

DEAR FELLOW STOCKHOLDERS,

Fiscal 2020 was a critical inflection point in our drive toward the goal of positive adjusted EBITDA in support of our long-term viability and growth plan. It was also a year full of unprecedented challenges as the COVID-19 pandemic caused significant disruption to our business, as well as nearly every other business around the globe. Throughout the year, we never lost our focus on improving the business in areas for which we have direct control, and we successfully navigated through despite the extraordinary headwinds. Capstone has either met or made significant progress against our objectives to significantly lower quarterly cash burn, improve gross margin, lower direct material costs, increase inventory turns and streamline operating expenses to position our company for sustained and profitable growth.

FISCAL 2020 – SALES REORGANIZATION STRATEGY

Our objectives on the operating cost side have come to fruition, and while we will not lose sight of these ongoing objectives, we must now look toward returning to revenue growth under our new, extremely lean global organization. As part of our long-term strategy, in January 2020, we divided our sales and marketing team into two separate organizations. One stand-alone organization will remain focused on developing and managing the existing worldwide distribution channel and will be led by Jen Derstine, who was promoted to Vice President of Marketing and Distribution. Additionally, Ms. Derstine will lead all marketing and advertising activities as we continue building Capstone into a strong and recognizable worldwide brand.

The second stand-alone organization will be led by Jim Crouse, a veteran of Capstone who was recently promoted to Chief Revenue Officer and is responsible for growing our national account business and long-term rental fleet. Additionally, Mr. Crouse will be responsible for business development, licensing, and new product partnerships. Mr. Crouse will also focus on new fuels, such as hydrogen, so our products will have the ability to generate carbon-free power utilizing hydrogen as the input fuel.

We believe this new sales strategy, when combined with a positive adjusted EBITDA, will better enable us to capture more market share with large, global customers, where we see greater potential at their facilities worldwide. Our existing distribution network remains our worldwide local presence, while the internal salesforce will build strong, long-term relationships with larger, more diverse customers.

FISCAL 2021 STRATEGIC GOALS

Throughout Fiscal 2020 and continuing into Fiscal 2021, management remains focused on a series of business goals that underpin a clear and specific strategy:

- New direct sales organization to leverage national and international accounts
- Lower average quarterly operating expenses from \$6.5 million to a range of \$5.0 - \$5.5 million

- Strive to reduce direct material costs \$3.0 million over the next twelve months
- Expand the high-margin factory long-term rental fleet to 10 MW
- Improve Factory Protection Plan attachment rates from 40% to 45%
- Continue to grow the Distributor Support System program
- Increase aftermarket spare parts margins and inventory turns
- Increase remanufactured parts capacity with newly upgraded Gosport UK operation

The culmination of these objectives was to reach a gross margin target of approximately 25% in the quarter ending June 30, 2020 (Fiscal 2021 Q1) and beyond, which will support positive adjusted EBITDA based on the company's new ultra-lean operating structure.

CONDUCTING BUSINESS DURING A PANDEMIC

It is impossible to discuss our year without addressing the COVID-19 global pandemic, and Capstone, like the rest of the world, was faced with the unprecedented COVID-19 global pandemic. We moved quickly to develop an emergency Business Continuity Plan (BCP) as a response to both the COVID-19 global pandemic and the ensuing shutdown of the worldwide economy. We implemented a safe working environment with fewer employees in our facilities by developing remote working capabilities, proper social distancing procedures, and providing facemasks, gloves and hand sanitizer stations throughout the building. By making these adjustments, it allowed us to continue serving our essential critical infrastructure customers worldwide, while maintaining the highest possible level of service and responsiveness.

As part of our BCP, we also applied for and received a loan under the Paycheck Protection Program (PPP) pursuant to the Coronavirus Aid, Relief, and Economic Security (CARES) Act. The loan was funded on April 24, 2020, with the proceeds used to support necessary fixed costs such as payroll, rent, and utilities in accordance with the relevant terms and conditions of the CARES Act. The loan provided necessary assistance to Capstone as it helped with our cash needs and enabled us to begin to slowly and carefully re-open, which in addition to

the broader economic shutdown, was also impacted by the effect of lower oil prices on our customers in the oil and gas markets. We are encouraged that within the boundaries of the government-regulated plan for re-starting the global economy, we have taken the initial steps to re-open our operations in full, using a staggered approach, which we expect to be completed by September 28, 2020.

While we are hopeful that the worst of the pandemic is behind us, it has changed our daily lives forever. As a policy, we will continue to exercise our individual and collective responsibilities to reduce viral transmissions to mutually protect ourselves and our community. We see no conflict in maintaining our diligence while supporting and committing to saving our customers money by improving the energy efficiency of their operations around the world. We are proud to say that we provide an economic benefit while also reducing carbon and global emissions in order to create a better environment for us all and help our customers achieve their carbon reduction goals.

The need to shift to green energy solutions has never been more evident than it is today. There is a strong argument to be made for a “green recovery” from the pandemic, especially as Europe is already moving in this direction. While the virus wreaked havoc on people’s health, personal lives, and finances, the planet took the opportunity to heal itself. With unprecedented worldwide restrictions on travel and business operations, emissions data showed cleaner air over nearly every major metro area in the world. In Venice, the water in the canals was almost crystal clear and in Krakow, Poland, people were enjoying the amazing view of the Trata Mountains, which were no longer obscured by the city’s smog.

This shift to low emission and higher efficiency energy solutions should not be a political issue that divides us, but a social issue that unites us to both improve the environment while at the same time saving money. During fiscal year 2020 alone, we helped customers worldwide save an estimated \$219 million dollars in annual energy costs and 368,000 tons of annual carbon emissions. We believe that businesses will increasingly look to improve their operations from an environmental, social and governance (ESG) perspective to be more socially conscious in response to investors and customers who frequently screen companies for their stance on these issues before potentially investing or making product buying decisions.

Sincerely,



Holly A. Van Duersen
Chair of the Board

HOW ARE WE A GREEN TECHNOLOGY?

Our world leading microturbine technology is highly efficient, ultra-low emission, and resilient with approximately 1/10 the raw stack emissions of traditional engine-based technology with system efficiencies as high as 90% in combined heat and power applications, which makes us a green solution even when running on fossil fuels. We are committed to improving the efficiency of energy around the world while simultaneously reducing global emissions of pollutants and greenhouse gases. Our systems help end users improve their impact on the environment while still meeting power and reliability needs.

Not only do we enable customers to reduce CO₂ and air emissions, but we also apply the same guidelines to our own environmental footprint by focusing internally on our energy consumption, waste disposal, and carbon footprint.

SILVER LININGS

Make no mistake that while this is a silver lining, it is not a situation we would want to repeat. Hopefully, we have all learned a valuable lesson on how powerful we are if we can all work together globally to find practical, cost-effective, and realistic ways to reduce our environmental impact on the world. Carbon reduction benefits everyone, but has the most impact on our children and future generations. The evidence is that the environment can recover and heal itself with a global effort from all people, governments, and corporations to make it happen. There is an opportunity now to make this a green recovery, which benefits not only the economy, but the quality of life for everyone. The younger generations, defined as Millennials and Generation Z, account for approximately 48% of the world’s population and are the most concerned when it comes to environmental sustainability as they are the first generations to grow up with climate change as a part of everyday life. As a clean energy solution provider, we are excited to say the future of clean energy has never been brighter and the need more evident.

To every Capstone Turbine stockholder, customer, supplier, distributor, and our resilient employees, the Capstone Board of Directors and Leadership Team would like to thank you for your ongoing and continued support, and we look forward to achieving great things together in the upcoming year.



Darren R. Jamison
President and Chief Executive Officer

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended March 31, 2020

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)

**16640 Stagg Street,
Van Nuys, California**
(Address of principal executive offices)

95-4180883
(I.R.S. Employer
Identification No.)

91406
(Zip Code)

(818) 734-5300

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of exchange on which registered
Common Stock, par value \$.001 per share	CPST	NASDAQ Capital Market
Series B Junior Participating Preferred Stock Purchase Rights		

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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, smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth 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 aggregate market value of the shares of Common Stock of the registrant held by non-affiliates on September 30, 2019 was approximately \$40.8 million.

As of June 24, 2020, there were 10,984,783, shares of the registrant's Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement relating to the registrant's 2020 annual meeting of stockholders are incorporated by reference into Part III of this report to the extent described therein.

CAPSTONE TURBINE CORPORATION

FORM 10-K

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PART I

Item 1. Business.

Overview

Capstone Turbine Corporation (“Capstone”, “We” or the “Company”) develops, manufactures, markets and services microturbine technology solutions for use in stationary distributed power generation and distribution networks applications, including energy efficient cogeneration combined heat and power (“CHP”), integrated combined heat and power (“ICHP”), and combined cooling, heat and power (“CCHP”), as well as renewable energy, natural resources, and critical power supply applications. Microturbines allow customers to produce power on-site in parallel with the electric grid or stand-alone when no utility grid is available. Several technologies are used to provide “on-site power generation” (also called “distributed generation”) such as reciprocating engines, solar photovoltaic power (“PV”), wind turbines and fuel cells. 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. For customers who do not have access to the electric utility grid, microturbines provide clean, on site power with fewer scheduled maintenance intervals and greater fuel flexibility than competing technologies. For customers with access to the electric grid, microturbines provide an additional source of continuous on-site power generation, thereby providing additional reliability and potential cost savings compared to the local utility. With our stand-alone feature, customers can produce their own energy in the event of a utility power outage and can use microturbines as their primary source of power for extended periods of time unlike traditional diesel standby generator sets. Because our microturbines also produce clean, usable heat energy, they provide economic advantages to customers who can benefit from the use of hot water, chilled water, air conditioning and steam. In addition, our microturbines have been used as battery charging generators for hybrid electric vehicles and to provide power to a vessel’s electrical loads in marine applications. Our microturbines are sold, installed and serviced primarily through our global distribution network. Together with our distributors, we offer new and remanufactured parts as well as a comprehensive Factory Protection Plan (“FPP”) through long-term service agreements ranging from 5 to 20 years.

As part of our long-term growth strategy, in January 2020, Capstone divided its sales and marketing team into two separate organizations. One stand-alone organization will remain focused on developing and managing the existing worldwide distribution channel and will lead all marketing and advertising activities as we continue building the Company into a strong and recognizable worldwide brand. The second stand-alone organization is responsible for growing the Company's national account business and long-term rental fleet. Additionally, this team will be responsible for business development, licensing, and new product partnerships. We will also continue to expand with new fuels, such as hydrogen and further growing our renewable market segment participation. We believe this new sales strategy, when combined with a positive adjusted EBITDA, will better enable us to capture more market share with large, global customers, where we see greater potential at dozens of their facilities worldwide. Our existing distribution network remains our worldwide feet-on-the-ground and our local presence, while the internal salesforce will build strong, long-term relationships with larger, more diverse customers.

We offer microturbines designed for commercial, industrial and onshore and offshore oil and gas applications with product offerings ranging from 30 kilowatts (“kW”) to one megawatt (“MW”) in electric power output, which can be deployed in arrays up to 10 MWs. Our microturbines combine patented air bearing technology, advanced combustion technology and sophisticated power electronics to form efficient and ultra-low emission electricity and cooling and heat production systems. Because of our air bearing technology, our microturbines do not require lube oil, grease, or traditional coolants. This means they do not require routine maintenance to change and dispose of lube oil, grease, or other liquid lubricants, as do the most common reciprocating engines. We also manufacture and supply controllers that provide complete automated system control, including load following and custom logic to protect against expensive local utility demand charges. These controllers include the legacy Capstone Logic Controllers (CLC) and the new Capstone PowerSync family of controllers.

Our microturbines can be fueled by various sources, including natural gas, propane, butane, various sour gases, renewable fuels such as renewable natural gas, landfill gas, biogas or digester gas, kerosene, diesel and biodiesel. Our

microturbines are available with integrated unit mounted heat exchangers, making them easy to engineer and install in applications where hot water, chilled water, air conditioning and steam is desired.

We sell microturbine units, components, controllers and accessories, as well as offer long-term microturbine rentals. We also remanufacture microturbine engines and provide new and remanufactured aftermarket spares parts, accessories, services, and comprehensive long-term service contracts from 5 to 20 years. Our microturbines are sold primarily through distributors and Original Equipment Manufacturers (“OEMs”). Distributors purchase our products for sale to end users and also provide service, application engineering and installation support. Distributors also provide a variety of additional services, including engineering, application, and air permit support services in which the microturbines will be used, installation support of the products at the end users’ sites, commissioning the installed applications and providing post commissioning service, including a comprehensive FPP. Our distributors perform as independent value-added resellers. OEMs integrate our products into their own product solutions.

This Annual Report on Form 10-K (this “Form 10-K”) refers to our fiscal years ending March 31 as its “Fiscal” years.

Company Response to COVID-19

In March 2020, the Company began to monitor the global effects of “COVID-19,” an infectious disease caused by Severe Acute Respiratory Syndrome Coronavirus 2 (SARS CoV-2) that was first detected in November 2019 in the city of Wuhan, China.

The subsequent spread of COVID-19 to the U.S. and many other parts of the world led the World Health Organization to characterize COVID-19 as a pandemic on March 11, 2020. Thereafter, most U.S. states imposed “stay-at-home” orders on their populations to stem the spread of COVID-19. Of specific interest to the Company, stay-at-home orders were imposed in the state of California on March 20, 2020.

On March 23, 2020 the Company enacted a Business Continuity Plan in response to COVID-19. Beginning March 30, 2020, the Company furloughed approximately 52 employees, leaving behind only staff deemed essential for day-to-day administrative operations for a minimum period of 45 days. The Company’s Leadership Team volunteered to take a 25% temporary salary cut as well as the fiscal 2020 Executive Bonus in equity in lieu of cash if earned. In addition, approximately 25 other top company managers volunteered to take a similar 15% reduction in salary. Several employees returned to work June 1st, most with the 15% voluntary salary cuts, with others scheduled to return in a staggered manner through to the end of September. Additionally, in March 2020, the directors voted to take a temporary 25% reduction in base cash retainer in support of the Company’s Business Continuity Plan. As a result of the continued global economic slowdown due to COVID-19 and the associated decline in global crude oil prices, the Company eliminated 26 employees on June 1, 2020. During the period of March 30, 2020 to June 1, 2020, the Company had a limited production capability of new microturbine products, but had pre-built approximately 5.9 MW of microturbine finished goods during March 2020, for shipment during this period of suspended production. The Company continues to maintain a crew of essential operations employees to manufacture service engines, remanufacture spare parts and provide service spares in support of FPPs and global distributor spare parts orders. The Company’s vendor supply chain has been impacted by the pandemic, however it continues to be operational as of today. However, the Company is looking to minimize incoming inventory receipts to less than \$6.0 million between April 1, 2020, and June 30, 2020, in order to minimize cash burn, increase liquidity, and increase inventory turns with a goal of generating positive working capital during the first and second quarter of Fiscal 2021.

On March 27, 2020, President Trump signed the Coronavirus Aid, Relief and Economic Security (the “CARES Act”), which, among other things, outlines the provisions of the Paycheck Protection Program (the “PPP”). The Company determined that it met the criteria to be eligible to obtain a loan under the PPP because, among other reasons, in light of the COVID-19 outbreak and the uncertainty of economic conditions related thereto, the loan was necessary to support the Company’s ongoing operations. Under the PPP, the Company could obtain a U.S. Small Business Administration loan in an amount equal to the average of the Company’s monthly payroll costs (as defined under the PPP) for calendar 2019 multiplied by 2.5 (approximately 10 weeks of payroll costs). Section 1106 of the CARES Act contains provisions for the forgiveness of all or a portion of a PPP loan, subject to the satisfaction of certain requirements. The amount eligible for

forgiveness is, subject to certain limitations, the sum of the Company's payroll costs, rent and utilities paid by the Company during the eight-week period beginning on the funding date of the PPP loan.

On April 24, 2020, the Company closed on a PPP loan in the amount of \$2,610,200, which was transferred by the Company into an account dedicated to allowable uses of the PPP loan proceeds. On May 13, 2020, the Company repaid \$660,200 of the loan in accordance with the Fourth Amendment to the Note Purchase Agreement between the Company and Goldman Sachs Specialty Lending Group, L.P.

The COVID-19 outbreak and the uncertainty of economic conditions relating thereto may negatively impact the Company's results of operations, cash flows and financial position; however, the overall financial impact cannot be reasonably estimated at this time. Based on the operational and financial plans that management has developed, the Company expects to be able to meet its financial obligations as they become due over the next twelve months.

Products

Our 30 kW ("C30") microturbine can produce enough electricity to power a small convenience store or cathodic protection for an oil or natural gas pipeline. The 65 kW ("C65") microturbine can produce enough heat to provide hot water to a 100 room hotel while also providing about one third of its electrical requirements. Our 200 kW ("C200") microturbine is well suited for larger hotels, office, commercial, and industrial buildings and wastewater treatment plants, among others. By packaging the C200 microturbine power modules into single enclosures which are available in multiple sizes and are built in similar dimensions to a standard shipping container or International Organization for Standardization ("ISO") sizes, we have created an upgradable family of microturbine offerings from 400 kW up to 1000 kW or 1 MW in a compact footprint engineered to function as a single source of power. Our 400 kW, 600 kW, 800 kW and 1000 kW ("C1000S Series") microturbines are well suited for utility substations, larger commercial and industrial facilities and remote oil and gas applications. The 600 kW and 800 kW systems can be shipped in a five-bay configuration which allows the end-use customer to add one to two more 200 kW microturbines in the future to increase their total onsite power production from 600 kW to 1000 kW without any change to the existing site footprint, as their business power demands expand over time.

We began commercial sales of our C30 products in 1998, targeting the emerging distributed generation industry that was being driven by fundamental changes in power requirements. In September 2000, we shipped the first commercial unit of our 60 kW microturbine ("C60"), which was replaced by the C65 model during the quarter ended March 31, 2006. We began shipping the C60 ICHP solution in 2003. Our C60 microturbine was the first combustion power generation product to be certified by the California Air Resources Board ("CARB") as meeting its stringent distributed generation emissions standards that went into effect in 2003. The first commercial C200 microturbine was shipped on August 28, 2008. Our C1000 Series product was developed based on our C200 microturbine engine. The C1000 Series product can be configured into 1,000 kW, 800 kW, 600 kW and 400 kW solutions in multiple sizes and are built in similar dimensions to a standard shipping container or ISO sizes, and depending on the configuration, provides the opportunity for future expandability. The first commercial shipment of our C1000 Series product was on December 29, 2008. During Fiscal 2016, we unveiled our C1000 Signature ("C1000S") microturbine as part of our new C1000S microturbine energy systems which also includes an 800 kW ("C800S"), a 600 kW ("C600S"), and a 400 kW ("C400S") microturbine. The C1000S microturbine incorporates over 70 components, system and design upgrades intended to improve the overall product quality and enhance the microturbine ownership experience in all applications but specifically for CHP and CCHP applications. We began shipping the C200 and C1000 Signature Series ICHP solution in the fourth quarter of fiscal 2017.

Our microturbines are compact, lightweight and environmentally friendly generators of electricity and heat compared to competing technologies. They operate on the same principle as a jet engine using a variety of commercially available fuels. For example, our microturbines can operate on low British Thermal Unit ("BTU") gas, which is gas with lower energy content, and can also operate on gas with a high amount of sulfur, known in the industry as sour gas. Examples of these fuel sources include methane from facilities such as wastewater treatment plants, landfills and anaerobic digesters. Our microturbines' multi-fuel capability provides competitive advantages with respect to some of

our selected vertical markets. The combustor system remains the same for all fuels except for the fuel injectors, which currently vary between liquid and multiple gaseous fuels.

Our microturbines incorporate four major design features: advanced combustion technology, patented air bearing technology, digital power electronics and proprietary remote monitoring systems.

Our advanced combustion technology allows our microturbines to achieve low emissions. Our natural gas fueled C65, C200S and C1000S series microturbines were certified by the CARB as meeting its stringent 2007 emissions requirements—the same emissions standard used to certify fuel cells and the same emissions levels as a central power plant. Our C65 and C200 Landfill and Digester Gas systems were certified by the CARB as meeting its 2008 waste gas emissions requirements for landfill and digester gas applications. These low emission levels not only provide an environmentally friendly product, but also eliminate permitting requirements in several municipalities for continuously operated onsite power generation.

The patented air bearing system allows the microturbine's single moving assembly to produce power without the need for typical petroleum-based lubrication. Air bearings use a high pressure field of air rather than petroleum lubricants. This improves reliability and reduces maintenance such as oil changes.

The digital power electronics manage critical functions and monitor operations of the microturbine; our electronic controls manage the microturbine's speed, temperature and fuel flow and communication with external networks and building management systems. The digital power electronics coordinate with the grid when the units are operated in a grid connect mode and with the onboard battery when equipped for standalone mode. The digital power electronics also include the functionality of seamless transfer capabilities, ensuring the end-users' critical loads do not experience any interruption to their operation in the event of a utility power outage. All control functions are performed digitally. Performance is optimized, resulting in low emissions, high reliability and high efficiency over a variable power range.

Our proprietary Capstone Remote Monitoring Software ("CRMS") allows end users to operate and manage the microturbine remotely. This remote capability can provide end users with power generation flexibility and cost savings.

Our electronic controls manage microturbines using our proprietary software and advanced algorithms. The controls start the turbogenerator and manage its load, coordinate the functioning of the microturbine with the grid, manage the speed, fuel flow and exhaust temperature of the microturbine, convert the variable frequency, up to a maximum of 1,600 Hertz and variable voltage power produced by the generator into a usable output of either 50 or 60 Hertz AC for stationary applications or DC for hybrid electric vehicle applications, and provide digital communications to externally maintain and control the equipment.

The electrical output of our units can be paralleled in multiple unit configurations through our Advanced Power Server product and a digital communications cable to serve larger installations requiring electrical loads up to ten megawatts. Our products can operate connected to the electric utility grid as a current source, on a standalone basis as a voltage source, multipacked to support larger loads as a "virtual single" unit and in dual mode, where the microturbine operates connected to the electric utility grid or operates independently.

We were the first microturbine manufacturer to achieve UL Class I, Division 2 certification and ATEX certification for operation in hazardous area oil and gas applications. These specially packaged systems are applied in oil and gas production areas with potentially explosive environments. Our C65, as well as our C200 and C1000 Signature Series grid connect and stand-alone microturbines are listed by Underwriters Laboratories ("UL") as meeting the UL 2200 stationary engine generator standards and the UL 1741 utility interconnection requirements.

Our C30 and C60 microturbines are certified by the California Energy Commission and were the first products to comply with the requirements of its "Rule 21" grid interconnection standard. This standard streamlines the process for connecting distributed generation systems to the grid in California. The benefits of achieving this standard include avoiding both costly external equipment procurement requirements and extensive site by site and utility by utility

analysis. Our protective relay functionality has also been recognized by the State of New York, which allows our microturbines to be connected to New York's electric utility grid.

We offer various accessories for our products including rotary gas compressors with digital controls, integrated heat recovery modules for CHP applications, dual mode controllers that allow automatic transition between grid connect and stand-alone modes, batteries with digital controls for stand-alone or dual mode operations, power servers for large multipack installations, protocol converters for Internet access, packaging options and miscellaneous parts such as frames, exhaust ducting, backflow dampers and installation hardware.

Applications

Stationary power generation applications can vary greatly depending on load size and demand location. From small 2 kW back-up generators to several large 1,000 MW central generating facilities, stationary power systems can offer superior fuel efficiency for the customer while also meeting strict emissions regulations. Historically, power generation in developed countries such as the United States has been part of a regulated utility system. However, a number of developments related primarily to the deregulation of the utility industry as well as significant technology advances have helped to broaden the range of power supply options available to interested parties.

Our full line of microturbine energy solutions target multiple vertical markets worldwide, including energy efficiency, renewable energy, natural resources, critical power supply, microgrid and transportation. Within these vertical markets, we focus on applications that we believe have the greatest near-term potential for the customer based on various different factors such as energy load demand, available fuels, economic payback and for some, government incentives. We also target smaller sub segments that fall within these vertical markets that may not otherwise be considered for on-site generation.

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 which we believe provides a significant economic advantage to our 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 approximately 85 percent for hot water and chilled water to as much as 90 percent or more for some steam and direct drying applications. 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.

When compared to onsite boilers, microturbines generally produce fewer commonly found air pollutants ("criteria pollutants"), such as nitrogen oxides ("NOx"), carbon monoxide ("CO") and volatile organic compounds ("VOCs"). In fact, our CHP or CCHP system can displace local boiler emissions altogether. A high efficiency CHP or CCHP system can allow for reduced net utility costs for end users as well as improved fuel consumption. The most common uses for captured thermal energy include space heating and air conditioning, water heating and water chilling, direct-drying and steam for industrial applications. In CCHP applications, the microturbine exhaust drives an absorption chiller, which produces the chilled water necessary for air conditioning and local use. Organizations of all sizes have used the heat generated by our microturbines at the many different types of commercial and industrial applications they serve, including hotels and resorts, hospitals and medical centers, as well as office buildings and large retail facilities.

Renewable Energy

There is a growing transition to renewable energy sources and technologies on a global scale. Our microturbines run efficiently on renewable fuels such as methane and other biogases from landfills, wastewater treatment facilities and renewable natural gas. They also run efficiently on other small biogas applications like food processing plants, livestock farms and agricultural green 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" renewable 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, as the sulfur can contaminate combustion engines lube oil leading to equipment breakdowns and higher lifecycle costs.

We introduced our C65 and C200 stand-alone digester products to the renewable energy market segment in 2007 and 2013, respectively. With these products, we are able to target many different types of renewable energy applications, including biogas producing facilities in third world countries and in remote locations that offer a valuable fuel source for the generation of electricity. The performance of our C65 digester gas system has been routinely evaluated to ensure that the combustion system is stable from 0 to 100 percent power output. Minor controls changes have been implemented to increase stability at low power levels. The ability to convert this low BTU fuel to electricity along with the high reliability and low maintenance features of this product make it well suited for this market.

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

Our microturbines are installed in the natural resource market for use in both onshore and offshore applications, including exploration, production, compression and transmission sites as a highly efficient and reliable source of prime 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 oil and gas 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 power to these remote oil and gas sites.

Major oil and gas companies are developing large shale reserves, or plays, in the United States. We have been shipping microturbines into the U.S. shale gas market since 2010. The addressable market for our microturbines in this industry is significant. The shale gas market for microturbines may grow as demand for natural gas continues to rise and the U.S. as the Environmental Protection Agency (“EPA”), the Department of the Interior and other federal and state agencies work to reduce the emission of hazardous air pollutants associated with natural gas development, including limitations on the flaring of excess gases. Our product sales in the natural resources market is driven by our microturbines’ reliability, emissions profile and ease of installation. However, our growth in the oil and gas sector within our natural resources market is primarily driven by oil prices. The company believes it will experience growth in this market when oil prices are sustained at or above \$50.00 per barrel.

The C30, C65 and C200 microturbines can be configured to meet Class 1 Zone 2 hazardous location requirements for the natural resources market. Hazardous location requirements are met through package ventilation changes for purging and pressurizing package air to avoid potential flammable mixtures as well as controls for emergency disconnect of fuel and electrical sources. The package is upgraded to stainless steel construction to withstand the often corrosive offshore environments where these units are installed. Oil and gas customers often prefer power generation systems that offer low maintenance and high reliability in order to ensure continued production.

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. The majority of microturbine based distributed generation installations have powered through hurricanes with little or no downtime. To meet these customer requirements, traditional solutions utilize Uninterruptible Power Supplies (“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.

We have developed the world’s only microturbine-powered UPS solutions that offer clean, IT grade power and can completely displace the need for traditional UPS and back-up diesel generators. We offer two UL listed microturbine powered UPS solutions: our UPSource microturbine powered solution, which provides a source for prime or emergency power; as well as our Hybrid UPS microturbine-powered solution, which provides power when dispatched in high

efficiency, standard UPS and emergency power. Both critical power supply products offer eight nines of availability in an n+1 configuration when the product has at least one independent back-up source. This measurement of availability is used in the data center industry to refer to 99.999999% of reliability. These integrated solutions are well suited for new facility construction or expansion and can be installed with absorption chillers or other heat recovery systems to obtain high efficiency levels while reducing operating costs, compared with traditional solutions and is a developing market segment for us.

Dual-mode units operating in a prime power configuration can support a 150 percent overload for up to 10 seconds during transient conditions. Dual-mode units operating in grid parallel mode can provide customers a back-up power system with an economic return. These systems offer high on-site energy efficiency when combined with a heat exchanger (CHP) to create hot water, or with a chiller (CCHP) for air conditioning at these facilities. This configuration, when combined with our Dual Mode Controller, can transition from the grid parallel mode to prime power mode in less than 10 seconds. Our microturbines can also be installed along with a rotary UPS to provide a complete line interactive continuous power solution. In this case, the microturbines remain in grid connect mode while the rotary UPS stabilizes the utility voltage and provides a seamless transfer from operation connected to the grid to operation isolated from the grid.

Microgrid

A microgrid is a group of interconnected loads and distributed energy resources that acts as a single controllable energy entity with respect to the grid. Distributed energy resources typically include other dual-mode microturbines, reciprocating engines, 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.

Additionally, we have our own programmable logic control system and sensors, which interface with other building automation systems and these control systems are one of the key aspects of monitoring a microgrid. The use of microgrid to serve local loads helps to reduce energy losses in transmission and distribution, further increasing the efficiency of the microgrid. We have been a part of numerous successful microgrid installations worldwide ranging from a wind turbine manufacturer, ski resort, university, industrial farm, utility software company, brewery and an electrical distribution utility. Capstone microturbines functionality is to ensure energy availability for advanced microgrids before and during disasters, such as hurricanes. They may also help reduce electrical expenditures in the years following a disaster when electric utility rates may be increased to pay for the expenses for grid infrastructure repairs and improvements associated with these disasters. We have seen continued development in the microgrid market segment.

Transportation

Our technology also can be 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 and reduced emissions when compared with traditional internal combustion engines. Internal combustion diesel engine manufacturers have been challenged for the last several years to develop technology improvements, prior to aftertreatment that reduce emissions to levels specified by the EPA and CARB 2007 and 2010 standards. Many manufacturers are incorporating aftertreatment that increases upfront equipment costs, vehicle weight and life cycle costs, which and may reduce overall engine efficiency.

Additionally, 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 generator set. In this application, the microturbines provide power to the vessel's electrical loads and, in some cases, the vessel is able to utilize the exhaust energy to increase the overall efficiency of the application, reducing overall fuel consumption and emissions. 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 battery charger and range extender. Our marine customers use both liquid fueled and natural gas microturbine products. Liquefied natural gas ("LNG") is in its early stages as a marine fuel, and the number of vessels powered by LNG is forecasted to double every two years over the next decade. Vessel owners can receive the same benefits as users of stationary products: low emissions with no exhaust aftertreatment, long maintenance intervals, high reliability, low noise and no vibration. Transportation is a developing market segment for us. In Fiscal 2020, transportation products were only for customer demonstrations.

Sales and Marketing

We primarily sell and market our microturbine product, parts and service through our global network of authorized distributors and a new direct sales team, which was formed in January 2020 to focus on OEMs and national accounts.

As part of our long-term growth strategy, in January 2020, Capstone divided its sales and marketing team into two separate organizations. One stand-alone organization will remain focused on developing and managing the existing worldwide distribution channel and will lead all marketing and advertising activities as we continue building the Company into a strong and recognizable worldwide brand. The second stand-alone organization is responsible for growing the Company's national account business and long-term rental fleet. Additionally, this team will be responsible for business development, licensing, and new product partnerships. We will also focus on new fuels, such as hydrogen and further growing our renewable market segment participation. We believe this new sales strategy, when combined with a positive adjusted EBITDA, will better enable us to capture more market share with large, global customers, where we see greater potential at dozens of their facilities worldwide. Our existing distribution network remains our worldwide feet-on-the-ground and our local presence, while the internal salesforce will build strong, long-term relationships with larger, more diverse customers.

Our worldwide distribution network was developed from the ground up and has become a valuable asset because we can reach end use customers globally. Each of our distributors is a strategically placed independent partner marketing, selling, and providing applications engineering support for our products on our behalf. In addition, distributors provide remote monitoring services, warranty support, local spare parts support, and customer training and long-term service support. Through our global distribution network, we offer a comprehensive FPP for a fixed fee to perform regularly scheduled and unscheduled maintenance as needed. We provide factory and onsite training to certify all personnel that perform sales, applications, commissioning and long-term service on our microturbines. Individuals who are certified are called Authorized Service Providers, and must be employed by a distributor or an end user in order to perform work pursuant to a FPP. To assure proper application and installation of our microturbine systems, we offer an installer training and an application engineering certification program. We offer to assist all customers by reviewing their installation designs in relation to the technical requirements for proper operation of our products, such as electrical interconnections, load requirements, fuel type and pressure, cooling air flow and turbine exhaust routing. As part of the microturbine commissioning process, we also receive a checklist to confirm that the final installation adheres to our technical requirements before we accept our standard manufacturer warranty obligations. Our typical terms of sale include shipment of the products with title, care, custody and control transferring at our dock, payment terms ranging from full payment in advance of shipment to payment in 90 days, and warranty periods of approximately 15 to 24 months from shipment depending on the product type. We typically do not have customer acceptance provisions in our agreements.

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 funding for increased strategic business-to-business marketing activities.

During Fiscal 2016, we launched Capstone Energy Finance, a joint venture that provides financing options for the purchase of our microturbines. Capstone Energy Finance provides end users with the ability to purchase electricity generated by our microturbine at their facility with no upfront capital investment and expand access to clean and reliable onsite energy. A power purchase agreement from Capstone Energy Finance enables organizations to reduce operating expenses by allowing them to buy electricity at a rate that is lower than what they currently pay today. Customers can purchase all or a portion of their energy from Capstone Energy Finance and eliminate exposure to volatile utility rates by locking in a fixed rate for a period of ten to twenty years. Capstone Energy Finance monitors and maintains the system for the entire term of the agreement, and customers pay only for the energy they use. We believe financing solutions offered by Capstone Energy Finance can help new and existing end-users evaluate their purchasing options and provide a solution to immediately improve their bottom line without requiring capital investment in new equipment. The adoption rate of the Capstone Energy Finance solution has been slower than we expected because our customers continue to utilize other financing options or elect to pay directly for our microturbines.

United States and Canada

We have distribution agreements with a number of companies throughout North America for the resale of our products. Many of these distributors serve multiple markets in their select geographic regions. The primary markets served in this region have been energy efficiency, renewable energy, natural resources, critical power, microgrid and transportation products. The energy efficiency and natural resources vertical markets are expected to grow as a result of an increased domestic production of hydrocarbons, the low downstream price of natural gas, as well as public and regulatory acceptance of distributed generation.

In developing our sales opportunities we have identified the need to address various requirements present in our target localities. These requirements include electric grid interconnection standards, gas utility connection requirements, emissions standards, building and fire safety codes and various inspections and approvals. The costs and scheduling ramifications of these various approvals, in conjunction with normal bidding process requirements and construction delays, can be significant to the completion of an installation. Our goal is to work with the applicable regulating entities to establish compliant standards for the installation of our microturbines so that the costs and installation timelines are minimized for our customers.

Latin America

Our target markets in Latin America are energy efficiency, renewable energy and natural resources. Oil and gas production projects continue to be a growing market in Latin America.

Energy reform in Mexico, for example, has opened new market opportunities for us by allowing competition among multiple players and enabling power generation companies to sell directly to consumers instead of only to the state-owned Federal Electricity Commission. Our strategy is to leverage our distribution network in Mexico across various market verticals.

South America constitutes a diverse group of markets that vary greatly in potential capture for us based on a number of factors, including availability of oil and gas production and transmission, energy pricing and political and investment climate. While we have distributors in nearly all South American countries, our management is focused on what we consider to be the top geographical markets, such as Colombia, Brazil, Bolivia, and Chile.

Asia and Australia

Our target markets in Asia and Australia are energy efficiency, renewable energy and natural resources. Our historical sales in Southeast Asia and Australia have primarily been in the energy efficiency and the oil and gas markets. Other areas in Asia and the Pacific Rim offer attractive opportunities as well. China is expected to see growth in the oil and gas market, while biogas recovery is showing signs of growth in Southeast Asia.

