continued investment in key growth initiatives in those markets. However, our revenue in the Middle East and African markets continues to be negatively impacted by the volatility of the global oil and gas markets and ongoing geopolitical tensions in these regions. The increase in revenue in the Latin American market was primarily because of an increase in C200 and C1000 Signature Series systems shipments during the three months ended September 30, 2018 compared to the same period last year. The decrease in revenue in the Asian and Australian markets was primarily because of a decrease in accessories and parts shipments during three months ended September 30, 2018 compared to the same period last year. The decrease in revenue in the European and Russian markets was primarily because of a decrease in product shipments into the European energy efficiency and renewable energy vertical markets. Our revenue in the European and Russian markets continues to be negatively impacted by the ongoing geopolitical tensions and a strong U.S. dollar in certain markets making our products more expensive in such markets.

Table of Contents

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

	Three Months Ended September 30,			2017		
	2018					
	Revenue	Megawatts	Units	Revenue	Megawatts	Units
Microturbine Product	\$ 14.9	15.9	82	\$ 12.2	11.3	68
Accessories and Parts	3.8			3.8		
Service	3.5			3.8		
Total Accessories, Parts and Service	7.3			7.6		
Total	\$ 22.2			\$ 19.8		

For the three months ended September 30, 2018, revenue from microturbine products increased \$2.7 million, or 22%, to \$14.9 million from \$12.2 million for the three months ended September 30, 2017. The increase in revenue and megawatts shipped was primarily because of a favorable shift in product mix, as we sold a higher number of our C1000 Series systems, offset by a decrease in revenue per megawatt shipped during the three months ended September 30, 2018 compared to the same period last year. Megawatts shipped was 15.9 megawatts and 11.3 megawatts during the three months ended September 30, 2018 and 2017, respectively. Average revenue per megawatt shipped was approximately \$0.9 million and \$1.1 million during the three months ended September 30, 2018 and 2017, respectively. Average revenue per megawatt decreased as a result of a shipment of 2.0 megawatts of remanufactured systems during the second quarter of Fiscal 2019. These systems had a much lower selling price than the new systems. The timing of shipments is subject to change based on several variables (including customer deposits, payments, availability of credit and delivery schedule changes), most of which are not within our control and can affect the timing of our revenue.

Revenue from our accessories and parts was \$3.8 million for each of the three months ended September 30, 2018 and 2017, respectively.

Service revenue for the three months ended September 30, 2018 decreased \$0.3 million, or 8%, to \$3.5 million from \$3.8 million for the three months ended September 30, 2017. The decrease in service revenue was primarily the result of not recognizing revenue on certain service contracts because of the reassignment of those service contracts from Capstone's legacy California distributor to Cal Microturbine. This decrease was offset by an increase in revenue from our Distributor Support System ("DSS program"). Effective January 1, 2018 we launched our DSS program to provide additional support for distributor business development activities, customer lead generation, brand awareness and tailored marketing services for each of our major geography and market vertical. This new program is funded by our distributors and was developed to provide improved worldwide distributor training, sales efficiency, website development, company branding and provide funding for increased strategic marketing activities. Earned revenue from our DSS program for the three months ended September 30, 2018 was \$0.3 million and included under the caption "Service revenue" in the accompanying condensed consolidated statements of operations.

Sales to Horizon Power Systems ("Horizon"), one of our domestic distributors, E-Finity Distributed Generation, LLC ("E-Finity"), one of our domestic distributors and Safwan Petroleum Technologies Company ("SPETCO International"), one of our Middle East and African distributors, accounted for 15%, 12% and 10%, respectively, of revenue for the three months ended September 30, 2018. Sales to Reliable Secure Power Systems, ("RSP"), Regatta Solutions, Inc. ("Regatta") and E-Finity Distributed Generation, LLC ("E-Finity"), three of the Company's domestic distributors, and Optimal Group Australia Pty Ltd, one of the Company's Australian distributors and IBT Europe GmbH ("IBT"), one of the Company's European distributors, accounted for 12%, 11%, 11%, 11% and 10%, respectively, of revenue for the three months ended September 30, 2017.

**Gross Margin** Cost of goods sold includes direct material costs, production and service center labor and overhead, inventory charges and provision for estimated product warranty expenses. The gross margin was \$2.0 million, or 9% of revenue, for the three months ended September 30, 2018 compared to a gross margin of \$3.0 million, or 15% of revenue, for the three months ended September 30, 2017. The decrease in gross margin of \$1.0 million during the three months ended September 30, 2018 compared to the three months ended September 30, 2017 was primarily because of incremental warranty expense of \$0.6 million, a \$0.4 million decrease in our direct material costs margin and higher production and service center labor and overhead expense of \$0.2 million, offset by lower royalty expense of \$0.2 million. In addition to consolidating our manufacturing processes into our Van Nuys location, management continues to

Table of Contents

implement initiatives to improve gross margin in Fiscal 2019 by further reducing manufacturing overhead and direct material costs, and improving product performance as we work to achieve profitability.

