# 2019 ANNUAL REPORT

Capstone®

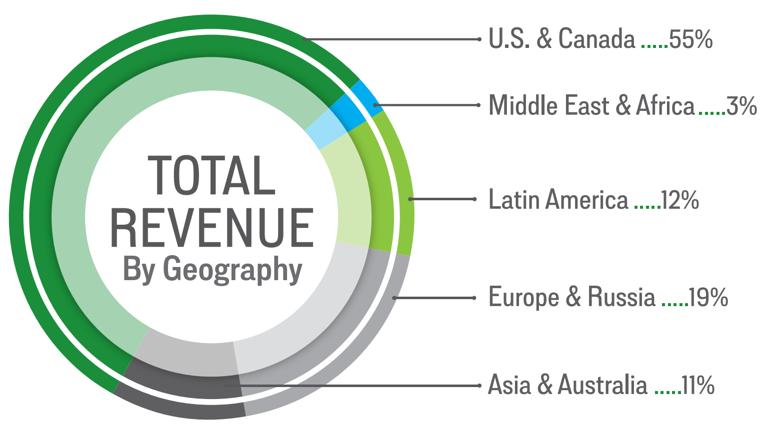

*At Capstone, we're committed to making a difference globally by creating world-class products that are helping to improve lives, the communities that we live and work in, and the planet for future generations.*

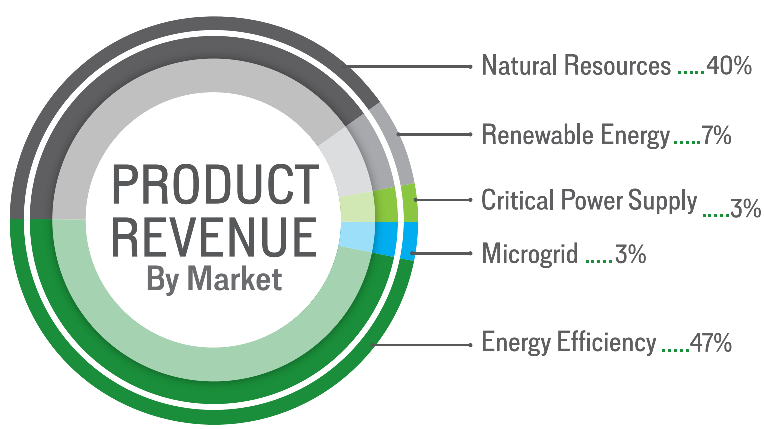
# CAPSTONE TURBINE FISCAL YEAR 2019 IN REVIEW

**88**
Global Distributors

**350,000**
Tons in Carbon Savings

**$253M**
in Financial Savings



## DEAR FELLOW STOCKHOLDERS,

We began our journey to near-term profitability with a strategic plan focused on operational restructuring and cost-cutting initiatives back in fiscal 2016. Since then we have cut our annual operating expenses in half, from a high of $49.2 million in fiscal 2015, which included bad debt expense for a Russian receivable, to $24.6 million in fiscal 2019. Although our focus on costs continues to be relentless, and we still have additional savings opportunities yet to realize, we invested most of fiscal 2019 on enterprise optimization. This included the introduction of new initiatives like the Distributor Support System ("DSS") program, an expansion of our long-term rental fleet, a direct material cost reduction strategy, additional lean manufacturing improvements and an expanded global parts remanufacturing program. As this initial phase moves toward successful completion, we are now in a position to leverage our reduced overhead and optimized enterprise to increase our fiscal 2020 focus on the last phase of our near-term profitability plan; which is a return to consistent double-digit revenue growth.

During fiscal 2019, we continued the research and development journey down our technology roadmap and improved our product and service offerings during the year. This included the continued successful rollout of the new family of PowerSync controllers used for Capstone Signature Series microturbines. We also developed and tested a new self-cleanable severe environment air filtration system for our Signature Series line of microturbine products to support our strategic expansion into the oil and gas business in the Middle East and Africa. We embarked upon a project to modernize our power electronics to today's cutting edge standards. In addition, our C65, C200 and C1000 Series microturbines became UL 1741 Supplement A ("SA") certified during fiscal 2019. Finally, we made significant improvements and upgrades to our industry-leading Factory Protection Program ("FPP") long-term service offering that we expect will increase our future service contract adoption rates.