Middle East and Africa

Our target market in the Middle East and Africa is primarily oil and gas. This includes flare gas to power projects which are a particularly attractive market opportunity given the volume of gas being flared and the need for stable power in the region. Our management has targeted distributors and customers involved in the capture and use of flare gas in the oil and gas market. However, the geopolitical environment in this region is still volatile, which can have an impact on our sales.

Europe and Russia

To address the European market, including Russia, we are strengthening our relationships with existing and new distributors and have increased local sales and service support. We have an office in Europe for the purpose of working with our local distributors on a daily basis to identify and understand growth opportunities. We have a recently upgraded Integrated Remanufacturing Facility (IRF) in the United Kingdom to make new and remanufactured parts readily available to our distributors. Europe has a history of extensive use of distributed generation technologies. We continue to diversify the company's overall presence in Russia and the surrounding Commonwealth of Independent States (CIS) as we explore new growth opportunities in these areas with multiple new distributors. The rebuilding of our business in Russia and the surrounding CIS area continues to evolve including the addition of our new Russia oil and gas distributor Arman Energo. Further, the continuation or escalation of the current geopolitical instability in Russia and Ukraine could continue to negatively impact our operations, sales, and future growth prospects in that region. For more information, see "Risk Factors" beginning on Page 18 of this Form 10-K.

Customers

Sales to E-Finity Distributed Generation, LLC ("E-Finity"), one of our domestic distributors, accounted for 12% and 13% of our revenue for the fiscal years ended March 31, 2020 and 2019, respectively. Sales to Cal Microturbine ("CAL"), one of our domestic distributors, accounted for 12% of our revenue for the year ended March 31, 2019. Additionally, E-Finity accounted for 14% of net accounts receivable as of March 31, 2020. Reliable Secure Power Systems, ("RSP"), one of our domestic distributors, and E-Finity, accounted for 14% and 10%, respectively, of net accounts receivable as of March 31, 2019.

On October 13, 2017, we entered into an Accounts Receivable Assignment Agreement (the "Assignment Agreement") and Promissory Note (the "Note") with Russian distributor 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 \$4.8 million as of March 31, 2019, and this balance was fully reserved.

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 Assignment 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.

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 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. 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 on December

20, 2019. The payments of \$0.4 million, \$0.3 million, and \$0.3 million, due March 20, 2019, June 20, 2019, and September 20, 2019, respectively, under the Amended Assignment Agreement, have not been received at the time of this filing. In September 2019, we sent TI a notice to cure default with a deadline of October 31, 2019. TI failed to cure the noticed default and we have since terminated TI's distributor agreement. As a result, the BPC accounts receivable and related accounts receivable reserve of \$4.8 million were written off.

We recorded a net bad debt expense of approximately \$0.4 million during Fiscal 2020 primarily due to the uncertainty of collections from certain distributors during the COVID-19 pandemic. We recorded a net bad debt recovery of approximately \$0.3 million during Fiscal 2019. As of September 30, 2019, we collected cumulatively approximately \$1.8 million from BPC on their previously reserved accounts receivable. Additionally, we collected cumulatively approximately \$1.5 million from TI, under the terms of the Assignment Agreement and the Amended Assignment Agreement. The BPC accounts receivable and related accounts receivable reserve of \$4.8 million were written off as of March 31, 2020.

Competition

The market for our products is highly competitive. Our microturbines compete with existing technologies such as reciprocating engines and compete with emerging distributed generation technologies, including solar-powered systems, wind-powered systems, fuel cells and other microturbines. Many potential customers rely on the utility grid for their electrical power. Many of our distributed generation competitors are large, well-established companies that derive competitive advantages from production economies of scale, worldwide presence, brand recognition and greater resources which they can devote to product development or promotion.

Often power purchased from the electric utility grid can be 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 (CHP and CCHP), where fuel costs are low (renewable energy/renewable fuels), where the costs of connecting to the grid may be high or impractical (such as remote power applications), where reliability and power quality are of critical importance, or in situations where peak shaving could be economically advantageous because of highly variable electricity prices. Because our microturbines can provide a reliable source of power and can operate on multiple fuel sources, our management believes we offer a level of flexibility not currently offered by other technologies such as reciprocating engines.

Our reciprocating engine competitors have products and markets that are well developed and technologies that have been proven for some time. A reciprocating engine, also known as an internal combustion engine, is similar to those used in automotive applications. Reciprocating engines are popular for primary and back-up power applications despite higher levels of emissions, noise and maintenance. These technologies, which in many cases have a lower up front cost than microturbines, are currently produced by Caterpillar Inc., Cummins Inc. (which recently entered into a joint venture with Eaton), Innio who recently bought the General Electric Gas Engine business, which now includes Waukesha and Jenbacher gas engines, MAN SE, and Tecogen, Inc. (which now includes American DG Energy Inc.), among others.

Our microturbines may also compete with other distributed generation technologies, including solar-powered systems, wind-powered systems, fuel cells and fly wheel. Solar and wind powered systems produce no emissions and benefit from above market contracts provided by state mandates. The main drawbacks to solar and wind powered systems is that they may not be dispatchable because of their dependence on weather conditions, the utility grid or high capital costs that can often make these systems uneconomical without government subsidies depending upon geographic locale and application of the technology. Although the market is still developing, a number of fuel cell providers are also focused on markets similar to ours, including Active Power Inc. (a division of Piller Power Systems Inc.), Ballard Power Systems Inc., Bloom Energy Corporation, FuelCell Energy Inc., LG Fuel Cell Systems, a business unit of LG Electronics, and Plug Power Inc. Fuel cells have slightly lower levels of NO_x, CO, VOCs and other criteria pollutant emissions than our microturbines. With equivalent government incentives, microturbines would provide a better economic value to end users in most applications.

We also compete with other companies who have microturbine products, including FlexEnergy and Turbec S.p.A.

Overall, we compete with end users' other options for electrical power and heat generation on the basis of our microturbine's ability to:

- provide power when a utility grid is not available or goes out of service;
- reduce total cost of purchasing electricity and fuel;
- improve electric power availability and provide high power quality;
- operate on multiple fuel types;
- reduce emissions (both criteria pollutants and greenhouse gases);
- simplify operation; and
- control maintenance costs and associated disposal of hazardous materials.

Governmental and Regulatory Impact

Our markets can be positively or negatively impacted by the effects of governmental and regulatory matters. We have systems installed in 73 countries around the world, each of which has their own policy and regulatory framework, which are subject to change. We are affected not only by energy policy, laws, regulations and incentives of governments in the markets in which we sell, but also by rules, regulations and costs imposed by utilities. Utility companies or governmental entities may place barriers on the installation or interconnection of our product with the electric grid. Further, utility companies may charge additional fees to customers who install on-site power generation; thereby reducing the electricity they take from the utility, or for having the capacity to use power from the grid for back-up or standby purposes. These types of restrictions, fees or charges could hamper the ability to install or effectively use our product, or increase the cost to our potential customers for using our systems. This could make our systems less economical, thereby adversely affecting our revenue and profitability. In addition, utility rate reductions can make our products less competitive which would have a material adverse effect on our operations. These costs, incentives and rules are not always the same as those faced by technologies with which we compete. However, rules, regulations, laws and incentives could also provide an advantage to our distributed generation solutions as compared with competing technologies if we are able to achieve required compliance in a lower cost, more efficient manner. Additionally, reduced emissions and higher fuel efficiency could help our customers combat the effects of climate change. Accordingly, we may benefit from increased government regulations that impose tighter emission standards particularly on burning coal and fuel oil and fuel efficiency as long as gas combustion technology solutions are not excluded.

Government funding can impact the rate of development of new technologies or improvements to existing technologies. We continue to engage with federal and state policymakers to support government programs that promote the deployment of our low emission and energy efficient products. Competing new technologies have historically received larger incentives and development funding than do microturbines. However, the U.S. Department of Energy continues to fund the development of cost-effective, high efficiency CHP that is responsive to site demands and grid requirements. Flexible CHP could provide additional generating capacity when grid demand increases or renewable resources are not available as well as other grid services, like frequency regulation, to keep the grid stable. As more intermittent renewable resources are added to the electric grid, grid operators need access to additional dispatchable generation capacity to ensure an adequate and stable power supply. Capstone's PowerSync controller could provide this automated response capability to allow for participation in grid services markets, where permitted.

In the United States, a 10% Federal Investment Tax Credit ("ITC") for CHP and microturbines is available through the end of 2021. In addition, bonus depreciation rules allow businesses to immediately deduct 100% of eligible

property placed in service after September 27, 2017 and before January 1, 2023. The deduction limit will phase down from 100% to 0% by 2027. As a result, we may see a positive impact on our sales in the United States due to the availability of this 10% tax credit and bonus depreciation. However, other CHP and gas-powered distributed energy technology-providers will also benefit from the return of these tax incentives, and, fuel cell technologies will receive a 30% ITC level with a phase down to 22% by 2022 and expiration in 2023. At the state level, slow approvals for natural gas pipeline infrastructure may impact gas availability in some areas, and efforts to incentivize building electrification over natural gas-fueled heat and power sources may inhibit sales. However, electricity demand spikes may also lead to higher electricity prices thereby improving project economics for on-site distributed power generation.

In global markets, European governments continue to support efficient CHP and are beginning to take action on reducing local air pollution through regulations like the EU's Medium Combustion Plant and EcoDesign Directives. Our low emission systems' ability to meet these programs' requirements may have a positive impact on our sales as implementation progresses. In the oil and gas market, many producers have committed to reduce methane emissions from their operations. Our low maintenance, reliable systems and our ability to run on a range of fuels could fit their needs and result in a positive impact on our sales.

Sourcing and Manufacturing

We are focused on continuously improving our supply chain effectiveness, strengthening our manufacturing processes and increasing operational efficiencies within our organization. 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. We continue to evaluate and implement new systems designed to provide improved quality, reliability, service, greater efficiency and lower supply chain costs.

During Fiscal 2020, we focused significant efforts on establishing additional long-term partnerships with several key vendors while consolidating and vertically integrating within our supply chain. We have located and qualified several new suppliers where previous single points of failure have occurred in past years. We have established and qualified dual source vendors for several critical long-lead time components which should mitigate the risks of supply chain interruptions in the future. Throughout the year, we have focused on several cost-reduction initiatives designed to reduce overall aftermarket and product costs to improve our operating cash position. Later in Fiscal 2020, we became aware of the COVID-19 pandemic and fully assessed our supply chain, determining that the sourcing controls and measures we put in place were adequate in helping prevent an interruption. While the COVID-19 situation remains fluid, we continue to put measures in place in the form of safety stocks and dual sourcing to prevent potential interruptions to the supply chain.

During Fiscal 2019, we identified a defect in one of the component parts for microturbine systems from one of our single source suppliers. As a result of this defect we have identified several new suppliers with greater engineering expertise and robust quality management systems. The transition is complex, lengthy and may result in an interruption in our manufacturing process. An interruption in our manufacturing process for this component part would adversely impact our results of operations. The efforts to qualify and dual source these components was completed in the fourth quarter of Fiscal 2019.

During 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.

During Fiscal 2019, we issued a prepayment of approximately \$2.2 million to this single source supplier. A new supplier has been fully qualified and has taken over as the primary source of this commodity for Capstone.

We have substantially increased our focus on process controls and validations, supplier controls, distribution controls and providing our operations teams with the training and tools necessary to drive continuous improvement in product quality. In addition, we remain focused on examining our operations and general business activities to identify cost improvement opportunities in order to enhance our operational effectiveness and use lean manufacturing processes. Our ability to leverage these capabilities may be affected by the current variability in our demand volumes and forecasting. Our demand volumes and forecasting could continue to be negatively impacted by the volatility of the global oil and gas markets, a strong U.S. dollar (making our products more expensive overseas), tariffs and/or import taxes, and ongoing global geopolitical tensions. Our strategy is to identify primary and secondary sources for critical components, both domestic and international, for when available to minimize production line down time due to unavailability of such parts, which could affect our ability to meet manufacturing schedules on build or a linear basis. In April 2019, we executed multiple new Long Term Agreements (“LTA”) including a new 10-year LTA with a new supplier. The LTA from the new supplier will initially reduce annual direct material costs an estimated \$2 million per year once the transition is completed. The strategy to reduce direct material costs is based on partnering with our supply base to drive collaborative cost improvements within its value chain which will enable the significant material cost reductions.

Solar Turbines Incorporated (“Solar”), a wholly owned subsidiary of Caterpillar Inc., was our sole supplier of recuperator cores prior to 2001. In 2000, we exercised an option to license Solar’s technology, which allows us to manufacture these cores ourselves and we began manufacturing them in June 2001. We are required to pay a per unit royalty fee for the life of Capstone’s patents for cores manufactured and sold by us using the technology. Royalties of approximately \$26,400 and \$33,200 were earned by Solar for the fiscal year ended March 31, 2020 and 2019, respectively.

In 2007, we entered into a Development and License Agreement (“Development Agreement”) with Carrier Corporation (“Carrier”) regarding the payment of royalties on the sale of each of our C200 microturbines. 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. Carrier earned \$0.4 million in royalties for C200 and C1000 Series system sales during the fiscal year ended March 31, 2019.

We have an approximately 42,300 square foot manufacturing footprint in our Van Nuys location in Southern California, running on a single shift. We believe that our production capacity goal of approximately 2,000 units per year, depending on product mix is well above our current production rates and will be achievable by adding additional shifts. This may require an increase in working capital and some additional capital expenditures when necessary.

Research and Development (“R&D”)

Our engineering mission has been on supporting the expansion of our existing suite of products, focusing on alternative fuels and technologies, maintaining relevance in the global evolution of grid interconnection requirements, and the launch of the PowerSync Controller. We focus our engineering efforts on coordinating our product design and manufacturing processes to bring our products to market in a cost-effective and timely manner. For the fiscal years ended March 31, 2020 and 2019, R&D expenses were \$3.6 million in each year, which amounts are equivalent to 5% and 4% of total revenue, respectively, for these fiscal years.

Our product development activities during Fiscal 2019 continued with the launch of the new family of PowerSync controllers used for Capstone microturbines. In Fiscal 2020 we completed the development and qualification of a new self-cleanable severe environment air filtration system for our Signature Series line of microturbine products.

Capstone has also embarked upon a project to modernize control electronics, providing common functionality, minimizing near term obsolescence concerns, and enabling long term support.

Phoenix Contact and Capstone partnered in a joint effort to improve on-site controls and integration with end-user customer facilities. The main objectives of developing the new PowerSync controller line were to further increase system reliability, availability and make Capstone microturbines easier to use for both end-user customers as well as Capstone distribution partners. Fiscal 2019 marked the first substantial integration of the PowerSync at a number of customer sites. From these integration and commissioning activities, Capstone and Phoenix Contact took feedback to make further improvements to software and hardware. The goal of such improvements is to make the whole process easier and more straightforward.

Our new self-cleanable severe environment air filtration system for our line of Signature Series microturbine products was launched during Fiscal 2019. During sand and dust storms common to most hot arid desert areas, particulate concentrations close to the ground can reach levels 20,000 times those in typical U.S. cities. Such dust and dirt loads can cripple conventional air filtration systems, cause massive maintenance expenditures and allow excessive dust concentrations to be ingested by the turbine. Capstone's new cleanable severe environment units employ industry standard high-efficiency filters. The systems feature self-cleanable pulse actuation to extend life and service interval, critical for remote sites. In Fiscal 2020 we delivered two C600 systems with the self-cleanable filtration to a new customer in the Middle East.

Our C65, C200 and C1000 Series microturbines became UL 1741 Supplement A (SA) certified during Fiscal 2019. This testing standard was written in response to California Rule 21, and in response to the local increased presence of distributed generation and require interactive grid support functions. Capstone benefitted substantially from previous certification successes for the German and Italian markets to expedite conformance to UL 1741 SA. Certification standards are becoming increasingly commonplace globally, with localization of controls and requirements. In Fiscal 2020, Capstone achieved Australian AS4777 certification for our C200 product line, and UK G99 Grid Interconnect type approval for C65 and C200 product lines. In addition, Germany released VDE 4110 for Medium Voltage Grid Interconnection, to augment the BDEW certification. Capstone achieved "Prototype Confirmation" for this new specification that enables continued operability in Germany.

In Fiscal 2019, Capstone was issued two patents related to fuel injection and emissions. The first patent issued is for a multi-staged lean pre-vaporizing, pre-mixing fuel injector providing ultra-low emissions that meet EPA Tier 4 requirements for power generation. Under this new program, exhaust emissions from these engines will be required to decrease by more than 90%. The second patent is for a multiple-fuel capable, pre-mixed, low emission injector for high flame speed fuel combustion. This patent is the foundation for continued development in achieving high reliability and performance with hydrogen content fuels.

Our partnership with the DOE provided funding during Fiscal 2017 in the amount of \$335,000 for one year to Argonne National Laboratory to conduct hydrogen and synthetic fuel or syngas testing on our C65 and C200 microturbines. Hydrogen testing was on hold while the test facility implemented mechanisms for safe handling, detection, and delivery of the hydrogen gas. The safety challenges have been resolved and testing has begun. Despite a challenging federal budgetary environment, funding has been extended to the 2020 government fiscal year for completion of the testing.

Capstone Turbine continues support of the University of California, Irvine ("UCI") through their Advanced Power and Energy Program, to evaluate Microturbine operation using hydrogen and natural gas fuel blends. The testing to be performed in Fiscal 2021 is sponsored by the local gas authority as they evaluate the impacts of gas grid hydrogen injection. Capstone and UCI continue to be key partners in advancing academic research while enabling commercialization of technology.

We partnered with FGC Plasma Solutions to test a new plasma-assisted fuel injection technology in our C65 microturbine. We worked together to develop a new combustion concept for improved turbine efficiency and emissions performance. The technology could enable more optimum operation of the engine as well as benefits from lower

emissions, increased fuel flexibility and improved reliability. Testing was completed in early Fiscal 2020 and results were positive whereby the solution could be implemented into our microturbine without adverse effects.

Capstone and Argonne National Laboratory are also partnering on a microturbine derivative utilizing Argonne's high-efficiency, fast-charging, and fast discharging Thermal Energy Storage System. This effort is funded through the Department of Energy's Technology Commercialization Fund. The thermal storage system is expected to improve the microturbine's overall efficiency increasing value to the customer. The Thermal Energy Storage System modeling and simulation was completed towards the end of Fiscal 2020. A review was conducted and the design of a prototype, small scale, system was decided. Fiscal 2021 will see the assembly of the small scale system and model validation performed at Argonne using their C65 test system.

In addition, we continue to work both cost reduction and performance enhancement activities to improve the value of our microturbine products for our customer base. Cost reduction activities are focused on leveraging the capabilities of our supply base and internal design lean manufacturing improvements. Product enhancements are focused on reducing the already very low maintenance requirements for our products, while at the same time improving operational efficiency, thereby reducing our customers' total cost of ownership.

Because of our single moving assembly, manufacturers believe there is also the opportunity to produce a lower cost product in larger automotive volumes. Our focus is on a next generation product that would include existing components and a liquid cooled set of electronics that are consistent with the size, cost and cooling strategies employed on vehicles today. Although we believe the hybrid electric bus and truck market has the potential to be a beneficial option for the bus and truck manufacturers, we temporarily suspended our development efforts with respect to C30 microturbines targeted at this market in response to our lower revenue. Management intends to continue with the next phase of development after we achieve profitability.

We are working with the Kenworth Truck Company to demonstrate a Class 7 series hybrid delivery truck with funding support from the South Coast Air Quality Management District and the San Joaquin Valley Air Pollution Control District. The Kenworth Class 7 hybrid truck is retrofitted with a refrigerated box body, and a 65kW Capstone microturbine operating on CNG. Emissions and fuel economy testing was completed at UC Riverside in 2018, including comparison testing of a similarly equipped traditional diesel truck. Results for the three tested drive cycles indicate the hybrid truck can provide 50 to 68% reduction in tailpipe NOx emissions, 19 to 27% reduction in overall CO2 emissions, and 26 to 32% reduction in operating cost. The next step is to operate the truck on actual customer delivery routes in both air districts to quantify the performance, emissions, fuel economy, and other benefits of a microturbine based hybrid solution. We expect to collect and utilize information from the Kenworth Class 7 hybrid truck's road testing and demonstration processes for future product developments and enhancements. A prototype or concept vehicle such as this may take several years to go into commercial production following completion of rigorous testing.

Our liquid fuel microturbines have demonstrated emissions levels which meet the CARB 2010 standards for Heavy Duty Diesel Engines ("HDDE"). The liquid fuel microturbine is able to meet these extremely low emissions requirements using its lean premix combustion technology with no exhaust aftertreatment. Competitive reciprocating engine technologies require aftertreatment components that increase system cost, require frequent maintenance, and impact engine efficiency. Our compressed natural gas ("CNG") fueled microturbines also meet extremely low emission standards, including the U.S. Environmental Protection Agency and CARB 2010 emissions requirements for On Road HDDE for Urban Bus. Test emissions from our natural gas microturbines measured dramatically less than the emissions levels set forth by the CARB standard including NOx at 75% and CO at 96% less than the required levels.

Our marine products have been used to provide hybrid electric marine propulsion, "hotel power," CHP, or CCHP. They may be ideal for small and mid-size commercial ships that travel inland waterways and emissions controlled areas ("ECAs"). Although we believe the marine sector has the potential to be a beneficial option for the vessel owners, we temporarily suspended our development efforts with respect to C30 microturbines targeted at this market in response to our lower revenue. We currently intend to continue with the next phase of development after we achieve profitability. In partnership with one of our long-term EMEA distributors, Capstone has developed a marine C65 for a private yacht manufacturer and in Fiscal 2020 we delivered the product and also received certification from Lloyd's Register EMEA for Lloyd's Register Rules and Regulations for the Classification of Special Service Craft 2018 - Part 6.

Our C65 Hybrid UPS product line has been evolving over the years. After having received the 2011 NOVA Award from the Construction Innovation Forum for the C65 Hybrid UPS Microturbine at Syracuse University's data center—labeled one of the greenest data centers in the world, our C65 Hybrid UPS system has continued development and has installations at Sempra in Monterey Park, California and our own data center in Van Nuys, California as well as two Department of Homeland Security installations, among several others. The product utilizes our inverter electronics and controls technology to provide continuous power quality to meet the customer's critical load. The load inverter is connected through a central power bus to provide power from one of three available power sources including the utility grid, battery storage system, or microturbine generator. Power to the critical load is synchronized to an available utility grid to allow direct bypass of the critical load to the utility grid. This redundant functionality is provided in a single integrated package that can be scaled to a larger seamless power unit through our multipack feature. These units can also be combined with a heat recovery module or an absorption chiller to provide higher total output efficiency. Unlike current UPS products combined with reciprocating engines for backup, our low emissions Hybrid UPS product allows for continuous operation year-round allowing customers the ability to receive a payback on their capital equipment investment. Although we believe the industrial UPS market has the potential to be a beneficial option for businesses that require constant supply of reliable energy, we temporarily suspended our development efforts with respect to C65 microturbines targeted at this market in response to our lower revenue. We currently intend to continue with the next phase of development after we achieve profitability.

Protecting our Intellectual Property Rights and Patents

We rely on a combination of patent, trade secret, copyright, "know how", and trademark laws and nondisclosure agreements to establish and protect our intellectual property rights in our products. In this regard, we have obtained 47 U.S. and 3 international patents (in certain cases covering the same technology in multiple jurisdictions). The patents we have obtained will expire between calendar years 2020 and 2037. We actively evaluate our patent portfolio and pursue new patent applications as we develop new technological innovations, as needed.

We believe that a policy of protecting intellectual property is one component of our strategy of being the leader in microturbine system technology and will provide us with a long term competitive advantage. In addition, we implement security procedures at our plants and facilities and have confidentiality agreements with our suppliers, distributors, employees and certain visitors to our facilities.

Organization and Employees

We were organized in 1988 in the State of California. Our company was reincorporated as Capstone Turbine Corporation on June 22, 2000 in the State of Delaware.

As of March 31, 2020, we had 100 full-time employees and 12 part time employees. No employees are covered by collective bargaining arrangements. We consider relations with our employees to be good.

Available Information

This Form 10-K, as well as our quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") are made available free of charge on our Internet website (<http://www.capstoneturbine.com>) as soon as reasonably practicable after such materials are electronically filed with or furnished to the Securities and Exchange Commission ("SEC").

Item 1A. Risk Factors

This document contains certain forward-looking statements (as such term is defined in Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the Exchange Act) pertaining to, among other things,

- *the COVID-19 pandemic*

- *our results of operations;*
- *profits and losses;*
- *our ability to raise additional capital;*
- *R&D activities;*
- *sales expectations;*
- *our ability to develop markets for our products;*
- *sources for parts;*
- *federal, state and local government regulations;*
- *our relationship with our distributors;*
- *industry and economic conditions applicable to us;*
- *the efficiency, reliability and environmental advantages of our products and their need for maintenance;*
- *our ability to be cost-competitive and to outperform competition;*
- *customer satisfaction;*
- *the value of using our products;*
- *our ability to achieve economies of scale;*
- *market advantage;*
- *return on investments;*
- *issues with suppliers;*
- *anticipation of product supply requirements;*
- *listing requirements;*
- *our microturbine technology;*
- *the utilization of our products;*
- *competition;*
- *the introduction of new technologies;*
- *our production capacity;*
- *international markets;*
- *protection of intellectual property;*

- *cybersecurity threats;*
- *the adequacy of our facilities;*
- *dividends;*
- *business strategy;*
- *product development;*
- *capital resources;*
- *capital expenditures;*
- *liquidity;*
- *amortization expense of intangibles;*
- *cost of warranties;*
- *stock-based compensation;*
- *our NOL rights plan;*
- *purchase and lease commitments;*
- *current liabilities;*
- *recently issued accounting standards;*
- *market risk;*
- *international sanctions risk;*
- *the strength of the U.S. dollar;*
- *interest rate sensitivity;*
- *the effect of cost reductions on future business initiatives;*
- *the Tax Cuts and Jobs Act; and*
- *growth of the shale gas market.*

These statements are based largely on our current expectations, estimates and forecasts and are subject to a number of risks and uncertainties. Actual results could differ materially from those anticipated by these forward-looking statements. Factors that can cause actual results to differ materially include, but are not limited to, those discussed below. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The following factors should be considered in addition to the other information contained herein in evaluating us and our business. We assume no obligation to update any of the forward-looking statements after the filing of this Form 10-K to conform such statements to actual results or to changes in our expectations, except as may be required by law.

The following are risk factors that could affect our business, financial condition, results of operations, and cash flows. These risk factors should be considered in connection with evaluating the forward-looking statements contained in this Form 10-K because these factors could cause actual results and conditions to differ materially from those

projected in forward-looking statements. Before you invest in our publicly traded securities, you should know that making such an investment involves some risks, including the risks described below. Additional risks of which we may not be aware or that we currently believe are immaterial may also impair our business operations or our stock price. If any of the risks actually occur, our business, financial condition, results of operations or cash flow could be negatively affected. In that case, the trading price of our common stock could decline, and you may lose all or part of your investment. In assessing these risks, investors should also refer to the other information contained or incorporated by reference in this Form 10-K, our quarterly reports on Form 10-Q and other documents filed by us from time to time.

The ongoing effects of the COVID-19 pandemic could adversely affect our business, financial condition, results of operations, or cash flows.

An infectious disease caused by Severe Acute Respiratory Syndrome Coronavirus 2 (SARS CoV-2) that was first detected in November 2019 in the city of Wuhan, China, known as COVID-19, resulted in an outbreak throughout the world. The subsequent spread of COVID-19 to the U.S. and many other parts of the world led the World Health Organization to characterize COVID-19 as a pandemic on March 11, 2020. Thereafter, most U.S. states imposed “stay-at-home” orders on their populations to stem the spread of COVID-19. Of specific interest to the Company, stay-at-home orders were imposed in the state of California on March 20, 2020. Governments, public institutions, and other organizations in countries and localities throughout the world have taken and are continuing to take certain emergency measures to combat the spread of COVID-19, including implementation of restrictions on travel and orders that restrict the operations of institutions such as schools and businesses. We have already furloughed 47 employees in the U.S. and the remaining 100 employees continue to support essential business operations. These conditions will negatively impact all aspects of our business. Our business is also dependent on the continued health and productivity of our employees, including our manufacturing employees, sales staff and corporate management teams. While the full impact of the COVID-19 outbreak and government response is not yet known, we have experienced initial impacts of this pandemic in the three months ended March 31, 2020 and it could materially harm our business, results of operations and financial condition in the future.

In addition, due to domestic and international governmental orders restricting certain activities in response to COVID-19, including in Van Nuys, California, where our corporate headquarters and many of our operations, including our principal manufacturing facility, are located, we have experienced, and may in the future experience, certain disruptions in our business, including changes to our on-site operations to reduce manufacturing capacity and implement social distancing, reductions in our suppliers’ ability to source, maintain inventory and ship raw materials in alignment with our demands, work stoppages, slowdowns and delays, including having most of our employees working outside of our offices, travel restrictions, reduced access to our customers for product training and case support, and cancellation of events, delays in product development efforts, and other negative impacts on our capacity to manufacture, our suppliers’ capacity to source and ship raw materials and our distributors’ ability to sell and support the use of our products.

The COVID-19 pandemic has also caused significant uncertainty and volatility in global financial markets. Due to such volatility, we may not be able to raise additional capital, if needed, on favorable terms, or at all. Further adverse economic events resulting from the COVID-19 pandemic, including a recession, depression or other sustained economic downturn, could materially and adversely affect our business, access to capital markets and the value of our common stock.

As of April 24, 2020, we entered into a loan with Western Alliance Bank in an aggregate principal amount of \$2,610,200 pursuant to PPP under the CARES Act. Forgiveness of this loan is only available for principal that is used for the limited purposes that qualify for forgiveness. While we intend to pursue the forgiveness of the PPP loan received in accordance with the requirements and limitations under the CARES Act, no assurance can be provided that forgiveness of any portion of the PPP loan will be obtained.

Additionally, our liquidity could be negatively impacted if these conditions continue for a significant period of time and we may be required to pursue additional sources of financing to obtain working capital, maintain appropriate inventory levels, and meet our financial obligations. Currently, capital and credit markets have been disrupted by the crisis and our ability to obtain any required financing is not guaranteed and largely dependent upon evolving market

conditions and other factors. Depending on the continued impact of the crisis, further actions may be required to improve our cash position and capital structure.

The ultimate impact of the COVID-19 pandemic is highly uncertain and subject to change. We do not yet know the full extent of potential impacts on our business, healthcare systems, the medical device industry or the global economy as a whole. However, these effects could adversely impact our business, financial condition, results of operations, or cash flows.

Our operating history is characterized by net losses. We anticipate further losses and we may never become profitable.

Since inception, we have incurred annual operating losses. We expect this trend to continue until such time that we can sell a sufficient number of units and achieve a cost structure to become profitable. Our business is such that we have relatively few repeat end use customers and limited repeat business compared to our competitors. As a result, we may not maintain or increase revenue. We may not have adequate cash resources to reach the point of profitability, and we may never become profitable. Even if we do achieve profitability, we may be unable to increase our sales and sustain or increase our profitability in the future.

Future issuances or sales of our common stock or exercises by holders of our outstanding warrants could lower our stock price and dilute the interests of existing stockholders.

We may issue additional shares of our common stock in the future. The issuance of a substantial amount of common stock could have the effect of substantially diluting the interests of our current stockholders. In addition, the sale of a substantial amount of common stock in the public market, either in the initial issuance or in a subsequent resale by investors who acquired such common stock in a private placement, could have a material adverse effect on the market price of our common stock. We cannot predict the effect, if any, that future public sales of our common stock or the availability of additional shares of our common stock for sale will have on the market and trading price of our common stock. In addition, we currently have warrants outstanding for the purchase of up to an aggregate of 1.5 million shares of our common stock and certain of our warrant holders also have the right to require us to register under the Securities Act the shares issuable upon exercise of their warrants. In addition, some of our outstanding warrants contain anti-dilution provisions that may, under certain circumstances, increase the number of shares issuable thereunder. To the extent the warrants outstanding are fully exercised, a significant number of shares of common stock will be issued, which will result in dilution to the holders of our shares of common stock and an increase in the number of shares eligible for resale in the public market. If any of our existing stockholders sell substantial amounts of our common stock in the public market, or if the public perceives that such sales could occur, this could have an adverse impact on the market and trading price of our securities, even if there is no relationship between such sales and the performance of our business.

We may be unable to fund our future operating requirements, which could force us to curtail our operations.

To the extent that the funds we now have on hand are insufficient to fund our future operating requirements, we would need to raise additional funds, through further public or private equity or debt financings depending upon prevailing market conditions. These financings may not be available or, if available, may be on terms that are not favorable to us and could result in dilution to our stockholders and reduction of the trading price of our stock. The state of capital markets when we seek to raise additional capital could also impede our ability to raise additional capital on favorable terms or at all. If adequate capital were not available to us, we likely would be required to significantly curtail our operations or possibly even cease our operations.

On February 4, 2019, we entered into a Note Purchase Agreement (the “Note Purchase Agreement”), by and among us, certain subsidiaries of us party thereto as guarantors, Goldman Sachs Specialty Lending Holdings, Inc. and any other purchasers party thereto from time to time (collectively, the “Purchaser”) and Goldman Sachs Specialty Lending Holdings, Inc., as collateral agent, in connection with the sale of senior secured notes by us in a private placement exempt from registration under the Securities Act. Under the Note Purchase Agreement, we sold to the Purchaser \$30.0 million aggregate principal amount of senior secured notes (the “Notes”) and the entire principal amount of the Notes is due and payable on February 4, 2022 (the “Maturity Date”). The Notes do not amortize and the entire principal balance is due in a single payment on the Maturity Date.

As a condition of the Note Purchase Agreement, we shall not permit consolidated liquidity on any date to be less than \$12.0 million until February 4, 2020 and thereafter, \$9.0 million. Borrowings under the Note Purchase Agreement will bear interest at a rate of 13.0% per annum, computed on the basis of a 360-day year composed of twelve 30-day months, and payable quarterly on March 31, June 30, September 30 and December 31 of each year until maturity, subject to increase during the occurrence of an event of default. Obligations under the Note Purchase Agreement are secured by all of our assets, including intellectual property and general intangibles. The Note Purchase Agreement contains customary covenants, including, among others, covenants that restrict our ability to incur debt, grant liens, make certain investments and acquisitions, pay dividends, repurchase equity interests, repay certain debt, amend certain contracts, enter into affiliate transactions and asset sales or make certain equity issuances (including equity issuances that would cause an ownership change within the meaning of Section 382 of the Internal Revenue Code), and covenants that require us to, among other things, provide annual, quarterly and monthly financial statements, together with related compliance certificates, maintain our property in good repair, maintain insurance and comply with applicable laws.

The Note Purchase Agreement also defines an event of default as, among other things, payment default, bankruptcy events, cross defaults, breaches of covenants and representations and warranties, changes of control, judgment defaults and an ownership change within the meaning of Section 382 of the Internal Revenue Code. An event of default, if not waived, could have a material adverse effect on us.

Our obligations under the Note Purchase Agreement could have important consequences, including the following:

- We may have difficulty obtaining additional financing at favorable interest rates to meet our requirements for operations, capital expenditures, general corporate or other purposes.
- We will be required to dedicate a substantial portion of our cash flow to the payment of principal and interest on the Notes, which will reduce the amount of funds available for operations, capital expenditures and future acquisitions.
- Goldman Sachs Specialty Lending Holdings, Inc., as collateral agent under the Note Purchase Agreement, may enforce any and all liens and security interests on the collateral we have used to secure the Notes and we may forfeit our right to such collateral.
- In order to avoid breaches of the Note Purchase Agreement covenant relating to Section 382 changes of ownership, we may be limited in the amount of additional equity securities we are able to sell to raise capital. Accordingly, our desire to preserve our federal and state net operating loss (“NOL”) carryforwards may cause us to forgo otherwise attractive funding opportunities.

We may be required to repay the Notes immediately if we default on any of the numerous financial or other restrictive covenants contained in the Note Purchase Agreement. It is not certain whether we will have, or will be able to obtain, sufficient funds to make any such accelerated payments. If any outstanding indebtedness under the Notes is accelerated, our assets may not be sufficient to repay such indebtedness.