Warranty expense is a combination of a standard warranty provision recorded at the time revenue is recognized and changes, if any, in estimates for reliability repair programs. Reliability repair programs are based upon estimates that are recorded in the period that new information becomes available, including design changes, cost of repair and product enhancements, which can include both in-warranty and out-of-warranty systems. The increase in warranty expense of \$0.6 million during the three months ended September 30, 2018 compared to the three months ended September 30, 2017 was primarily because of an increase in the standard warranty provision as a result of a supplier defect identified during the first quarter of Fiscal 2019. Management expects warranty expense in Fiscal 2019 to be higher than in Fiscal 2018 primarily because of an increase in the standard warranty provision.

Direct material costs margin decreased \$0.4 million during the three months ended September 30, 2018 compared to the three months ended September 30, 2017 primarily as a result of an increase in FPP expenses associated with higher than normal levels of unscheduled maintenance activities and lower selling price of two C1000 refurbished systems.

Production and service center labor and overhead expense increased \$0.2 million during the three months ended September 30, 2018 compared to the three months ended September 30, 2017 primarily because of an increase in overhead allocated to finished goods inventory of \$0.4 million, offset by a decrease in salaries expense of \$0.2 million.

On July 25, 2018, we and Carrier entered into a Second Amendment to the Development and License Agreement (“Second Amendment”) whereby we agreed to pay Carrier approximately \$3.0 million to conclude our current royalty obligation under the Development and License Agreement, dated as of September 4, 2007, as amended (“Development Agreement”) and release us from any future royalty payment obligations. The Second Amendment also removed non-compete provisions from the Development Agreement, allowing us to design, market or sell our C200 System in conjunction with any energy system and compete with Carrier products in the CCHP market. On September 19, 2018, we paid in full the negotiated royalty settlement of \$3.0 million to Carrier, and as such, there is no further royalty obligation to Carrier. The prepaid royalty of \$3.0 million has been recorded under the caption “Prepaid expenses and other current assets” in the accompanying condensed consolidated balance sheets and will be amortized in the accompanying condensed consolidated statement of operations over a 15-year amortization period through September 2033 using an effective royalty rate. The effective royalty rate is calculated as the prepaid royalty settlement divided by total projected C200 System units over the 15-year amortization period. Royalty expense decreased \$0.2 million during the three months ended September 30, 2018 compared to the three months ended September 30, 2017 primarily because we concluded our royalty obligation under the Development Agreement.

The following table summarizes our gross margin (in millions except percentages):

	Three Months Ended September 30,	
	2018	2017
Gross Margin		
Product	\$ 0.3	\$ 0.9
As a percentage of product revenue	2 %	7 %
Accessories, parts and service	\$ 1.7	\$ 2.1

Edgar Filing: CAPSTONE TURBINE Corp - Form 10-Q/A

As a percentage of accessories, parts and service revenue            24 %    28 %

Total Gross Margin    \$ 2.0      \$ 3.0

As a percentage of total revenue    9 %      15 %

The decrease in product gross margin during the three months ended September 30, 2018 compared to the three months ended September 30, 2017 was primarily because of an increase in warranty expense, lower selling price of two C1000 refurbished systems, an increase in direct material costs and an increase in overhead allocated to finished goods inventory. Accessories, parts and service gross margin decreased during the three months ended September 30, 2018 compared to the three months ended September 30, 2017 primarily because of lower than expected service revenue, resulting from reassignment of certain long-term factory protection plan contracts from our legacy California distributor

Table of Contents

to Cal Microturbine and higher than normal levels of unscheduled maintenance activities primarily because of a supplier defect identified during the first quarter of Fiscal 2019.

**Research and Development (“R&D”) Expenses** R&D expenses for the three months ended September 30, 2018 decreased \$0.2 million, or 18%, to \$0.9 million from \$1.1 million in the three months ended September 30, 2017. The overall decrease in R&D expenses of approximately \$0.2 million resulted from a decrease in salaries expense of approximately \$0.3 million, offset by an increase in supplies expense of \$0.1 million. Management expects R&D expenses in Fiscal 2019 to be slightly higher than in Fiscal 2018 as a result of ongoing product development costs.

**Selling, General, and Administrative (“SG&A”) Expenses** SG&A expenses for the three months ended September 30, 2018 increased \$0.5 million, or 10%, to \$5.3 million from \$4.8 million for the three months ended September 30, 2017. The net increase in SG&A expenses was comprised of increases of approximately \$0.2 million in allocated costs for shared-services facilities expense, \$0.2 million in professional services expense, including legal expenses and \$0.1 million in marketing expense. Excluding the one-time Leadership Incentive Program and bad debt recovery recorded in Fiscal 2018, management expects SG&A expenses in Fiscal 2019 to be slightly higher than in Fiscal 2018 primarily as a result of increases in salaries expense, marketing expense, allocated costs for shared-services facilities expense and professional services, including legal and shareholder expenses.

**Interest Expense** Interest expense was \$0.2 million and \$0.1 million during the three months ended September 30, 2018 and 2017, respectively. As of September 30, 2018, we had total debt of \$12.5 million outstanding under the Bridge Bank credit facility.