## FISCAL 2019 STRATEGIC GOALS REVIEW

Our near-term profitability plan was built around four core business initiatives and key strategic pillars: Improved Cash Flow; Double-Digit Revenue Growth; Improved Diversification; and Increased Operating Expense Absorption. In fiscal 2019, we made significant progress in improving our liquidity and balance sheet. We announced in February 2019 that 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. This note is especially key in that it provides us the necessary capital to further develop new business opportunities in areas such as long-term rentals, which requires a more flexible balance sheet. In the third quarter, we also leveraged our at-the-market equity program to cover the deployment costs of approximately $2.8 million for the C1000 Signature Series systems for one of the world's largest oil and gas producers under our newly expanded long-term rental program.

In fiscal 2019, we grew revenue by 1%, and while this fell short of our double-digit growth goal, if the units that were allocated to our long-term rental program are added back as product sales, our product revenue growth in fiscal 2019 would have been 9% when compared to fiscal 2018. Business conditions were mixed but improved as the year progressed. We ended the year with strong product revenue growth in our fourth quarter, with an 11% increase versus the same period last year. Our book-to-bill ratio also ended strong at 1.4:1 in our fourth quarter, providing excellent momentum as we enter the new fiscal year.

Our diversification initiatives generated positive results in fiscal 2019, where we sold to 63 different distributors in 41 different countries. While our revenue in the European and Russian markets continues to be impacted by the ongoing geopolitical tensions and a strong U.S. dollar, our revenue from the Russian market increased 11% during fiscal 2019 compared to the same period last year, primarily due to the improvement of sales from several new distributors in the Russian and CIS market.

Our fourth strategic pillar is to increase the absorption of operating expenses, which is being led by our aftermarket sales and services business. This includes increasing global remanufacturing of spare parts, higher attachment rates of our FPP service contracts in the natural resource market vertical, selling air bearings into adjacent technologies and recurring revenue from our DSS program and newly expanded long-term rental program. We also revamped our spare parts pricing philosophy and expanded our DSS program. Finally, during the fourth quarter of fiscal 2019, we signed multiple FPP contracts covering a combined total of 30.7 megawatts, a record for Capstone.

## FISCAL 2020 STRATEGIC OBJECTIVES

In our view, revenue growth is headed towards an inflection point, and we are setting a solid foundation towards meeting our goal of annual double-digit revenue growth. Capstone's revenue growth is expected to be driven by both product revenue and aftermarket accessories, parts and service revenue. Additionally, our push to develop more opportunities in the long-term rental market would impact our business mix and revenue. We continue to see several positive industry trends that we expect will help drive product revenue growth this fiscal year and beyond.

The natural resources, or oil and gas, sector was a key factor in fiscal 2019 accounting for approximately 40% of revenue and should continue to be in fiscal 2020 if oil prices remain above $50 per barrel. During the year, we expanded our business into the Middle East with successful projects in Oman, Qatar, Saudi Arabia and the United Arab Emirates. We expect that the higher oil prices we have been experiencing and the move toward reduced gas flaring will continue to drive demand and should provide a positive backdrop for Capstone's microturbines. Our systems offer distinct advantages for users in the sector, with the most prominent being our high reliability, low maintenance, emissions compliance and fuel flexibility.

Applications in the energy efficiency market will also remain key for us in fiscal 2020 and accounted for 47% of fiscal 2019 revenue. During the year, we continued to see strong growth in the U.S. market and look to Canada, Latin America, Caribbean, Australia and Europe to expand in the new fiscal year. A variety of companies across a number of sectors such as office buildings, hospitality and manufacturing plants are continuing to make the needed investments in order to improve their energy efficiency, reduce their costs and lower their environmental footprint. Our microturbine systems provide those users with a tangible return on their investment and our installed base of successful projects is continuing to grow.