If we are unable to either substantially improve our operating results or obtain additional financing, we may be unable to continue to operate at current levels.

We have experienced recurring operating losses and as of March 31, 2020, we had an accumulated deficit of approximately \$900.9 million. On March 31, 2020, we had cash and cash equivalents of \$15.1 million, and working capital of \$29.8 million. This compares to \$878.9 million, \$29.7 million and \$42.0 million, respectively, on March 31, 2019. As a condition of the Note Purchase Agreement with the Purchaser, our consolidated liquidity on any date may not be less than \$12.0 million through the first anniversary date of February 4, 2020, and \$9.0 million thereafter.

Our business strategy is focused on profitability-oriented initiatives such as reducing operating expenses, diversifying and increasing revenue, and improving gross margin. We may not be able to execute the business strategy successfully and if we are unable to generate positive cash flow, potential customers may choose not to purchase our

products or utilize our program. Moreover, the business strategy is based upon projections, which are in turn based upon estimates and assumptions. There can be no assurance as to the accuracy of the projections, estimates and assumptions which underlie the business strategy or as to our ability to execute the business strategy successfully.

Should we be unable to execute our plans to increase sales and margins while controlling costs, we may be unable to continue to operate at our current levels on a longer-term basis. In particular, we must generate positive cash flow from operations and net income and otherwise improve our results of operations substantially on a longer-term basis. Our available cash and proceeds from future financings, if any, that we may be able to obtain, may not be sufficient to fund our operating expenses, capital expenditures and other cash requirements. Any such lack of funds would affect our ability to continue to operate at current levels. These events and circumstances could have a material adverse effect on our ability to raise additional capital and on the market value of our common stock and our ability to maintain our credit facility. Moreover, should we experience a cash shortage that requires us to curtail or cease our operations, or should we be unable to continue to operate at current levels, you could lose all or part of your investments in our securities.

SEC regulations limit the amount of funds we can raise during any 12-month period pursuant to our shelf registration statement on Form S-3.

SEC regulations limit the amount that companies with a public float of less than \$75 million may raise during any 12-month period pursuant to a shelf registration statement on Form S-3, or the Baby Shelf Rule. We are currently limited by the Baby Shelf Rule and are not able to use the remaining availability under our shelf registration statement to raise more than one-third of our public float. Furthermore, if we are required to file a new registration statement on another form, we may incur additional costs and be subject to delays due to review by the SEC staff.

Impairment charges on our long-lived assets, including intangible assets with finite lives would adversely affect our financial position and results of operations.

We evaluate the carrying value of long-lived assets, including intangible assets with finite lives, for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. To determine whether impairment has occurred, we compare the undiscounted cash flows of the long-lived asset group with its carrying value. The estimation of future cash flows requires significant estimates of factors that include future sales growth, gross margin performance, including our estimates of reductions in our direct material costs, and reductions in operating expenses. If our sales growth, gross margin performance or other estimated operating results are not achieved at or above our forecasted level, or inflation exceeds our forecast, the carrying value of our asset group may prove to be unrecoverable and we may incur impairment charges in the future. In addition, significant and unanticipated changes in circumstances, such as significant adverse changes in business climate, unanticipated competition, loss of key customers or changes in technology or markets, could require a charge for impairment that can materially and adversely affect our reported net loss and our stockholders' equity.

A sustainable market for microturbines may never develop or may take longer to develop than we anticipate which would adversely affect our results of operations.

Our products represent an emerging market, and we do not know whether our targeted customers will accept our technology or will purchase our products in sufficient quantities to allow our business to grow. To succeed, demand for our products must increase significantly in existing markets, and there must be strong demand for products that we introduce in the future. In addition, as part of our business strategy, we are focusing our marketing efforts on the energy efficiency, renewable energy, natural resources, critical power, microgrid and transportation markets. We may be unable to grow our business in these target markets. If a sustainable market fails to develop or develops more slowly than we anticipate, we may be unable to recover the losses we have incurred to develop our products, we may have further impairment of assets, and we may be unable to meet our operational expenses. The development of a sustainable market for our systems may be hindered by many factors, including some that are out of our control. Examples include:

- consumer reluctance to try a new product;

- regulatory requirements;
- the cost competitiveness of our microturbines;
- costs associated with the installation and commissioning of our microturbines;
- maintenance and repair costs associated with our microturbines;
- the future costs and availability of fuels used by our microturbines;
- economic downturns and reduction in capital spending;
- consumer perceptions of our microturbines' safety and quality;
- the emergence of newer, more competitive technologies and products;
- growth of the HEV market; and
- decrease in domestic and international incentives.

We depend upon the development of new products and enhancements of existing products.

Our operating results depend on our ability to develop and introduce new products, enhance existing products and reduce the costs to produce our products. The success of our products is dependent on several factors, including proper product definition, product cost, timely completion and introduction of the products, differentiation of products from those of our competitors, meeting changing customer requirements, emerging industry standards and market acceptance of these products. The development of new, technologically advanced products and enhancements is a complex and uncertain process requiring high levels of innovation, as well as the accurate anticipation of technological and market trends. There can be no assurance that we will successfully identify new product opportunities, develop and bring new or enhanced products to market in a timely manner, successfully lower costs and achieve market acceptance of our products, or that products and technologies developed by others will not render our products or technologies obsolete or uncompetitive.

Our operating results are dependent, in large part, upon the successful commercialization of our products. Failure to produce our products as scheduled and budgeted would materially and adversely affect our business and financial condition.

We cannot be certain that we will deliver ordered products in a timely manner. We have limited production slots for our products. Any delays in production will increase our costs, reduce future production slots and could significantly impact our business, financial condition and operating results.

We may not be able to produce our products on a timely basis if we fail to correctly anticipate product supply requirements or if we suffer delays in production resulting from issues with our suppliers. Our suppliers may not supply us with a sufficient amount of components or components of adequate quality, or they may provide components at significantly increased prices.

Some of our components are currently available only from a single source or limited sources. We may experience delays in production if we fail to identify alternative suppliers, or if any parts supply is interrupted, each of which could materially adversely affect our business and operations. In order to reduce manufacturing lead times and ensure adequate component supply, we enter into agreements with certain suppliers that allow them to procure inventories based upon criteria defined by us. If we fail to anticipate customer demand properly, an oversupply of parts could result in excess or obsolete inventories, which could adversely affect our business. Additionally, if we fail to correctly anticipate our internal supply requirements, an undersupply of parts could limit our production capacity. Our inability to meet volume commitments with suppliers could affect the availability or pricing of our parts and components. A reduction or interruption in supply, a significant increase in price of one or more components or a

decrease in demand of products could materially adversely affect our business and operations and could materially damage our customer relationships. Financial problems of suppliers on whom we rely could limit our supply of components or increase our costs. Also, we cannot guarantee that any of the parts or components that we purchase will be of adequate quality or that the prices we pay for the parts or components will not increase. Inadequate quality of products from suppliers could interrupt our ability to supply quality products to our customers in a timely manner. Additionally, defects in materials or products supplied by our suppliers that are not identified before our products are placed in service by our customers could result in higher warranty costs and damage to our reputation. We also outsource certain of our components internationally. As a result of outsourcing internationally, we may be subject to delays in delivery because of regulations associated with the import/export process, delays in transportation or regional instability.

During the first quarter of Fiscal 2019, we identified a defect in one of the component parts for microturbine systems from one of our single source suppliers. As a result of this defect we have identified several new suppliers with greater engineering expertise and robust quality management systems. The transition is complex, lengthy and may result in an interruption in our manufacturing process. An interruption in our manufacturing process for this component part would adversely impact our results of operations. The efforts to qualify and dual source these components was completed in the fourth quarter of Fiscal 2019.

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. Capacity issues at a supplier could cause an interruption in parts and could result in 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. A new supplier has been fully qualified and has taken over as the primary source of this commodity for Capstone.

Commodity market factors impact our costs and availability of materials.

Our products contain a number of commodity materials from metals, which include steel, special high temperature alloys, copper, nickel and molybdenum, to computer components. The availability of these commodities could impact our ability to acquire the materials necessary to meet our production requirements. The cost of metals has historically fluctuated. The pricing could impact the costs to manufacture our products. If we are not able to acquire commodity materials at prices and on terms satisfactory to us or at all, our operating results may be materially adversely affected.

Adverse economic conditions may have an impact on our business and financial condition, including some effects we may not be able to predict.

Adverse economic conditions may prevent our customers from purchasing our products or delay their purchases, which would adversely affect our business, financial condition 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 adverse economic conditions. Our revenue continues to be negatively impacted by the volatility of the global oil and gas markets, a strong U.S. dollar (making our products more expensive overseas) and ongoing global geopolitical tensions.

Product quality expectations may not be met, causing slower market acceptance or warranty cost exposure.

In order to achieve our goal of improving the quality and lowering the total costs of ownership of our products, we may require engineering changes. Such improvement initiatives may render existing inventories obsolete or excessive. Despite our continuous quality improvement initiatives, we may not meet customer expectations. Any significant quality issues with our products could have a material adverse effect on our rate of product adoption, results of operations, financial condition and cash flow. Moreover, as we develop new configurations for our microturbines and as our customers place existing configurations in commercial use, our products may perform below expectations. Any

significant performance below expectations could adversely affect our operating results, financial condition and cash flow and affect the marketability of our products.

We sell our products with warranties. There can be no assurance that the provision for estimated product warranty will be sufficient to cover our warranty expenses in the future. We cannot ensure that our efforts to reduce our risk through warranty disclaimers will effectively limit our liability. Any significant incurrence of warranty expense in excess of estimates could have a material adverse effect on our operating results, financial condition and cash flow. Further, we have at times undertaken programs to enhance the performance of units previously sold. For example, during Fiscal 2017, we recorded a one-time non-cash warranty provision of approximately \$5.2 million to proactively retrofit select non-Signature Series C200 microturbines with the more robust new Signature Series generator components to improve product performance and reliability. Additionally, our warranty provision was negatively impacted in Fiscal 2019 because of a supplier defect that was identified during the first quarter of Fiscal 2019.

These enhancements have at times been provided at no cost or below our cost. If we choose to offer such programs again in the future, such actions could result in significant costs.

We operate in a highly competitive market among competitors who have significantly greater resources than we have and we may not be able to compete effectively.

We compete with several technologies, including reciprocating engines, fuel cells and solar power. Competing technologies may receive certain benefits, like governmental subsidies or promotion, or be able to offer consumer rebates or other incentives that we cannot receive or offer to the same extent. This could enhance our competitors' abilities to fund research, penetrate markets or increase sales. We also compete with other manufacturers of microturbines.

Our competitors include several well-known companies with histories of providing power solutions. They have substantially greater resources than we do and have established worldwide presence. Because of greater resources, some of our competitors may be able to adapt more quickly to new or emerging technologies and changes in customer requirements, to devote greater resources to the promotion and sale of their products than we can or lobby for governmental regulations and policies to create competitive advantages vis-à-vis our products. We believe that developing and maintaining a competitive advantage will require continued investment by us in product development and quality, as well as attention to product performance, our product prices, our conformance to industry standards, manufacturing capability and sales and marketing. In addition, current and potential competitors have established or may in the future establish collaborative relationships among themselves or with third parties, including third parties with whom we have business relationships. Accordingly, new competitors or alliances may emerge and rapidly acquire significant market share.

Overall, the market for our products is highly competitive and is changing rapidly. We believe that the primary competitive factors affecting the market for our products, including some that are outside of our control, include:

- name recognition, historical performance and market power of our competitors;
- product quality and performance;
- operating efficiency;
- product price;
- availability, price and compatibility of fuel;
- development of new products and features; and
- emissions levels.

There is no assurance that we will be able to successfully compete against either current or potential competitors or that competition will not have a material adverse effect on our business, operating results, financial condition and cash flow.

Our products involve a lengthy sales cycle, and we may not anticipate sales levels appropriately, which could impair our results of operations.

The sale of our products typically involves a significant commitment of capital by customers, which can result in the typical delays associated with large capital expenditures. For these and other reasons, the sales cycle associated with our products is typically lengthy and subject to a number of significant risks over which we have little or no control. We plan our production and inventory levels based on internal forecasts of customer demand, which is highly unpredictable and can fluctuate substantially. If sales in any period fall significantly below anticipated levels, our financial condition, results of operations and cash flow would suffer. If demand in any period increases well above anticipated levels, we may have difficulties in responding, incur greater costs to respond, or be unable to fulfill the demand in sufficient time to retain the order, which would negatively impact our operations. In addition, our operating expenses are based on anticipated sales levels, and a high percentage of our expenses are generally fixed in the short term. As a result of these factors, a small fluctuation in timing of sales can cause operating results to vary materially from period to period.

Net product orders for Fiscal 2020 were \$33.8 million and contributed to an ending backlog of \$37.7 million at March 31, 2020. The book-to-bill ratio was 1.4:1 for Fiscal 2020. Book-to-bill ratio is the ratio of new orders we received to units shipped and billed during a period. However, because our backlog represents only the estimated amount of future product revenue to be recognized under negotiated contracts as shipments convert backlog to recognized revenue for accounting purposes, we may not be able to fully realize the revenue value reported in our backlog, and our backlog may not be indicative of future revenues. 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. Based on historical experience, management expects that a significant portion of our backlog may not be shipped within the next 18 months. The timing of shipments is subject to change based on several variables (including customer deposits, payments, availability of credit and customer delivery schedule changes), most of which are not in our control and can affect the timing of our revenue. As a result, management believes the book-to-bill ratio demonstrates the current demand for our products in the given period.

On October 13, 2017, we entered into the Assignment Agreement and the Notes with 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.

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 the Amended Assignment Agreement and 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 was contingent upon TI’s payment to us of the remaining approximately \$1.5 million in five payments by September 20, 2019. The payments of \$0.4 million, \$0.3 million, and \$0.3 million due March 20, 2019, June 20, 2019, and September 20, 2019, respectively, under the Amended Assignment Agreement, have not been received at the time of this filing. 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 on December 20, 2019. In September 2019, we sent TI a notice to cure default with a deadline of October 31, 2019. TI failed to cure the noticed default and we have since terminated TI’s distributor

agreement. As a result, the BPC accounts receivable and related accounts receivable reserve of \$4.8 million were written off.

As a result of 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, for Fiscal 2019, we removed product orders related to BPC from backlog for approximately \$20.7 million. During the three months ended June 30, 2019 we removed approximately \$4.6 million. These removals were the result of our continuous review of BPC related backlog with TI which resulted in us no longer honoring the product pricing. Due to the cancellation of our distributor agreement with TI, we removed product orders related to BPC from backlog for approximately \$15.8 million during the three months ended December 31, 2019. There are no remaining backlog related to BPC as of March 31, 2020.

If we do not effectively implement our sales, marketing and service plans, our sales will not grow and our results of operations will suffer.

Our sales and marketing efforts may not achieve intended results and, therefore, may not generate the revenue we anticipate. As a result of our corporate strategies, we have decided to focus our resources on selected vertical markets. We may change our focus to other markets or applications in the future. There can be no assurance that our focus or our near term plans will be successful. If we are not able to address markets for our products successfully, we may not be able to grow our business, compete effectively or achieve profitability.

Our business and financial performance depends in part on the oil and natural gas industry, and a decline in prices for oil and natural gas may have an adverse effect on our revenue, cash flows, profitability and growth.

The significant decline in oil and natural gas prices beginning in late 2014 caused a reduction in our customers' spending and associated drilling and completion activities, which had an adverse effect on our revenue for multiple years. We experienced an improvement in revenue during Fiscal 2019 due to favorable oil prices, however revenue has decreased in Fiscal 2020 due to declining oil prices. We continue to be impacted by the volatility of the global oil and gas industry. If prices were to remain low or decline further, we would expect to see similar declines in our customers' spending which would have an adverse effect on our revenue. In addition, a worsening of these conditions may result in a material adverse impact on certain of our customers' liquidity and financial position resulting in further spending reductions, delays in the collection of amounts owing to us and similar impacts.

Our sales and results of operations could be materially and adversely impacted by risks inherent in international markets.

As we expand in international markets, customers may have difficulty or be unable to integrate our products into their existing systems or may have difficulty complying with foreign regulatory and commercial requirements. As a result, our products may require redesign. Any redesign of the product may delay sales or cause quality issues. In addition, we may be subject to a variety of other risks associated with international business, including import/export restrictions, fluctuations in currency exchange rates and economic or political instability. Our business in particular is also subject to risks relating to uncertainties and effects of the implementation of the United Kingdom's referendum to withdraw membership from the EU (referred to as "Brexit"), including financial, legal, tax and trade implications. In addition, doing business internationally subjects us to risks relating to political or social unrest, as well as corruption and government regulation, including U.S. laws such as the Foreign Corrupt Practices Act and the U.K. Bribery Act, that impose stringent requirements on how we conduct our foreign operations. If any of these events occur, our businesses may be adversely affected.

Changes to trade regulation, quotas, duties or tariffs, and sanctions caused by the changing U.S. and geopolitical environments or otherwise, may increase our costs or limit the amount of raw materials and products that we can import, or may otherwise adversely impact our business.

The current U.S. administration has voiced strong concerns about imports from countries that it perceives as engaging in unfair trade practices, and may decide to impose import duties or other restrictions on products, components or raw materials sourced from those countries, which may include China, Mexico, and other countries from which we

import components or raw materials. Any such duties or restrictions could have a material adverse effect on our business, results of operations or financial condition.

Moreover, these new tariffs, or other changes in U.S. trade policy, could trigger retaliatory actions by affected countries. Certain foreign governments have instituted or are considering imposing trade sanctions on certain U.S. goods. Others are considering the imposition of sanctions that will deny U.S. companies access to critical raw materials. A “trade war” of this nature or other governmental action related to tariffs or international trade agreements or policies has the potential to adversely impact demand for our products, our costs, customers, suppliers and/or the U.S. economy or certain sectors thereof and, thus, to adversely impact our businesses.

The U.S. government imposes sanctions through executive orders restricting U.S. companies from conducting business activities with specified individuals and companies, such as in Russia and the Ukraine, and requires export licenses for certain of such activities. While we believe that the executive orders currently do not have a material impact on our business, the sanctions imposed by the U.S. government could be expanded in the future. If we are unable to conduct business with new or existing customers or pursue opportunities with sanctioned countries, our business, including revenue, profitability and cash flows, could be materially adversely affected.

Our business may be impacted by international instability, war, terrorism, and geopolitical events.

International political and economic instability or volatility, geopolitical regional conflicts, terrorist activity, political unrest, civil strife, acts of war, public corruption, expropriation and other economic or political uncertainties could interrupt and negatively affect the performance of our services, sale of our products or other business operations. A slowdown in economic growth in some emerging markets could result in long sales cycles, greater risk of uncollectible accounts and longer collection cycles. Fluctuations or devaluations in currency values, especially in emerging markets, could have an adverse effect on us, our suppliers, logistics providers and manufacturing vendors. All of these factors could result in increased costs or decreased revenues, and could materially and adversely affect our product sales, financial condition and results of operations.

We may not be able to retain or develop relationships with OEMs or distributors in our targeted markets, in which case our sales would not increase as expected.

In order to serve certain of our targeted markets, we believe that we must ally ourselves with companies that have particular expertise or better access to those markets. We believe that retaining or developing relationships with strong OEMs (which to date have typically resold our products under their own brands or packaged our products with other products as part of an integrated unit) or distributors in these targeted markets can improve the rate of adoption as well as reduce the direct financial burden of introducing a new technology and creating a new market. Because of OEMs’ and distributors’ relationships in their respective markets, the loss of an OEM or distributor could adversely impact the ability to penetrate our target markets. We offer our OEMs and distributors stated discounts from list price for the products they purchase. In the future, to attract and retain OEMs and distributors we may provide volume price discounts or otherwise incur significant costs that may reduce the potential revenue from these relationships. We may not be able to retain or develop appropriate OEMs and distributors on a timely basis, and we cannot provide assurance that the OEMs and distributors will focus adequate resources on selling our products or will be successful in selling them. In addition, some of the relationships may require that we grant exclusive distribution rights in defined territories. These exclusive distribution arrangements could result in our being unable to enter into other arrangements at a time when the OEM or distributor with whom we form a relationship is not successful in selling our products or has reduced its commitment to market our products. We cannot provide assurance that we will be able to negotiate collaborative relationships on favorable terms or at all. Our inability to have appropriate distribution in our target markets may adversely affect our financial condition, results of operations and cash flow.

If any of our distributor relationships is not successful, we may terminate or choose not to renew the related distributor agreement, which may result in interference with the wind down of the relationship or the transition of end-user service agreements, and could potentially negatively impact our distribution channel or result in litigation costs or other expenses.

Successfully managing our distribution channel in an effort to reach various potential customer segments for our products and services is a complex process. Each of our distributors is a strategically placed independent partner that provides for marketing and selling of our products and services on our behalf. If our distribution relationships are not successful, we may lose sales opportunities, customers, and revenues. Our agreements with our distribution partners require them to comply with performance conditions that are subject to interpretation, which could result in disagreements. At any given time, we may be in disputes with one or more distribution partners. Any such dispute could result in lengthy and costly litigation, even if the outcome is ultimately in our favor. We cannot predict the outcome of any arbitration or litigation, the effect of any negative judgment against us or the amount of any settlement that we may enter into with such distribution partners. A contractual dispute with a distribution partner may result in our or our distribution partner seeking to terminate the related distribution agreement, even if such termination would be wrongful, which could harm our business, or interfere with a previously agreed wind down of the relationship or transition of end-user service agreements. Any prolonged disruptions of our distribution channels that results from the termination of one or more of our distributions or our failure to renew our distribution agreements with our desired distributors, could negatively affect our ability to effectively sell our products and would materially and adversely affect our business, financial condition, results of operations and prospects.

We have substantial accounts receivable, and increased bad debt expense or delays in collecting accounts receivable could have a material adverse effect on our cash flows and results of operations.

Our accounts receivable balance, net of allowances, was \$16.2 million as of March 31, 2020 and 2019. Days sales outstanding in accounts receivable (“DSO”) at the end of Fiscal 2020 was 85 days, compared with 70 days at the end of Fiscal 2019. We recorded net bad debt expense of approximately \$0.4 million during Fiscal 2020, and net bad debt recovery of approximately \$0.3 million during Fiscal 2019. No assurances can be given that future bad debt expense will not increase above current operating levels. Increased bad debt expense or delays in collecting accounts receivable could have a material adverse effect on cash flows and results of operations.

We may experience a delay in payment or may not collect on the Accounts Receivable Assignment Agreement or Promissory Note with Turbine International, LLC.

On October 13, 2017, we entered into the Assignment Agreement and the Notes with 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.

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.

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 June 5, 2018, we entered into the Amended Assignment Agreement and 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. 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 on December 20, 2019. The payments of \$0.4 million, \$0.3 million, and \$0.3 million, due March 20, 2019, June 20, 2019, and September 20, 2019, respectively, under the Amended Assignment Agreement, have not been received at the time of this filing. In September 2019, we sent TI a notice to cure default with a deadline of October 31, 2019. TI failed to cure the noticed default and we have since terminated TI's distributor agreement. As a result, the BPC accounts receivable and related accounts receivable reserve of \$4.8 million were written off.

Loss of a significant customer could have a material adverse effect on our results of operations.

E-Finity accounted for approximately 12% of our revenue for Fiscal 2020. Additionally, E-Finity accounted for 14% of net accounts receivable as of March 31, 2020. The loss of E-Finity or any other significant customer could have a material adverse effect on our results of operations and financial condition.

We may not be able to develop sufficiently trained applications engineering, installation and service support to serve our targeted markets.

Our ability to identify and develop business relationships with companies who can provide quality, cost-effective application engineering, installation and service can significantly affect our success. The application engineering and proper installation of our microturbines, as well as proper maintenance and service, are critical to the performance of the units. Additionally, we need to reduce the total installed cost of our microturbines to enhance market opportunities. Our inability to improve the quality of applications, installation and service while reducing associated costs could affect the marketability of our products.

Changes in our product components may require us to replace parts held at distributors.

We have entered into agreements with some of our distributors requiring that if we render parts obsolete in inventories they own and hold in support of their obligations to serve fielded microturbines, we are required to replace the affected stock at no cost to the distributors. It is possible that future changes in our product technology could involve costs that have a material adverse effect on our results of operations, cash flow or financial position.

We operate in a highly regulated business environment, and changes in regulation could impose significant costs on us or make our products less economical, thereby affecting demand for our microturbines.

Our products are subject to federal, state, local and foreign laws and regulations, governing, among other things, emissions and occupational health and safety. Regulatory agencies may impose special requirements for the implementation and operation of our products or that may significantly affect or even eliminate some of our target markets. We may incur material costs or liabilities in complying with government regulations. In addition, potentially significant expenditures could be required in order to comply with evolving environmental and health and safety laws, regulations and requirements that may be adopted or imposed in the future. Furthermore, our potential utility customers must comply with numerous laws and regulations. The deregulation of the utility industry may also create challenges for our marketing efforts. For example, as part of electric utility deregulation, federal, state and local governmental authorities may impose transitional charges or exit fees, which would make it less economical for some potential customers to switch to our products. We can provide no assurances that we will be able to obtain these approvals and changes in a timely manner, or at all. Non-compliance with applicable regulations could have a material adverse effect on our operating results.

The market for electricity and generation products is heavily influenced by federal and state government regulations and policies. The deregulation and restructuring of the electric industry in the United States and elsewhere may cause rule changes that may reduce or eliminate some of the advantages of such deregulation and restructuring. We cannot determine how any deregulation or restructuring of the electric utility industry may ultimately affect the market for our microturbines. Changes in regulatory standards or policies could reduce the level of investment in the research and development of alternative power sources, including microturbines. Any reduction or termination of such programs could increase the cost to our potential customers, making our systems less desirable, and thereby adversely affect our revenue and other operating results.

Utility companies or governmental entities could place barriers to our entry into the marketplace, and we may not be able to effectively sell our products.

Utility companies or governmental entities could place barriers on the installation of our products or the interconnection of the products with the electric grid. Further, they may charge additional fees to customers who install on-site generation or have the capacity to use power from the grid for back-up or standby purposes. These types of restrictions, fees or charges could hamper the ability to install or effectively use our products or increase the cost to our potential customers for using our systems. This could make our systems less desirable, thereby adversely affecting our revenue and other operating results. In addition, utility rate reductions can make our products less competitive which would have a material adverse effect on our operations. The cost of electric power generation bears a close relationship to natural gas and other fuels. However, changes to electric utility tariffs often require lengthy regulatory approval and include a mix of fuel types as well as customer categories. Potential customers may perceive the resulting swings in natural gas and electric pricing as an increased risk of investing in on-site generation.

We may not achieve production cost reductions necessary to competitively price our products, which would adversely affect our sales.

We believe that we will need to reduce the unit production cost of our products over time to maintain our ability to offer competitively priced products. Our ability to achieve cost reductions will depend on our ability to develop low cost design enhancements, to obtain necessary tooling and favorable supplier contracts and to increase sales volumes so we can achieve economies of scale. We cannot provide assurance that we will be able to achieve any such production cost reductions. Our failure to achieve such cost reductions could have a material adverse effect on our business and results of operations.

We have effected reductions in our operating costs and, as a result, our ability to cut costs further and sustain our business initiatives may be limited.

Beginning in April 2015, we have implemented various initiatives to reduce operating costs across all functions of the Company and focus our business efforts on our most promising near-term product opportunities. As a result of these cost-cutting initiatives, we may have a more limited ability to further reduce costs to increase our liquidity should such measures become necessary. Any further reductions may have a materially negative impact on our business.

Potential intellectual property, labor, product liability, stockholder or other litigation may adversely impact our business.

From time to time, we may face litigation relating to intellectual property, labor, product liability, stockholder and other matters. An adverse judgment could negatively impact our financial position and results of operations, the trading price of our common stock and our ability to obtain future financing on favorable terms or at all. Whether or not resolved in a manner adverse to us, any litigation could be costly, divert management attention or result in increased costs of doing business. Further, our insurance coverage is limited for these and other claims against us, and we may not have adequate insurance or financial resources to pay for our liabilities or losses from any such claims.

Our business could be negatively impacted if we fail to adequately protect our intellectual property rights or if third parties claim that we are in violation of their intellectual property rights.

We view our intellectual property rights as important assets. We seek to protect our intellectual property rights through a combination of patent, trademark, copyright and trade secret laws, as well as licensing and confidentiality agreements. These protections may not be adequate to prevent third parties from using our intellectual property without our authorization, breaching any confidentiality agreements with us, copying or reverse engineering our products, or developing and marketing products that are substantially equivalent to or superior to our own. The unauthorized use of our intellectual property by others could reduce our competitive advantage and harm our business. If it became necessary for us to litigate to protect these rights, any proceedings could be burdensome and costly and we may not prevail. We cannot guarantee that any patents, issued or pending, will provide us with any competitive advantage or will not be challenged by third parties. Moreover, the expiration of our patents may lead to increased competition with respect to

certain products. In addition, we cannot be certain that we do not or will not infringe third parties' intellectual property rights. Any such claim, even if it is without merit, may be expensive and time-consuming to defend, subject us to damages, cause us to cease making, using or selling certain products that incorporate the disputed intellectual property, require us to redesign our products, divert management time and attention and/or require us to enter into costly royalty or licensing arrangements.

We face security and cybersecurity risks related to our electronic processing of sensitive and confidential business and product data. If we are unable to protect our data or the data of our customers, a security breach could damage our reputation and have a material adverse effect on our business.

As a manufacturer of high technology commercial products, we face security and cyber security threats, as well as the potential for business disruptions associated with information technology failures or cyber security attacks. Given the nature of our business, we collect process and retain sensitive and confidential customer and associate data, in addition to proprietary business information. Our business, including our turbines and related energy assets may be vulnerable to a data compromise, computer viruses, physical and electronic break-ins and manipulations and similar disruptions, which may not be prevented by our efforts to secure our computer systems and assets, which include vulnerability scans and patching, network firewalls, identity and access management, data encryption, intrusion detection and prevention devices. Regular penetration tests of our networks are conducted by a third party service provider and we leverage any findings to further enhance our security. We also employ secure file transfer options to provide security for processing, transmission and storage of confidential information. Our critical data is backed up to a separate secured data storage facility. However, our efforts may not be able to prevent rapidly evolving types of cyber-attacks and a successful breach of our computer systems could result in misappropriation of personal, payment or sensitive business information. In addition, we rely on associates, contractors and other third parties who may attempt to circumvent our security measures in order to obtain such information, and may purposefully or inadvertently cause a breach involving such information. A security breach involving confidential and proprietary data or the fleet of turbines we have deployed across the globe for our customers could damage our reputation and our ability to retain existing customers or gain new customers. The competitive advantages derived from our R&D efforts, the usefulness of our products and services, our reputation and our stock price could be impacted. In addition, we may incur material liabilities and remediation costs as a result of a security breach and, our insurance may not be sufficient to cover the impact to the business. Although we have developed mitigating security controls to reduce our cyber risk and protect our data and our products, our customers' data and our customers' turbines from a security breach, such measures cannot provide absolute security and accordingly any security breach may have a material adverse effect on our business. Moreover, changing privacy laws in the United States, Europe and elsewhere, including the adoption by the European Union of the General Data Protection Regulation ("GDPR"), which became effective May 2018, creates new individual privacy rights and imposes increased obligations on companies handling personal data. Consequently, we may incur significant costs related to prevention and compliance with laws regarding the protection and unauthorized disclosure of personal information. A failure to comply with the stringent rules of the GDPR could result in fines of up to €20 million. Further, a greater number of our employees are working remotely in response to the COVID-19 pandemic and related government actions, which could expose us to greater risks related to cybersecurity and our information technologies systems.

We may incur costs and liabilities as a result of product liability claims.

We face a risk of exposure to product liability claims in the event that the use of our products is alleged to have resulted in injury or other damage. Although we currently maintain product liability insurance coverage, we may not be able to obtain such insurance on acceptable terms in the future, if at all, or obtain insurance that will provide adequate coverage against potential claims. Product liability claims can be expensive to defend and can divert the attention of management and other personnel for long periods of time, regardless of the ultimate outcome. A significant unsuccessful product liability defense could have a material adverse effect on our financial condition and results of operations. In addition, we believe our business depends on the strong brand reputation we have developed. If our reputation is damaged, we may face difficulty in maintaining our market share and pricing with respect to some of our products, which could reduce our sales and profitability.

We have significant tax assets, usage of which may be subject to limitations in the future.

At March 31, 2020, we had federal and state net operating loss carryforwards of approximately \$643.7 million and \$162.0 million, respectively, which may be utilized to reduce future taxable income, subject to limitations under Section 382 of the Internal Revenue Code of 1986. These deferred tax assets have been fully offset by a valuation allowance. Any subsequent accumulations of common stock ownership leading to a change of control under Section 382 of the U.S. Internal Revenue Code of 1986, including through sales of stock by large stockholders, all of which are outside of our control, could limit and defer our ability to utilize our net operating loss carryforwards to offset future federal income tax liabilities.

Activities necessary to integrate any future acquisitions may result in costs in excess of current expectations or be less successful than anticipated.

We may acquire other businesses in the future and the success of these transactions will depend on, among other things, our ability to develop productive relationships with the corresponding distributors and to integrate assets and personnel, if any, acquired in these transactions and to apply our internal controls processes to these acquired businesses. The integration of any acquired businesses or significant assets may require significant attention from our management, and the diversion of management's attention and resources could have a material adverse effect on our ability to manage our business. Furthermore, we may not realize the degree or timing of benefits we anticipated when we first enter into these transactions. If actual integration costs are higher than amounts assumed, if we are unable to integrate the assets and personnel acquired in an acquisition as anticipated, or if we are unable to fully benefit from anticipated synergies, our business, financial condition, results of operations, and cash flows could be materially adversely affected.

Operational restructuring may result in asset impairment or other unanticipated charges.

As a result of our corporate strategy, we have identified opportunities to outsource to third-party suppliers certain functions which we currently perform. We believe outsourcing can reduce product costs, improve product quality and increase operating efficiency. These actions may not yield the expected results, and outsourcing may result in production delays or lower quality products. Transitioning to outsourcing may cause certain of our affected employees to leave before the outsourcing is complete. This could result in a lack of the experienced in-house talent necessary to successfully implement the outsourcing. Further, depending on the nature of operations outsourced and the structure of agreements we reach with suppliers to perform these functions, we may experience impairment in the value of manufacturing assets related to the outsourced functions or other unanticipated charges, which could have a material adverse effect on our operating results.

We may not be able to manage our growth effectively, expand our production capabilities or improve our operational, financial and management information systems, which would impair our results of operations.

If we are successful in executing our business plan, we will experience growth in our business that could place a significant strain on our business operations, management and other resources. Our ability to manage our growth will require us to expand our production capabilities, continue to improve our operational, financial and management information systems, and to motivate and effectively manage our employees. We cannot provide assurance that our systems, procedures and controls or financial resources will be adequate, or that our management will keep pace with this growth. We cannot provide assurance that our management will be able to manage this growth effectively.

Our success depends in significant part upon the continuing service of management and key employees.

Our success depends in significant part upon the continuing service of our executive officers, senior management and sales and technical personnel. The failure of our personnel to execute our strategy or our failure to retain management and personnel could have a material adverse effect on our business. Our success will be dependent on our continued ability to attract, retain and motivate highly skilled employees. There can be no assurance that we can do so.

Our internal control systems rely on employees trained in the execution of the controls. Loss of these employees or our inability to replace them with similarly skilled and trained individuals or new processes in a timely manner could adversely impact our internal control mechanisms.

Our operations are vulnerable to interruption by fire, earthquake and other events beyond our control.

Our operations are vulnerable to interruption by fire, earthquake and other events beyond our control. Our executive offices, manufacturing facility, and auxiliary inventory storage facility are located in southern California. Because the southern California area is located in an earthquake-sensitive area, we are particularly susceptible to the risk of damage to, or total destruction of, our facilities in southern California and the surrounding transportation infrastructure, which could affect our ability to make and transport our products. If an earthquake, fire or other natural disaster occurs at or near our facilities, our business, financial condition, operating results and cash flow could be materially adversely affected.