Six Months Ended September 30, 2018 and 2017

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

	Six Months Ended	
	September 30,	
	2018	2017
	Revenue	Revenue
United States and Canada	\$ 22.1	\$ 19.6
Europe and Russia	9.3	7.1
Latin America	5.4	2.9
Asia and Australia	4.4	6.4
Middle East and Africa	2.2	3.0
Total	\$ 43.4	\$ 39.0

**Revenue** Revenue for the six months ended September 30, 2018 increased \$4.4 million, or 11%, to \$43.4 million from \$39.0 million for the six months ended September 30, 2017. The change in revenue for the six months ended September 30, 2018 compared to the six months ended September 30, 2017 included increases in revenue of \$2.5 million from the United States and Canadian markets, \$2.5 million from the Latin American market and \$2.2 million from the European and Russian markets. These increases in revenue were offset by decreases in revenue of \$2.0 million from the Asian and Australian markets and \$0.8 million from the Middle East and African markets. The increase in revenue in the United States and Canadian markets during the six months ended September 30, 2018 compared to the same period the previous year was primarily because of higher accessories, parts and service revenue and product shipments into the natural resources vertical market continues to improve on our C30 and C1000 Signature Series. The increase in revenue in the Latin American market was primarily because of an increase in C200 and C1000 Signature Series systems shipments during the six months ended September 30, 2018 compared to the same period last year. The increase in revenue in the European and Russian markets was primarily because the



European energy efficiency and renewable energy vertical markets continue to improve. Our revenue in the European and Russian markets continues to be negatively impacted by the ongoing geopolitical tensions and a strong U.S. dollar in certain markets making our products more expensive in such markets. The decrease in revenue in the Middle East and African markets was primarily the result of the shift in certain customers' project timelines compared to the same period last year. Our revenue in the Middle East and African markets continues to be negatively impacted by the volatility of the global oil and gas markets and ongoing geopolitical tensions in these regions. The decrease in revenue in the Asian and Australian markets was primarily because of decreases in accessories and parts revenue and product shipments into the energy efficiency and renewable energy vertical markets during the six months ended September 30, 2018 compared to the same period last year.

Table of Contents

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

	Six Months Ended September 30, 2018			2017		
	Revenue	Megawatts	Units	Revenue	Megawatts	Units
Microturbine Product	\$ 28.5	28.8	140	\$ 24.8	23.4	120
Accessories and Parts	7.2			6.7		
Service	7.7			7.5		
Total Accessories, Parts and Service	14.9			14.2		
Total	\$ 43.4			\$ 39.0		

For the six months ended September 30, 2018, revenue from microturbine products increased \$3.7 million, or 15%, to \$28.5 million from \$24.8 million for the six months ended September 30, 2017. The increase in revenue and megawatts shipped was primarily because of a favorable shift in product mix, as we sold a higher number of our C1000 Series systems, offset by a decrease in revenue per megawatt shipped during the six months ended September 30, 2018 compared to the same period last year. Megawatts shipped during the six months ended September 30, 2018 increased 5.4 megawatts, or 23%, to 28.8 megawatts from 23.4 megawatts during the six months ended September 30, 2017. Average revenue per megawatt shipped was approximately \$1.0 million and \$1.1 million during the six months ended September 30, 2018 and 2017, respectively. Average revenue per megawatt decreased as a result of the shipment of 2.0 megawatts of remanufactured systems during the second quarter of Fiscal 2019. These systems had a much lower selling price than the new systems. The timing of shipments is subject to change based on several variables (including customer deposits, payments, availability of credit and delivery schedule changes), most of which are not within our control and can affect the timing of our revenue.

For the six months ended September 30, 2018, revenue from our accessories and parts increased \$0.5 million, or 7%, to \$7.2 million from \$6.7 million for the six months ended September 30, 2017. The increase in revenue from accessories and parts was primarily because of delivery of certain large parts orders, offset by lower accessories shipments of our Organic Rankine Cycle (“ORC”) systems.

Service revenue for the six months ended September 30, 2018 increased \$0.2 million, or 3%, to \$7.7 million from \$7.5 million for the six months ended September 30, 2017. The increase in service revenue was primarily because of revenue from our new DSS program, offset by a decrease in service revenue. The decrease in service revenue was primarily the result of not recognizing revenue on certain service contracts because of the reassignment of those service contracts from Capstone’s legacy California distributor to Cal Microturbine. Earned revenue from our DSS program for the six months ended September 30, 2018 was \$0.5 million and included under the caption “Service revenue” in the accompanying condensed consolidated statements of operations.

For the six months ended September 30, 2018, E-Finity and Horizon, accounted for 11% and 10% of revenue, respectively. For the six months ended September 30, 2017, E-Finity, Horizon and Optimal accounted for 13%, 12% and 10% of revenue, respectively.

**Gross Margin** Cost of goods sold includes direct material costs, production and service center labor and overhead, inventory charges and provision for estimated product warranty expenses. The gross margin was approximately \$3.9 million, or 9% of revenue, for the six months ended September 30, 2018 compared to a gross margin of \$5.2 million, or 13% of revenue, for the six months ended September 30, 2017. The decrease in gross margin of \$1.3 million during the six months ended September 30, 2018 compared to the six months ended September 30, 2017 was primarily because of a \$0.7 million decrease in our direct material costs margin, higher production and service center labor and overhead expense of \$0.7 million and incremental warranty expense of \$0.2 million, offset by lower royalty expense

of \$0.2 million and inventory charges of \$0.1 million. In addition to consolidating our manufacturing processes into our Van Nuys location, management continues to implement initiatives to improve gross margin in Fiscal 2019 by further reducing manufacturing overhead and direct material costs, and improving product performance as we work to achieve profitability.