Although a relatively small percentage of revenue for Capstone in fiscal 2019, microgrids are an especially compelling industry trend. Based on the U.S. Department of Energy's definition, "a microgrid is a local energy grid with control capability, which means it can disconnect from the traditional grid and operate autonomously. A microgrid generally operates while connected to the grid, but importantly, it can break off and operate on its own using local energy generation in times of crisis like storms or power outages, or for other reasons. A microgrid not only provides backup for the grid in case of emergencies but can also be used to cut costs or connect to a local resource that is too small or unreliable for traditional grid use. A microgrid allows communities to be more energy independent and, in some cases, more environmentally friendly." This is a perfect fit for Capstone's energy solutions as our technology can serve as the backbone for a microgrid while allowing for the integration of other renewable generation sources. We are positioning the company to leverage these trends, which we expect will become more prevalent in the years to come.

Aftermarket accessories, parts and service revenue is key to both our growth goals as well as our expense absorption and as such, our profitability. We are taking steps to improve this by expanding our industry-leading FPP program, which now provides comprehensive coverage for up to 20 years.

## ESG FOCUS AND SUSTAINABILITY FOOTPRINT PHILOSOPHY

In fiscal 2019, we sharpened our focus on building a company that strives to adhere to the framework of Environmental, Social and Governance ("ESG") principals and standards that will continue in the years ahead. Capstone is committed to improving the efficiency of energy generated around the world while simultaneously reducing global emissions of pollutants and greenhouse gases. Capstone's systems help end-users reduce their environmental impact while meeting critical power and reliability needs. Our technology remains a key driver, and in fiscal 2019 alone, Capstone's end-use customers eliminated an estimated 350,000 tons of carbon emissions using our innovative microturbine technology when compared to electricity from their local utility, while capturing financial savings of approximately $253 million. This equates to the annual equivalent carbon reduction derived from over approximately 412 thousand acres of forest or from removing over 74 thousand passenger vehicles driven per year.

## FISCAL 2019 CONCLUSION

During the year, we made significant progress toward each of our goals, recognizing that it served as a critical building block for our future. Looking forward, our efforts will intensify as we continue to lead with steadfast determination and focus on reaching our near-term profitability goals and strategic objectives of driving growth and building sustainable value for our customers and stockholders.

In closing, on behalf of the entire Capstone Team, we would like to express our gratitude to our valued stockholders, customers, distributors, employees and suppliers for your ongoing support, as well as thank each and every one of you for placing your confidence in Capstone Turbine Corporation.

Sincerely,

Holly A. Van Duersen

**Holly A. Van Duersen**
Chair of the Board

**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, 2019**

**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**<br>(State or other jurisdiction of incorporation or organization) | **95-4180883**<br>(I.R.S. Employer Identification No.) |
| **16640 Stagg Street, Van Nuys, California**<br>(Address of principal executive offices) | **91406**<br>(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, 2018 was approximately $67.6 million.

As of June 6, 2019, there were 72,661,104, shares of the registrant's Common Stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the definitive proxy statement relating to the registrant's 2019 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.

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. Our microturbines can be fueled by various sources, including natural gas, propane, butane, sour gas, renewable fuels such as landfill 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 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 for up 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 the applications 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.

**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 600 kW up to 1000 kW or 1 MW in a compact footprint engineered to function as a single source of power. Our 600kW, 800kW and 1000 kW ("C1000S Series") microturbines are well suited for utility substations, larger commercial and industrial facilities and remote oil and gas applications.

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 and 600 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 800kW ("C800S") or 600kW ("C600S") 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 microturbine's 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 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 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.

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 exploring 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. Our product sales in the natural resources market is driven by our microturbines' reliability, emissions profile and ease of installation. However, we experienced growth in the oil and gas sector within our natural resources market during Fiscal 2019, which we believe was primarily because oil prices remained 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 heath 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*

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 automated 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 2019, 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, OEMs and national accounts. 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 provide 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, Chile and Ecuador.