We cannot be certain of the future effectiveness of our internal controls over financial reporting. If we are unable to maintain effective internal controls over our financial reporting, investors may lose confidence in our ability to provide reliable and timely financial reports and the value of our common stock may decline.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we are required to include in our annual reports on Form 10-K our assessment of the effectiveness of our internal controls over financial reporting. This assessment includes disclosure of any material weaknesses identified by our management in our internal controls over financial reporting. Our management concluded that our internal controls over financial reporting were effective as of March 31, 2020. We may in the future identify material weaknesses in our internal controls over financial reporting that we have not discovered to date. If we cannot adequately maintain the effectiveness of our internal controls over financial reporting, we might be subject to sanctions or investigation by regulatory authorities, such as the SEC. Any such action could adversely affect our financial results and the market price of our securities.

We are subject to a number of pending lawsuits.

We and certain of our current and former officers are named as defendants in a shareholder class action lawsuit filed in the United States District Court for the Central District of California, and in a separate but similar lawsuit brought by two individual shareholders in the United States District Court for the Central District of California. Additionally, we and certain of our current and former officers and directors are named as defendants in various state and federal derivative suits. We may be named as defendants in future lawsuits. These current and future matters may result in significant liabilities and diversion of our management's time, attention and resources. Given the uncertain nature of litigation generally, we are not able in all cases to estimate the amount or range of loss that could result from an unfavorable outcome in these matters. In view of these uncertainties, the outcome of these matters may result in charges in excess of any established reserves and, to the extent available, liability insurance. Protracted litigation, including any adverse outcomes, may have an adverse impact on our business, financial condition or results of operations. In addition, any significant judgment or settlement amount may require us to incur additional indebtedness, adversely affect our liquidity and ability to service our indebtedness, or require us to restructure or amend the terms of our indebtedness. See Item 3—Legal Proceedings of this Form 10-K for more information regarding currently pending legal proceedings.

If we fail to meet all applicable Nasdaq Capital Market requirements and Nasdaq determines to delist our common stock, the delisting could adversely affect the market liquidity of our common stock, impair the value of your investment and adversely affect our ability to raise needed funds.

Our common stock is listed on the Nasdaq Capital Market. In order to maintain that listing, we must satisfy minimum financial and other requirements. On November 23, 2018, we received a notice from the Listing Qualifications Department of the Nasdaq Stock Market ("Nasdaq") stating that, for the last 30 consecutive business days, the closing bid price for our common stock had been below the minimum \$1.00 per share requirement for continued listing on the Nasdaq Capital Market as set forth in Nasdaq Listing Rule 5550(a)(2). In accordance with Nasdaq Listing Rule 5810(c)(3)(A), we were provided 180 calendar days, or until May 22, 2019, to regain compliance with the minimum bid price requirement. On May 23, 2019, we received notice that in accordance with Nasdaq Listing Rule 5810(c)(3)(A), the Listing

Qualifications Department of Nasdaq had granted us an additional 180 days, or until November 18, 2019, to regain compliance with Nasdaq's \$1.00 per share minimum bid price requirement under Nasdaq Marketplace Listing Rule 5550(a)(2). The May 23, 2019 notification letter had no effect at that time on the listing of our common stock on The Nasdaq Capital Market or trading of our common stock. We provided written notice of our intention to cure the minimum bid price deficiency during this additional 180-day period by effecting a reverse stock split if necessary. On October 21, 2019, following votes of our board of directors and stockholders, we effected a one-for-ten (1:10) reverse stock split of our common stock. On November 5, 2019, we received written notification from the Nasdaq Listing Qualifications Staff indicating that the bid price for our common stock closed at or above \$1.00 per share for at least 10 consecutive business days. Accordingly, we regained compliance with the minimum bid price requirement for continued listing on the Nasdaq Capital Market pursuant to Nasdaq Marketplace Listing Rule 5550(a)(2).

If we fail to meet all applicable Nasdaq Capital Market requirements in the future and Nasdaq determines to delist our common stock, the delisting could adversely affect the market liquidity of our common stock and adversely affect our ability to obtain financing for the continuation of our operations. This delisting could also impair the value of your investment.

The market price of our common stock has been, and may continue to be, highly volatile and you could lose all or part of your investment in our securities.

An investment in our securities is risky, and stockholders could lose their investment in our securities or suffer significant losses and wide fluctuations in the market value of their investment. The market price of our common stock is highly volatile and is likely to continue to be highly volatile. Given the continued uncertainty surrounding many variables that may affect our business and the industry in which we operate, our ability to foresee results for future periods is limited. This variability could affect our operating results and thereby adversely affect our stock price. Many factors that contribute to this volatility are beyond our control and may cause the market price of our common stock to change, regardless of our operating performance. Factors that could cause fluctuation in our stock price may include, among other things:

- actual or anticipated variations in quarterly operating results;
- market sentiment toward alternative energy stocks in general or toward us;
- changes in financial estimates or recommendations by securities analysts;
- conditions or trends in our industry or the overall economy;
- loss of one or more of our significant customers;
- errors, omissions or failures by third parties in meeting commitments to us;
- changes in the market valuations or earnings of our competitors or other technology companies;
- the trading of options on our common stock;
- announcements by us or our competitors of significant acquisitions, strategic partnerships, divestitures, joint ventures or other strategic initiatives;
- announcements of significant market events, such as power outages, regulatory changes or technology changes;
- changes in the estimation of the future size and growth rate of our market;
- future equity financings;

- the failure to produce our products on a timely basis in accordance with customer expectations;
- the inability to obtain necessary components on time and at a reasonable cost;
- litigation or disputes with customers or business partners;
- capital commitments;
- additions or departures of key personnel;
- sales or purchases of our common stock;
- the trading volume of our common stock;
- developments relating to litigation or governmental investigations; and
- further decreases in or continued low levels of oil, natural gas and electricity prices.

In addition, the stock market in general, and the Nasdaq Capital Market and the market for technology companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of particular companies affected. The market prices of securities of technology companies and companies servicing the technology industries have been particularly volatile. These broad market and industry factors may cause a material decline in the market price of our common stock, regardless of our operating performance. In the past, following periods of volatility in the market price of a company's securities, securities class-action litigation has often been instituted against that company. This type of litigation, regardless of whether we prevail on the underlying claim, could result in substantial costs and a diversion of management's attention and resources, which could materially harm our financial condition, results of operations and cash flow.

Our business could be negatively affected as a result of a proxy contest.

A proxy contest and any related litigation would require us to incur significant legal and advisory fees, proxy solicitation expenses and administrative and associated costs and require significant time and attention by management, our board of directors and employees, and would divert the attention of our board of directors and senior management from the pursuit of our business strategy, which could adversely affect our results of operations and financial condition. Any perceived uncertainties as to our future direction and control, our ability to execute on our strategy, or changes to the composition of our board of directors or senior management team arising from a proxy contest could lead to the perception of a change in the direction of our business, instability or lack of continuity which may be exploited by our competitors and may result in the loss of potential business opportunities and may make it more difficult to pursue our strategic initiatives or attract and retain qualified personnel and business partners, any of which could adversely affect our business and operating results. We may choose to initiate, or may become subject to, litigation as a result of the proxy contest or matters arising from the proxy contest, which would serve as a further distraction to our board of directors, management and employees and would require us to incur significant additional costs. In addition, the market price of our common stock could be subject to significant fluctuation or otherwise be adversely affected by the uncertainties described above or the outcome of a proxy contest or any related litigation.

Similarly, a proxy contest with any other activist investor could result in the turnover of a majority of our board of directors. If such a change in the composition of our board of directors were to occur, it could trigger the change of control provisions of certain agreements and arrangements to which we are a party, including the Note Purchase Agreement, our Amended and Restated Severance Pay Plan and, if followed by a qualifying termination of certain of our executive officers the Change in Control Severance Agreements, between us and Darren Jamison, our President and Chief Executive Officer and other executives.

Under the Note Purchase Agreement, a change of control constitutes an event of default that would entitle Goldman Sachs Specialty Lending Holdings, Inc. to, among other remedies, declare all of our outstanding borrowings under the Note Purchase Agreement immediately due and payable. Under the Amended and Restated Change of Control Severance Plan and the Amended and Restated Change in Control Severance Agreement, as amended, following a change of control, upon the occurrence of a qualifying termination of Mr. Jamison or certain of our other executive officers and employees, we will be obligated to make specified severance payments to the terminated employee.

If such a change in our board composition were to occur, and if our board of directors were unable to take certain mitigating action to avoid triggering, or if we were unable to obtain a waiver of, these and other similar change of control provisions to which we are subject, the resulting payments and other obligations required of us could have a material adverse effect on our liquidity and ability to conduct our business or could otherwise materially and adversely affect our business, results of operations and financial condition.

Provisions in our certificate of incorporation, bylaws and our NOL rights plan, as well as Delaware law, may discourage, delay or prevent a merger or acquisition at a premium price.

Provisions of our second amended and restated certificate of incorporation, amended and restated bylaws and our stockholder rights plan, as well as provisions of the General Corporation Law of the State of Delaware, could discourage, delay or prevent unsolicited proposals to merge with or acquire us, even though such proposals may be at a premium price or otherwise beneficial to you. These provisions include our board's authorization to issue shares of preferred stock, on terms the board determines in its discretion, without stockholder approval, and the following provisions of Delaware law that restrict many business combinations.

We are subject to the provisions of Section 203 of the General Corporation Law of the State of Delaware, which could prevent us from engaging in a business combination with a 15% or greater stockholder for a period of three years from the date such stockholder acquired such status unless appropriate board or stockholder approvals are obtained.

On May 6, 2019, we and Broadridge Financial Solutions, Inc. successor-in-interest to Computershare Inc., as Rights Agent, entered into a Rights Agreement (the "NOL Rights Agreement") designed to diminish the risk that our ability to use our net operating losses and certain other tax assets to reduce potential future federal income tax obligations would become subject to limitations by reason of us experiencing an "ownership change," as defined in Section 382 of the Internal Revenue Code of 1986, as amended. The NOL Rights Agreement replaces the Company's Rights Agreement, dated May 6, 2016, by and between the Company and Broadridge Financial Solutions, Inc., as successor-in-interest to Computershare Inc., as rights agent (the "Original Rights Agreement"). While this NOL Rights Agreement is intended to preserve our net operating losses, it effectively deters current and future purchasers from becoming 4.99% stockholders. The NOL Rights Agreement could also make it more difficult for a third party to acquire us, even if doing so would benefit our stockholders.

The market price of our common stock may be adversely affected by market conditions affecting the stock markets in general, including price and trading fluctuations on Nasdaq.

Market conditions may result in volatility in the level of, and fluctuations in, market prices of stocks generally and, in turn, our common stock and sales of substantial amounts of our common stock in the market, in each case being unrelated or disproportionate to changes in our operating performance. Concerns over global stability and economic conditions in the United States and abroad have contributed to the extreme volatility of the markets which may have an effect on the market price of our common stock.

If securities or industry analysts do not publish research or publish inaccurate or unfavorable research about our business, our stock price and trading volume could decline.

The trading market for our common stock will depend in part on the research and reports that securities or industry analysts publish about us or our business. We do not have any control over these analysts. If one or more of the analysts who covers us downgrades our stock or publishes inaccurate or unfavorable research about our business, our

stock price would likely decline. If one or more of these analysts ceases coverage of us or fails to publish reports on us regularly, demand for our stock could decrease, which could cause our stock price and trading volume to decline.

We do not intend to pay cash dividends. We have never paid dividends on our capital stock and we do not anticipate paying any dividends in the foreseeable future. Consequently, any gains from an investment in our securities will likely depend on whether the price of our common stock increases.

We have not paid dividends on any of our capital stock to date and we currently intend to retain our future earnings, if any, to fund the development and growth of our business. As a result, capital appreciation, if any, of our common stock will be your sole source of gain for the foreseeable future. Consequently, in the foreseeable future, you will likely only experience a gain from your investment in our securities if the price of our common stock increases.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

During the third quarter of Fiscal 2018, we consolidated our operations and offices into our Van Nuys location in Southern California. Our principal corporate offices, administrative, sales and marketing, R&D and support facilities consist of approximately 79,000 square feet of leased office space, warehouse space and assembly, test space and manufacturing facility for our recuperator cores located at 16640 Stagg Street in Van Nuys, California. This lease will expire in February 2023 and we have one five-year option to extend the term of this lease. Additionally, we lease approximately 9,216 square feet of warehouse space at 16701 Stagg Street in Van Nuys, California. This lease will expire in June 2024 and we have one five-year option to extend the term of this lease. Management believes these facilities are adequate for our current needs. We also leased an approximately 98,000 square foot facility located at 21211 Nordhoff Street in Chatsworth, California. Our lease expired in September 2019, and we moved our inventory and other property from this facility and vacated the premises.

Item 3. Legal Proceedings.

Federal Securities Class Action

Two putative securities class action complaints were filed against us and certain of our current and former officers in the United States District Court for the Central District of California under the following captions: David Kinney, etc. v. Capstone Turbine, et al., No. 2:15-CV-08914 on November 16, 2015 (the “Kinney Complaint”) and Kevin M. Grooms, etc. v. Capstone Turbine, et al., No. 2:15-CV-09155 on November 25, 2015 (the “Grooms Complaint”).

The Kinney Complaint alleged material misrepresentations and omissions in public statements regarding BPC and the likelihood that BPC would not be able to fulfill many legal and financial obligations to us. The Kinney Complaint also alleged that our financial statements were not appropriately adjusted in light of this situation and were not maintained in accordance with GAAP, and that we lacked adequate internal controls over accounting. The Kinney Complaint alleged that these public statements and accounting irregularities constituted violations by all named defendants of Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, as well as violations of Section 20(a) of the Exchange Act by the individual defendants. The Grooms Complaint made allegations and claims that were substantially identical to those in the Kinney Complaint, and both complaints sought compensatory damages of an undisclosed amount. On January 16, 2016, several shareholders filed motions to consolidate the Kinney and Grooms actions and for appointment as lead plaintiff. On February 29, 2016, the Court granted the motions to consolidate, and appointed a lead plaintiff. On May 6, 2016, a Consolidated Amended Complaint with allegations and claims substantially identical to those of the Kinney Complaint was filed in the consolidated action. The putative class period in the Consolidated Amended Complaint was June 12, 2014 to November 5, 2015. Defendants filed a motion to dismiss the Consolidated Amended Complaint on June 17, 2016. On March 10, 2017, the Court issued an order granting defendants’ motion to dismiss in its entirety with leave to amend. Plaintiffs filed an amended complaint on April 28,

2017. Defendants' motion to dismiss was filed June 2, 2017. Plaintiffs filed their opposition to the motion to dismiss on July 7, 2017, and defendants filed their reply in support of the motion to dismiss on July 28, 2017. The court vacated the hearing that was scheduled for August 18, 2017. On February 9, 2018, the Court issued an Order denying defendants' motion to dismiss. On March 30, 2018, defendants filed an answer to the Consolidated Amended Complaint. On May 17, 2018, the Court issued a scheduling order setting a trial date of March 17, 2020. On June 26, 2018, the Court entered an order vacating all deadlines through the end of October 2018 and temporarily staying formal discovery and other proceedings to allow the parties time to conduct a mediation. The parties participated in mediation on September 24, 2018, which did not result in a settlement. On November 16, 2018, after further settlement discussions, the parties advised the Court that they had reached an agreement in principle to settle the action in its entirety. The agreement in principle was subject to several conditions, including the execution of a stipulation of settlement that was satisfactory to all parties, and preliminary and final approval from the court, among other things. Plaintiffs filed a motion seeking preliminary approval of the proposed settlement on April 12, 2019, and filed supplementary declarations in support of the motion on May 2, 2019. Preliminary approval of the settlement was granted on May 17, 2019. On September 24, 2019, lead counsel for plaintiffs filed a motion for attorneys' fees and reimbursement of litigation expenses. On October 25, 2019, plaintiffs filed a motion for final approval of the settlement. On November 15, 2019, the Court issued an order approving the settlement and the payment of attorneys' fees, litigation expenses, and class representative payments, and entering final judgment in the action. Our insurance carrier funded the settlement amount.

Federal Individual Securities Action

An individual securities complaint was filed against us, our Chief Executive Officer, and additional unidentified defendants in the United States District Court for the Central District of California under the following caption: FiveT Investment Management LTD, et al., v. Capstone Turbine, et al., No. 2:18-CV-03512 on April 25, 2018. The lawsuit alleged material misrepresentations and omissions regarding our revenue, sales, and operations because of alleged improper revenue recognition and backlog calculations related to BPC. The lawsuit alleged that these statements constituted violations by all named defendants of Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, as well as violations of Section 20(a) of the Exchange Act by the individual defendants. The complaint also asserted claims against all named defendants for fraud, negligent misrepresentation, violations of California Civil Code sections 1709 and 1710, and California Corporations Code sections 25400 and 25401. Additionally, the complaint asserted a cause of action against the individual defendants for breach of fiduciary duty. It demanded compensatory damages for the amount of damages allegedly suffered, pre-judgment and post-judgment interest, and fees.

On June 29, 2018, the plaintiffs filed an Amended Complaint for Common Law Fraud and Negligent Misrepresentation. The Amended Complaint asserted claims for common law fraud and negligent misrepresentation, against the Company, Mr. Jamison, and unidentified individual defendants. The Amended Complaint demanded damages in an unspecified amount, plus pre-judgment and post-judgment interest and fees. Defendants filed their answer to the Amended Complaint on August 17, 2018. The parties participated in a mediation on September 24, 2018. The mediation did not result in a settlement. On October 12, 2018, the plaintiffs filed a motion for leave to amend their complaint, seeking to reinstate the cause of action for violation of California Civil Code section 25401. On November 29, 2018, the Court granted plaintiffs' motion for leave to amend and plaintiffs filed their Second Amended Complaint, which asserted claims for common law fraud, negligent misrepresentation, and violation of California Civil Code section 25401 against the Company, Mr. Jamison, and unidentified individual defendants. On December 20, 2018, defendants filed their answer to the Second Amended Complaint. On June 6, 2019, the parties reached a confidential settlement of the action and the suit was dismissed with prejudice on July 1, 2019. Our insurance carrier funded the settlement amount.

State Derivative Lawsuits — California

On February 18, 2016, a purported shareholder derivative action was filed in Los Angeles Superior Court in the State of California against us and certain of our current and former officers and directors under the following caption: Stesiak v. Jamison, et al., No. BC610782. The lawsuit alleges that certain of our current and former officers and directors knew or should have known that BPC would be unable to fulfill its obligations to us, but allowed us to make false and misleading statements regarding BPC and our financial condition. The complaint also alleges that the defendants failed to timely adjust our account receivables and backlog to reflect BPC's inability to pay us. The

complaint asserts causes of action for breach of fiduciary duty and unjust enrichment. It demands damages for the amount of damage sustained by us as a result of the individual defendants' alleged breach of fiduciary duties and unjust enrichment, that we institute corporate governance reforms, and disgorgement from the individual defendants. On May 5, 2016, the parties filed a stipulation and proposed order seeking to stay this action until such time as the defendants' motion(s) to dismiss the federal securities class action were either granted with prejudice or denied in whole or in part. On May 10, 2016, the Court entered that proposed order. On March 9, 2018, following the Court's order denying defendants' motion to dismiss in the federal securities class action, the parties filed a stipulation and proposed order seeking to stay this action until the close of fact discovery in the federal securities class action. On March 20, 2018, the Court entered that proposed order. A status conference is scheduled for July 1, 2020.

On June 8, 2016, a purported shareholder derivative action entitled *Velma Kilpatrick v. Simon, et al.*, No. BC623167, was filed in Los Angeles Superior Court in the State of California against us and certain of our current and former officers and directors. The complaint alleges that certain of our current and former officers and directors knew or should have known that BPC would be unable to fulfill its obligations to us, but allowed us to make false and misleading statements regarding BPC and our financial condition. The complaint also alleges that the defendants failed to timely adjust our account receivables and backlog to reflect BPC's inability to pay us. The complaint asserts causes of action for breach of fiduciary duty. It demands damages for the amount of damage sustained by us as a result of the individual defendants' alleged breach of fiduciary duties, and that we institute corporate governance reforms. On August 23, 2016, the parties filed a stipulation and proposed order seeking to stay this action until such time as the defendants' motion(s) to dismiss the federal securities class action were either granted with prejudice or denied in whole or in part. On March 9, 2018, following the Court's order denying defendants' motion to dismiss in the federal securities class action, the parties filed a stipulation and proposed order seeking to stay this action until the close of fact discovery in the federal securities class action. On March 20, 2018 the Court entered that proposed order. A status conference is scheduled for June 26, 2020.

The parties in both of the above state derivative lawsuits participated in a mediation held on September 24, 2018. On May 6, 2019, the parties reached an agreement in principle regarding corporate governance reforms to be implemented in settlement of the action. The parties have not yet formalized a settlement, however, which is subject to several conditions, including the execution of a stipulation of settlement that is satisfactory to all parties and preliminary and final approval from the court, among other things. Settlement discussions are ongoing. We have not recorded any liability as of March 31, 2020 as our insurance carrier will fund the settlement amount.

Federal Derivative Lawsuits

On March 7, 2016, a purported shareholder derivative action was filed in the United States District Court for the Central District of California against us and certain of our current and former officers and directors under the following caption: *Haber v. Jamison, et al.*, No. CV16-01569-DMG (RAOx). The lawsuit alleges that certain of our current and former officers and directors knew or should have known that BPC would be unable to fulfill its obligations to us, but allowed us to make false and misleading statements regarding BPC and our financial condition. The complaint asserts a cause of action for breach of fiduciary duty. It demands damages for the amount of damage sustained by us as a result of the individual defendants' alleged breach of fiduciary duties, and equitable relief, including that we institute appropriate corporate governance reforms. On May 11, 2016, the parties filed a stipulation and proposed order seeking to stay this action until such time as the defendants' motion(s) to dismiss the federal securities class action were either granted with prejudice or denied in whole or in part. On May 13, 2016, the Court entered that proposed order.

On July 12, 2016 and July 18, 2016, respectively, two additional purported shareholder derivative actions were filed in the United States District Court for the Central District of California against us and certain of our current and former officers and directors, under the caption *Tuttle v. Atkinson, et al.*, No. CV16-05127, and *Boll v. Jamison, et al.*, No. CV16-5282, respectively. The lawsuits allege that certain of our current and former officers and directors knew or should have known that BPC would be unable to fulfill its obligations to us, but allowed us to make false and misleading statements regarding BPC and our financial condition. The Tuttle complaint asserts causes of action for breach of fiduciary duty, gross mismanagement, and unjust enrichment, and the Boll complaint asserts causes of action for breach of fiduciary duty, unjust enrichment, abuse of control, gross mismanagement, and waste of corporate assets. Both complaints demand damages sustained by us as a result of the individual defendants' alleged breaches of fiduciary

duties, and equitable relief, including that we institute appropriate corporate governance reforms. The federal derivative actions were stayed until such time as the defendants' motion(s) to dismiss the federal securities class action were either granted with prejudice or denied in whole or in part. On March 9, 2018, following the Court's order denying defendants' motion to dismiss in the federal securities class action, the parties filed a stipulation and proposed order seeking to stay this action until the close of fact discovery in the federal securities class action. On March 13, 2018, the Court granted the parties' stipulation.

The parties in the above federal derivative lawsuits participated in a mediation held on September 24, 2018. On May 6, 2019, the parties reached an agreement in principle regarding corporate governance reforms to be implemented in settlement of the action. The parties have not yet formalized a settlement, however, which is subject to several conditions, including the execution of a stipulation of settlement that is satisfactory to all parties and preliminary and final approval from the court, among other things. Settlement discussions are ongoing. We have not recorded any liability as of March 31, 2020 as our insurance carrier will fund the settlement amount.

Capstone Turbine Corporation v. Regatta Solutions, Inc.

On August 23, 2018, we initiated arbitration proceedings against its former distributor, Regatta Solutions, Inc. ("Regatta"), with the American Arbitration Association ("AAA"), under the following caption: Capstone Turbine Corp. v. Regatta Solutions, Inc., Case No. 01-18-0003-0860 (the "Capstone-Regatta Arbitration"). We have alleged claims against Regatta for breach of contract and unjust enrichment relating to the parties' prior distributor relationship, which terminated at the end of March of 2018, and the related wind-down agreement between the parties. As remedies for these claims, we are seeking compensatory, consequential, and punitive damages, along with declaratory relief and attorney's fees, interest, and costs.

On October 18, 2018, Regatta filed its answer and cross-claims in the Capstone-Regatta Arbitration. In its cross-claims, Regatta asserted claims for breach of contract, intentional interference with prospective economic advantage, fraud, and intentional interference with contractual relations, relating to the parties' agreement to wind-down relations and Regatta's purported sales efforts in California. As remedies for these alleged claims, Regatta sought no less than \$1.5 million in general and compensatory damages, along with punitive and exemplary damages, as well as attorney's fees and costs. We have filed and served an answering statement denying Regatta's counterclaims and asserting several affirmative defenses.

Also on October 18, 2018, Regatta filed a lawsuit in the Superior Court of the State of California, County of Orange, alleging two counts of fraud, and one count of interference with contractual relations, individually against Mr. James Crouse, then Executive Vice President of Sales for the Company, arising out of the same allegations made in Regatta's counterclaim. As remedies for these alleged claims, Regatta again sought no less than \$1.5 million in general and compensatory damages, along with punitive and exemplary damages, as well as attorney's fees and costs. The case was filed under the caption Regatta Solutions, Inc., v. Jim Crouse, et. al., Case No. 30-2018-01026571-CU-FR-CJC. On December 14, 2018, Regatta stipulated and agreed to arbitrate its claims against Mr. James Crouse and dismissed him from the Superior Court action.

On January 16, 2019, the parties participated in a mediation that did not resolve the dispute. The parties continued their settlement discussions and held a follow-on mediation on April 24, 2019 at which point the parties came to a resolution of the matter. Following initial compliance with the settlement terms, Regatta breached its obligations thereunder and the parties thereafter resolved the continuing dispute at a further mediation on January 29, 2020. As of March 31, 2020, Regatta met all of its material obligations under the settlement terms, and all matters related to the litigation were dismissed with prejudice on April 10, 2020. The settlement did not have a material impact on our condensed consolidated financial statements.

Capstone Turbine Corporation v. Turbine International, LLC.

On February 3, 2020, Capstone Turbine Corporation filed suit against its former distributor, TI, in the Superior Court of California for the County of Los Angeles under the following caption: Capstone Turbine Corporation v. Turbine International, LLC; Case No. 20STCV04372 ("Capstone-Turbine Intl. Litigation"). We have alleged claims

against Turbine Intl. for breach of contract and for injunctive relief relating to the parties' prior distributor relationship, which terminated at the end of March of 2018, and Turbine Intl.'s failure to satisfy its payment obligations under certain financial agreements, namely an accounts receivable agreement and promissory note in favor of Capstone. As remedies for these claims, we are seeking compensatory, consequential, along with injunctive relief and attorney's fees, interest, and costs.

On March 18, 2020, Turbine Intl. filed its answer and cross-claims in the Capstone-Turbine Intl. Litigation. In its cross-claims, Turbine Intl. has asserted claims against Capstone, and individually against Mr. James Crouse, Capstone's Chief Revenue Officer, for breach of contract under the distributor agreement, accounts receivable agreement and promissory note, fraud, breach of the covenant of good faith and fair dealing, unjust enrichment and constructive trust, negligent misrepresentation, violation of the unfair practices act, violation of racketeer influenced corrupt organizations act, and conspiracy to commit fraud. As remedies for these alleged claims, Turbine Intl. are seeking compensatory, consequential, and punitive damages along with attorney's fees, interest, and costs. Capstone answered the cross-claims on May 7, 2020. A case management conference is scheduled for August 19, 2020. We have not recorded any liability as of March 31, 2020, as no loss is expected.

Item 4. Mine Safety Disclosures.

Not applicable.

PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Market Information

Our common stock is publicly traded on the Nasdaq Capital Market under the symbol “CPST”.

Stockholders

As of June 26, 2020, there were 236 stockholders of record of our common stock. This does not include the number of persons whose stock is held in nominee or “street name” accounts through brokers.

Dividends

We have never declared or paid any cash dividends on our capital stock. We currently intend to retain all available funds and any future earnings, if any, to fund the development and expansion of our business and we do not anticipate paying any cash dividends in the foreseeable future. Any future determination to pay cash dividends will be made at the discretion of our board of directors. In addition, the terms of our outstanding indebtedness restrict our ability to pay cash dividends, and any future indebtedness that we may incur could preclude us from paying cash dividends.

Securities Authorized for Issuance Under Equity Compensation Plan.

Information about our equity compensation plans in Item 11 of Part III of this Annual Report on Form 10-K is incorporated herein by reference.

Recent Sales of Unregistered Securities

On February 10, 2020, in connection with a sponsorship agreement involving an equity-based payment to a non-employee recipient, we issued \$600,000 in unregistered shares of common stock of the Company to the recipient. This transaction was exempt from registration under the Securities Act in reliance upon Section 4(a)(2) of the Securities Act. The recipient of restricted shares of our common stock in this transaction represented their intentions to acquire the securities for investment only and not with a view to or for sale in connection with any distribution thereof, and appropriate legends were placed upon the stock certificates issued in these transactions.

On February 26, 2020, in connection with a consulting agreement involving an equity-based payment to a non-employee recipient, we issued 100,000 unregistered shares of common stock of the Company to the recipient. This transaction was exempt from registration under the Securities Act in reliance upon Section 4(a)(2) of the Securities Act. The recipient of restricted shares of our common stock in this transaction represented their intentions to acquire the securities for investment only and not with a view to or for sale in connection with any distribution thereof, and appropriate legends were placed upon the stock certificates issued in these transactions.

Issuer Purchases of Equity Securities

There were no repurchases of shares of common stock made during the fiscal year ended March 31, 2020.

Item 6. Selected Financial Data.

We are a smaller reporting company as defined by Rule 12b-2 of the Exchange Act and are not required to provide the information required under this Item.

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

The following Management’s Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from the results discussed in the forward-looking statements. Factors that might cause a difference include, but are not limited to, those discussed under Item 1A (Risk Factors) in this Form 10-K. The following section is qualified in its entirety by the more detailed information, including our financial statements and the notes thereto, which appears elsewhere in this Form 10-K.

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 (CHP) and (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 2020 were to improve cash flow, working capital, and our balance sheet; grow revenue through accelerating global product sales; diversify into additional market verticals and geographies; and increase aftermarket sales absorption. During Fiscal 2020 our net loss was \$22.0 million and our basic and diluted loss per share was \$2.70 compared to \$16.7 million and \$2.49, respectively, in the same period of the previous year. The increase in the net loss during Fiscal 2020 was primarily because of lower revenue, higher operating costs and interest expense. The decrease in revenue was primarily due to weakness in the natural resources market due to declining oil prices, as well as COVID-19 shutdowns and movement restrictions that resulted in delays in certain customers’ project timelines and product shipments in all of our global markets. Product revenue was lower primarily due to weakening in the United States natural resources market. Additionally, we build to a fixed number of production slots for our microturbines each quarter and during Fiscal 2020, we allocated five C1000 Signature Series systems production slots to our long-term rental program, resulting in lower product revenue. The increase in operating expense was primarily attributable to higher marketing costs and bad debt expense recorded during Fiscal 2020. On February 4, 2019, we entered into a \$30.0 million three-year term note with Goldman Sachs to replace the existing \$15.0 million revolving credit facility with Bridge Bank, which resulted in higher interest expense during Fiscal 2020 compared to Fiscal 2019. Fiscal 2020 was characterized by growth of our aftermarket service business because of additional revenue from our FPP long-term service contracts and rental income from our factory rental program compared to Fiscal 2019. Additionally, the U.S. dollar has strengthened against other currencies and 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 renewable energy markets. We also continued to see interest in critical power supply applications as customers want solutions that can handle both primary and backup power. Transportation is a developing market segment for us and currently transportation products were only for customer demonstrations.

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 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 and renewable energy markets.

The following table summarizes our product shipments by vertical markets:

	Year Ended March 31,	
	2020	2019
Energy efficiency	54%	47%
Natural resources	32%	40%
Renewable energy	14%	7%
Critical Power Supply	—	3%
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—Crude 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.

Renewable Energy

There is a growing transition to renewable energy sources and technologies on a global scale. Our microturbines run efficiently on renewable fuels such as methane and other biogases from landfills, wastewater treatment facilities and renewable natural gas. They also run efficiently on other small biogas applications like food processing plants, livestock farms and agricultural green 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” renewable 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, as the sulfur can contaminate combustion engines lube oil leading to equipment breakdowns and higher lifecycle costs.

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 acts 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 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.

Additionally, our technology is 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 2020, transportation products were only for customer demonstrations.

Backlog

Net product orders were approximately \$33.8 million and \$46.2 million for Fiscal 2020 and Fiscal 2019, respectively. Ending backlog was approximately \$37.7 million at March 31, 2020 compared to \$71.3 million at March 31, 2019. Book-to-bill ratio was 1.4:1 and 1.1:1 for Fiscal 2020 and 2019, respectively. Book-to-bill ratio is the ratio of new orders we received to units shipped and billed during a period.

During the second quarter of Fiscal 2020, we removed from product backlog orders related to Green Energy Sustainable Solutions, Inc. (“GESS”) of approximately \$10.6 million. This removal was the result of Capstone’s findings following further review of GESS’s ability to meet its obligations under their national account agreement.

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 the Assignment Agreement and the Note with 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.

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 the Guarantor, entered into 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 the Amended Assignment Agreement and 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 was contingent upon TI’s payment to us of the remaining approximately \$1.5 million in five payments by September 20, 2019. The payments of \$0.4 million, \$0.3 million, and \$0.3 million due March 20, 2019, June 20, 2019, and September 20, 2019, respectively, under the Amended Assignment Agreement, have not been received at the time of this filing. 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 on December 20, 2019. In September 2019, we sent TI a notice to cure default with a deadline of October 31, 2019. TI failed to cure the noticed default and we have since terminated TI’s distributor agreement. As a result, the BPC accounts receivable and related accounts receivable reserve of \$4.8 million were written off.

As a result of the above amendments we removed product orders related to BPC from backlog of approximately \$20.4 million and \$20.7 million, for Fiscal 2020 and Fiscal 2019, respectively. These removals were the result of our continuous review of BPC related backlog with TI which resulted in us no longer honoring the product pricing, and the cancellation of our distributor agreement with TI. There are no remaining backlog related to BPC as of March 31, 2020.

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 distributors who resell our products to end users. We have a total of 88 distributors, OEMs and national accounts. In the United States and Canada, we currently have 23 distributors, OEMs and national accounts. Outside of the United States and Canada, we currently have 65 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 2—Summary of Significant Accounting Policies 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 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 at the end of Fiscal 2020 and Fiscal 2019 was approximately \$82.4 million and \$78.9 million, respectively, which represents the value of the contractual agreement for FPP services that has not been earned and extends through Fiscal 2035. Additionally, we offer new and remanufactured parts through our global distribution network. Service revenue in Fiscal 2020 was approximately 30% of total revenue.

- 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 Fiscal 2020, we introduced and expanded our PowerSync family of controllers, easily customizable for our microturbine systems. Additionally, we delivered our first production self-cleanable severe environment air filtration system for our Signature Series line of microturbine products.

We continued on a project to modernize electronics to today's standards, providing common functionality and enabling long term support. To support our global fleet during Fiscal 2020, we achieved Australian AS4777 certification for our C200 product line, and UK G99 Grid Interconnect type approval for our C65 and C200 product lines. In addition, Germany released VDE 4110 for Medium Voltage Grid Interconnection, to augment the BDEW certification. We achieved "Prototype Confirmation" for this new specification that enables continued operability in Germany.

In partnership with one of our long-term EMEA distributors, we developed a marine C65 for a private yacht manufacturer and in Fiscal 2020 we delivered the product and also received certification from Lloyd's Register EMEA for Lloyd's Register Rules and Regulations for the Classification of Special Service Craft 2018 - Part 6.

We are also developing a more efficient microturbine CHP system with the support of the DOE, 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 microturbine in our development test lab. Management intends to continue with the next phase of development and commercialization after we achieve profitability. 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 first quarter of Fiscal 2019, we identified a defect in one of the component parts for microturbine systems from one of our single source suppliers. As a result of this defect, we have identified several new suppliers with greater engineering expertise and robust quality management systems. The transition is complex, lengthy and may result in an interruption in our manufacturing process. An interruption in our manufacturing process for this component part would adversely impact our results of operations. The efforts to qualify and dual source these components was completed in the fourth quarter of Fiscal 2019.