Direct material costs margin decreased \$0.7 million during the six months ended September 30, 2018 compared to the six months ended September 30, 2017 primarily as a result of an increase in FPP expenses associated with higher

Table of Contents

than normal levels of scheduled and unscheduled maintenance activities and lower selling price of two C1000 refurbished systems.

Production and service center labor and overhead expense increased \$0.7 million during the six months ended September 30, 2018 compared to the six months ended September 30, 2017 primarily because of increases of approximately \$0.5 million in overhead allocated to finished goods inventory, \$0.4 million in consulting expense and \$0.1 million in supplies expense, offset by decreases of \$0.2 million in salaries expense and \$0.1 million in facilities expense.

The increase in warranty expense of \$0.2 million during the six months ended September 30, 2018 compared to the six months ended September 30, 2017 was primarily because of an increase in our warranty provision as a result of a supplier defect identified during the first quarter of Fiscal 2019. Management expects warranty expense in Fiscal 2019 to be higher than in Fiscal 2018 primarily because of an increase in the standard warranty provision.

On July 25, 2018, we and Carrier entered into a Second Amendment whereby we agreed to pay Carrier approximately \$3.0 million to conclude our current royalty obligation under the Development Agreement and release us from any future royalty payment obligations. The Second Amendment also removed non-compete provisions from the Development Agreement, allowing us to design, market or sell our C200 System in conjunction with any energy system and compete with Carrier products in the CCHP market. On September 19, 2018, we paid in full the negotiated royalty settlement of \$3.0 million to Carrier, and as such, there is no further royalty obligation to Carrier. The prepaid royalty of \$3.0 million has been recorded under the captions "Prepaid expenses and other current assets" and "Other assets" in the accompanying condensed consolidated balance sheets and will be amortized in the accompanying condensed consolidated statement of operations over a 15-year amortization period through September 2033 using an effective royalty rate. The effective royalty rate is calculated as the prepaid royalty settlement divided by total projected C200 System units over the 15-year amortization period. Royalty expense decreased \$0.2 million during the six months ended September 30, 2018 compared to the six months ended September 30, 2017 primarily because we concluded our royalty obligation under the Development Agreement.

Inventory charges decreased \$0.1 million during the six months ended September 30, 2018 compared to the six months ended September 30, 2017 primarily as the result of a decrease in scrap material.

The following table summarizes our gross margin (in millions except percentages):

	Six Months Ended September 30,			
	2018	2017		
Gross Margin				
Product	\$ 0.4	\$ 0.9		
As a percentage of product revenue	1 %	4 %		
Accessories, parts and service	\$ 3.5	\$ 4.3		
As a percentage of accessories, parts and service revenue	23 %	30 %		
Total Gross Margin	\$ 3.9	\$ 5.2		
As a percentage of total revenue	9 %	13 %		

The decrease in product gross margin during the six months ended September 30, 2018 compared to the six months ended September 30, 2017 was primarily because of an increase in warranty expense, lower selling price of two

C1000 refurbished systems and an increase in direct material costs. In addition, the decrease in product gross margin was because of an increase expense associated with overhead allocated to finished goods inventory. Accessories, parts and service gross margin decreased during the six months ended September 30, 2018 compared to the six months ended September 30, 2017 primarily the result of not recognizing revenue on certain service contracts because of the reassignment of those service contracts from Capstone's legacy California distributor to Cal Microturbine. In addition, the accessories, parts and service margin decreased because of higher than normal levels of scheduled and unscheduled maintenance activities primarily as a result of a supplier defect identified during the first quarter of Fiscal 2019.

Table of Contents

**R&D Expenses** R&D expenses for the six months ended September 30, 2018 decreased \$0.5 million, or 22%, to \$1.8 million from \$2.3 million in the six months ended September 30, 2017. The overall decrease in R&D expenses of approximately \$0.5 million resulted primarily from a decrease in salaries expense during the six months ended September 30, 2018 compared to the same period last year. Management expects R&D expenses in Fiscal 2019 to be slightly higher than in Fiscal 2018 as a result of ongoing product development costs.

**SG&A Expenses** SG&A expenses for the six months ended September 30, 2018 increased \$1.1 million, or 11%, to \$10.9 million from \$9.8 million for the six months ended September 30, 2017. The net increase in SG&A expenses was comprised of increases of approximately \$0.3 million in allocated costs for shared-services facilities expense, \$0.3 million in marketing expense, \$0.2 million in salaries expense, \$0.2 million in professional services expense, including legal expenses and \$0.1 million in consulting expense. Excluding the one-time Leadership Incentive Program and bad debt recovery recorded in Fiscal 2018, management expects SG&A expenses in Fiscal 2019 to be slightly higher than in Fiscal 2018 primarily as a result of increases in salaries expense, marketing expense, allocated costs for shared-services facilities expense and professional services, including legal and shareholder expenses.

**Interest Expense** Interest expense was \$0.3 million during each of the six months ended September 30, 2018 and 2017. As of September 30, 2018, we had total debt of \$12.5 million outstanding under the credit facility.