*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 spare parts distribution center 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 distributor Turbine International, LLC discussed below. 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 16 of this Form 10-K.

**Customers**

Sales to E-Finity Distributed Generation, LLC ("E-Finity"), one of our domestic distributors, accounted for 13% and 16% of our revenue for the fiscal years ended March 31, 2019 and 2018, 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, 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. Serba Dinamik Sdn Bhd ("Serba"), one of our Malaysian distributors, E-Finity, and Supernova Energy Services SAS ("Supernova"), one of our Colombian distributors, accounted for 20%, 18% and 10%, respectively, of net accounts receivable as of March 31, 2018.

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

Pursuant to the terms of the Assignment Agreement, we agreed to assign to TI the right, title and interest to receivables owed to us from BPC Engineering, our former Russian distributor ("BPC"), upon TI's payment to us of $2.5

million in three payments by February 1, 2018. We received payments from TI of approximately $1.0 million under the Assignment Agreement during Fiscal 2018, which was recorded as bad debt recovery. The receivables owed to us from BPC had a balance of $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 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. We collected approximately $0.5 million from TI during Fiscal 2019, under the terms of the Amended Assignment Agreement. Under the terms of the Amended Note, TI agreed to pay us $3.8 million over a three-year period in 13 equal quarterly installments starting in December 20, 2019. As of March 31, 2019, the right, title and interest to the accounts receivables owed to us from BPC had not been assigned to TI, as TI had not yet made all payments as required under the Amended Assignment Agreement. The payment of $0.4 million, due March 20, 2019 under the Amended Assignment Agreement, has not been received at the time of this filing.

We recorded a net bad debt recovery of approximately $0.3 million and $1.1 million during Fiscal 2019 and 2018, respectively. As of March 31, 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 remaining balance of the fully reserved accounts receivable was $4.8 million as of March 31, 2019.

**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 NOx, CO, VOCs and other criteria pollutant emissions than our microturbines. With higher 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 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 is funding research to explore the role CHP could play as a flexible resource to provide additional generating capacity when the grid demands increase and/or to provide other services, such as frequency regulation for stabilization. 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 new 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 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 identified and has been fully qualified and is now working towards increasing its capacity and is expected to meet our production volumes during Fiscal 2020.

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 $33,200 and $30,900 were earned by Solar for the fiscal year ended March 31, 2019 and 2018, 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 and $0.9 million in royalties for C200 and C1000 Series system sales during each of the fiscal years ended March 31, 2019 and 2018.

During the third quarter of Fiscal 2018, we consolidated our operations and offices into our Van Nuys location in Southern California. We have an approximately 42,300 square foot manufacturing footprint 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, 2019 and 2018, R&D expenses were $3.6 million and $4.0 million, respectively, which amounts are equivalent to 4% and 5% 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. We also continued development and testing 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-use 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 will feature self-cleanable pulse actuation to extend life and service interval, critical for remote sites.

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 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.

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. Despite a challenging federal budgetary environment, funding has been extended to the 2019 government fiscal year for completion of the testing.

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 will enable more optimum operation of the engine as well as benefits from lower emissions, increased fuel flexibility and improved reliability. Testing will commence in Fiscal 2020 and will be held at Argonne National Laboratory.

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. Integration and demonstration of the technology will take place at the end of Fiscal 2020.

In Fiscal 2020, as part of an ARPA-E award, Capstone Turbine will work with Washington State University to develop and demonstrate a solid oxide fuel cell based hybrid power system utilizing Capstone's proven and reliable microturbine. The new hybrid power system would bridge the natural gas powered industry today with the energy systems of the future.

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.