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. During

the first quarter of Fiscal 2019, we issued a prepayment of approximately \$2.2 million to this single source supplier. As of March 31, 2020, there were gradual improvement trends in the capacity issues at the supplier. A new supplier has been fully qualified and has taken over as the primary source of this commodity for Capstone.

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.

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.

Reverse Stock Split At the annual meeting of stockholders of the Company held on August 29, 2019, the Company's stockholders approved an amendment to our Second Amended and Restated Certificate of Incorporation (the "Amendment") to effect a reverse stock split of our common stock at a ratio in the range of one-for-five (1:5) to one-for-ten (1:10). Pursuant to such authority granted by the stockholders, the Company's board of directors approved a one-for-ten (1:10) reverse stock split (the "Reverse Stock Split") of the common stock and the filing of the Amendment. The certificate was filed with the Secretary of State of Delaware, effective on October 21, 2019 and the Reverse Stock Split became effective as of that date as filed with the SEC under the Securities and Exchange Act. Accordingly, all references to numbers of common shares, including the number of common shares on an as-if-converted basis, per-share data and share prices and exercise prices in the accompanying condensed consolidated financial statements have been adjusted to reflect the reverse stock split on a retroactive basis.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses and related disclosures of contingent liabilities. On an on-going basis, we evaluate our estimates, including but not limited to those related to long-lived assets, including finite-lived intangible assets and fixed assets, bad debts, inventories, warranty obligations, stock-based compensation, income taxes and contingencies. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe that the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

- We evaluate the carrying value of long-lived assets, including intangible assets with finite lives, for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. Factors that are considered important that could trigger an impairment review include a current-period operating or cash flow loss combined with a history of operating or cash flow losses and a projection or forecast that demonstrates continuing losses or insufficient income associated with the use of a long-lived asset or asset group. Other factors include a significant change in the manner of the use of the asset or a significant negative industry or economic trend. This evaluation is performed based on undiscounted estimated future cash flows compared with the carrying value of the related assets. If the undiscounted estimated future cash flows are less than the carrying value, an impairment loss is recognized and the loss is measured by the difference between the carrying value and the estimated fair value of the asset group. The estimated fair value of the assets is determined using the best information available. On a quarterly basis, we assess whether events or changes in circumstances have occurred that potentially indicate the carrying value of long-lived assets may not be recoverable. Intangible assets include a

manufacturing license, technology, backlog and customer relationships. We reevaluate the useful life determinations for these intangible assets each reporting period to determine whether events and circumstances warrant a revision in their remaining useful lives. We performed an analysis as of March 31, 2020 and determined that there was no impairment. See Note 5—Intangible Assets in the “Notes to Consolidated Financial Statements.”

- Our inventories are valued at the lower of cost (determined on a first in first out (“FIFO”) basis) or net realizable value. We routinely evaluate the composition of our inventories and identify slow-moving, excess, obsolete or otherwise impaired inventories. Inventories identified as impaired are evaluated to determine if write-downs are required. Included in this assessment is a review for obsolescence as a result of engineering changes in our product. Future product enhancement and development may render certain inventories obsolete, resulting in additional write-downs of inventories. In addition, inventories are classified as current or long-term based on our sales forecast and also, in part, based on our projected usage for warranty claims and service. A change in forecast could impact the classification of inventories.
- We provide for the estimated cost of warranties at the time revenue from sales is recognized. We also accrue the estimated costs to address reliability repairs on products no longer under warranty when, in our judgment, and in accordance with a specific plan developed by us, it is prudent to provide such repairs. We estimate warranty expenses based upon historical and projected product failure rates, estimated costs of parts, labor and shipping to repair or replace a unit and the number of units covered under the warranty period. While we engage in extensive quality programs and processes, our warranty obligation is affected by failure rates and service costs in correcting failures. As we have more units commissioned and longer periods of actual performance, additional data becomes available to assess future warranty costs. When we have sufficient evidence that product changes are altering the historical failure occurrence rates, the impact of such changes is then taken into account in estimating future warranty liabilities. Changes in estimates are recorded in the period that new information, such as design changes, cost of repair and product enhancements, becomes available. Should actual failure rates or service costs differ from our estimates, revisions to the warranty liability would be required and could be material to our financial condition, results of operations and cash flow.
- Our revenue consists of sales of products, parts, accessories and service, which includes FPPs, net of discounts. Our distributors purchase products, parts and FPPs for sale to end users and are also required to provide a variety of additional services, including application engineering, installation, commissioning and post-commissioning service. Our standard terms of sales to distributors and direct end users include transfer of title, care, custody and control at the point of shipment, payment terms ranging from full payment in advance of shipment to payment in 90 days, no right of return or exchange, and no post-shipment performance obligations by us except for warranties provided on the products and parts sold. We recognize revenue when all of the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or service has been rendered, selling price is fixed or determinable and collectability is reasonably assured. Service revenue derived from time and materials contracts is recognized as the service is performed. FPP contracts are agreements to perform certain agreed-upon service to maintain a product for a specified period of time. Service revenue derived from FPP contracts is recognized on a straight-line basis over the contract period. We occasionally enter into agreements that contain multiple elements, such as equipment, installation, engineering and/or service. Effective January 1, 2018, we launched our DSS program to fund 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. Service revenue derived from our DSS program began in March 2018 and is recognized on a pro rata basis as the distributors purchase our products.
- Trade accounts receivable are recorded at the invoiced amount and typically non-interest bearing. We maintain allowances for estimated losses resulting from the inability of our customers to make required payments and other accounts receivable allowances. We evaluate all accounts aged over 60 days past payment terms. If the financial condition of our customers deteriorates or if other conditions arise that

result in an impairment of their ability or intention to make payments, additional allowances may be required.

- We have a history of unprofitable operations. These losses generated significant federal and state net operating loss (“NOL”) carryforwards. We record a valuation allowance against the net deferred income tax assets associated with these NOLs if it is “more likely than not” that we will not be able to utilize them to offset future income taxes. Because of the uncertainty surrounding the timing of realizing the benefits of our favorable tax attributes in future income tax returns, a valuation allowance has been provided against all of our net deferred income tax assets. We currently provide for income taxes only to the extent that we expect to pay cash taxes, primarily foreign and state taxes. It is possible, however, that we could be profitable in the future at levels which could cause management to determine that it is more likely than not that we will realize all or a portion of the NOL carryforwards. Upon reaching such a conclusion, we would record the amount of net deferred tax assets that are expected to be realized. Such adjustment would increase income in the period that the determination was made.
- We recognize stock-based compensation expense associated with stock options in the statement of operations. Determining the amount of stock-based compensation to be recorded requires us to develop estimates to be used in calculating the grant-date fair value of stock options. We calculate the grant-date fair values using the Black-Scholes valuation model.

The use of Black-Scholes model requires us to make estimates of the following assumptions:

- *Expected volatility*—The estimated stock price volatility was derived based upon our actual historic stock prices over the expected option life, which represents our best estimate of expected volatility.
- *Expected option life*—The expected life, or term, of options granted was derived from historical exercise behavior and represents the period of time that stock option awards are expected to be outstanding.
- *Risk-free interest rate*—We used the yield on zero-coupon U.S. Treasury securities for a period that is commensurate with the expected life assumption as the risk-free interest rate.

The amount of stock-based compensation cost is recorded on a straight-line basis over the vesting period.

Results of Operations

Year Ended March 31, 2020 Compared to Year Ended March 31, 2019

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

	Year Ended March 31,	
	2020	2019
	Revenue	Revenue
United States and Canada	\$ 32.2	\$ 46.3
Europe and Russia	16.5	16.1
Latin America	9.1	9.6
Asia and Australia	8.6	9.1
Middle East and Africa	2.5	2.3
Total	<u>\$ 68.9</u>	<u>\$ 83.4</u>

Revenue Revenue for Fiscal 2020 decreased \$14.5 million, or 17%, to \$68.9 million from \$83.4 million for Fiscal 2019. The change in revenue for Fiscal 2020 compared to Fiscal 2019 included decreases in revenue of \$14.1 million from the United States and Canadian markets, \$0.5 million from the Latin American markets, and \$0.5 million from the Asian and Australian markets. These overall decreases in revenue were offset by increases in revenue of \$0.4 million from the European and Russian markets and \$0.2 million from the Middle East and African markets. The decrease in revenue in the United States and Canadian markets during Fiscal 2020 compared to the same period the previous year was primarily because of decreases in product shipments into the natural resources and energy efficiency vertical markets, as well as lower accessories and parts revenue. These decreases were primarily in the United States and were due to weakness in the oil and gas market as a result of a decline in oil prices, as well as the COVID-19 pandemic, which has affected the timing of customer demand for our products. The decrease in revenue in the Latin American market was primarily because of a decrease in C1000 Signature Series systems shipments into the natural resources market during Fiscal 2020 compared to the same period last year. The decrease in revenue in the Asian and Australian markets was primarily because of decreases in product shipments into the energy efficiency and natural resources vertical markets during Fiscal 2020 compared to the same period last year. The increase in revenue in the European and Russian markets during Fiscal 2020 compared to the same period last year was primarily because the European energy efficiency and natural resources vertical markets continue to improve. The increase in revenue in the Middle East and African markets was primarily because of increases in accessories and parts revenue during Fiscal 2020 compared to the same period last year.

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

	Year Ended March 31,					
	2020			2019		
	Revenue	Megawatts	Units	Revenue	Megawatts	Units
Microturbine Product	<u>\$ 33.8</u>	33.2	214	<u>\$ 51.4</u>	51.0	270
Accessories and Parts	14.4			14.9		
Service	20.7			17.1		
Total Accessories, Parts and Service	<u>35.1</u>			<u>32.0</u>		
Total	<u>\$ 68.9</u>			<u>\$ 83.4</u>		

For Fiscal 2020, revenue from microturbine products decreased \$17.6 million, or 34%, to \$33.8 million from \$51.4 million for Fiscal 2019. The decrease in revenue was primarily the result of weakness in the oil and gas market due to a decline in oil prices, as well as the COVID-19 pandemic, which has affected the timing of customer demand for our products compared to the same period last year. Megawatts shipped during Fiscal 2020 decreased 17.8 megawatts, or 35%, to 33.2 megawatts from 51.0 megawatts during Fiscal 2019. Average revenue per megawatt shipped was approximately \$1.0 million in both Fiscal 2020 and 2019. 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 Fiscal 2020, revenue from our accessories and parts decreased \$0.5 million, or 3%, to \$14.4 million from \$14.9 million for Fiscal 2019. The decrease in revenue from accessories and parts was primarily because of lower accessories and parts shipments as a result of the COVID-19 shutdowns and movement restrictions in all of our global markets.

Service revenue for Fiscal 2020 increased \$3.6 million, or 21%, to \$20.7 million from \$17.1 million for Fiscal 2019. The increase in service revenue was primarily due to increases in revenue from our FPP service agreements and microturbine rental program. FPP service revenue increased primarily because in Fiscal 2019 we did not recognize revenue on certain service contracts because of the reassignment of those service contracts from Capstone's legacy California distributor to Cal Microturbine ("CAL"), one of our domestic distributors. Earned revenue from our DSS program for Fiscal 2020 and 2019 was \$1.7 million in each year and is included under the caption "Service revenue" in the accompanying condensed consolidated statements of operations.

Sales to E-Finity, one of our domestic distributors, accounted for 12% and 13% of our revenue for the years ended March 31, 2020 and 2019, respectively. Sales to CAL accounted for 12% of our revenue for the year ended March 31, 2019.

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. Gross margin was approximately \$9.0 million, or 13% of revenue, for Fiscal 2020, compared to gross margin of \$9.5 million, or 11% of revenue, for Fiscal 2019. The decrease in gross margin of \$0.5 million during Fiscal 2020 compared to Fiscal 2019 was primarily because of a \$4.4 million decrease in our direct material costs margin and higher inventory charges of \$0.2 million, offset by decreases in warranty expense of \$1.6 million, royalty expense of \$0.2 million, and lower production and service center labor and overhead expense of \$2.3 million. Management continues to implement initiatives to improve gross margin in Fiscal 2021 by further reducing manufacturing overhead and direct material costs, and improving product performance as we work to achieve profitability.

Direct material costs margin, calculated as total revenue less our direct material costs, decreased \$4.4 million during Fiscal 2020 compared to Fiscal 2019 primarily because of a \$4.4 million decrease in product direct material costs margin due to lower volume and a decrease of approximately \$1.1 million in FPP direct material cost margin primarily due to higher than normal levels of unscheduled maintenance activities as a result of a supplier defect identified during the first quarter of Fiscal 2019, which were partially offset by \$1.1 million of rental, DSS, parts and accessories direct material costs margin.

The decrease in warranty expense of \$1.6 million during Fiscal 2020 compared to Fiscal 2019 was primarily because of a lower standard warranty provision as a result of the supplier defect identified during the first quarter of Fiscal 2019, which did not materially impact Fiscal 2020 warranty expense as most affected units were out of the warranty period. Management expects the warranty expense in Fiscal 2021 to be in line with Fiscal 2020.

Production and service center labor and overhead expense decreased \$2.3 million during Fiscal 2020 compared to Fiscal 2019 primarily because of decreases of approximately \$0.7 million in salaries expense, \$0.7 million overhead allocated to finished goods inventory, \$0.4 million in freight expense, \$0.4 million in supplies expense, \$0.2 million in consulting expense, and \$0.2 million of product certification expense, offset by an increase of \$0.3 million of depreciation expense.

Royalty expense decreased \$0.2 million during Fiscal 2020 compared to Fiscal 2019 primarily because we concluded our royalty obligation with Carrier.

Inventory charges increased \$0.2 million during Fiscal 2020 compared to Fiscal 2019 primarily as the result of a decrease in the provision for excess and obsolete inventory.

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

	Year Ended March 31,	
	2020	2019
Gross Margin		
Product	\$ (0.6)	\$ 0.2
As a percentage of product revenue	(2)%	— %
Accessories, parts and service	\$ 9.6	\$ 9.3
As a percentage of accessories, parts and service revenue	27 %	29 %
Total Gross Margin	<u>\$ 9.0</u>	<u>\$ 9.5</u>
As a percentage of total revenue	13 %	11 %

The decrease in product gross margin during Fiscal 2020 compared to Fiscal 2019 was primarily because of a decrease in volume of product shipments due to weakness in the oil and gas market from decline in oil prices, as well as the COVID-19 pandemic, which has affected the timing of customer demand for our products compared to the same period last year. Accessories, parts and service gross margin increased during Fiscal 2020 compared to Fiscal 2019 primarily due to an increase in our high margin rental revenue, as well as lower revenue and higher costs in Fiscal 2019 associated with the reassignment of certain service contracts from Capstone’s legacy California distributor to Cal Mircoturbine, partially offset by higher maintenance activities in Fiscal 2020 as a result of a supplier defect identified during the first quarter of Fiscal 2019.

Research and Development Expenses (“R&D”) R&D expenses for Fiscal 2020 and 2019 were each \$3.6 million. Management expects R&D expenses in Fiscal 2021 to be lower than in Fiscal 2020 as a result of lower costs from our COVID-19 Business Continuity Plan.

Selling, General and Administrative (“SG&A”) Expenses SG&A expenses for Fiscal 2020 increased \$1.2 million, or 6%, to \$22.2 million from \$21.0 million for Fiscal 2019. The net increase in SG&A expenses was comprised of increases of approximately \$0.5 million in marketing expense, \$0.2 million in legal expense and \$0.1 million in shareholder costs. In addition, the increase in SG&A expense resulted from higher bad debt expense of \$0.8 million during Fiscal 2020 compared to the same period last year. These increases were offset by decreases of \$0.1 million in salaries expense and \$0.3 million in business travel expense. Management expects SG&A expenses in Fiscal 2021 to be lower than in Fiscal 2020 primarily as a result of lower costs from our COVID-19 Business Continuity Plan.

Interest Expense Interest expense increased \$3.7 million to \$5.2 million during Fiscal 2020 from \$1.5 million for Fiscal 2019. Interest expense increased because of higher debt outstanding and a higher interest rate. As of March 31, 2020, we had total debt of \$30.0 million outstanding. On February 4, 2019, we entered into a \$30.0 million three-year term note with Goldman Sachs to replace the existing \$15.0 million revolving credit facility with Bridge Bank. See Liquidity and Capital Resources— Three-year Term Note below for additional discussion on our three-year term note with Goldman Sachs.

Income Tax Provision Income tax expense increased \$4,000, or 50%, to \$12,000 during Fiscal 2020 from \$8,000 during Fiscal 2019. Income tax expense incurred was related to state and foreign taxes. The effective income tax rate of -0.1% differs from the federal and state blended statutory rate of approximately 23.5% primarily as a result of maintaining a full valuation allowance against net deferred tax assets. At March 31, 2020, we had federal and state net operating loss carryforwards of approximately \$643.7 million and \$162.0 million, respectively, which may be utilized to reduce future taxable income, subject to limitations under Section 382 of the Internal Revenue Code of 1986. We provided a valuation allowance for 100% of our net deferred tax asset of \$169.8 million at March 31, 2020 because the realization of the benefits of these favorable tax attributes in future income tax returns is not deemed more likely than not. Similarly, at March 31, 2019, the net deferred tax asset was fully reserved.

Quarterly Results of Operations

The following table presents unaudited quarterly financial information. This information was prepared in accordance with GAAP, and, in the opinion of management, contains all adjustments necessary for a fair presentation of such quarterly information when read in conjunction with the financial statements included elsewhere herein. Our operating results for any prior quarters may not necessarily indicate the results for any future periods.

(In thousands, except per share data)

(Unaudited)	Year Ended March 31, 2020				Year Ended March 31, 2019			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Revenue	\$ 11,560	\$ 17,383	\$ 20,740	\$ 19,244	\$ 22,019	\$ 18,030	\$ 22,174	\$ 21,189
Cost of goods sold	11,102	14,755	17,659	16,379	18,665	15,790	20,137	19,367
Gross margin	458	2,628	3,081	2,865	3,354	2,240	2,037	1,822
Operating expenses:								
R&D	838	972	900	938	887	891	891	932
SG&A	5,195	5,280	5,499	6,237	5,424	4,574	5,308	5,651
Loss from operations . . .	(5,575)	(3,624)	(3,318)	(4,310)	(2,957)	(3,225)	(4,162)	(4,761)
Net loss (1)	<u>\$ (6,950)</u>	<u>\$ (4,907)</u>	<u>\$ (4,448)</u>	<u>\$ (5,593)</u>	<u>\$ (3,954)</u>	<u>\$ (3,450)</u>	<u>\$ (4,357)</u>	<u>\$ (4,897)</u>
Net loss per common share—basic and diluted (1)	<u>\$ (0.74)</u>	<u>\$ (0.59)</u>	<u>\$ (0.59)</u>	<u>\$ (0.77)</u>	<u>\$ (0.55)</u>	<u>\$ (0.50)</u>	<u>\$ (0.67)</u>	<u>\$ (0.79)</u>

(1) Loss per-share amounts for all periods has been retroactively adjusted to reflect the Company's 1-for-10 reverse stock split, which was effective October 21, 2019.

During the three months ended December 31, 2018, we received approximately \$0.4 million under the Assignment Agreement with TI and it has been recorded as recovery of bad debts and included under SG&A. There was no payment received under the Amended Assignment Agreement with TI during the three months ended March 31, 2019. During the three months ended March 31, 2020 we reserved approximately \$0.5 million for certain past due distributors because collections were uncertain given the COVID-19 pandemic business environment.

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, 2021 include approximately \$2.5 million for rental units and plant and equipment costs related to manufacturing and operations. We have invested our cash in institutional funds that invest in high quality short-term money market instruments to provide liquidity for operations and for capital preservation.

Our cash, cash equivalents and restricted cash balances decreased \$14.6 million during the fiscal year ended March 31, 2020, compared to an increase of \$10.3 million during the fiscal year ended March 31, 2019. The decrease in cash, cash equivalents and restricted cash during Fiscal 2020 compared to the increase in cash, cash equivalents and restricted cash during the same period last year was primarily related to the \$30.0 million three-year term note with Goldman Sachs entered into during the fourth quarter of Fiscal 2019 to replace the existing \$15.0 million revolving credit facility with Bridge Bank as described below. Under the three-year term note with Goldman Sachs we are not permitted to allow our cash and cash equivalents to be less than \$12.0 million through the first anniversary date of February 4, 2020, and \$9.0 million thereafter.

On April 15, 2020, we applied for an unsecured loan in the principal amount of \$2,610,200 under the PPP loan (the "PPP Loan"). On March 23, 2020 the Company enacted a Business Continuity Plan in response to COVID-19. Beginning March 30, 2020, the Company furloughed approximately 52 employees, leaving behind only staff deemed

essential for day-to-day administrative operations for a minimum period of 45 days. The Company's Leadership Team volunteered to take a 25% temporary salary cut as well as the fiscal 2020 Executive Bonus in equity in lieu of cash if earned. In addition, approximately 25 other top company managers volunteered to take a similar 15% reduction in salary and the directors voted to take a temporary 25% reduction in base cash retainer. We believe these programs will supplement our current and future available capital resources.

Operating Activities During the fiscal year ended March 31, 2020, we used \$19.7 million in cash in our operating activities, which consisted of a net loss for the period of \$21.9 million and cash used for working capital of \$4.0 million, offset by non-cash adjustments (primarily warranty provision, accounts receivable allowances, depreciation and amortization, stock based compensation and inventory provision) of \$6.2 million. During the fiscal year ended March 31, 2019, we used \$17.7 million in cash in our operating activities, which consisted of a net loss for the period of \$16.7 million and cash used for working capital of \$6.1 million, offset by non-cash adjustments of \$5.1 million.

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

	<u>Year Ended March 31,</u>	
	<u>2020</u>	<u>2019</u>
Net loss	\$ (21,898)	\$ (16,659)
Non-cash operating activities(1)	6,160	5,115
Changes in operating assets and liabilities:		
Accounts receivable	(449)	91
Inventories	(1,499)	(5,850)
Accounts payable and accrued expenses	(2,567)	3,048
Prepaid expenses, other current assets and other assets	1,215	(3,813)
Other changes in operating assets and liabilities	(660)	365
Net cash used in operating activities	<u>\$ (19,698)</u>	<u>\$ (17,703)</u>

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

The change in non-cash operating activities during the fiscal year ended March 31, 2020 compared to the same period the previous fiscal year was primarily because of the provision for warranty expenses during the fiscal year ended March 31, 2019 as a result of a supplier defect identified during the first quarter of Fiscal 2019. Additionally, contributing to the change was the amortization of debt issuance costs from the Goldman Sachs term note payable during the fiscal year ended March 31, 2020. The change in accounts receivable during the fiscal year ended March 31, 2020 was primarily the result of lower revenue in Fiscal 2020 and delayed collection from certain customers, compared to fiscal year ended March 31, 2019. The change in inventory was primarily the result of a decrease in raw materials partially offset by an increase in finished goods during the fiscal year ended March 31, 2020 compared to an increase in raw materials partially offset by a decrease in finished goods during the fiscal year ended March 31, 2019. 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 fiscal year ended March 31, 2020 compared to the same period the previous fiscal year. The change in prepaid expenses, other current assets and other liabilities during the fiscal year ended March 31, 2020 was primarily because of a negotiated royalty settlement to Carrier and a supplier prepayment obligation in Fiscal 2019, each described below, and a marketing demonstration unit accounted for as a deferred marketing cost in Fiscal 2020. The change in other operating assets and liabilities during the fiscal year ended March 31, 2020 compared to fiscal year ended March 31, 2019, was primarily the result of an increase in deferred revenue attributable to FPP contracts.

Investing Activities Net cash used in investing activities of \$4.2 million and \$3.4 million during the fiscal year ended March 31, 2020 and 2019, respectively, relates primarily to the acquisition of fixed assets, rental units and leasehold improvements made to our Van Nuys location. During the fiscal year ended March 31, 2020 and 2019, we deployed approximately \$3.2 million and \$2.8 million of our C1000 Signature Series systems under our factory rental program, respectively.

Financing Activities During the fiscal year ended March 31, 2020, we generated approximately \$9.2 million in cash from financing activities compared to cash generated during the fiscal year ended March 31, 2019 of approximately \$31.4 million. The funds generated from financing activities during the fiscal year ended March 31, 2020 were primarily the result of proceeds from the September 2019 registered direct offering and proceeds from the at-the-market offering program described below. The funds generated from financing activities during the fiscal year ended March 31, 2019 were primarily the result of net proceeds from our three-year term note with Goldman Sachs and the at-the-market offering program, each described below, offset by repayment of notes payable and capital lease obligations.

At-the-market offerings

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 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 \$30.0 million. During the fiscal year ended March 31, 2019, we issued 0.3 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 March 31, 2019, 2.6 million shares of the Company's common stock were cumulatively sold pursuant to the at-the-market offering program and the net proceeds to the Company 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.

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 fiscal year ended March 31, 2020, we issued 1.7 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 \$5.3 million after deducting commissions paid of approximately \$0.2 million. As of March 31, 2020, approximately \$12.2 million remained available for issuance with respect to this at-the-market offering program.

Warrants

On April 13, 2018, a warrant holder exercised its rights under the warrant agreement to exercise on a cashless basis 576,000 Series A warrants at an exercise price of \$6.00 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 380,625 shares of common stock.

As of March 31, 2020, there were 271,875 Series A warrants outstanding and there are no Series B warrants outstanding. Of the total Series A warrants outstanding, 217,875 Series A warrants were issued with an exercise price of \$25.50 per share of common stock, and have an expiration date of October 25, 2021, and 54,000 Series A warrants with anti-dilution provisions were issued with an initial exercise price of \$13.40 per share of common stock, and have an expiration date of April 22, 2021. As of March 31, 2020, because of the anti-dilution provisions, these warrants had an adjusted exercise price of \$1.15 per share of common stock.

On February 4, 2019, we sold to Goldman Sachs & Co. LLC (the "Holder"), a Purchase Warrant for Common Shares (the "Warrant") pursuant to which the Holder may purchase shares of the Company's common stock, par value \$0.001 per share (the "Common Shares") in an aggregate amount of up to 404,634 shares (the "Warrant Shares"). The Warrant was sold to the Holder at a purchase price of \$150,000, in a private placement exempt from registration under the Securities Act. The Warrant may be exercised by the Holder at any time after August 4, 2019 at an exercise price equal to \$8.86 and will expire on February 4, 2024. The Warrant contains standard adjustment provisions in the event of additional stock issuances below the exercise price of the warrant, stock splits, combinations, rights offerings and similar transactions. The value of the Warrant was \$2.3 million upon issuance, and has been classified as an equity instrument in additional paid in capital in our consolidated balance sheets. Our common stock and warrant transactions during Fiscal 2020 triggered certain anti-dilution provisions in the warrants outstanding, resulting in an additional 49,891 warrants issued, which were treated as a deemed dividend in the amount of \$87,362.

On December 9, 2019, we entered into Amendment No. 1 to the Purchase Warrant for Common shares (the “Amendment No. 1”) with Special Situations Investing Group II, LLC (as successor in interest to Goldman Sachs & Co. LLC) (the “Warrant Holder”) that amends the Warrant. The Amendment No. 1 amends the first paragraph of the Warrant to increase the number of Warrant Shares issuable under the Warrant (on a post-reverse split basis) and to decrease the exercise price from \$8.86 per share (on a post-reverse split basis) to \$3.80 per share (the “Per Share Warrant Exercise Price”). The Amendment No. 1 also amends Section 2.1 of the Warrant such that the Per Share Anti-Dilution Price is equal to the Per Share Warrant Exercise Price.

On September 4, 2019, we entered into a Securities Purchase Agreement (the “Securities Purchase Agreement”) with certain institutional and accredited investors pursuant to which we agreed to issue and sell in a registered direct offering (the “Registered Direct Offering”) an aggregate of 580,000 shares of our common stock, par value \$0.001 per share at a negotiated purchase price of \$5.00 per share, and pre-funded warrants to purchase up to an aggregate of 440,000 shares of our common stock at a negotiated purchase price of \$5.00 per Pre-Funded Warrant, for aggregate gross proceeds of approximately \$5.1 million (580,000 shares of our common stock plus 440,000 pre-funded warrants at a \$5.00 per share purchase price), before deducting placement agent fees and other offering expenses. Net proceeds from the offering were \$4.6 million. The offering closed on September 9, 2019. On October 24, 2019, a warrant holder exercised its rights to the warrant agreement to exercise on a cash basis 440,000 pre-funded warrants at an exercise price of \$0.001 per share under the warrant agreement.

In a concurrent private placement, we agreed to issue to the purchasers warrants to purchase 765,000 shares of Common Stock, which represent 75% of the number of shares of Common Stock and shares underlying the Pre-Funded Warrants purchased in the Registered Direct Offering, pursuant to the Securities Purchase Agreement. The Common Warrants will be exercisable for shares of Common Stock at an initial exercise price of \$6.12 per share for a period of five years, starting on April 2, 2020 and expiring on April 2, 2025. None of these warrants have been exercised as of the date of this report.

There were no stock options exercised during the years ended March 31, 2020 and 2019, respectively. Employee stock purchases, net of repurchases of shares of our common stock for employee taxes due on vesting of restricted stock units, resulted in approximately \$0.1 million of net cash used during the fiscal year ended March 31, 2020, compared with \$0.1 million of net cash used during the fiscal year ended March 31, 2019.

Former Credit Facility Upon closing with the Purchaser and Goldman Sachs Specialty Lending Holdings, Inc., our existing credit facilities with Bridge Bank were paid off in full.

Three-year Term Note On February 4, 2019 (the “Closing Date”), we entered into a Note Purchase Agreement (the “Note Purchase Agreement”), by and among us, certain subsidiaries of us as guarantors, Goldman Sachs Specialty Lending Holdings, Inc. and any other purchasers party thereto from time to time (collectively, the “Purchaser”) and Goldman Sachs Specialty Lending Holdings, Inc., as collateral agent, in connection with the sale of senior secured notes of us in a private placement exempt from registration under the Securities Act. Under the Note Purchase Agreement, we sold to the Purchaser \$30.0 million aggregate principal amount of senior secured notes (the “Notes”), which bear interest at a rate of 13.0% per annum, computed on the basis of a 360-day year composed of twelve 30-day months, and payable quarterly on March 31, June 30, September 30 and December 31 of each year until maturity. The first interest payment on the Notes will be on March 31, 2019. The entire principal amount of the Notes is due and payable on February 4, 2022 (the “Maturity Date”). The Notes do not amortize and the entire principal balance is due in a single payment on the Maturity Date. As of March 31, 2019, \$30.0 million in borrowings were outstanding under the three-year term note. Under the three-year term note with Goldman Sachs we are not permitted to allow our cash and cash equivalents to be less than \$12.0 million through the first anniversary date of February 4, 2020, and \$9.0 million thereafter. On December 9, 2019, we entered into a Second Amendment (the “Second Amendment”) to the Note Purchase Agreement. Under the Second Amendment, Section 6.21 of the Note Purchase Agreement was amended to increase the Section 382 Ownership Shift threshold to not exceed 40.0%. In addition to the Note Purchase Agreement, on February 4, 2019, the Company sold the Warrant pursuant to which the Holder may purchase shares of the Company’s Common Shares. The Warrant was sold to the Holder at a purchase price of \$150,000, in a private placement exempt from registration under the Securities Act. The Warrant may be exercised by the Holder at any time after August 4, 2019 at an exercise price equal to \$8.86 and will expire on February 4, 2024. The Warrant contains standard adjustment provisions in the event of

additional stock issuances below the exercise price of the warrant, stock splits, combinations, rights offerings and similar transactions. The value of the Warrant was \$2.3 million, and has been classified as an equity instrument in additional paid in capital in our consolidated balance sheets. Our common stock and warrant transactions during Fiscal 2020 triggered certain anti-dilution provisions in the warrants outstanding, resulting in an additional 49,891 warrants issued, which were treated as a deemed dividend in the amount of \$87,362. On December 9, 2019, the Company entered into Amendment No. 1 with the Warrant Holder that amends the Warrant. The Amendment No. 1 amends the first paragraph of the Warrant to increase the number of Warrant Shares issuable under the Warrant (on a post-reverse split basis) and to decrease the exercise price from \$8.86 per share (on a post-reverse split basis) to the Per Share Warrant Exercise Price. The Amendment No. 1 also amends Section 2.1 of the Warrant such that the Per Share Anti-Dilution Price is equal to the Per Share Warrant Exercise Price.

Working Capital Cash used in working capital was \$4.0 million during the fiscal year ended March 31, 2020, a decrease of \$2.2 million from the \$6.2 million cash used during the fiscal year ended March 31, 2019. We attribute the decrease in our working capital requirements primarily to changes in inventory, as well as the negotiated royalty settlement agreement payment to Carrier and prepayments to one of our single source suppliers during Fiscal 2019 with no such transactions during Fiscal 2020. These decreases in working capital requirements were offset by a decrease in accounts payable due to the timing of payments to our vendors.

Evaluation of Ability to Maintain Current Level of Operations In connection with preparing the consolidated financial statements for the fiscal year ended March 31, 2020, 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 Fiscal 2020 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, the COVID-19 pandemic, and ongoing global geopolitical tensions. We incurred a net loss of \$21.9 million and used cash in operating activities of \$19.7 million during the fiscal year ended March 31, 2020. Our working capital requirements during the fiscal year ended March 31, 2020 were higher than management's expectations due to a higher level of finished goods in inventory due to the COVID-19 pandemic, which has affected the timing of customer demand for our products, as well as cash used for accounts payable due to timing of payments. Our net loss expanded during the year ended March 31, 2020 primarily because of a decrease in product volume and higher FPP scheduled and unscheduled maintenance activities primarily as a result of a supplier defect identified during the first quarter of Fiscal 2019. Additionally, operating expenses were higher in Fiscal 2020 compared to Fiscal 2019 primarily due to the recording of a bad debt reserve for certain past due receivables because of uncertain collectability due to the COVID-19 pandemic in Fiscal 2020 and we received approximately \$0.4 million under the Assignment Agreement with TI in Fiscal 2019. As of March 31, 2020, we had cash and cash equivalents of \$15.1 million, and outstanding debt of \$30.0 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 lower our operating costs and to develop our geographical and vertical markets. We may seek to raise funds by selling additional securities (through the at-the-market offering or otherwise) to the public or to selected investors or by obtaining additional debt financing. There is no assurance that we will be able to obtain additional funds on commercially favorable terms or at all. If 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 term note payable with Goldman Sachs and the funds raised by selling additional securities through the at-the-market offering as of the date of issuance of our Fiscal 2020 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 Fiscal 2020 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
- our customers' ability to afford and/or finance our products.

Our accounts receivable balance, net of allowances, was \$16.2 million as of March 31, 2020 and 2019, respectively. Days sales outstanding in accounts receivable, ("DSO"), increased to 85 days as of March 31, 2020 compared to 70 days as of March 31, 2019 due to delayed collections in all markets due to the COVID-19 pandemic and the weakening oil and gas markets. We recorded net bad debt expense of approximately \$0.4 million and net bad debt recovery of approximately \$0.3 million, for the years ended March 31, 2020 and 2019, respectively.

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

Paycheck Protection Program Loan On April 15, 2020, we applied for an unsecured loan in the principal amount of \$2,610,200 under the PPP loan. The PPP was established under the recently congressionally approved CARES Act and is administered by the SBA. On April 24, 2020, we entered into a promissory note with Western Alliance Bank. The Company received the full amount of the Loan on April 24, 2020. In accordance with the requirements of the CARES Act, we intend to use proceeds from the PPP Loan to support fixed costs such as payroll costs, rent and utilities. On May 13, 2020, the Company repaid \$660,200 of the loan in accordance with the Fourth Amendment to the Note Purchase Agreement between the Company and Goldman Sachs Specialty Lending Group, L.P.

The advance under the Loan bears interest at a rate per annum of 1%. The PPP Loan matures on April 24, 2022.

Forgiveness of this loan is only available for principal that is used for the limited purposes that qualify for forgiveness. While we intend to pursue the forgiveness of the PPP Loan received in accordance with the requirements and limitations under the CARES Act, no assurance can be provided that forgiveness of any portion of the PPP Loan will be obtained.

Off-Balance Sheet Arrangements

We do not have any material off-balance sheet arrangements.