**Liquidity and Capital Resources**

Our cash requirements depend on many factors, including the execution of our plan. We expect to continue to devote substantial capital resources to running our business and implementing the strategic changes summarized herein. Our planned capital expenditures for the year ending March 31, 2019 include approximately \$1.0 million for plant and equipment costs related to manufacturing and operations. However, management expects to spend more than planned primarily as a result of deploying several of our microturbines under our microturbine rental program. We have invested our cash in institutional funds that invest in high quality short term money market instruments to provide liquidity for operations and for capital preservation.

Our cash, cash equivalents and restricted cash balances decreased \$1.1 million during the six months ended September 30, 2018, compared to a decrease of \$4.5 million during the six months ended September 30, 2017. The increase in cash, cash equivalents and restricted cash during the six months ended September 30, 2018 compared to the same period last year was because of higher cash generated from financing activities primarily from the issuance of common stock through the at-the-money offering program as described below.

**Operating Activities** During the six months ended September 30, 2018, we used \$12.6 million in cash in our operating activities, which consisted of a net loss for the period of \$9.2 million and cash used for working capital of \$6.2 million, offset by non-cash adjustments (primarily warranty provision, accounts receivable allowances, depreciation and amortization, stock based compensation and inventory provision) of \$2.8 million. During the six months ended September 30, 2017, we used \$5.9 million in cash in our operating activities, which consisted of a net loss for the period of \$7.8 million and cash used for working capital of \$1.4 million, offset by non-cash adjustments of \$3.3 million.

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

Six Months Ended  
September 30,

Edgar Filing: CAPSTONE TURBINE Corp - Form 10-Q/A

	2018	2017
Net loss	\$ (9,255)	\$ (7,760)
Non-cash operating activities(1)	2,825	3,269
Changes in operating assets and liabilities:		
Accounts receivable	(619)	3,778
Inventories	(320)	(2,360)
Accounts payable and accrued expenses	448	(790)
Other changes in operating assets and liabilities	(5,674)	(1,989)
Net cash used in operating activities	\$ (12,595)	\$ (5,852)

---

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

Table of Contents

The change in non-cash operating activities during the six months ended September 30, 2018 compared to the same period the previous fiscal year was primarily because of the provision for warranty expenses during the six months ended September 30, 2018 primarily as a result of a supplier defect identified during the first quarter of Fiscal 2019. The change in accounts receivable during the six months ended September 30, 2018 was primarily the due to delayed collection from certain customers, compared to a decrease in accounts receivable during the six months ended September 30, 2017, which was primarily the result of higher revenue in the fourth quarter of Fiscal 2017. The change in inventory was primarily the result of an increase in raw materials offset by a reduction in finished goods during the six months ended September 30, 2018 compared to an increase in finished goods during the six months ended September 30, 2017. The change in accounts payable and accrued expenses was primarily the result of the level of inventory receipts and timing of payments made by us during the six months ended September 30, 2018 compared to the same period the previous fiscal year. The change in other operating assets and liabilities during the six months ended September 30, 2018 was primarily because of a negotiated royalty settlement to Carrier and a supplier prepayment obligation, each described below. The change in other operating assets and liabilities during the six months ended September 30, 2017 was primarily the result of warranty payments for the proactive retrofit of certain non-Signature Series C200 microturbines and this warranty program was completed during the three months ended December 31, 2017.

On July 25, 2018, we and Carrier entered into a Second Amendment whereby we agreed to pay Carrier approximately \$3.0 million to conclude our current royalty obligation under the Development Agreement and release us from any future royalty payment obligations. The Second Amendment also removed non-compete provisions from the Development Agreement, allowing us to design, market or sell our C200 System in conjunction with any energy system and compete with Carrier products in the CCHP market. On September 19, 2018, we paid in full the negotiated royalty settlement agreement of \$3.0 million to Carrier, as such there is no further royalty obligation to Carrier.

During the three months ended March 31, 2018, we received notification from one of our single source suppliers that they were at maximum capacity and would require prepayment and a significant increase in the price of multiple components in order to fulfill our supply requirements for Fiscal 2019. During the six months ended September 30, 2018 we issued a prepayment of approximately \$2.2 million to this single source supplier.

**Investing Activities** Net cash used in investing activities of \$0.3 million and \$0.5 million during the six months ended September 30, 2018 and 2017, respectively, relates primarily to the acquisition of fixed assets and leasehold improvements made to our Van Nuys location, respectively. During the fiscal year ended March 31, 2018, we consolidated our operations and offices into our Van Nuys, California location from our Chatsworth, California location.

**Financing Activities** During the six months ended September 30, 2018, we generated approximately \$11.8 million in financing activities compared to cash generated during the six months ended September 30, 2017 of approximately \$1.8 million. The funds generated from financing activities during the six months ended September 30, 2018 were primarily the result of proceeds from the at-the-market offering program described below and net proceeds from our credit facility, offset by repayment of notes payable and capital lease obligations. The funds generated from financing activities during the six months ended September 30, 2017 were primarily the result of proceeds from the at-the-market offering program, offset by net repayments under the credit facility and the repayment of notes payable and capital lease obligations.