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 58 U.S. and 4 international patents (in certain cases covering the same technology in multiple jurisdictions). The patents we have obtained will expire between calendar years 2019 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, 2019, we had 153 full-time employees and one part time employee. 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,*

- *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.*

***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 6.8 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 of 1933, as amended. 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, 2019, we had an accumulated deficit of approximately $878.9 million. On March 31, 2019, we had cash and cash equivalents of $29.7 million, and working capital of $42.0 million. This compares to $862.2 million, $19.4 million and $21.7 million, respectively, on March 31, 2018. 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.

Our business strategy is focused on profitability-oriented initiatives such as reducing operating expenses, diversifying and increasing revenue, improving gross margin and utilizing our joint venture, Capstone Energy Finance to provide financing options for the purchase of Capstone microturbines. 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.

***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. Due to their capacity issues, it is uncertain if we will experience an interruption in parts from this supplier or be able to fully offset or recover any resulting component price increases. This could impact margins or sales in future quarters. During the first quarter of Fiscal 2019, we issued a prepayment of approximately $2.2 million to this single source supplier. A new supplier has been identified and has been fully qualified and is now working towards increasing its capacity and is expected to meet our production volumes during Fiscal 2020.

***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. Although we experience revenue growth in fiscal 2019, 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 2019 were $46.2 million and contributed to an ending backlog of $71.3 million at March 31, 2019. The book-to-bill ratio was 1.1:1 for Fiscal 2019. 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 an Accounts Receivable Assignment Agreement (the "Assignment Agreement") and Promissory Note (the "Note") with Turbine International, LLC ("TI").

Pursuant to the terms of the Assignment Agreement, we agreed to assign to TI the right, title and interest to receivables owed to us from BPC Engineering, our former Russian distributor ("BPC"), upon TI's payment to us of $2.5 million in three payments by February 1, 2018. We received payments from TI of approximately $1.0 million under the Assignment Agreement during Fiscal 2018, which was recorded as bad debt recovery. The receivables owed to us from BPC had a balance of $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 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. We collected approximately $0.5 million from TI during Fiscal 2019, under the terms of the Amended Assignment Agreement. Under the terms of the Amended Note, TI agreed to pay us $3.8 million over a three-year period in 13 equal quarterly installments starting in December 20, 2019. As of March 31, 2019, the right, title and interest to the accounts receivables owed to us from BPC had not been assigned to TI, as TI had not yet made all payments as required under the Amended Assignment Agreement. The payment of $0.4 million, due March 20, 2019 under the Amended Assignment Agreement, has not been received at the time of this filing.

Due to the above amendments, during the three months ended March 31, 2018 we removed product orders related to BPC from backlog for approximately $7.2 million. This removal was the result of product pricing that we no longer would honor. Additionally, for Fiscal 2019, we removed product orders related to BPC from backlog for approximately $20.7 million. This removal was the result of our continuous review of BPC related backlog with TI which resulted in us no longer honoring the product pricing. After removal of the foregoing orders, the remaining backlog related to BPC as of March 31, 2019 comprises up to approximately 42% of our total backlog. This remaining backlog related to BPC continues to be reviewed with TI and the other new distributors in the region, and they have the right to request delivery of those backlog orders if the associated projects proceed. Nonetheless, the remaining backlog related to BPC may be negatively impacted.

***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. Although we have experienced an improvement in revenue during Fiscal 2019 due to favorable oil prices, we continue to be impacted by the volatility of the global oil and gas industry. If prices were to decline again, 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 and $16.0 million as of March 31, 2019 and March 31, 2018, respectively. Days sales outstanding in accounts receivable ("DSO") at the end of Fiscal 2019 was 70 days, compared with 69 days at the end of Fiscal 2018. We recorded net bad debt recovery of approximately $0.3 million and $1.1 million during Fiscal 2019 and Fiscal 2018, 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.