Inflation

Inflation did not have a material impact on our results of operations or financial condition for the fiscal years ended March 31, 2020 and 2019. In an effort to offset the adverse impact of inflation on earnings, we have historically raised selling prices on all products, parts, accessories and services. However, any future adverse impact of inflation on our raw materials and energy costs may not be similarly recoverable through our selling price increases.

Impact of Recently Issued Accounting Standards

Adopted

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 adopted ASU 2016-02 on April 1, 2019. See Note 13—Leases for additional discussion of the impact of the adoption of ASU 2016-02.

In 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 years. Early adoption is permitted if financial statements have not yet been issued. We adopted ASU 2018-07 on April 1, 2019 and it did not have a material impact on our condensed consolidated financial statements.

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 adopted Release No. 33-10532 on April 1, 2019 and it did not have a material impact on our financial disclosures.

Not yet adopted

Other standards issued but not yet effective, which are not discussed, are not considered material to the Company.

Item 7A. Quantitative and Qualitative Disclosure About Market Risk.

We are a smaller reporting company as defined by Rule 12b-2 of the Exchange Act and are not required to provide the information required under this Item.

Item 8. Financial Statements and Supplementary Data.

Our Consolidated Financial Statements included in this Form 10-K beginning at page F-1 are incorporated in this Item 8 by reference.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that the information required to be disclosed in our reports under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

In connection with the preparation of this Form 10-K for the fiscal year ended March 31, 2020, an evaluation was performed under the supervision and with the participation of our management, including the CEO and CFO, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). Based on this evaluation, our CEO and CFO have concluded that our disclosure controls and procedures are effective as of March 31, 2020 to ensure that the information required to be disclosed by us in reports we submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the rules and forms prescribed by the SEC. Additionally, such information is accumulated and communicated to management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over our financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) or 15d-15(f) under the Exchange Act as a process designed by, or under the supervision of, our CEO and CFO and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

We conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework). Based on this evaluation, management concluded that we maintained effective internal control over financial reporting as of March 31, 2020.

Changes in Internal Control Over Financial Reporting

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

Item 9B. Other Information.

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

Directors

The information required by this Item will be included in the Company's 2020 Proxy Statement to be filed with the SEC in connection with the solicitation of proxies for the Company's 2020 Annual Meeting of Shareholders ("2020 Proxy Statement") and is incorporated herein by reference. Such Proxy Statement will be filed with the SEC within 120 days after the end of the fiscal year to which this report relates.

Delinquent Section 16(a) Reports

The information required regarding Section 16(a) beneficial ownership reporting compliance will be included in the Company's 2020 Proxy Statement and is incorporated herein by reference.

Item 11. Executive Compensation.

The information required by this Item will be included in the Company's 2020 Proxy Statement and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information required by this Item will be included in the Company's 2020 Proxy Statement and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

The information required by this Item will be included in the Company's 2020 Proxy Statement and is incorporated herein by reference.

Item 14. Principal Accounting Firm Fees and Services.

The information required by this Item will be included in the Company's 2020 Proxy Statement and is incorporated herein by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules.

(a) 1. and 2. Financial statements and financial statement schedule

The financial statements, notes and financial statement schedule are listed in the Index to Consolidated Financial Statements on page F-1 of this Report.

3. Exhibits

The exhibits filed as part of this Form 10-K are set forth on the Exhibit Index immediately preceding the signatures of this Form 10-K. The Exhibit Index is incorporated herein by reference.

Item 16. Form 10-K Summary.

Not applicable.

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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Financial statement schedules not included in this Form 10-K have been omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors of
Capstone Turbine Corporation

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Capstone Turbine Corporation (the “Company”) as of March 31, 2020 and 2019, the related consolidated statements of operations, stockholders’ equity and cash flows for each of the two years in the period ended March 31, 2020, and the related notes (collectively referred to as the “financial statements”). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of March 31, 2020 and 2019, and the results of its operations and its cash flows for each of the two years in the period ended March 31, 2020 and 2019, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Marcum LLP

Marcum LLP

We have served as the Company’s auditor since 2017.

Costa Mesa, California
June 26, 2020

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)

	<u>March 31,</u> <u>2020</u>	<u>March 31,</u> <u>2019</u>
Assets		
Current Assets:		
Cash and cash equivalents	\$ 15,068	\$ 29,727
Accounts receivable, net of allowances of \$703 at March 31, 2020 and \$5,298 at March 31, 2019	16,240	16,222
Inventories, net	21,460	20,343
Prepaid expenses and other current assets	3,987	3,818
Total current assets	<u>56,755</u>	<u>70,110</u>
Property, plant, equipment and rental assets, net	7,749	5,291
Non-current portion of inventories	1,221	1,403
Intangible assets, net	—	187
Other assets	8,230	2,972
Total assets	<u>\$ 73,955</u>	<u>\$ 79,963</u>
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts payable and accrued expenses	\$ 15,000	\$ 16,638
Accrued salaries and wages	1,644	1,637
Accrued warranty reserve	1,934	2,614
Deferred revenue	7,898	7,167
Current portion of notes payable and lease obligations	477	31
Total current liabilities	<u>26,953</u>	<u>28,087</u>
Deferred revenue - non-current	944	1,069
Term note payable, net	27,963	27,099
Long-term portion of notes payable and lease obligations	5,074	212
Other long-term liabilities	—	342
Total liabilities	<u>60,934</u>	<u>56,809</u>
Commitments and contingencies (Note 12)		
Stockholders' Equity:		
Preferred stock, \$.001 par value; 1,000,000 shares authorized; none issued	—	—
Common stock, \$.001 par value; 51,500,000 shares authorized, 10,286,366 shares issued and 10,228,789 shares outstanding at March 31, 2020; 7,216,910 shares issued and 7,190,671 shares outstanding at March 31, 2019	10	7
Additional paid-in capital	915,755	903,803
Accumulated deficit	(900,869)	(878,884)
Treasury stock, at cost; 57,577 shares at March 31, 2020 and 26,239 shares at March 31, 2019	(1,875)	(1,772)
Total stockholders' equity	<u>13,021</u>	<u>23,154</u>
Total liabilities and stockholders' equity	<u>\$ 73,955</u>	<u>\$ 79,963</u>

See accompanying notes to consolidated financial statements.

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)

	Year Ended	
	March 31,	
	<u>2020</u>	<u>2019</u>
Revenue:		
Product, accessories and parts	\$ 48,143	\$ 66,303
Service	20,783	17,109
Total revenue	<u>68,926</u>	<u>83,412</u>
Cost of goods sold:		
Product, accessories and parts	42,273	60,149
Service	17,622	13,811
Total cost of goods sold	<u>59,895</u>	<u>73,960</u>
Gross margin	<u>9,031</u>	<u>9,452</u>
Operating expenses:		
Research and development	3,649	3,600
Selling, general and administrative	22,211	20,958
Total operating expenses	<u>25,860</u>	<u>24,558</u>
Loss from operations	(16,829)	(15,106)
Other income (expense)	133	(43)
Interest income	8	—
Interest expense	(5,198)	(1,502)
Loss before provision for income taxes	(21,886)	(16,651)
Provision for income taxes	12	8
Net loss	<u>(21,898)</u>	<u>(16,659)</u>
Less: Deemed dividend on purchase warrant for common shares	87	—
Net loss attributable to common stockholders	<u>\$ (21,985)</u>	<u>\$ (16,659)</u>
Net loss per common share attributable to common stockholders—basic and diluted	<u>\$ (2.70)</u>	<u>\$ (2.49)</u>
Weighted average shares used to calculate basic and diluted net loss per common share attributable to common stockholders	<u>8,150</u>	<u>6,700</u>

See accompanying notes to consolidated financial statements.

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands, except share amounts)

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Treasury Stock		Total Stockholders' Equity
	Shares	Amount			Shares	Amount	
Balance, March 31, 2018	5,726,011	\$ 5	\$ 889,650	\$ (862,225)	14,596	\$ (1,658)	\$ 25,772
Purchase of treasury stock	—	—	—	—	11,643	(114)	(114)
Vested restricted stock awards	29,700	—	113	—	—	—	113
Stock-based compensation	—	—	907	—	—	—	907
Exercise of employee stock purchases	102	—	1	—	—	—	1
Stock awards to Board of Directors	45,719	—	(70)	—	—	—	(70)
Issuance of common stock, net of issuance costs . .	1,034,757	1	10,934	—	—	—	10,935
Warrants exercised	380,621	1	(4)	—	—	—	(3)
Warrants issued	—	—	2,272	—	—	—	2,272
Net loss	—	—	—	(16,659)	—	—	(16,659)
Balance, March 31, 2019	<u>7,216,910</u>	<u>\$ 7</u>	<u>\$ 903,803</u>	<u>\$ (878,884)</u>	<u>26,239</u>	<u>\$ (1,772)</u>	<u>\$ 23,154</u>
Purchase of treasury stock	—	—	—	—	31,338	(103)	(103)
Vested restricted stock awards	73,983	—	102	—	—	—	102
Stock-based compensation	—	—	913	—	—	—	913
Exercise of employee stock purchases	522	—	3	—	—	—	3
Stock awards to Board of Directors	26,315	—	(24)	—	—	—	(24)
Issuance of common stock, net of issuance costs . .	2,528,636	2	10,580	—	—	—	10,582
Warrants exercised	440,000	1	—	—	—	—	1
Change in warrants valuation	—	—	291	—	—	—	291
Deemed dividend on purchase warrant for common shares	—	—	87	(87)	—	—	—
Net loss	—	—	—	(21,898)	—	—	(21,898)
Balance, March 31, 2020	<u>10,286,366</u>	<u>\$ 10</u>	<u>\$ 915,755</u>	<u>\$ (900,869)</u>	<u>57,577</u>	<u>\$ (1,875)</u>	<u>\$ 13,021</u>

See accompanying notes to consolidated financial statements.

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended March 31,	
	2020	2019
Cash Flows from Operating Activities:		
Net loss	\$ (21,898)	\$ (16,659)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,616	1,261
Amortization of financing costs and discounts	1,155	311
Amortization of right-of-use assets	870	—
Provision for (reduction in) accounts receivable allowances	431	(345)
Inventory provision	564	778
Provision for warranty expenses	594	2,200
(Gain) loss on disposal of equipment	17	2
Stock-based compensation	913	907
Changes in operating assets and liabilities:		
Accounts receivable	(449)	91
Inventories	(1,499)	(5,850)
Prepaid expenses, other current assets and other assets	1,215	(3,813)
Accounts payable and accrued expenses	(2,567)	3,049
Accrued salaries and wages and long term liabilities	8	(6)
Accrued warranty reserve	(1,274)	(1,269)
Deferred revenue	606	1,640
Net cash used in operating activities	<u>(19,698)</u>	<u>(17,703)</u>
Cash Flows from Investing Activities:		
Expenditures for property, equipment and rental assets	(4,207)	(3,360)
Net cash used in investing activities	<u>(4,207)</u>	<u>(3,360)</u>
Cash Flows from Financing Activities:		
Repayment of revolving credit facility	—	(8,527)
Net proceeds from term note payable	—	29,262
Repayment of notes payable and lease obligations	(613)	(337)
Cash used in employee stock-based transactions	(100)	(114)
Net proceeds from issuance of common stock and warrants	9,959	11,098
Net cash provided by financing activities	<u>9,246</u>	<u>31,382</u>
Net increase (decrease) in Cash, Cash Equivalents and Restricted Cash	(14,659)	10,319
Cash, Cash Equivalents and Restricted Cash, Beginning of Year	29,727	19,408
Cash, Cash Equivalents and Restricted Cash, End of Year	<u>\$ 15,068</u>	<u>\$ 29,727</u>
Supplemental Disclosures of Cash Flow Information:		
Cash paid during the period for:		
Interest	\$ 3,603	\$ 453
Income taxes	\$ 17	\$ 6
Supplemental Disclosures of Non-Cash Information:		
Acquisition of property and equipment through accounts payable	\$ 72	\$ —
Issuance of common stock for services to be received	\$ 700	\$ —
Deemed dividend	\$ 87	\$ —

See accompanying notes to consolidated financial statements.

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Description of the Company and Basis of Presentation

Capstone Turbine Corporation (the “Company”) develops, manufactures, markets and services microturbine technology solutions for use in stationary distributed power generation applications and distribution networks, including cogeneration (combined heat and power (“CHP”), integrated combined heat and power (“ICHP”), and combined cooling, heat and power (“CCHP”), renewable energy, natural resources, and critical power supply. The Company also remanufactures microturbine engines and provides aftermarket parts and services, which includes our Factory Protection Plan (“FPP”), Distributor Support System program (“DSS program”), and long-term microturbine rentals. The Company was organized in 1988 and has been commercially producing its microturbine generators since 1998.

This Annual Report on Form 10-K (this “Form 10-K”) refers to the Company’s fiscal years ended March 31 as its “Fiscal” years.

The consolidated financial statements include the accounts of the Company, Capstone Turbine International, Inc., its wholly owned subsidiary that was formed in June 2004, Capstone Turbine Singapore Pte., Ltd., its wholly owned subsidiary that was formed in February 2011, and Capstone Turbine Financial Services, LLC, its wholly owned subsidiary that was formed in October 2015, after elimination of inter-company transactions. The Company closed its wholly owned subsidiary, Capstone Turbine Singapore Pte., Ltd and the corporate structure related to this entity was dissolved in September 2018.

2. Summary of Significant Accounting Policies

Cash Equivalents The Company considers only those investments that are highly liquid and readily convertible to cash with original maturities of three months or less at date of purchase as cash equivalents.

Fair Value of Financial Instruments The carrying value of certain financial instruments, including cash equivalents, accounts receivable, accounts payable, revolving credit facility and notes payable approximate fair market value based on their short-term nature. See Note 10—Fair Value Measurements, for disclosure regarding the fair value of other financial instruments.

Accounts Receivable Trade accounts receivable are recorded at the invoiced amount and are typically non-interest bearing. The Company maintains allowances for estimated losses resulting from the inability of customers to make required payments and other accounts receivable allowances. Changes in the accounts receivable allowances are as follows as of March 31, 2020 and 2019 (in thousands):

Balance, March 31, 2018	\$ 5,744
Reductions charged to costs and expenses	(345)
Bad debt write-off	(101)
Balance, March 31, 2019	\$ 5,298
Additions charged to costs and expenses.....	431
Bad debt write-off	(5,026)
Balance, March 31, 2020	<u>\$ 703</u>

Inventories The Company values inventories at the lower of cost (determined on a first in first out (“FIFO”) basis) or net realizable value. The composition of inventory is routinely evaluated to identify slow-moving, excess, obsolete or otherwise impaired inventories. Inventories identified as impaired are evaluated to determine if write-downs are required. Included in the assessment is a review for obsolescence as a result of engineering changes in the Company’s products. All inventories expected to be used in more than one year are classified as long-term.

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Depreciation and Amortization Depreciation and amortization are provided for using the straight-line method over the estimated useful lives of the related assets, ranging from two to ten years. Leasehold improvements are amortized over the lease term or the estimated useful lives of the assets, whichever is shorter. Intangible assets that have finite useful lives are amortized over their estimated useful lives using the straight-line method.

Long-Lived Assets The Company reviews the recoverability of long-lived assets, including intangible assets with finite lives, whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. If the expected future cash flows from the use of such assets (undiscounted and without interest charges) are less than the carrying value, the Company may be required to record a write-down, which is determined based on the difference between the carrying value of the assets and their estimated fair value. The Company performed an analysis as of March 31, 2020 and determined that no impairment was necessary. See Note 5—Intangible Assets.

Deferred Revenue Deferred revenue consists of deferred product and service revenue and customer deposits. Deferred revenue will be recognized when earned in accordance with the Company's revenue recognition policy. The Company has the right to retain all or part of customer deposits under certain conditions.

Revenue On April 1, 2018, the Company adopted the new revenue standard ASU 2014-09 and applied it to all contracts using the modified retrospective method. The Company determined there was no change in applying the new revenue standard, therefore no adjustment to the opening balance of accumulated deficit was needed.

The Company derives its revenues primarily from system sales, service contracts and professional services. Revenues are recognized when control of the systems and services is transferred to the Company's customers in an amount that reflects the consideration it expects to be entitled to in exchange for those services.

The Company determines revenue recognition through the following steps:

- Identification of the contract, or contracts, with a customer
- Identification of the performance obligations in the contract
- Determination of the transaction price
- Allocation of the transaction price to the performance obligations in the contract
- Recognition of revenue when, or as, the Company satisfies a performance obligation

The Company recognizes revenue when performance obligations identified under the terms of contracts with its customers are satisfied, which generally occurs, for systems, upon the transfer of control in accordance with the contractual terms and conditions of the sale. The majority of the Company's revenue associated with systems is recognized at a point in time when the system is shipped to the customer. Revenue from service contracts and post-shipment performance obligations is recognized when or as those obligations are satisfied. The Company primarily offers assurance-type standard warranties that do not represent separate performance obligations and will separately offer and price extended warranties that are separate performance obligations for which the associated revenue is recognized over-time based on the extended warranty period. The Company records amounts billed to customers for reimbursement of shipping and handling costs within revenue. Shipping and handling costs associated with outbound freight after control over a system has transferred to a customer are accounted for as fulfillment costs and are included in cost of goods sold. Sales taxes and other usage-based taxes are excluded from revenue.

Comprehensive Factory Protection Plan ("FPP") service contracts require payment at the beginning of the contract period. Advance payments are not considered a significant financing component as they are typically received

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

less than one year before the related performance obligations are satisfied. These payments are treated as a contract liability and are classified in deferred revenue in the Condensed Consolidated Balance Sheets. Once control transfers to the customer and the Company meets the revenue recognition criteria, the deferred revenue is recognized in the Condensed Consolidated Statement of Operations. The deferred revenue relating to the annual maintenance service contracts is recognized in the Condensed Consolidated Statement of Operations on a straight line basis over the expected term of the contract.

Significant Judgments - Contracts with Multiple Performance Obligations

The Company enters into contracts with its customers that often include promises to transfer multiple products, parts, accessories, FPP and services. A performance obligation is a promise in a contract with a customer to transfer products or services that are distinct. Determining whether products and services are distinct performance obligations that should be accounted for separately or combined as one unit of accounting may require significant judgment.

Products, parts and accessories are distinct as such services are often sold separately. In determining whether FPP and service contracts are distinct, the Company considers the following factors for each FPP and services agreement: availability of the services from other vendors, the nature of the services, the timing of when the services contract was signed in comparison to the product delivery date and the contractual dependence of the product on the customer's satisfaction with the professional services work. To date, the Company has concluded that all of the FPP and services contracts included in contracts with multiple performance obligations are distinct.

The Company allocates the transaction price to each performance obligation on a relative standalone selling price ("SSP") basis. The SSP is the price at which the Company would sell a promised product or service separately to a customer. Judgment is required to determine the SSP for each distinct performance obligation.

The Company determines SSP by considering its overall pricing objectives and market conditions. Significant pricing practices taken into consideration include the Company's discounting practices, the size and volume of the Company's transactions, the customer demographic, the geographic area where systems and services are sold, price lists, its go-to-market strategy, historical sales and contract prices. The determination of SSP is made through consultation with and approval by the Company's management, taking into consideration the go-to-market strategy. As the Company's go-to-market strategies evolve, the Company may modify its pricing practices in the future, which could result in changes to SSP.

In certain cases, the Company is able to establish SSP based on observable prices of products or services sold separately in comparable circumstances to similar customers. The Company uses a single amount to estimate SSP when it has observable prices.

If SSP is not directly observable, for example when pricing is highly variable, the Company uses a range of SSP. The Company determines the SSP range using information that may include market conditions or other observable inputs. The Company typically has more than one SSP for individual products and services due to the stratification of those products and services by customer size and geography.

Unsatisfied Performance Obligations

The Company has elected the practical expedient to disclose only the value of unsatisfied performance obligations for contracts with an original expected length greater than one year. The majority of the Company's revenues resulted from sales of inventoried systems with short periods of manufacture and delivery and thus are excluded from this disclosure.

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of March 31, 2020, the FPP backlog was approximately \$82.4 million, which represents the value of the contractual agreement for FPP services that has not been earned and extends through Fiscal 2035.

Practical Expedients

We apply a practical expedient to expense costs as incurred for costs to obtain a contract when the amortization period would have been one year or less. These costs are recorded within sales and marketing expenses.

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

Research and Development ("R&D") The Company accounts for grant distributions and development funding as offsets to R&D expenses and both are recorded as the related costs are incurred. There were no offsets to R&D during the fiscal year ended March 31, 2020 and 2019.

Income Taxes Deferred income tax assets and liabilities are computed for differences between the consolidated financial statement and income tax basis of assets and liabilities. Such deferred income tax asset and liability computations are based on enacted tax laws and rates applicable to periods in which the differences are expected to reverse. Valuation allowances are established, when necessary, to reduce deferred income tax assets to the amounts expected to be realized.

ASC Topic 740-10, *Income Taxes*, clarifies the accounting for uncertainty in income taxes recognized in our financial statements in accordance with accounting principles generally accepted in the United States of America, or GAAP. Income tax positions must meet a more-likely-than-not recognition threshold to be recognized. Income tax positions that previously failed to meet the more-likely-than-not threshold are recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not threshold are derecognized in the first subsequent financial reporting period in which that threshold is no longer met. Our policy is to recognize interest and penalties accrued on any unrecognized tax benefits as interest and other expense, net in the statements of operations.

Contingencies The Company records an estimated loss from a loss contingency when information available prior to issuance of its financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated.

Risk Concentrations Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. At March 31, 2020, the majority of our cash balances were held at financial institutions located in California. The accounts at these institutions are insured by the Federal Deposit Insurance Corporation up to certain limits. Balances that exceed the insurance coverage aggregate to approximately \$14.7 million as of March 31, 2020. The Company places its cash and cash equivalents with high credit quality institutions. The Company performs ongoing credit evaluations of its customers and maintains an allowance for potential credit losses.

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Sales to E-Finity Distributed Generation, LLC (“E-Finity”), one of the Company’s domestic distributors, accounted for 12% and 13% of the Company’s revenue for the fiscal years ended March 31, 2020 and 2019, respectively. Sales to Cal Microturbine (“CAL”), one of the Company’s domestic distributors, accounted for 12% of the Company’s revenue for the year ended March 31, 2019. Additionally, E-Finity accounted for 14% of net accounts receivable as of March 31, 2020. Reliable Secure Power Systems, (“RSP”), one of our domestic distributors and E-Finity, accounted for 14% and 10%, respectively, of net accounts receivable as of March 31, 2019.

On October 13, 2017, the Company 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, the Company agreed to assign to TI the right, title and interest to receivables owed to the Company from BPC Engineering, its former Russian distributor (“BPC”), upon TI’s payment to the Company of \$2.5 million in three payments by February 1, 2018. The Company received payments from TI of approximately \$1.0 million under the Assignment Agreement during Fiscal 2018, which was recorded as bad debt recovery.

On October 13, 2017, the Company 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 the Company’s limited business relationship with TI and the missed payments on the Assignment Agreement, the Company deferred recognition of the Assignment Agreement and Note until collectability is reasonably assured.

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

On June 5, 2018, the Company 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 the Company from BPC was be contingent upon TI’s payment to the Company of the remaining approximately \$1.5 million in five payments by September 20, 2019. Under the terms of the Amended Note, TI agreed to pay the Company \$3.8 million over a three-year period in 13 equal quarterly installments starting on December 20, 2019. The payments of \$0.4 million, \$0.3 million, and \$0.3 million, due March 20, 2019, June 20, 2019, and September 20, 2019, respectively, under the Amended Assignment Agreement, have not been received at the time of this filing. In September 2019, the Company sent TI a notice to cure default with a deadline of October 31, 2019. TI failed to cure the noticed default and the Company has since terminated TI’s distributor agreement. As a result, the BPC accounts receivable and related accounts receivable reserve of \$4.8 million were written off.

The Company recorded net bad debt expense of \$0.4 million and net bad debt recovery of \$0.3 million for the fiscal years ended March 31, 2020 and 2019, respectively. As of September 30, 2019, the Company cumulatively collected approximately \$1.8 million from BPC on their accounts receivable, which has been previously reserved. The Company cumulatively collected approximately \$1.5 million from TI, under the terms of the Assignment Agreement and the Amended Assignment Agreement. The BPC accounts receivable and related accounts receivable reserve of \$4.8 million were written off as of March 31, 2020.

Certain components of the Company’s products are available from a limited number of suppliers. An interruption in supply could cause a delay in manufacturing, which would affect operating results adversely.

Estimates and Assumptions The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions that

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

affect the amounts reported in the financial statements and accompanying notes. Significant estimates include accounting for accounts receivable allowances, stock-based compensation, inventory write-downs, valuation of long-lived assets including intangible assets with finite lives, product warranties, income taxes and other contingencies. Actual results could differ from those estimates.

Net Loss Per Common Share Basic loss per common share is computed using the weighted-average number of common shares outstanding for the period. Diluted loss per share is also computed without consideration to potentially dilutive instruments because the Company incurred losses which would make such instruments antidilutive. Outstanding stock options and restricted stock units at March 31, 2020 and 2019 were 0.3 million and 0.2 million, respectively. As of March 31, 2020 and 2019, the number of warrants excluded from diluted net loss per common share computations was approximately 1.5 million and 0.7 million, respectively.

Stock-Based Compensation Options or stock awards are recorded at their estimated fair value at the measurement date. The Company recognizes compensation cost for options and stock awards that have a graded vesting schedule on a straight-line basis over the requisite service period for the entire award.

Leases Effective April 1, 2019, the Company accounts for its leases under ASC 842, Leases. Under this guidance, arrangements meeting the definition of a lease are classified as operating or financing leases and are recorded on the consolidated balance sheet as both a right of use asset and lease liability, calculated by discounting fixed lease payments over the lease term at the rate implicit in the lease or the Company's incremental borrowing rate. Lease liabilities are increased by interest and reduced by payments each period, and the right of use asset is amortized over the lease term. For operating leases, interest on the lease liability and the amortization of the right of use asset result in straight-line rent expense over the lease term.

In calculating the right of use asset and lease liability, the Company elects to combine lease and non-lease components. The Company excludes short-term leases having initial terms of 12 months or less from the new guidance as an accounting policy election and recognizes rent expense on a straight-line basis over the lease term.

The Company continues to account for leases in the prior period financial statements under ASC Topic 840.

Reverse Stock Split At the annual meeting of stockholders of the Company held on August 29, 2019, the Company's stockholders approved an amendment to our Second Amended and Restated Certificate of Incorporation (the "Amendment") to effect a reverse stock split of our common stock at a ratio in the range of one-for-five (1:5) to one-for-ten (1:10). Pursuant to such authority granted by the stockholders, the Company's board of directors approved a one-for-ten (1:10) reverse stock split (the "Reverse Stock Split") of the common stock and the filing of the Amendment. The certificate was filed with the Secretary of State of Delaware, effective on October 21, 2019 and the Reverse Stock Split became effective as of that date as filed with the SEC under the Securities and Exchange Act. Accordingly, all references to numbers of common shares, including the number of common shares on an as-if-converted basis, per-share data and share prices and exercise prices in the accompanying condensed consolidated financial statements have been adjusted to reflect the reverse stock split on a retroactive basis.

Evaluation of Ability to Maintain Current Level of Operations In connection with preparing the consolidated financial statements for the fiscal year ended March 31, 2020, 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 Fiscal 2020 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, the COVID-19 pandemic, and ongoing global geopolitical tensions. We incurred a net loss of \$21.9 million and used cash in operating activities of \$19.7 million during the fiscal year ended March 31, 2020. Our working capital requirements during the fiscal year ended March 31,

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2020 were higher than management's expectations due to a higher level of finished goods in inventory due to the COVID-19 pandemic, which has affected the timing of customer demand for our products, as well as cash used for accounts payable due to timing of payments. Our net loss expanded during the year ended March 31, 2020 primarily because of a decrease in product volume and higher FPP scheduled and unscheduled maintenance activities primarily as a result of a supplier defect identified during the first quarter of Fiscal 2019. Additionally, operating expenses were higher in Fiscal 2020 compared to Fiscal 2019 primarily due to the recording of a bad debt reserve for certain past due receivables because of uncertain collectability due to the COVID-19 pandemic in Fiscal 2020 whereas we received approximately \$0.4 million under the Assignment Agreement with TI in Fiscal 2019. As of March 31, 2020, we had cash and cash equivalents of \$15.1 million, and outstanding debt of \$30.0 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 lower our operating costs and to develop our geographical and vertical markets. We may seek to raise funds by selling additional securities (through the at-the-market offering or otherwise) to the public or to selected investors or by obtaining additional debt financing. There is no assurance that we will be able to obtain additional funds on commercially favorable terms or at all. If 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 term note payable with Goldman Sachs and the funds raised by selling additional securities through the at-the-market offering as of the date of issuance of our Fiscal 2020 financial statements, we will be able to meet our financial obligations as they become due over at least the next twelve months from the date of issuance of our Fiscal 2020 financial statements.

Segment Reporting The Company is considered to be a single reporting segment. The business activities of this reporting segment are the development, manufacture and sale of turbine generator sets and their related parts and service. Following is the geographic revenue information based on the primary operating location of the Company's customers (in thousands):

	Year Ended March 31,	
	2020	2019
United States	\$ 31,082	\$ 45,480
Mexico	2,361	5,005
All other North America	1,145	791
Total North America	<u>34,588</u>	<u>51,276</u>
Russia	3,653	3,176
All other Europe	12,858	12,886
Total Europe	<u>16,511</u>	<u>16,062</u>
Asia	4,074	5,229
Australia	4,559	3,874
All other	9,194	6,971
Total Revenue	<u>\$ 68,926</u>	<u>\$ 83,412</u>

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes the Company’s revenue by product (in thousands):

	Year Ended March 31,	
	2020	2019
C30	\$ 1,518	\$ 1,810
C65	9,366	11,719
C200	3,880	5,218
C600	7,204	6,286
C800	3,253	5,846
C1000	8,340	20,538
Unit upgrades	229	—
Microturbine Products	\$ 33,790	\$ 51,417
Accessories and Parts	14,353	14,886
Total Product, Accessories and Parts	48,143	66,303
Service	20,783	17,109
Total Revenue	<u>\$ 68,926</u>	<u>\$ 83,412</u>

Substantially all of the Company’s operating assets are in the United States.

Recent Accounting Pronouncements 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. On April 1, 2019, the Company adopted this standard. See Note 12—Leases for additional discussion of the impact of the adoption of ASU 2016-02.

In June 2018, the FASB issued ASU 2018-07, “Share-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 years. Early adoption is permitted if financial statements have not yet been issued. The Company adopted ASU 2018-07 on April 1, 2019 and it did not have a material impact on the Company’s condensed consolidated financial statements.

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

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

quarter that begins after the effective date of the amendments. The Company adopted Release No. 33-10532 on April 1, 2019 and it did not have a material impact on the Company's financial disclosures.

3. Inventories

Inventories are valued at the lower of cost (determined on a first in first out ("FIFO") basis) or net realizable value and consisted of the following as of March 31, 2020 and 2019 (in thousands):

	March 31, 2020	March 31, 2019
Raw materials	\$ 20,672	\$ 24,426
Work in process.....	3	—
Finished goods.....	4,820	1,207
Total	25,495	25,633
Less inventory reserve	(2,814)	(3,887)
Less non-current portion.....	(1,221)	(1,403)
Current portion	<u>\$ 21,460</u>	<u>\$ 20,343</u>

The non-current portion of inventories represents that portion of the inventories in excess of amounts expected to be used in the next twelve months. The non-current inventories are primarily comprised of repair parts for older generation products that are still in operation, but are not technologically compatible with current configurations. The weighted average age of the non-current portion of inventories on hand as of March 31, 2020 is 1.2 years. The Company expects to use the non-current portion of the inventories on hand as of March 31, 2020 over the periods presented in the following table (in thousands):

<u>Expected Period of Use</u>	<u>Non-current Inventory Balance Expected to be Used</u>
13 to 24 months.....	\$ 687
25 to 36 months.....	534
Total.....	<u>\$ 1,221</u>

4. Property, Plant and Equipment

Property, plant and equipment as of March 31, 2020 and 2019 consisted of the following (in thousands):

	March 31, 2020	March 31, 2019
Machinery, equipment, automobiles and furniture.....	\$ 15,115	\$ 15,344
Leasehold improvements	7,857	11,074
Molds and tooling	3,101	2,893
Rental assets	5,986	2,818
	32,059	32,129
Less, accumulated depreciation	(24,310)	(26,838)
Total property, plant, equipment and rental assets, net	<u>\$ 7,749</u>	<u>\$ 5,291</u>

The Company regularly reassesses the useful lives of property and equipment and retires assets no longer in service. Depreciation expense for property, plant and equipment was \$1.3 million and \$1.0 million for the fiscal years ended March 31, 2020 and 2019, respectively.

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Intangible Assets

Intangible assets consisted of the following (in thousands):

	March 31, 2020			
	Weighted Average Amortization Period	Intangible Assets, Gross	Accumulated Amortization	Intangible Assets, Net
Manufacturing license.....	17 years	\$ 3,700	\$ 3,700	\$ —
Technology	10 years	2,240	2,240	—
Trade name & parts, service and TA100 customer relationships. . .	1.2 to 5 years	1,766	1,766	—
Total		<u>\$ 7,706</u>	<u>\$ 7,706</u>	<u>\$ —</u>

	March 31, 2019			
	Weighted Average Amortization Period	Intangible Assets, Gross	Accumulated Amortization	Intangible Assets, Net
Manufacturing license.....	17 years	\$ 3,700	\$ 3,700	\$ —
Technology	10 years	2,240	2,053	187
Trade name & parts, service and TA100 customer relationships. . .	1.2 to 5 years	1,766	1,766	—
Total		<u>\$ 7,706</u>	<u>\$ 7,519</u>	<u>\$ 187</u>

Amortization expense for the intangible assets was \$0.2 million for the fiscal years ended March 31, 2020 and 2019.

The manufacturing license provides the Company with the ability to manufacture recuperator cores previously purchased from Solar Turbines Incorporated (“Solar”). The Company is required to pay a per-unit royalty fee for the life of Capstone’s patents for cores manufactured and sold by the Company using the technology. Royalties of approximately \$26,400 and \$33,200 were earned by Solar for the fiscal years ended March 31, 2020 and 2019, respectively. Earned royalties of approximately \$52,500 and \$26,100 were unpaid as of March 31, 2020 and 2019, respectively, and are included in accrued expenses in the accompanying balance sheets.

6. Accrued Warranty Reserve

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

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

such changes is then taken into account in estimating future warranty liabilities. Changes in the accrued warranty reserve are as follows as of March 31, 2020 and 2019 (in thousands):

	2020	2019
Balance, beginning of the period	\$ 2,614	\$ 1,682
Standard warranty provision	594	2,200
Deductions for warranty claims	(1,274)	(1,268)
Balance, end of the period	\$ 1,934	\$ 2,614

7. Revenue Recognition

The following table presents disaggregated revenue by business group for the fiscal year ended March 31, 2020 (in thousands):

	Fiscal Year Ended March 31, 2020
Microturbine Products	\$ 33,790
Accessories and Parts	14,353
Total Product, Accessories and Parts	48,143
Service	20,783
Total Revenue	\$ 68,926

Following is the geographic revenue information based on the primary operating location of the Company's customers for the fiscal year ended March 31, 2020 (in thousands):

	Fiscal Year Ended March 31, 2020
United States	\$ 31,082
Mexico	2,361
All other North America	1,145
Total North America	34,588
Russia	3,653
All other Europe	12,858
Total Europe	16,511
Asia	4,074
Australia	4,559
All other	9,194
Total Revenue	\$ 68,926

Contract Balances

Our contract liabilities consist of advance payments for systems as well as deferred revenue on service obligations and extended warranties. The current portion of deferred revenue is included in current liabilities under deferred revenue and the non-current portion of deferred revenue is included in other non-current liabilities in the consolidated balance sheets.