On June 7, 2018, we entered into a sales agreement with H.C. Wainwright & Co., LLC with respect to an at-the-market offering program pursuant to which we may offer and sell, from time to time at our sole discretion, shares of our common stock, having an aggregate offering price of up to \$25.0 million. We will set the parameters for



sales of the shares, including the number to be sold, the time period during which sales are requested to be made, any limitation on the number that may be sold in one trading day and any minimum price below which sales may not be made. During the three months ended September 30, 2018, we issued 3.0 million shares of our common stock under this at-the-market offering program and the net proceeds to us from the sale of our common stock were approximately \$3.1 million after deducting commissions paid of approximately \$0.1 million. During the six months ended September 30, 2018, we issued 3.7 million shares of our common stock under this at-the-market offering program and the net proceeds to us from the sale of our common stock were approximately \$4.1 million after deducting commissions paid of approximately \$0.1 million. As of September 30, 2018, approximately \$20.7 million remained available for issuance with respect to this at-the-market offering program.

Table of Contents

On April 13, 2018, a warrant holder exercised its rights to the warrant agreement to exercise on a cashless basis 5,760,000 Series A warrants at an exercise price of \$0.60 per share under the warrant agreement. In accordance with terms of the warrant agreement, after taking into account the shares withheld to satisfy the cashless exercise option, the Company issued 3,806,243 shares of common stock.

Effective August 28, 2015, we entered into a sales agreement with Cowen and Company, LLC with respect to an at-the-market offering program pursuant to which we offered and sold, from time to time at our sole discretion, shares of our common stock, having an aggregate offering price of up to \$30.0 million. During the six months ended September 30, 2018, we issued 2.8 million shares of our common stock under the at-the-market offering program and the net proceeds to us from the sale of our common stock were approximately \$4.0 million after deducting commissions paid of approximately \$0.1 million. As of September 30, 2018, 26.0 million shares of our common stock were cumulatively sold pursuant to the at-the-market offering program and the net proceeds to us from the sale of the common stock were approximately \$28.6 million after deducting commissions paid of approximately \$0.8 million. This at-the-market offering program expired on May 29, 2018.

There were no stock options exercised during the six months ended September 30, 2018 and 2017, respectively. Repurchases of shares of our common stock for employee taxes due on vesting of restricted stock units, net of employee stock purchases, resulted in approximately \$73,000 and \$22,000 of net cash used during the six months ended September 30, 2018 and 2017, respectively.

**Credit Facility** The Company maintains Bridge Bank Credit Agreements with Western Alliance Bank through Bridge Bank, with credit support provided by the Export-Import Bank of the United States through its working capital guarantee program. Under the terms of the Bridge Bank Credit Agreements, the Company may borrow up to \$15.0 million on a revolving basis depending on, among other factors, the amount of its eligible inventory and accounts receivable. The Bridge Bank Credit Agreements will terminate in accordance with their terms on June 2, 2021.

On June 1, 2018, the Company entered into a letter agreement (the "Letter Agreement") with Bridge Bank. The Letter Agreement extended the maturity date under the Company's Bridge Bank Credit Agreements from June 2, 2019 to June 2, 2021. The Letter Agreement increased the line of credit to an amount up to \$15.0 million from \$12.0 million. Additionally, the Letter Agreement reduced the per annum interest rate from prime rate plus 1.50 percent to 1.00 percent; the facility fee from 0.625% to 0.5%, and the cash collateral held at Bridge Bank from 42% to 40%, which is \$6.0 million of the \$15.0 million facility, as well as no fee for early termination.

Total borrowings, letter of credit obligations and the then aggregate committed amount of cash management services under the Bridge Bank Credit Agreements may not exceed 85% of the sum of unrestricted cash and the amount of cash collateral held at Bridge Bank. As a condition of the Bridge Bank Credit Agreements, the Company has restricted \$6.0 million of cash equivalents as additional security for the credit facility. Borrowings under the Bridge Bank Credit Agreements will bear per annum interest at the prime rate plus 1.0 percent, subject to increase during the occurrence of an event of default. Obligations under the Bridge Bank Credit Agreements are secured by all of the Company's assets, including intellectual property and general intangibles.

The Bridge Bank Credit Agreements include affirmative covenants as well as negative covenants that prohibit a variety of actions without Bridge Bank's consent, including covenants that limit the Company's ability to (a) incur or guarantee debt, (b) create liens, (c) enter into any merger, recapitalization or similar transaction or purchase all or substantially all of the assets or stock of another entity or (d) sell, assign, transfer or otherwise dispose of the Company's assets.

The financial covenants of the domestic credit agreement with Bridge Bank (the "Domestic Facility"), which is included in the Bridge Bank Credit Agreements, requires the Company not to exceed specified levels of losses relative to its

financial model and the outstanding line of credit advances may not exceed 85% of the sum of unrestricted cash and the amount of cash collateral held at Bridge Bank. The Domestic Facility also defines an event of default to include a material adverse effect on the Company's business. An event of default for this or any other reason, if not waived, could have a material adverse effect on the Company. As of September 30, 2018 we were in compliance with the covenants contained in the Bridge Bank Credit Agreements for Fiscal 2019.

**Working Capital** Cash used for working capital was \$6.2 million during the six months ended September 30, 2018, an increase of \$4.8 million from the cash used for working capital of \$1.4 million during the six months ended

Table of Contents

September 30, 2017. We attribute the increase in our working capital requirements primarily because of \$3.0 million negotiated royalty settlement agreement payment to Carrier, \$2.2 million in prepayments to one of our single source suppliers that notified us that they were at maximum capacity and would require prepayment and a significant increase in the price of multiple components in order to fulfill our supply requirements for Fiscal 2019, and a pay down of accrued expenses of \$1.0 million with respect to our one-time leadership incentive program compensation.