***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 an Accounts Receivable Assignment Agreement (the "Assignment Agreement") and Promissory Note (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. 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 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. We collected approximately $0.5 million from TI during Fiscal 2019, under the terms of the Amended Assignment Agreement. Under the terms of the Amended Note, TI agreed to pay us $3.8 million over a three-year period in 13 equal quarterly installments starting in December 20, 2019. As of March 31, 2019, the right, title and interest to the accounts receivables owed to us from BPC had not been assigned to TI, as TI had not yet made all payments as required under the Amended Assignment Agreement. The payment of $0.4 million, due March 20, 2019 under the Amended Assignment Agreement, has not been received at the time of this filing.

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

E-Finity and CAL accounted for approximately 13% and 12%, respectively, of our revenue for Fiscal 2019. Additionally, RSP and E-Finity accounted for 14% and 10%, respectively, of net accounts receivable as of March 31, 2019. The loss of E-Finity, CAL, RSP, 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.

***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, 2019, we had federal and state net operating loss carryforwards of approximately $643.2 million and $153.6 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, 2019. 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 have been 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 has 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 has no effect at this time on the listing of our common stock on The Nasdaq Capital Market or trading of our common stock. We may achieve compliance during this additional 180-day period if the closing bid price of our common stock is at least $1.00 per share for a minimum of 10 consecutive business days by November 18, 2019. If we fail to regain compliance on or prior to November 18, 2019, our stock will be subject to delisting by Nasdaq. 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. If we deem a reverse stock split necessary, we will request stockholder approval at our annual meeting of stockholders, to be held on August 30, 2019.

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. Management believes our Van Nuys facility is adequate for our current needs. We also lease an approximately 98,000 square foot facility located at 21211 Nordhoff Street in Chatsworth, California. This lease expires in September 2019, and we have one five-year option to extend the term of this lease, which we do not expect to exercise. We are in the process of moving inventory and other property from our facility in Chatsworth and we may incur certain expenses as a condition of the lease as a result of vacating 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 putative class in the Kinney Complaint was comprised of all purchasers of our securities between November 7, 2013 and November 5, 2015. The Kinney Complaint alleges 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 alleges 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 alleges 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 makes allegations and claims that are substantially identical to those in the Kinney Complaint, and both complaints seek 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 is 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 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. 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. A hearing on the motion for preliminary approval of the settlement is scheduled for May 17, 2019. If the settlement is finalized and approved by the Court, the Company's insurance carrier will fund the settlement amount. We have not recorded any liability as of March 31, 2019 since any potential loss is not considered material as our insurance carrier will fund 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 alleges 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. We have not recorded any liability as of March 31, 2019 as our insurance carrier will fund 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 are 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 29, 2019.

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 are 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 July 29, 2019.

The parties in both of the above state derivative lawsuits participated in a mediation held on September 24, 2018. The parties did not reach a settlement on the day of the mediation and negotiations are ongoing.

*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 are 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 are 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 both of the above federal derivative lawsuits participated in a mediation held on September 24, 2018. The parties did not reach a settlement on the day of the mediation and negotiations are ongoing.

*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, 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 has 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 is seeking 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, Executive Vice President of Sales for us, 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 did come to a resolution of the matter. The parties are currently engaged in drafting a more formal settlement agreement that upon execution will require the respective matters to be dismissed. The Company has not recorded any liability as of March 31, 2019, since any potential loss is not probable or reasonably estimable given the current status of the proceedings.

*Capstone Turbine Corporation v. Energy Systems, Inc.*

On August 17, 2018 Capstone initiated arbitration proceedings against its former distributor, Energy Systems of Caribbean, Inc. ("Energy Systems") by seeking declaratory relief that its action in terminating the distributorship was justified under the law. The claim was filed with the American Arbitration Association under the following caption: Capstone Turbine Corp. v. Energy Systems of Caribbean, Inc., Case No. 01-18-0003-1307. As remedies for these claims, we are seeking declaratory relief and attorney's fees, interest and costs.