As of March 31, 2020, the balance of deferred revenue was approximately \$8.8 million compared to \$8.2 million as of March 31, 2019. This overall increase in the balance of deferred revenue of \$0.6 million during the fiscal year ended March 31, 2020 was comprised of increases in deferred revenue attributable to FPP contracts of \$0.5 million

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

and DSS program of \$0.1 million. Changes in deferred revenue during the fiscal year ended March 31, 2020 and 2019 are as follows (in thousands):

	2020	2019
FPP Balance, beginning of the period	\$ 4,882	\$ 3,549
FPP Billings	17,004	15,650
FPP Revenue recognized	(16,544)	(14,318)
Balance attributed to FPP contracts	5,342	4,881
DSS Program	1,831	1,689
Deposits	1,669	1,666
Deferred revenue balance, end of the period	\$ 8,842	\$ 8,236

Deferred revenue attributed to FPP contracts represents the unearned portion of our agreements. FPP agreements are generally paid quarterly in advance with revenue recognized on a straight line basis over the contract period. Deposits are primarily non-refundable cash payments from distributors for future orders.

As of March 31, 2020, approximately \$5.3 million of revenue is expected to be recognized from remaining performance obligations for FPP service contracts. The Company expects to recognize revenue on approximately \$4.4 million of these remaining performance obligations over the next 12 months and the balance of \$0.9 million will be recognized thereafter. Revenue from remaining performance obligations for professional services contracts as of March 31, 2020 was not material.

8. Income Taxes

Loss before provision for income taxes consisted of the following for the years ended March 31, 2020 and 2019 (in thousands):

	Year Ended March 31,	
	2020	2019
United States	\$ (21,920)	\$ (16,678)
Foreign	34	27
Loss before provision for income taxes	\$ (21,886)	\$ (16,651)

Current income tax provision is the amount of income taxes reported or expected to be reported on our income tax return. The provision for current income taxes was \$12,000 and \$8,000 for the years ended March 31, 2020 and March 31, 2019, respectively. The current income taxes were related to state income and foreign taxes. The Company did not have current federal income taxes for the fiscal year ended March 31, 2020.

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Actual income tax expense differed from the amount computed by applying statutory corporate income tax rates to loss from operations before income taxes. A reconciliation of income tax (benefit) expense to the federal statutory rate follows (in thousands):

	<u>Year Ended March 31,</u>	
	<u>2020</u>	<u>2019</u>
Federal income tax benefit at the statutory rate	\$ (4,596)	\$ (3,497)
State taxes, net of federal effect	(248)	(583)
Foreign taxes	2	3
Expiring NOLs and tax credits	6,273	6,137
Impact of state rate change	24	(67)
Valuation allowance	(1,792)	(2,135)
Shortfall in tax benefit—stock compensation	321	111
True-up	(2)	2
Other	30	37
Income tax expense	<u>\$ 12</u>	<u>\$ 8</u>

The Company's deferred tax assets and liabilities consisted of the following at March 31, 2020 and 2019 (in thousands):

	<u>Year Ended March 31,</u>	
	<u>2020</u>	<u>2019</u>
Deferred tax assets:		
Inventories	\$ 1,536	\$ 1,842
Warranty reserve	454	630
Bad debt reserve	139	1,245
Deferred revenue	1,684	1,584
Net operating loss ("NOL") carryforwards	146,503	145,835
Tax credit carryforwards	15,227	16,021
Depreciation, amortization and impairment loss	1,652	2,734
Lease liability	1,263	—
Interest limitation	1,570	—
Other	998	1,726
Deferred tax assets	<u>171,026</u>	<u>171,617</u>
Valuation allowance for deferred tax assets	<u>(169,825)</u>	<u>(171,617)</u>
Deferred tax assets, net of valuation allowance	1,201	—
Deferred tax liabilities:		
Right of use assets	(1,201)	—
Net deferred tax assets	<u>\$ —</u>	<u>\$ —</u>

Because of the uncertainty surrounding the timing of realizing the benefits of favorable tax attributes in future income tax returns, the Company has placed a valuation allowance against its net deferred income tax assets. The change in valuation allowance for fiscal years ended March 31, 2020 and 2019 was \$1.8 million and \$2.1 million, respectively.

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company's NOL and tax credit carryforwards for federal and state income tax purposes at March 31, 2020 were as follows (in thousands):

	<u>Amount</u>	<u>Expiration Period</u>
Federal NOL generated before April 1, 2018	\$ 604,959	2021 - 2038
Federal NOL generated after March 31, 2018	\$ 38,730	Indefinite
State NOL	\$ 162,008	2021 - 2039
Federal tax credit carryforwards	\$ 7,570	2021 - 2038
State tax credit carryforwards.	\$ 9,692	Indefinite

The NOLs and federal and state tax credits can be carried forward to offset future taxable income, if any. Utilization of the NOLs and tax credits are subject to an annual limitation of approximately \$57.3 million due to the ownership change limitations provided by the Internal Revenue Code of 1986 and similar state provisions. The federal tax credit carryforward is a research and development credit, which may be carried forward. The state tax credits consist of a research and development credit can be carried forward indefinitely.

Accounting Standards Codification ("ASC") 740, Income Taxes clarifies the accounting for income taxes by prescribing a minimum recognition threshold that a tax position is required to meet before being recognized in the financial statements. ASC 740 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. Based on management's evaluation, the total amount of unrecognized tax benefits related to research and development credits as of March 31, 2020 and 2019 was \$2.3 million and \$2.4 million, respectively. There were no interest or penalties related to unrecognized tax benefits as of March 31, 2020 or March 31, 2019. The amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate as of March 31, 2020 and March 31, 2019 was \$2.3 million and \$2.4 million, respectively. However, this impact would be offset by an equal increase in the deferred tax valuation allowance as the Company has recorded a full valuation allowance against its deferred tax assets because of uncertainty as to future realization. The fully reserved recognized federal and state deferred tax assets related to research and development credits balance as of March 31, 2020 and 2019 was \$7.6 million and \$8.4 million, and \$9.7 million and \$9.0 million, respectively.

A reconciliation of the beginning and ending amount of total gross unrecognized tax benefits is as follows (in thousands):

Balance at March 31, 2018	\$ 2,467
Gross increase related to prior year tax positions	—
Gross increase related to current year tax positions	—
Lapse of statute of limitations	<u>(77)</u>
Balance at March 31, 2019	\$ 2,390
Gross increase related to prior year tax positions	—
Gross increase related to current year tax positions	—
Lapse of statute of limitations	<u>(118)</u>
Balance at March 31, 2020	<u>\$ 2,272</u>

The Company does not expect a material change to its unrecognized tax benefits over the next twelve months.

The Company files income tax returns in the U.S. federal jurisdiction and various state, local and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state, local or non-U.S. income tax examinations by tax authorities for the years before 2014. However, net operating loss carryforwards remain subject to examination to the extent they are carried forward and impact a year that is open to examination by tax authorities. The Company's evaluation was performed for the tax years which remain subject to examination by major tax jurisdictions as

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

of March 31, 2020. When applicable, the Company accounts for interest and penalties generated by tax contingencies as interest and other expense, net in the statements of operations.

In response to the coronavirus (COVID-19) pandemic, the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) was enacted on March 27, 2020 in the U.S. The CARES Act includes many measures to assist companies, including temporary changes to income and non-income-based tax laws. The Company currently does not expect the CARES Act to have a material impact on the Company’s financial results, including on the Company’s annual estimated effective tax rate. The Company will continue to monitor and assess the impact the CARES Act, and similar legislation in other countries, with respect to what impact they may have on the Company’s business and financial results.

9. Stockholders’ Equity

The following table summarizes, by statement of operations line item, stock-based compensation expense for the fiscal years ended March 31, 2020 and 2019 (in thousands):

	Year Ended	
	March 31,	
	2020	2019
Cost of goods sold	\$ 69	\$ 51
Research and development	44	32
Selling, general and administrative	800	824
Stock-based compensation expense	<u>\$ 913</u>	<u>\$ 907</u>

2000 and 2017 Equity Incentive Plans

In June 2000, the Company adopted the 2000 Equity Incentive Plan (“2000 Plan”). The 2000 Plan provides for a total maximum aggregate number of shares which may be issued of 184,900 shares. In June 2017, the Company’s Board of Directors (the “Board”) adopted the Capstone Turbine Corporation 2017 Equity Incentive Plan (the “2017 Plan”) which was approved by the stockholders at the Company’s 2017 annual meeting of stockholders on August 31, 2017 (the “2017 Annual Meeting”). The 2017 Plan provides for awards of up to 300,000 shares of common stock. The 2017 Plan is administered by the Compensation Committee designated by the Board (the “Compensation Committee”). The Compensation Committee’s authority includes determining the number of incentive awards and vesting provisions. On June 5, 2018, the Company’s Board of Directors adopted an amendment of the 2017 Plan to increase the aggregate number of shares of common stock authorized for issuance under the 2017 Plan by 300,000 shares of common stock. The amendment of the 2017 Plan was approved by the Company’s stockholders at the 2018 annual meeting of stockholders on August 30, 2018.

On August 29, 2019, at the Company’s 2019 annual meeting, the Registrant’s stockholders approved another amendment to the 2017 Plan to increase the aggregate number of shares authorized for issuance under the 2017 Plan by 300,000 shares to 900,000 shares of common stock. As of March 31, 2020, there were 398,993 shares available for future grants under the 2017 Plan.

Stock Options

The Company issued stock options under the 2000 Plan and issues stock options under the 2017 Plan to employees, non-employee directors and consultants that vest and become exercisable over a four-year period and expire 10 years after the grant date. The Company uses a Black-Scholes valuation model to estimate the fair value of the options at the grant date, and compensation cost is recorded on a straight-line basis over the vesting period. All options are subject to the following vesting provisions: one-fourth vest one year after the issuance date and 1/48th vest on the

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

first day of each full month thereafter, so that all options will be vested on the first day of the 48th month after the grant date. Information relating to stock options for fiscal year ended March 31, 2020, is as follows:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Options outstanding at March 31, 2019	17,499	\$ 209.36		
Granted	—	\$ —		
Exercised	—	\$ —		
Forfeited, cancelled or expired	<u>(6,250)</u>	<u>\$ 198.21</u>		
Options outstanding at March 31, 2020	<u>11,249</u>	<u>\$ 215.56</u>	<u>2.1</u>	<u>—</u>
Options fully vested at March 31, 2020 and those expected to vest beyond March 31, 2020	<u>11,249</u>	<u>\$ 215.56</u>	<u>2.1</u>	<u>—</u>
Options exercisable at March 31, 2020	<u>11,249</u>	<u>\$ 215.56</u>	<u>2.1</u>	<u>—</u>

Black-Scholes Model Valuation Assumptions

There were no stock options granted during the fiscal year ended March 31, 2020 or 2019. There was no expense associated with stock options during the fiscal year ended March 31, 2020 or 2019. There were no unvested stock option awards as of March 31, 2020.

Restricted Stock Units and Performance Restricted Stock Units

The Company issued restricted stock units under the 2000 Plan and issues restricted stock units under the 2017 Plan to employees, non-employee directors and consultants. The restricted stock units are valued based on the closing price of the Company's common stock on the date of issuance, and compensation cost is recorded on a straight-line basis over the vesting period. During the fiscal year ended March 31, 2017, the Company established an accounting policy election to assume zero forfeiture for restricted stock units and account for forfeitures when they occur through the adoption of ASU 2016-09. The restricted stock units vest in equal installments over a period of four years. For restricted stock units with four year vesting, one-fourth vest annually beginning one year after the issuance date. The restricted stock units issued to non-employee directors vest one year after the issuance date. The following table outlines the restricted stock unit and performance restricted stock unit ("PRSU") activity:

<u>Restricted Stock Units and Performance Restricted Stock Units</u>	<u>Shares</u>	<u>Weighted Average Grant Date Fair Value</u>
Nonvested restricted stock units outstanding at March 31, 2019	221,778	\$ 10.20
Granted	262,370	4.74
Vested and issued	(100,296)	9.84
Forfeited	<u>(53,022)</u>	<u>8.34</u>
Nonvested restricted stock units outstanding at March 31, 2020	<u>330,830</u>	<u>6.28</u>
Restricted stock units expected to vest beyond March 31, 2020	<u>330,830</u>	<u>\$ 6.28</u>

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table provides additional information on restricted stock units and performance restricted stock units for the Company’s fiscal years ended March 31, 2020 and 2019:

	Year Ended March 31,	
	2020	2019
Restricted stock compensation expense (in thousands)	\$ 913	\$ 907
Aggregate fair value of restricted stock units vested and issued (in thousands).	\$ 384	\$ 748
Weighted average grant date fair value of restricted stock units granted during the period.	\$ 4.74	\$ 0.98

As of March 31, 2020, there was approximately \$1.2 million of total compensation cost related to unvested restricted stock units that is expected to be recognized as expense over a weighted average period of 2.4 years.

The Company’s PRSU activity is included in the above restricted stock units tables. The PRSU program has a two-year or three-year performance measurement period. The performance measurement occurs in the second year (for a two-year grant) or third year (for a three-year grant) following the grant date. The program is intended to have overlapping performance measurement periods (e.g., a new three-year cycle begins each year on April 1), subject to Compensation Committee approval. At the end of each performance measurement period, the Compensation Committee will determine the achievement against the performance objectives.

During the fiscal year ended March 31, 2020, the Company granted 30,139 PRSUs with a third-year performance measurement and the criteria measured by the Company’s cash flow from operations and aftermarket sales absorption. The target PRSU awards for each participant, will be paid upon achievement of the target level of performance for cash flow from operations and aftermarket sale absorption, taking into account the applicable weighting for the individual metric. Achievement of a performance goal at the threshold level will result in a payment that is 50% of the target PRSU award. Achievement of a performance goal at the maximum level will result in a payment that is 150% of the target PRSU award. The Compensation Committee will use an interpolation table that weights performance between levels for determining the portion of the Target PRSU that is earned.

The weighted average per share grant date fair value of PRSUs granted during Fiscal 2020 was \$8.90. Based on the Company’s assessment as of March 31, 2020, the threshold for one of the performance measurements on the 2-year vesting PRSU was met and as a result we recorded compensation expense of approximately \$0.1 million during the fiscal year ended March 31, 2020. Such compensation expense is recognized over the corresponding requisite service period and will be adjusted in subsequent reporting periods if the Company’s assessment of the probable level of achievement of the performance goals changes. The Company will continue to periodically assess the likelihood of the PRSU threshold being met until the end of the applicable performance period.

Restricted Stock Awards

The Company issued restricted stock awards under the 2000 Plan to employees and non-employee directors. There were no restricted stock awards granted during the fiscal year ended March 31, 2020 or 2019. No expense was recorded associated with its restricted stock awards during the fiscal year ended March 31, 2020 or 2019.

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

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Employee Stock Purchase Plan

In June 2000, the Company adopted the Employee Stock Purchase Plan (the “ESPP”). The ESPP provides for the granting of rights to purchase common stock to regular full and part-time employees or officers of the Company and its subsidiaries. In June 2017, the Board unanimously approved an amendment and restatement to the ESPP which was approved by the stockholders at the Company’s annual meeting of stockholders on August 31, 2017. Prior to the current amendment, 7,000 shares of the Company’s common stock had been reserved for issuance. As amended, the ESPP continued by its terms and the number of shares of the Company’s common stock available increased by 50,000 shares which reserved for issuance a total of 57,000 shares of common stock. Under the ESPP, shares of the Company’s common stock are issued upon exercise of the purchase rights. The ESPP will continue by its terms through June 30, 2020, unless terminated sooner. The maximum amount that an employee can contribute during a purchase right period is \$25,000 or 15% of the employee’s regular compensation. Under the ESPP, the exercise price of a purchase right is 95% of the fair market value of such shares on the last day of the purchase right period. The fair market value of the stock is its closing price as reported on the Nasdaq Capital Market on the day in question. During the fiscal years ended March 31, 2020 and 2019, the Company issued a total of 522 shares and 101 shares of stock, respectively, to regular full and part-time employees or officers of the Company who elected to participate in the ESPP. As of March 31, 2020, there were 48,838 shares available for future grant under the ESPP.

Stockholder Rights Plan

On May 6, 2019, the Company’s Board of Directors (the “Board”), declared a dividend of one right (a “New Right”) for each of the Company’s issued and outstanding shares of common stock, \$0.001 par value per share (“Common Stock”). The dividend will be paid to the stockholders of record at the close of business on May 16, 2019 (the “Record Date”). Each New Right entitles the registered holder, subject to the terms of the NOL Rights Agreement (as defined below), to purchase from the Company one one-thousandth of a share of the Company’s Series B Junior Participating Preferred Stock (the “Preferred Stock”) at a price of \$5.22 (the “Exercise Price”), subject to certain adjustments. The description and terms of the New Rights are set forth in the Rights Agreement dated as of May 6, 2019 (the “NOL Rights Agreement”) between the Company and Broadridge Financial Solutions, Inc., as Rights Agent (the “Rights Agent”).

The NOL Rights Agreement replaces the Company’s Rights Agreement, dated May 6, 2016, by and between the Company and Broadridge Financial Solutions, Inc., as successor-in-interest to Computershare Inc., as rights agent (the “Original Rights Agreement”). The Original Rights Agreement, and the rights thereunder to purchase fractional shares of Preferred Stock, expired at 5:00 p.m., New York City time, on May 6, 2019 and the NOL Rights Agreement was entered into immediately thereafter.

The purpose of the NOL Rights Agreement is to diminish the risk that the Company’s ability to use its net operating losses and certain other tax assets (collectively, “Tax Benefits”) to reduce potential future federal income tax obligations would become subject to limitations by reason of the Company’s experiencing an “ownership change,” as defined in Section 382 of the Internal Revenue Code of 1986, as amended (the “Tax Code”). A company generally experiences such an ownership change if the percentage of its stock owned by its “5-percent shareholders,” as defined in Section 382 of the Tax Code, increases by more than 50 percentage points over a rolling three-year period. The NOL Rights Agreement is designed to reduce the likelihood that the Company will experience an ownership change under Section 382 of the Tax Code by (i) discouraging any person or group from becoming a 4.9% shareholder and (ii) discouraging any existing 4.9% shareholder from acquiring additional shares of the Company’s stock.

The New Rights will not be exercisable until the earlier to occur of (i) the close of business on the tenth business day after a public announcement or filing that a person has, or group of affiliated or associated persons have, become an “Acquiring Person,” which is defined as a person or group of affiliated or associated persons who, at any time after the date of the NOL Rights Agreement, have acquired, or obtained the right to acquire, beneficial ownership of 4.9% or more of the Company’s outstanding shares of Common Stock, subject to certain exceptions or (ii) the close of

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

business on the tenth business day after the commencement of, or announcement of an intention to commence, a tender offer or exchange offer the consummation of which would result in any person becoming an Acquiring Person (the earlier of such dates being called the “Distribution Date”). Certain synthetic interests in securities created by derivative positions, whether or not such interests are considered to be ownership of the underlying Common Stock or are reportable for purposes of Regulation 13D of the Securities Exchange Act, are treated as beneficial ownership of the number of shares of Common Stock equivalent to the economic exposure created by the derivative position, to the extent actual shares of the Common Stock are directly or indirectly held by counterparties to the derivatives contracts.

With respect to certificates representing shares of Common Stock outstanding as of the Record Date, until the Distribution Date, the New Rights will be evidenced by such certificates for shares of Common Stock registered in the names of the holders thereof, and not by separate Rights Certificates, as described further below. With respect to book entry shares of Common Stock outstanding as of the Record Date, until the Distribution Date, the New Rights will be evidenced by the balances indicated in the book entry account system of the transfer agent for the Common Stock. Until the earlier of the Distribution Date and the Expiration Date, as described below, the transfer of any shares of Common Stock outstanding on the Record Date will also constitute the transfer of the New Rights associated with such shares of Common Stock. As soon as practicable after the Distribution Date, separate certificates evidencing the New Rights (“Right Certificates”) will be mailed to holders of record of the Common Stock as of the close of business on the Distribution Date, and such Right Certificates alone will evidence the New Rights.

The New Rights, which are not exercisable until the Distribution Date, will expire prior to the earliest of (i) May 6, 2022 or such later day as may be established by the Board prior to the expiration of the New Rights, provided that the extension is submitted to the Company’s stockholders for ratification at the next annual meeting of stockholders of the Company succeeding such extension; (ii) the time at which the New Rights are redeemed pursuant to the NOL Rights Agreement; (iii) the time at which the New Rights are exchanged pursuant to the NOL Rights Agreement; (iv) the time at which the New Rights are terminated upon the occurrence of certain transactions; (v) the close of business on the first day after the Company’s 2019 annual meeting of stockholders, if approval by the stockholders of the Company of the NOL Rights Agreement has not been obtained on or prior to the close of business on the first day after the Company’s 2019 annual meeting of stockholders; (vi) the close of business on the effective date of the repeal of Section 382 of the Tax Code, if the Board determines that the NOL Rights Agreement is no longer necessary or desirable for the preservation of Tax Benefits; and (vii) the close of business on the first day of a taxable year of the Company to which the Board determines that no Tax Benefits are available to be carried forward, (the earliest of (i), (ii), (iii), (iv), (v), (vi) and (vii) is referred to as the “Expiration Date”).

Each share of Preferred Stock will be entitled, when, as and if declared, to a preferential per share quarterly dividend payment equal to the greater of (i) \$1.00 per share or (ii) an amount equal to 1,000 times the aggregate quarterly dividend declared per share of Common Stock since the immediately preceding quarterly dividend payment date for the Common Stock (or, with respect to the first quarterly dividend payment on the Common Stock, since the first issuance of the Preferred Stock). Each share of Preferred Stock will entitle the holder thereof to 1,000 votes on all matters submitted to a vote of the stockholders of the Company. In the event of any merger, consolidation or other transaction in which shares of Common Stock are converted or exchanged, each share of Preferred Stock will be entitled to receive 1,000 times the amount received per one share of Common Stock.

Offerings of Common Stock and Warrants and At-the-Market Offering Program

At-the-Market Offering

Effective August 28, 2015, the Company entered into a sales agreement with Cowen and Company, LLC with respect to an at-the-market offering program pursuant to which the Company offered and sold, from time to time at its sole discretion, shares of its common stock, having an aggregate offering price of up to \$30.0 million. During the fiscal year ended March 31, 2019, the Company issued 0.3 million shares of the Company’s common stock under this at-the-market offering program and the net proceeds to the Company from the sale of the Company’s common stock were

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

approximately \$4.0 million after deducting commissions paid of approximately \$0.1 million. As of March 31, 2019, 2.6 million shares of the Company's common stock were cumulatively sold pursuant to the at-the-market offering program and the net proceeds to the Company 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.

On June 7, 2018, the Company entered into a sales agreement with H.C. Wainwright & Co., LLC with respect to an at-the-market offering program pursuant to which the Company may offer and sell, from time to time at its sole discretion, shares of its common stock, having an aggregate offering price of up to \$25.0 million. The Company will set the parameters for sales of the shares, including the number to be sold, the time period during which sales are requested to be made, any limitation on the number that may be sold in one trading day and any minimum price below which sales may not be made. During the fiscal year ended March 31, 2020, the Company issued 1.7 million shares of the Company's common stock under the at-the-market offering program and the net proceeds to the Company from the sale of the Company's common stock were approximately \$5.3 million after deducting commissions paid of approximately \$0.2 million. As of March 31, 2020, approximately \$12.2 million remained available for issuance with respect to this at-the-market offering program.

Warrants

On April 13, 2018, a warrant holder exercised its rights to the warrant agreement to exercise on a cashless basis 576,000 Series A warrants at an exercise price of \$6.00 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 380,621 shares of common stock.

As of March 31, 2020, there were 271,875 Series A warrants outstanding and there are no Series B warrants outstanding. Of the total Series A warrants outstanding, 217,875 Series A warrants were issued with an exercise price of \$25.50 per share of common stock, and have an expiration date of October 25, 2021, and 54,000 Series A warrants with anti-dilution provisions were issued with an initial exercise price of \$13.40 per share of common stock, and have an expiration date of April 22, 2021. As of March 31, 2020, because of the anti-dilution provisions, these warrants had an adjusted exercise price of \$1.15 per share of common stock.

On February 4, 2019, the Company sold to Goldman Sachs & Co. LLC (the "Holder"), a Purchase Warrant for Common Shares (the "Warrant") pursuant to which the Holder may purchase shares of the Company's common stock, par value \$0.001 per share (the "Common Shares") in an aggregate amount of up to 404,634 shares (the "Warrant Shares"). The Warrant was sold to the Holder at a purchase price of \$150,000, in a private placement exempt from registration under the Securities Act.

The Warrant may be exercised by the Holder at any time after August 4, 2019 at an exercise price equal to \$8.86 and will expire on February 4, 2024. The Warrant contains standard adjustment provisions in the event of additional stock issuances below the exercise price of the warrant, stock splits, combinations, rights offerings and similar transactions. The value of the Warrant was \$2.3 million, and has been classified as an equity instrument in additional paid in capital in our consolidated balance sheets. The value of the Warrant was determined using the Black-Scholes Option Pricing model using the following assumptions:

	Fiscal Year Ended March 31, 2019
Risk-free interest rate	2.5%
Contractual term	5 years
Expected volatility	76%

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company's common stock and warrant transactions during Fiscal 2020 triggered certain anti-dilution provisions in the warrants outstanding. As a result, the Company issued an additional 49,891 warrants and recorded a deemed dividend amounting to \$87,362.

On December 9, 2019, the Company entered into an Amendment No. 1 to the Purchase Warrant for Common shares (the "Amendment No. 1") with Special Situations Investing Group II, LLC (as successor in interest to Goldman Sachs & Co. LLC) (the "Warrant Holder") that amends the Warrant. The Amendment No. 1 amends the first paragraph of the Warrant to increase the number of Warrant Shares issuable under the Warrant (on a post-reverse split basis) and to decrease the exercise price from \$8.86 per share (on a post-reverse split basis) to \$3.80 per share (the "Per Share Warrant Exercise Price"). The Amendment No. 1 also amends Section 2.1 of the Warrant such that the Per Share Anti-Dilution Price is equal to the Per Share Warrant Exercise Price. As a result of the decrease in exercise price, we recorded the change in valuation of \$0.3 million as additional debt discount with a corresponding entry to additional paid in capital in the consolidated balance sheets.

On September 4, 2019, the Company entered into a Securities Purchase Agreement (the "Securities Purchase Agreement") with certain institutional and accredited investors pursuant to which the Company agreed to issue and sell in a registered direct offering (the "Registered Direct Offering") an aggregate of 580,000 shares of our common stock, par value \$0.001 per share at a negotiated purchase price of \$5.00 per share, and pre-funded warrants to purchase up to an aggregate of 440,000 shares of our common stock at a negotiated purchase price of \$5.00 per Pre-Funded Warrant, for aggregate gross proceeds of approximately \$5.1 million (580,000 shares of our common stock plus 440,000 pre-funded warrants at a \$5.00 per share purchase price), before deducting placement agent fees and other offering expenses. Net proceeds from the offering were \$4.6 million. The offering closed on September 9, 2019. On October 24, 2019, a warrant holder exercised its rights to the warrant agreement to exercise on a cash basis 440,000 pre-funded warrants at an exercise price of \$0.001 per share under the warrant agreement.

In a concurrent private placement, we agreed to issue to the purchasers warrants to purchase 765,000 shares of Common Stock, which represent 75% of the number of shares of Common Stock and shares underlying the Pre-Funded Warrants purchased in the Registered Direct Offering, pursuant to the Securities Purchase Agreement. The Common Warrants will be exercisable for shares of Common Stock at an initial exercise price of \$6.12 per share for a period of five years, starting on April 2, 2020 and expiring on April 2, 2025. None of these warrants have been exercised as of the date of this report.

Stock to Vendors

On February 10, 2020, the Company and Andretti Autosport 6, Inc. ("AA"), a race team participating in the IndyCar Series sanctioned by INDYCAR, LLC (the "Series"), entered into a Sponsorship Agreement (the "Sponsorship Agreement") effective January 1, 2020 through December 31, 2020, whereby the Company agreed to sponsor AA's Car #88 participation in the Series on a full-time basis. In exchange for AA's participation in the Series, the Company agreed to a sponsorship fee in the total amount of approximately, \$1.3 million of which \$0.7 million will be paid in cash due and payable in four installments and \$0.6 million in unregistered shares of common stock of the Company.

During the term of the Sponsorship Agreement and any renewal or extension of the agreement, the Company has agreed that it shall exclusively sponsor the AA Group (as defined therein). The Sponsorship Agreement contains, among other provisions, certain representations and warranties by the parties, intellectual property protection covenants, certain indemnification rights in favor of each party and customary confidentiality provisions.

Due to the COVID-19 pandemic, the IndyCar Series was delayed and did not begin until June 2020. Cash paid under the Sponsorship Agreement was \$0.3 million as of March 31, 2020 and stock in the amount of 229,886 was issued as of February 10, 2020. Both the cash and the value of the unregistered shares of common stock have been recorded as

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

a prepaid marketing cost and are included in Prepaid expenses and other current assets and Stockholder's Equity in the Consolidated Balance Sheets as of March 31, 2020.

10. Fair Value Measurements

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

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

Level 2. Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets
- Quoted prices for identical or similar assets or liabilities in inactive markets
- Inputs other than quoted prices that are observable for the asset or liability
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means

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

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

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

Basis for Valuation

The carrying values reported in the condensed consolidated balance sheets for cash and cash equivalents, accounts receivable and accounts payable approximate fair values because of the immediate or short-term maturities of these financial instruments. The term note payable has been recorded net of a discount based on the fair value of the associated warrant and capitalized debt issuance costs. The carrying values and estimated fair values of these obligations are as follows (in thousands):

	As of March 31, 2020		As of March 31, 2019	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Term note payable.	\$ 27,963	\$ 30,000	\$ 27,099	\$ 30,000

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. Term Note Payable

On February 4, 2019 (the “Closing Date”), we entered into a Note Purchase Agreement (the “Note Purchase Agreement”), by and among us, certain subsidiaries of us party thereto as guarantors, Goldman Sachs Specialty Lending Holdings, Inc. and any other purchasers party thereto from time to time (collectively, the “Purchaser”) and Goldman Sachs Specialty Lending Holdings, Inc. Under the Note Purchase Agreement, we sold to the Purchaser \$30.0 million aggregate principal amount of senior secured notes (the “Notes”), which bear interest at a rate of 13.0% per annum and payable quarterly on March 31, June 30, September 30 and December 31 of each year until maturity. The first interest payment on the Notes will be on March 31, 2019. The entire principal amount of the Notes is due and payable on February 4, 2022 (the “Maturity Date”). The Notes do not amortize and the entire principal balance is due in a single payment on the Maturity Date. As of March 31, 2019, \$30.0 million in borrowings were outstanding under the three-year term note.

Obligations under the Note Purchase Agreement are secured by all of our assets, including intellectual property and general intangibles. The Note Purchase Agreement contains customary covenants, including, among others, covenants that restrict our ability to incur debt, grant liens, make certain investments and acquisitions, pay dividends, repurchase equity interests, repay certain debt, amend certain contracts, enter into affiliate transactions and asset sales or make certain equity issuances (including equity issuances that would cause an ownership change within the meaning of Section 382 of the Internal Revenue Code), and covenants that require us to, among other things, provide annual, quarterly and monthly financial statements, together with related compliance certificates, maintain its property in good repair, maintain insurance and comply with applicable laws.

On December 9, 2019, the Company entered into a Second Amendment (the “Second Amendment”) to the Note Purchase Agreement. Under the Second Amendment, the parties agreed to amend Section 6.21 of the Note Purchase Agreement to increase the Section 382 Ownership Shift threshold to not exceed 40.0%.

The financial covenants of the Note Purchase Agreement require the Company not to exceed specified levels of Adjusted EBITDA losses relative to its financial model, beginning with the fiscal quarter ending September 30, 2020. Additionally, we shall not permit our minimum consolidated liquidity, which consists of our cash and cash equivalents, to be less than \$12.0 million through February 4, 2020, and \$9.0 million thereafter. As of March 31, 2020, the Company was in compliance with the covenants contained in the Note Purchase Agreement.

The three-year term note has been recorded net of a discount based on the fair value of the associated common stock warrants and debt issuance costs totaling \$2.0 million. Amortization of the debt discount and debt issuance costs was \$1.2 million for the fiscal year ended March 31, 2020, based on an effective interest rate, and has been recorded as interest expense in the consolidated statements of operations.

Interest expense related to the term note payable during the fiscal year ended March 31, 2020 was \$5.2 million, which includes \$1.2 million in amortization of debt issuance costs.

When we entered into the Note Purchase Agreement the existing credit facility with Bridge Bank was paid in full. As such, there was no interest expense related to the credit facility during the fiscal year ended March 31, 2020. Interest expense related to the credit facility during the fiscal year ended March 31, 2019 was \$0.7 million, which includes \$0.1 million in amortization of debt issuance costs.

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

12. Commitments and Contingencies

Purchase Commitments

As of March 31, 2020, the Company had firm commitments to purchase inventories of approximately \$28.5 million through Fiscal 2023. Certain inventory delivery dates and related payments are not scheduled; therefore amounts under these firm purchase commitments will be payable upon the receipt of the related inventories.

Lease Commitments

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), to require lessees to recognize most leases on the balance sheet, while recognition on the statement of operations will remain similar to current lease accounting. The ASU requires lessees to recognize a liability for lease obligations, which represents the discounted obligation to make future lease payments, and a corresponding right-of-use (ROU) asset on the balance sheet. The guidance requires disclosure of key information about leasing arrangements that is intended to give financial statement users the ability to assess the amount, timing and potential uncertainty of cash flows related to leases. The ASU also eliminates real estate-specific provisions and modifies certain aspects of lessor accounting.

The Company adopted the new standard on April 1, 2019 using the modified retrospective approach. The Company has elected to apply the transition method that allows companies to continue applying the guidance under the lease standard in effect at that time in the comparative periods presented in the consolidated financial statements and recognize a cumulative-effect adjustment to the opening balance of retained earnings on the date of adoption. The Company also elected the “package of practical expedients”; which permits us not to reassess under the new standard our prior conclusions about lease identification, lease classification and initial direct costs; the use of hindsight in order to calculate the lease term of existing assets; the use of the portfolio approach on similar assets; and has elected not to separate lease and non-lease assets.

Results for reporting periods beginning after April 1, 2019 are presented under the new standard, while prior period amounts are not adjusted and continue to be reported under the accounting standards in effect for the prior period. Upon adoption of the new lease standard, on April 1, 2019, the Company recorded approximately \$5.5 million of right-of-use assets, adjusted for the reclassification of deferred rent and lease incentive of approximately \$0.3 million, and \$5.8 million of operating lease liabilities, within the Company’s condensed consolidated balance sheets upon adoption. The adoption of this standard did not have an impact on the Company’s condensed consolidated statement of operations or cash flows and did not result in a cumulative catch-up adjustment to the opening balance of retained earnings. Financed leases are not material to the Company’s condensed consolidated financial statements and are therefore not included in the disclosures.

In June 2019, the Company entered into a new lease of approximately 9,216 square feet of warehouse space at 16701 Stagg Street in Van Nuys, California. Upon the lease commencement date in July 2019, the Company recorded \$0.5 million of right-of-use assets and operating lease liabilities.

The Company leases offices and manufacturing facilities under various non-cancelable operating leases expiring at various times through Fiscal 2025. All of the leases require the Company to pay maintenance, insurance and property taxes. The lease agreements for primary office and manufacturing facilities provide for rent escalation over the

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

lease term and renewal options for five-year periods. Lease expense is recognized on a straight-line basis over the term of the lease.

The components of lease expense were as follows for the year ended March 31, 2020 (in thousands):

	Year Ended March 31, 2020
Operating lease cost	\$ 1,532

Rental expense for operating leases classified under the previous accounting standard, Accounting Standards Codification (“ASC”) Topic 840, for the fiscal year ended March 31, 2019 was approximately \$2.3 million.

Supplemental balance sheet information related to the leases was as follows (in thousands):

Operating Leases	March 31, 2020
Operating lease right-of-use assets	\$ 5,118
Total operating lease right-of-use assets	\$ 5,118
Operating lease liability, current	\$ 443
Operating lease liability, non-current	4,941
Total operating lease liabilities	\$ 5,384

The Company records its right-of-use assets within other assets (non-current) and its operating lease liabilities within current and long-term portion of notes payable and lease obligations.