**Evaluation of Ability to Maintain Current Level of Operations** In connection with preparing the consolidated financial statements for the second quarter of Fiscal 2019, management evaluated whether there were conditions and events, considered in the aggregate, that raised substantial doubt about our ability to meet our obligations as they became due for the next twelve months from the date of issuance of our first quarter of Fiscal 2019 financial statements. Management assessed that there were such conditions and events, including a history of recurring operating losses, negative cash flows from operating activities, the continued negative impact by the volatility of the global oil and gas markets, a strong U.S. dollar in certain markets making our products more expensive in such markets and ongoing global geopolitical tensions. We incurred a net loss of \$4.4 million and used cash in operating activities of \$6.6 million for the second quarter of Fiscal 2019. Cash used in operating activities includes a payment of approximately \$3.0 million to Carrier for a negotiated royalty settlement agreement. See Note 14—Other Current Liabilities for additional discussion on the negotiated royalty settlement agreement. Our working capital requirements during the second quarter of Fiscal 2019 were higher than management’s expectations primarily the result of not recognizing revenue on certain service contracts because of the reassignment of those service contracts from Capstone’s legacy California distributor to Cal Microturbine, which resulted in a higher than expected net loss. In addition, our net loss was negatively impacted during the second quarter of Fiscal 2019 because of an increase in our warranty provision as a result of a supplier defect identified during the first quarter of Fiscal 2019. As of September 30, 2018, we had cash, cash equivalents and restricted cash of \$18.3 million, and outstanding borrowings under our credit facility of \$12.5 million.

As of September 30, 2018, we had cash, cash equivalents and restricted cash of \$18.3 million, and outstanding borrowings under our credit facility of \$12.5 million.

Management evaluated these conditions in relation to our ability to meet our obligations as they become due. Our ability to continue current operations and to execute on management’s plan is dependent on our ability to generate cash flows from operations. Management believes that we will continue to make progress on our path to profitability by continuing to maintain low operating expenses and develop our geographical and vertical markets. We may seek to raise funds by selling additional securities (through at-the-market offering or otherwise) or by obtaining additional debt financing. There is no assurance that we will be able to obtain additional funds on commercially favorable terms or at all. If we raise additional funds by issuing additional equity or convertible debt securities, the fully diluted ownership percentages of existing stockholders will be reduced. In addition, any equity or debt securities that we would issue may have rights, preferences or privileges senior to those of the holders of our common stock.

Based on our current operating plan, management anticipates that, given current working capital levels, current financial projections, the ability to borrow under our credit facility and the funds raised by selling additional securities through the at-the-market offering as of the date of issuance of our second quarter of Fiscal 2019 financial statements, we will be able to meet our financial obligations as they become due over the next twelve months from the date of issuance of our first quarter of Fiscal 2019 financial statements.

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

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

## Table of Contents

- our customers' ability to afford and/or finance our products.

Our accounts receivable balance, net of allowances, was \$16.5 million and \$16.0 million as of September 30, 2018 and March 31, 2018, respectively. Days sales outstanding in accounts receivable, ("DSO"), increased by 7 days to 68 days as of September 30, 2018 compared to 61 days as of September 30, 2017. The increase in our DSO was primarily because of a delay in a specific customer accounts receivable. We recorded a net bad debt expense of approximately \$0.1 million during the six months ended September 30, 2018. We recorded a net bad debt recovery of approximately \$22,000 during the six months ended September 30, 2017.

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

### New Accounting Pronouncements

#### Adopted

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU, 2014-09, Revenue from Contracts with Customers (Topic 606), ("ASU 2014-09"). ASU 2014-09 outlines a single, comprehensive model for accounting for revenue from contracts with customers and requires more detailed disclosure to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from such contracts. ASU 2014-09 provides a five-step analysis of transactions to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. On April 1, 2018, we adopted ASU 2014-09 under the modified retrospective transition method. This method was applied to contracts that were not complete as of the date of initial application of ASU 2014-09.

During the first quarter of Fiscal 2019, we recognized revenue based on ASU 2014-09, however revenue for the first quarter of Fiscal 2018 was recognized based on Accounting Standards Codification, Topic 605, Revenue Recognition. See Note 13—Revenue Recognition for additional discussion of the impact of the adoption of ASU 2014-09.

#### Not yet adopted

On August 17, 2018, the SEC issued Release No. 33-10532, "Disclosure Update and Simplification", ("Release No. 33-10532") which amends certain redundant, duplicative, outdated, superseded or overlapping disclosure requirements. The amendments in this rule are intended to facilitate the disclosure of information to investors and to simplify compliance without significantly impacting the mix of information provided to investors. The amendments also expand the disclosure requirements regarding the analysis of stockholders' equity for interim financial statements, in which entities will be required to present a reconciliation for each period for which a statement of comprehensive income is required to be filed. The final rule became effective on November 5, 2018, however the SEC announced that it would not object if a filer's first presentation of the changes in stockholders' equity were included in its Form 10-Q for the quarter that begins after the effective date of the amendments. We are currently evaluating the impact of Release No. 33-10532 on our consolidated financial position and results of operations.