Supplemental cash flow information related to the leases was as follows (in thousands):

	Year Ended March 31, 2020
Cash paid for amounts included in the measurement of lease liabilities	
Operating cash flows from operating leases	\$ 1,609

Other supplemental operating lease information consists of the following:

Weighted average remaining lease life	7 years
Weighted average discount rate	13%

At March 31, 2020, the Company’s minimum commitments under non-cancelable operating leases were as follows (in thousands):

Year Ending March 31,	Operating Leases
2021	\$ 1,116
2022	1,099
2023	1,125
2024	1,153
2025	1,077
Thereafter	3,002
Total lease payments	\$ 8,572
Less: imputed interest	(3,188)
Present value of operating lease liabilities	\$ 5,384

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Other Commitments

The Company has agreements with certain of its distributors requiring that if the Company renders parts obsolete in inventories the distributors own and hold in support of their obligations to serve fielded microturbines, then the Company is required to replace the affected stock at no cost to the distributors. While the Company has never incurred costs or obligations for these types of replacements, it is possible that future changes in the Company's product technology could result and yield costs to the Company if significant amounts of inventory are held at distributors. As of March 31, 2020, no significant inventories were held at distributors.

Legal Matters

Federal Securities Class Action

Two putative securities class action complaints were filed against us and certain of our current and former officers in the United States District Court for the Central District of California under the following captions: David Kinney, etc. v. Capstone Turbine, et al., No. 2:15-CV-08914 on November 16, 2015 (the "Kinney Complaint") and Kevin M. Grooms, etc. v. Capstone Turbine, et al., No. 2:15-CV-09155 on November 25, 2015 (the "Grooms Complaint").

The Kinney Complaint alleged material misrepresentations and omissions in public statements regarding BPC and the likelihood that BPC would not be able to fulfill many legal and financial obligations to us. The Kinney Complaint also alleged that our financial statements were not appropriately adjusted in light of this situation and were not maintained in accordance with GAAP, and that we lacked adequate internal controls over accounting. The Kinney Complaint alleged that these public statements and accounting irregularities constituted violations by all named defendants of Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, as well as violations of Section 20(a) of the Exchange Act by the individual defendants. The Grooms Complaint made allegations and claims that were substantially identical to those in the Kinney Complaint, and both complaints sought compensatory damages of an undisclosed amount. On January 16, 2016, several shareholders filed motions to consolidate the Kinney and Grooms actions and for appointment as lead plaintiff. On February 29, 2016, the Court granted the motions to consolidate, and appointed a lead plaintiff. On May 6, 2016, a Consolidated Amended Complaint with allegations and claims substantially identical to those of the Kinney Complaint was filed in the consolidated action. The putative class period in the Consolidated Amended Complaint was June 12, 2014 to November 5, 2015. Defendants filed a motion to dismiss the Consolidated Amended Complaint on June 17, 2016. On March 10, 2017, the Court issued an order granting defendants' motion to dismiss in its entirety with leave to amend. Plaintiffs filed an amended complaint on April 28, 2017. Defendants' motion to dismiss was filed June 2, 2017. Plaintiffs filed their opposition to the motion to dismiss on July 7, 2017, and defendants filed their reply in support of the motion to dismiss on July 28, 2017. The court vacated the hearing that was scheduled for August 18, 2017. On February 9, 2018, the Court issued an Order denying defendants' motion to dismiss. On March 30, 2018, defendants filed an answer to the Consolidated Amended Complaint. On May 17, 2018, the Court issued a scheduling order setting a trial date of March 17, 2020. On June 26, 2018, the Court entered an order vacating all deadlines through the end of October 2018 and temporarily staying formal discovery and other proceedings to allow the parties time to conduct a mediation. The parties participated in mediation on September 24, 2018, which did not result in a settlement. On November 16, 2018, after further settlement discussions, the parties advised the Court that they had reached an agreement in principle to settle the action in its entirety. The agreement in principle was subject to several conditions, including the execution of a stipulation of settlement that was satisfactory to all parties, and preliminary and final approval from the court, among other things. Plaintiffs filed a motion seeking preliminary approval of the proposed settlement on April 12, 2019, and filed supplementary declarations in support of the motion on May 2, 2019. Preliminary approval of the settlement was granted on May 17, 2019. On September 24, 2019, lead counsel for plaintiffs filed a motion for attorneys' fees and reimbursement of litigation expenses. On October 25, 2019, plaintiffs filed a motion for final approval of the settlement. On November 15, 2019, the Court issued an order

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

approving the settlement and the payment of attorneys' fees, litigation expenses, and class representative payments, and entering final judgment in the action. Our insurance carrier funded the settlement amount.

Federal Individual Securities Action

An individual securities complaint was filed against us, our Chief Executive Officer, and additional unidentified defendants in the United States District Court for the Central District of California under the following caption: FiveT Investment Management LTD, et al., v. Capstone Turbine, et al., No. 2:18-CV-03512 on April 25, 2018. The lawsuit alleged material misrepresentations and omissions regarding our revenue, sales, and operations because of alleged improper revenue recognition and backlog calculations related to BPC. The lawsuit alleged that these statements constituted violations by all named defendants of Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, as well as violations of Section 20(a) of the Exchange Act by the individual defendants. The complaint also asserted claims against all named defendants for fraud, negligent misrepresentation, violations of California Civil Code sections 1709 and 1710, and California Corporations Code sections 25400 and 25401. Additionally, the complaint asserted a cause of action against the individual defendants for breach of fiduciary duty. It demanded compensatory damages for the amount of damages allegedly suffered, pre-judgment and post-judgment interest, and fees.

On June 29, 2018, the plaintiffs filed an Amended Complaint for Common Law Fraud and Negligent Misrepresentation. The Amended Complaint asserted claims for common law fraud and negligent misrepresentation, against the Company, Mr. Jamison, and unidentified individual defendants. The Amended Complaint demanded damages in an unspecified amount, plus pre-judgment and post-judgment interest and fees. Defendants filed their answer to the Amended Complaint on August 17, 2018. The parties participated in a mediation on September 24, 2018. The mediation did not result in a settlement. On October 12, 2018, the plaintiffs filed a motion for leave to amend their complaint, seeking to reinstate the cause of action for violation of California Civil Code section 25401. On November 29, 2018, the Court granted plaintiffs' motion for leave to amend and plaintiffs filed their Second Amended Complaint, which asserted claims for common law fraud, negligent misrepresentation, and violation of California Civil Code section 25401 against the Company, Mr. Jamison, and unidentified individual defendants. On December 20, 2018, defendants filed their answer to the Second Amended Complaint. On June 6, 2019, the parties reached a confidential settlement of the action and the suit was dismissed with prejudice on July 1, 2019. Our insurance carrier funded the settlement amount.

State Derivative Lawsuits — California

On February 18, 2016, a purported shareholder derivative action was filed in Los Angeles Superior Court in the State of California against us and certain of our current and former officers and directors under the following caption: Stesiak v. Jamison, et al., No. BC610782. The lawsuit alleges that certain of our current and former officers and directors knew or should have known that BPC would be unable to fulfill its obligations to us, but allowed us to make false and misleading statements regarding BPC and our financial condition. The complaint also alleges that the defendants failed to timely adjust our account receivables and backlog to reflect BPC's inability to pay us. The complaint asserts causes of action for breach of fiduciary duty and unjust enrichment. It demands damages for the amount of damage sustained by us as a result of the individual defendants' alleged breach of fiduciary duties and unjust enrichment, that we institute corporate governance reforms, and disgorgement from the individual defendants. On May 5, 2016, the parties filed a stipulation and proposed order seeking to stay this action until such time as the defendants' motion(s) to dismiss the federal securities class action were either granted with prejudice or denied in whole or in part. On May 10, 2016, the Court entered that proposed order. On March 9, 2018, following the Court's order denying defendants' motion to dismiss in the federal securities class action, the parties filed a stipulation and proposed order seeking to stay this action until the close of fact discovery in the federal securities class action. On March 20, 2018, the Court entered that proposed order. A status conference is scheduled for July 1, 2020.

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On June 8, 2016, a purported shareholder derivative action entitled *Velma Kilpatrick v. Simon, et al.*, No. BC623167, was filed in Los Angeles Superior Court in the State of California against us and certain of our current and former officers and directors. The complaint alleges that certain of our current and former officers and directors knew or should have known that BPC would be unable to fulfill its obligations to us, but allowed us to make false and misleading statements regarding BPC and our financial condition. The complaint also alleges that the defendants failed to timely adjust our account receivables and backlog to reflect BPC's inability to pay us. The complaint asserts causes of action for breach of fiduciary duty. It demands damages for the amount of damage sustained by us as a result of the individual defendants' alleged breach of fiduciary duties, and that we institute corporate governance reforms. On August 23, 2016, the parties filed a stipulation and proposed order seeking to stay this action until such time as the defendants' motion(s) to dismiss the federal securities class action were either granted with prejudice or denied in whole or in part. On March 9, 2018, following the Court's order denying defendants' motion to dismiss in the federal securities class action, the parties filed a stipulation and proposed order seeking to stay this action until the close of fact discovery in the federal securities class action. On March 20, 2018 the Court entered that proposed order. A status conference is scheduled for June 26, 2020.

The parties in both of the above state derivative lawsuits participated in a mediation held on September 24, 2018. On May 6, 2019, the parties reached an agreement in principle regarding corporate governance reforms to be implemented in settlement of the action. The parties have not yet formalized a settlement, however, which is subject to several conditions, including the execution of a stipulation of settlement that is satisfactory to all parties and preliminary and final approval from the court, among other things. Settlement discussions are ongoing. We have not recorded any liability as of March 31, 2020 as our insurance carrier will fund the settlement amount.

Federal Derivative Lawsuits

On March 7, 2016, a purported shareholder derivative action was filed in the United States District Court for the Central District of California against us and certain of our current and former officers and directors under the following caption: *Haber v. Jamison, et al.*, No. CV16-01569-DMG (RAOx). The lawsuit alleges that certain of our current and former officers and directors knew or should have known that BPC would be unable to fulfill its obligations to us, but allowed us to make false and misleading statements regarding BPC and our financial condition. The complaint asserts a cause of action for breach of fiduciary duty. It demands damages for the amount of damage sustained by us as a result of the individual defendants' alleged breach of fiduciary duties, and equitable relief, including that we institute appropriate corporate governance reforms. On May 11, 2016, the parties filed a stipulation and proposed order seeking to stay this action until such time as the defendants' motion(s) to dismiss the federal securities class action were either granted with prejudice or denied in whole or in part. On May 13, 2016, the Court entered that proposed order.

On July 12, 2016 and July 18, 2016, respectively, two additional purported shareholder derivative actions were filed in the United States District Court for the Central District of California against us and certain of our current and former officers and directors, under the caption *Tuttle v. Atkinson, et al.*, No. CV16-05127, and *Boll v. Jamison, et al.*, No. CV16-5282, respectively. The lawsuits allege that certain of our current and former officers and directors knew or should have known that BPC would be unable to fulfill its obligations to us, but allowed us to make false and misleading statements regarding BPC and our financial condition. The Tuttle complaint asserts causes of action for breach of fiduciary duty, gross mismanagement, and unjust enrichment, and the Boll complaint asserts causes of action for breach of fiduciary duty, unjust enrichment, abuse of control, gross mismanagement, and waste of corporate assets. Both complaints demand damages sustained by us as a result of the individual defendants' alleged breaches of fiduciary duties, and equitable relief, including that we institute appropriate corporate governance reforms. The federal derivative actions were stayed until such time as the defendants' motion(s) to dismiss the federal securities class action were either granted with prejudice or denied in whole or in part. On March 9, 2018, following the Court's order denying defendants' motion to dismiss in the federal securities class action, the parties filed a stipulation and proposed order seeking to stay this action until the close of fact discovery in the federal securities class action. On March 13, 2018, the Court granted the parties' stipulation.

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The parties in the above federal derivative lawsuits participated in a mediation held on September 24, 2018. On May 6, 2019, the parties reached an agreement in principle regarding corporate governance reforms to be implemented in settlement of the action. The parties have not yet formalized a settlement, however, which is subject to several conditions, including the execution of a stipulation of settlement that is satisfactory to all parties and preliminary and final approval from the court, among other things. Settlement discussions are ongoing. We have not recorded any liability as of March 31, 2020 as our insurance carrier will fund the settlement amount.

Capstone Turbine Corporation v. Regatta Solutions, Inc.

On August 23, 2018, we initiated arbitration proceedings against its former distributor, Regatta Solutions, Inc. (“Regatta”), with the American Arbitration Association (“AAA”), under the following caption: Capstone Turbine Corp. v. Regatta Solutions, Inc., Case No. 01-18-0003-0860 (the “Capstone-Regatta Arbitration”). We have alleged claims against Regatta for breach of contract and unjust enrichment relating to the parties’ prior distributor relationship, which terminated at the end of March of 2018, and the related wind-down agreement between the parties. As remedies for these claims, we are seeking compensatory, consequential, and punitive damages, along with declaratory relief and attorney’s fees, interest, and costs.

On October 18, 2018, Regatta filed its answer and cross-claims in the Capstone-Regatta Arbitration. In its cross-claims, Regatta asserted claims for breach of contract, intentional interference with prospective economic advantage, fraud, and intentional interference with contractual relations, relating to the parties’ agreement to wind-down relations and Regatta’s purported sales efforts in California. As remedies for these alleged claims, Regatta sought no less than \$1.5 million in general and compensatory damages, along with punitive and exemplary damages, as well as attorney’s fees and costs. We have filed and served an answering statement denying Regatta’s counterclaims and asserting several affirmative defenses.

Also on October 18, 2018, Regatta filed a lawsuit in the Superior Court of the State of California, County of Orange, alleging two counts of fraud, and one count of interference with contractual relations, individually against Mr. James Crouse, then Executive Vice President of Sales for the Company, arising out of the same allegations made in Regatta’s counterclaim. As remedies for these alleged claims, Regatta again sought no less than \$1.5 million in general and compensatory damages, along with punitive and exemplary damages, as well as attorney’s fees and costs. The case was filed under the caption Regatta Solutions, Inc., v. Jim Crouse, et. al., Case No. 30-2018-01026571-CU-FR-CJC. On December 14, 2018, Regatta stipulated and agreed to arbitrate its claims against Mr. James Crouse and dismissed him from the Superior Court action.

On January 16, 2019, the parties participated in a mediation that did not resolve the dispute. The parties continued their settlement discussions and held a follow-on mediation on April 24, 2019 at which point the parties came to a resolution of the matter. Following initial compliance with the settlement terms, Regatta breached its obligations thereunder and the parties thereafter resolved the continuing dispute at a further mediation on January 29, 2020. As of March 31, 2020, Regatta met all of its material obligations under the settlement terms, and all matters related to the litigation were dismissed with prejudice on April 10, 2020. The settlement did not have a material impact on our condensed consolidated financial statements.

Capstone Turbine Corporation v. Turbine International, LLC.

On February 3, 2020, Capstone Turbine Corporation filed suit against its former distributor, Turbine International, LLC (“Turbine Intl.”), in the Superior Court of California for the County of Los Angeles under the following caption: Capstone Turbine Corporation v. Turbine International, LLC; Case No. 20STCV04372 (“Capstone-Turbine Intl. Litigation”). We have alleged claims against Turbine Intl. for breach of contract and for injunctive relief relating to the parties’ prior distributor relationship, which terminated at the end of March of 2018, and Turbine Intl.’s failure to satisfy its payment obligations under certain financial agreements, namely an accounts receivable agreement

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

and promissory note in favor of Capstone. As remedies for these claims, we are seeking compensatory, consequential, along with injunctive relief and attorney's fees, interest, and costs.

On March 18, 2020, Turbine Intl. filed its answer and cross-claims in the Capstone-Turbine Intl. Litigation. In its cross-claims, Turbine Intl. has asserted claims against Capstone, and individually against Mr. James Crouse, Capstone's Chief Revenue Officer, for breach of contract under the distributor agreement, accounts receivable agreement and promissory note, fraud, breach of the covenant of good faith and fair dealing, unjust enrichment and constructive trust, negligent misrepresentation, violation of the unfair practices act, violation of racketeer influenced corrupt organizations act, and conspiracy to commit fraud. As remedies for these alleged claims, Turbine Intl. are seeking compensatory, consequential, and punitive damages along with attorney's fees, interest, and costs. Capstone answered the cross-claims on May 7, 2020. A case management conference is scheduled for August 19, 2020. We have not recorded any liability as of March 31, 2020, as the matter is too early to estimate.

13. Employee Benefit Plans

The Company maintains a defined contribution 401(k) profit-sharing plan in which all employees are eligible to participate. Employees may contribute up to Internal Revenue Service annual limits or, if less, 90% of their eligible compensation. Employees are fully vested in their contributions to the plan. The plan also provides for both Company matching and discretionary contributions, which are determined by the Board of Directors. The Company has been matching 50 cents on the dollar up to 6% of the employee's contributions since February 2019. Prior to that date, the Company had been matching 50 cents on the dollar up to 4% of the employee's contributions since October 2006. There were no Company contributions to the plan prior to October 2006. The Company's match vests 25% a year over four years starting from the employee's hire date. The Company recorded expense of approximately \$0.3 million for the fiscal year ended March 31, 2020 and 2019.

14. Other Assets

The Company was a party to a Development and License Agreement with Carrier Corporation ("Carrier") regarding the payment of royalties on the sale of each of the Company's 200 kilowatt ("C200") microturbines. During the three months ended September 30, 2013, we reached our repayment threshold level and the fixed rate royalty was reduced by 50%. On July 25, 2018, the Company and Carrier entered into a Second Amendment to the Development and License Agreement ("Second Amendment") whereby the Company agreed to pay Carrier approximately \$3.0 million to conclude the Company's current royalty obligation under the Development and License Agreement, dated as of September 4, 2007, as amended ("Development Agreement") and release the Company from any future royalty payment obligations. The Second Amendment also removed non-compete provisions from the Development Agreement, allowing the Company to design market or sell its C200 System in conjunction with any energy system and compete with Carrier products in the CCHP market. Carrier earned zero and \$0.4 million in royalties for C200 and C1000 Series system sales during each of the fiscal years ended March 31, 2020 and 2019, respectively. There were no unpaid, earned royalties as of March 31, 2020 and 2019.

On September 19, 2018, the Company 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. A 15-year amortization period is the minimum expected life cycle of the current generation of product. The effective royalty rate is calculated as the prepaid royalty settlement divided by total projected C200 System units over the 15-year amortization period. On a quarterly basis, the Company will perform a re-forecast of C200 System unit shipments, to see if a change needs to be made to the effective royalty rate. Accordingly, if the Company's future projections change, its effective royalty rates would change, which could affect the amount and timing of royalty expense the Company recognizes. If impairment exists, then the

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

prepaid royalty asset could be written down to fair value. Prepaid royalties are classified as current assets to the extent that such amounts will be recognized in the Company’s condensed consolidated statements of operations within the next 12 months. The current and long-term portions of prepaid royalties, included in other current assets and other assets, respectively, consisted of (in thousands):

	March 31, 2020	March 31, 2019
Other current assets	\$ 124	\$ 124
Other assets	2,672	2,768
Royalty-related assets	\$ 2,796	\$ 2,892

15. Subsequent Events

The Company has evaluated all subsequent events through the filing date of this Form 10-K with the SEC, to ensure that this filing includes appropriate disclosure of events both recognized in the financial statements as of March 31, 2020, and events which occurred subsequently but were not recognized in the financial statements. There were no subsequent events which required recognition, adjustment to or disclosure in the financial statements other than disclosed in this note.

SBA Paycheck Protection Program Loan

On April 15, 2020, the Company submitted an application to its banking partner Western Alliance Bank, an Arizona corporation (“Western Alliance”) under the Small Business Administration (the “SBA”) Paycheck Protection Program enabled by the Coronavirus Aid, Relief and Economic Security Act of 2020 (the “CARES Act”). Western Alliance entered into a Note on April 24, 2020 (the “Note”) with the Company and agreed to make available to the Company a loan in the amount of \$2,610,200 (the “Loan”). The Company received the full amount of the Loan on April 24, 2020 (the “Initial Disbursement Date”) and currently plans to use the proceeds to support fixed costs such as payroll costs, rent and utilities in accordance with the relevant terms and conditions of the CARES Act. On May 13, 2020, the Company repaid \$660,200 of the loan in accordance with the Fourth Amendment to the Note Purchase Agreement between the Company and Goldman Sachs Specialty Lending Group, L.P.

The advance under the Loan bears interest at a rate per annum of 1%. The term of the Loan is two years, ending April 24, 2022 (the “Maturity Date”).

Beginning on the seventh month following the Initial Disbursement Date, the Company is required to pay monthly principal and interest payments, with each installment payment first to pay interest accrued since the Initial Disbursement Date, then to bring principal current. The Company may adjust the payment amount periodically to amortize the principal over the remaining term of the Note.

The Loan may be forgiven partially or fully if the funding received are used for payroll costs, interest on mortgages, rent, and utilities, provided that at least 75% of the forgiven amount has been used for payroll costs. Forgiveness is based on the Company maintaining, or quickly rehiring employees and maintaining applicable salary levels.

Forgiveness will be reduced if full-time headcount declines, or if salaries and wages decrease. Any forgiveness of the Loan shall be subject to approval of the SBA and will require the Company and Western Alliance to apply to the SBA for such treatment in the future.

The Company is currently evaluating the impact on its financial statements and the accounting will largely depend on the Company’s ability to have the loan forgiven.

CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note Purchase and Warrant Amendments

On April 24, 2020, the Company entered into a Third Amendment (the “Third Amendment”) to the Note Purchase Agreement. Under the Third Amendment, the parties agreed to amend the Note Purchase Agreement to, among other things, carve out the Loan pursuant to the CARES Act from the negative covenants restricting the Company from incurring certain debt and the related terms and conditions as a result of such Loan.

On May 13, 2020, the Company entered into a Fourth Amendment (the “Fourth Amendment”) to the Note Purchase Agreement. Under the Fourth Amendment, the parties agreed to amend the Note Purchase Agreement to amend certain repayment language with respect to the Loan pursuant to the CARES Act.

On June 16, 2020, the Company entered into a Fifth Amendment (the “Fifth Amendment”) to the Note Purchase Agreement. Under the Fifth Amendment, the Parties agreed to amend Section 6.21 of the Note Purchase Agreement to increase the Section 382 Ownership Shift (as defined therein) threshold to not exceed 42.0% until April 1, 2021, and 40% thereafter. All other provisions, terms and conditions of the Note Purchase Agreement remain in effect.

On June 16, 2020, the Company entered into an Amendment No. 2 to the Purchase Warrant for Common Shares (“Amendment No. 2”) with Special Situations Investing Group II, LLC (as successor in interest to Goldman Sachs & Co. LLC) (the “Warrant Holder”) that amends that certain Purchase Warrant for Common Shares originally issued by the Company to Goldman Sachs & Co. LLC, dated February 4, 2019 (the “Warrant”).

Amendment No. 2 amends the first paragraph of the Warrant to decrease the number of Warrant Shares (as defined therein) issuable under the Warrant and to decrease the exercise price from \$3.80 per share to \$2.61 per share (the “Per Share Warrant Exercise Price”). The Company would receive aggregate gross proceeds of approximately \$1,186,312.86 if the outstanding Warrant is exercised at the new Per Share Warrant Exercise Price.

Amendment No. 2 also amends Section 2.1 of the Warrant such that the Per Share Anti-Dilution Price (as defined therein) is equal to the Per Share Warrant Exercise Price as provided in the Amendment No. 2 to the Warrant. All other terms and provisions in the Warrant remain in effect.

Exhibit Index

Exhibit Number	Description
3.1	Second Amended and Restated Certificate of Incorporation of Capstone Turbine Corporation(a)
3.2	Certificate of Amendment to the Second Amended and Restated Certificate of Incorporation of Capstone Turbine Corporation, filed October 21, 2019(b)
3.3	Fourth Amended and Restated Certificate of Incorporation of Capstone Turbine Corporation(c)
3.4	Certificate of Elimination of Series A Junior Participating Preferred Stock of Capstone Turbine Corporation, dated May 9, 2016(d)
3.5	Certificate of Designations of Series B Junior Participating Preferred Stock of Capstone Turbine Corporation(d)
4.1	Specimen stock certificate(e)
4.2	NOL Rights Agreement, dated May 6, 2019, between Capstone Turbine Corporation and Broadridge Financial Solutions, Inc. successor-in-interest to Computershare Inc.(f)
4.3	Form of Series A Warrant issued to investors in the April 2016 public offering(g)
4.4	Form of Pre-Funded Series B Warrant issued to investors in the April 2016 public offering(g)
4.5	Form of Series A Warrant issued to investors in the October 2016 public offering(h)
4.6	Form of Pre-Funded Series B Warrant issued to investors in the October 2016 public offering(h)
4.7	Note Purchase Agreement, date as of February 4, 2019, by and among Capstone Turbine Corporation, certain of its subsidiaries party thereto as guarantors, Goldman Sachs Specialty Lending Holdings, Inc., as purchase and any other purchasers party thereto from time to time and Goldman Sachs Specialty Lending Holdings, Inc. as collateral agent (i)
4.8	Purchase Warrant for Common Shares issued in favor of Goldman Sachs & Co. LLC, dated February 4, 2019 (i)
4.9	Rights Agreement by and between Capstone Turbine Corporation and Broadridge Financial Solutions, Inc., dated May 6, 2019 (f)
4.10	Form of Prefunded Series C Warrant issued to investors in the September 2019 public offering (j)
4.11	Form of Series D Warrant issued to investors in the September 2019 public offering (j)
4.12	Second Amendment to the Note Purchase Agreement, dated as of December 9, 2019, by and among Capstone Turbine Corporation, certain subsidiaries of the company and Goldman Sachs Specialty Lending Group L.P. (a successor in interest to Goldman Sachs Specialty Lending Holdings, Inc.) (k)
4.13	Amendment No. 1 to the Purchase Warrant for Common Shares issued in favor of Special Situations Investing Group II, LLC (a successor in interest to Goldman Sachs & Co. LLC), dated December 9, 2019 (k)
4.14	Third Amendment to the Note Purchase Agreement, dated as of April 24, 2020, by and among Capstone Turbine Corporation, certain subsidiaries of the Company and Goldman Sachs Specialty Lending Group, L.P. (as successor in interest to Goldman Sachs Specialty Lending Holdings, Inc.) (l)
4.15	Note between Western Alliance Bank and Capstone Turbine Corporation, effective as of April 24, 2020 (l)
4.16	Fourth Amendment to the Note Purchase Agreement, dated as of May 13, 2020, by and among Capstone Turbine Corporation, certain subsidiaries of the Company and Goldman Sachs Specialty Lending Group, L.P. (m)
4.17	Fifth Amendment to the Note Purchase Agreement, dated as of June 16, 2020, by and among Capstone Turbine Corporation, certain subsidiaries of the Company and Goldman Sachs Specialty Lending Group, L.P. (as successor in interest to Goldman Sachs Specialty Lending Holdings, Inc.) (n)
4.18	Amendment No. 2 to the Purchase Warrant for Common Shares issued in favor of Special Situations Investing Group II, LLC (as successor in interest to Goldman Sachs & Co. LLC), dated June 16, 2020 (n)

Exhibit Number	Description
4.19	Description of the Registrant's Securities Registered Pursuant to Section 12 of the Securities Exchange Act of 1934, as Amended
10.1	Lease between Capstone Turbine Corporation and Prologis, L.P., formerly known as AMB Property, L.P., dated September 25, 2000, as amended, for leased premises at 16640 Stagg Street, Van Nuys, California(o)
10.2	Fourth Amendment to Lease, dated June 7, 2017, between Capstone Turbine Corporation and Prologis, L.P., for leased premises at 16640 Stagg Street, Van Nuys, California(p)
10.3*	Capstone Turbine Corporation 2017 Equity Incentive Plan effective August 30, 2017(q)
10.4*	Capstone Turbine Corporation Employee Stock Purchase Plan effective August 30, 2017(r)
10.5*	Amended and Restated Capstone Turbine Corporation Change of Control Severance Plan(s)
10.6	Development and License Agreement between Capstone Turbine Corporation and Carrier Corporation, successor-in-interest to UTC Power Corporation, dated September 4, 2007(t)
10.7	Promissory Note between Capstone Turbine Corporation and Turbine International, LLC, dated October 13, 2017(u)
10.8	Guaranty between Capstone Turbine Corporation and Hispania Petroleum, S.A., dated October 13, 2017(u)
10.9	First Amendment to the Accounts Receivable Assignment Agreement and Promissory Note between Capstone Turbine Corporation and Turbine International, LLC, dated June 5, 2018 (v)
10.10*	Capstone Turbine Corporation Amended and Restated Executive Performance Incentive Plan as amended and restated effective August 29, 2013(w)
10.11*	Amendment to the Capstone Turbine Corporation Amended and Restated Executive Performance Incentive Plan, dated June 9, 2014(x)
10.12*	Form of Inducement Stock Option Agreement(y)
10.13*	Form of Inducement Restricted Stock Unit Agreement(y)
10.14*	Amended and Restated Change in Control Severance Agreement with Darren R. Jamison, dated June 14, 2012(z)
10.15*	First Amendment to Amended and Restated Change in Control Severance Agreement with Darren R. Jamison, effective June 14, 2015(aa)
10.16*	Capstone Turbine Corporation Severance Pay Plan as amended and restated effective February 1, 2010(aa)
10.17	Form of Securities Purchase Agreement used in the September 2019 offering (j)
10.18	At the Market Offering Agreement, dated June 7, 2018, between Capstone and H.C. Wainright & Co., LLC (bb)
10.19	Second Amendment to the Development and License Agreement, dated July 25, 2018, between Capstone Turbine Corporation and Carrier Corporation (cc)
10.20*	Capstone Turbine Corporation 2017 Equity Incentive Plan, as amended (dd)
10.21*	Form of Change in Control Agreement (ee)
10.22*	Form of Restricted Stock Unit Award Agreement for Company Employees under the Capstone Turbine Corporation 2017 Stock Option and Incentive Plan –Four Year Vesting Schedule
10.23*	Form of Restricted Stock Unit Award Agreement for Company Employees under the Capstone Turbine Corporation 2017 Stock Option and Incentive Plan –Three Year Vesting Schedule
10.24*	Form of Restricted Stock Unit Award Agreement for Company Employees under the Capstone Turbine Corporation 2017 Stock Option and Incentive Plan –Two Year Vesting Schedule
10.25*	Form of Performance Restricted Stock Unit Award Agreement for Company Employees under the Capstone Turbine Corporation 2017 Stock Option and Incentive Plan
14.1	Code of Business Conduct(ff)

Exhibit Number	Description
14.2	Code of Ethics for Senior Financial Officers and Chief Executive Officer(ff)
21	Subsidiary List
23	Consent of Marcum LLP
24	Power of Attorney (included on the signature page of this Form 10-K)
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes–Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes–Oxley Act of 2002
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes–Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Schema Document
101.CAL	XBRL Calculation Linkbase Document
101.LAB	XBRL Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document
101.DEF	XBRL Definition Linkbase Document

*Management contract or compensatory plan or arrangement

- (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 Capstone Turbine Corporation’s Current Report on Form 8-K, filed on October 21, 2019 (File No. 001-15957).
- (c) Incorporated by reference to Capstone Turbine Corporation’s Current Report on Form 8-K, filed September 1, 2017 (File No. 001-15957).
- (d) Incorporated by reference to Capstone Turbine Corporation’s Current Report on Form 8-K, filed on May 9, 2016 (File No. 001-15957).
- (e) Incorporated by reference to Capstone Turbine Corporation’s Registration Statement on Form S-1/A, dated June 21, 2000 (File No. 333-33024).
- (f) Incorporated by reference to Capstone Turbine Corporation’s Current Report on Form 8-K, filed on May 6, 2019 (File No. 001-15957).
- (g) Incorporated by reference to Capstone Turbine Corporation’s Current Report on Form 8-K, filed on April 21, 2016 (File No. 001-15957).
- (h) Incorporated by reference to Capstone Turbine Corporation’s Current Report on Form 8-K, filed on October 18, 2016 (File No. 001-15957).
- (i) Incorporated by reference to Capstone Turbine Corporation’s Current Report on Form 8-K, filed on February 5, 2019 (File No. 001-15957).
- (j) Incorporated by reference to Capstone Turbine Corporation’s Current Report on Form 8-K, filed on September 4, 2019 (File No. 001-15957).
- (k) Incorporated by reference to Capstone Turbine Corporation’s Current Report on Form 8-K, filed on December 9, 2019 (File No. 001-15957).
- (l) Incorporated by reference to Capstone Turbine Corporation’s Current Report on Form 8-K, filed on April 29, 2020 (File No. 001-15957).

- (m) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on May 15, 2020 (File No. 001-15957).
- (n) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on June 17, 2020 (File No. 001-15957).
- (o) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended March 31, 2013 (File No. 001-15957).
- (p) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended on March 31, 2017 (File No. 001-15957).
- (q) Incorporated by reference to Appendix A to Capstone Turbine Corporation's Definitive Proxy Statement, filed on July 21, 2017 (File No. 001-15957).
- (r) Incorporated by reference to Appendix B to Capstone Turbine Corporation's Definitive Proxy Statement, filed on July 21, 2017 (File No. 001-15957).
- (s) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2004 (File No. 001-15957).
- (t) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2007 (File No. 001-15957).
- (u) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on October 13, 2017 (File No. 001-15957).
- (v) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K, filed on June 7, 2018 (File No. 001-15957).
- (w) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2013 (File No. 001-15957).
- (x) Incorporated by reference to Appendix B to Capstone Turbine Corporation's Definitive Proxy Statement, filed on July 16, 2014 (File No. 001-15957).
- (y) Incorporated by reference to Capstone Turbine Corporation's Registration Statement on Form S-8, dated June 17, 2009 (File No. 333-160049).
- (z) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended on March 31, 2012 (File No. 001-15957).
- (aa) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended on March 31, 2015 (File No. 001-15957).
- (bb) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on June 7, 2018 (File No. 001-15957).
- (cc) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on July 26, 2018 (File No. 001-15957).
- (dd) Incorporated by reference to Appendix A to Capstone Turbine Corporation's Definitive Proxy Statement, filed July 13, 2018 (File No. 001-15957).
- (ee) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K filed on June 5, 2018 (File No. 001-15957).

(ff) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended March 31, 2014 (File No. 001-15957).

SIGNATURES

Pursuant to the requirements of Sections 13 or 15(d) 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

Date: June 26, 2020

By: /s/ Frederick S. Hencken III
Frederick S. Hencken III
Chief Financial Officer & Chief Accounting Officer
(Principal Financial and Accounting Officer)

KNOW ALL MEN BY THESE PRESENTS, that we, the undersigned officers and directors of Capstone Turbine Corporation, hereby severally constitute Darren R. Jamison and Frederick S. Hencken III, and each of them singly, our true and lawful attorneys with full power to them, and each of them singly, to sign for us and in our names in the capacities indicated below, this Annual Report on Form 10-K and any and all amendments to said Form 10-K, and generally to do all such things in our names and in our capacities as officers and directors to enable Capstone Turbine Corporation to comply with the provisions of the Securities Exchange Act of 1934, and all requirements of the Securities and Exchange Commission, hereby ratifying and confirming our signatures as they may be signed by our said attorneys, or any of them, to said Form 10-K and any and all amendments thereto.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ DARREN R. JAMISON</u> Darren R. Jamison	President, Chief Executive Officer and Director (Principal Executive Officer)	June 26, 2020
<u>/s/ FREDERICK S. HENCKEN III</u> Frederick S. Hencken III	Chief Financial Officer and Chief Accounting Officer (Principal Financial and Accounting Officer)	June 26, 2020
<u>/s/ HOLLY A. VAN DEURSEN</u> Holly A. Van Deursen	Chair of the Board of Directors	June 26, 2020
<u>/s/ PAUL DEWEESE</u> Paul DeWeese	Director	June 26, 2020
<u>/s/ ROBERT C. FLEXON</u> Robert C. Flexon	Director	June 26, 2020
<u>/s/ YON Y. JORDEN</u> Yon Y. Jordan	Director	June 26, 2020
<u>/s/ GARY J. MAYO</u> Gary J. Mayo	Director	June 26, 2020
<u>/s/ ROBERT F. POWELSON</u> Robert F. Powelson	Director	June 26, 2020
<u>/s/ DENISE WILSON</u> Denise Wilson	Director	June 26, 2020