On June 2018, the FASB issued ASU 2018-07, “Shared-Based Payment Arrangements with Nonemployees” (Topic 505), (“ASU 2018-07”). ASU 2018-07 simplifies the accounting for share-based payments granted to nonemployees for goods and services. Under ASU 2018-07, most of the guidance on such payments to nonemployees will be aligned with the requirements for share-based payments granted to employees. Under the ASU 2018-07, the measurement of equity-classified nonemployee share-based payments will be fixed on the grant date, as defined in ASC 718, and will use the term nonemployee vesting period, rather than requisite service period. The amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal

Table of Contents

years. Early adoption is permitted if financial statements have not yet been issued. We are currently evaluating the impact of ASU 2018-07 on our consolidated financial position and results of operations.

On December 22, 2017, the SEC issued guidance under Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act (“SAB 118”) directing taxpayers to consider the impact of the U.S. legislation as “provisional” when it does not have the necessary information available, prepared or analyzed (including computations) in reasonable detail to complete its accounting for the change in tax law. In accordance with SAB 118, our estimated income tax is considered provisional and our analysis is expected to be finalized by the end of the 2018 calendar year.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), (“ASU 2016-02”). The purpose of ASU 2016-02 is to provide financial statement users a better understanding of the amount, timing, and uncertainty of cash flows arising from leases. The adoption of ASU 2016-02 will result in the recognition of a right-of-use asset and a lease liability for most operating leases. New disclosure requirements include qualitative and quantitative information about the amounts recorded in the financial statements. In September 2017, the FASB issued ASU 2017-13, Revenue Recognition (Topic 605), Revenue from Contracts with Customers (Topic 606), Leases (Topic 840), and Leases (Topic 842), which provides additional implementation guidance on the previously issued ASU 2016-02 Leases (Topic 842). ASU 2016-02 requires a lessee to recognize assets and liabilities on the balance sheet for leases with lease terms greater than 12 months. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018. ASU 2016-02 requires a modified retrospective transition by means of a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year in which the guidance is effective with the option to elect certain practical expedients. Early adoption is permitted. We are currently evaluating the impact of ASU 2016-02 on our consolidated financial position and results of operations.

Off-Balance Sheet Arrangements

We did not have during the periods presented, and we do not currently have, any off balance sheet arrangements, as defined under SEC rules.



Table of Contents

PART II — OTHER INFORMATION

Item 6. Exhibits

Exhibit Number	Description
3.1	<u>Second Amended and Restated Certificate of Incorporation of Capstone Turbine Corporation</u> (a)
3.2	<u>Certificate of Amendment to the Second Amended and Restated Certificate of Incorporation of Capstone Turbine Corporation, dated August 30, 2012</u> (b)
3.3	<u>Certificate of Amendment to the Second Amended and Restated Certificate of Incorporation of Capstone Turbine Corporation, filed November 6, 2015</u> (c)
3.4	<u>Fourth Amended and Restated Bylaws of Capstone Turbine Corporation</u> (d)
4.1	<u>Form of Senior Indenture by and between Capstone Turbine Corporation and Computershare Trust Company, N.A., Trustee</u> (e)
4.2	<u>Form of Subordinated Indenture by and between Capstone Turbine Corporation and Computershare Trust Company, N.A., Trustee</u> (e)
10.1	<u>Form of Change in Control Agreement</u> (f)
10.2	<u>First Amendment to the Accounts Receivable Agreement and Promissory Note between Capstone Turbine Corporation and Turbine International, LLC, dated June 5, 2018</u> (g)
10.3	<u>At The Market Offering Agreement, dated June 7, 2018, between Capstone Turbine Corporation and H.C. Wainwright &amp; Co., LLC</u> (h)
10.4	<u>Second Amendment to The Development and License Agreement between Capstone Turbine Corporation and Carrier Corporation, dated July 25, 2018, effective September 4, 2007</u> (i)
10.5	<u>First Amendment to Business Financing Agreement between Capstone Turbine Corporation and Western Alliance Bank, N.A. dated June 1, 2018</u> (g)
31.1	<u>Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes—Oxley Act of 2002</u>
31.2	<u>Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes—Oxley Act of 2002</u>
32.1	<u>Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes—Oxley Act of 2002</u> (j)
101.INS	XBRL Instance Document (j)
101.SCH	XBRL Schema Document (j)
101.CAL	XBRL Calculation Linkbase Document (j)
101.LAB	XBRL Label Linkbase Document (j)
101.PRE	XBRL Presentation Linkbase Document (j)
101.DEF	XBRL Definition Linkbase Document (j)

---

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

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

(c) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on November 6, 2015 (File No. 001-15957)

(d) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on September 1, 2017 (File No. 001-15957)

(e) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form S-3 on filed on June 7, 2018 (File No. 333-225503)

(f) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on June 11, 2018 (File No. 001-15957)

Table of Contents

(g) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 10-K, filed on June 7, 2018 (File No. 001-15957)

(h) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on June 7, 2018 (File No. 001-15957)

(i) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on June 7, 2018 (File No. 001-15957)

(j) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q, filed on November 6, 2018 (File No. 001-15957)

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CAPSTONE TURBINE CORPORATION

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

Date: November 8, 2018