On August 22, 2018, Energy Systems filed a claim against us in Puerto Rico alleging Breach of Distribution Contract under Law No. 75 of June 24, 1964, as amended, 10 l.p.r.a. §§ 278-278. The case was filed under the caption Energy Systems of Caribbean, Inc., v. Capstone Turbine Corporation, CIVIL NO. SJ2018cv06543 (904). As remedies for these alleged claims, Energy Systems seeks actual damages, injunctive relief, attorney's fees and costs. This matter was subsequently removed to the United States District Court for the District of Puerto Rico based on diversity jurisdiction (Case No. 3:18-cv-01611). The parties have since stipulated to a stay of both the federal litigation and arbitration so that the parties may pursue settlement.

The parties entered into settlement discussions and on April 29, 2019 participated in mediation to resolve the dispute. The mediation was successful and the parties are currently drafting a more formal settlement agreement that upon execution will require the respective matters to be dismissed. We have not recorded any liability as of March 31, 2019 since any potential loss is not considered material.

**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”. 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 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 have been provided 180 calendar days, or until May 22, 2019, to regain compliance with the minimum bid price requirement. In order to regain compliance, the bid price of the Company’s common stock must close at $1.00 per share or more for a minimum of ten consecutive business days, at which time Nasdaq would provide written confirmation of the Company’s compliance. On May 23, 2019, the Company was afforded an additional 180-day grace period to regain compliance with the minimum bid price requirement.

*Stockholders*

As of June 6, 2019, there were 243 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.

*Recent Sales of Unregistered Securities*

There were no sales of unregistered securities during the fourth quarter ended March 31, 2019.

*Issuer Purchases of Equity Securities*

There were no repurchases of shares of common stock made during the fiscal year ended March 31, 2019.

### 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 (combined heat and power ("CHP") and combined cooling, heat and power ("CCHP")), where fuel costs are low (renewable energy/renewable fuels), where the costs of connecting to the grid may be high or impractical (such as remote power applications), where reliability and power quality are of critical importance, or in situations where peak shaving could be economically advantageous because of highly variable electricity prices. Our microturbines can be interconnected to other distributed energy resources to form "microgrids" (also called "distribution networks") located within a specific geographic area and provide power to a group of buildings. Because our microturbines can provide a reliable source of power and can operate on multiple fuel sources, management believes they offer a level of flexibility not currently offered by other technologies such as reciprocating engines.

Our goals for Fiscal 2019 were to achieve EBITDA breakeven; significantly grow gross margin and revenue for our accessories, parts and service; strengthen our core market verticals, while diversifying into additional market verticals and geographies; and drive towards 100% aftermarket sales absorption. During Fiscal 2019 our net loss increased by 67% to \$16.7 million and our basic and diluted loss per share increased by 25% to \$0.25 compared to \$10.0 million and \$0.20, respectively, in the same period of the previous year. The increase in the net loss during Fiscal 2019 was primarily because of higher warranty expense, higher than normal levels of FPP scheduled and unscheduled maintenance activities and interest expense. Our warranty provision and FPP scheduled and unscheduled maintenance activities negatively impacted Fiscal 2019 net loss primarily because of a supplier defect that was identified during the first quarter of Fiscal 2019. 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 2019 compared to Fiscal 2018. Fiscal 2019 was characterized by growth of our aftermarket service business because of additional revenue from our Distributor Support System ("DSS program") and rental income from our factory rental program compared to Fiscal 2018. Additionally, although the U.S. dollar has somewhat weakened against other currencies, it 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 experienced revenue growth in the natural resources market during Fiscal 2019, which we believe was primarily because oil prices continued to be higher than \$50.00 a barrel, we continued to be impacted by the volatility of the global oil and gas markets and the ongoing global geopolitical tensions. 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, | |
|---|---|---|
| | **2019** | **2018** |
| Energy efficiency | 47% | 47% |
| Natural resources | 40% | 38% |
| Renewable energy | 7% | 9% |
| Critical Power Supply | 3% | 4% |
| Microgrid | 3% | 2% |

*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 heath 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.

Our technology is also used in marine applications. Our customers have applied our products in the commercial vessel and luxury yacht market segments. The application for our marine products is for use as a ship auxiliary engine. In this application, the microturbines provide power to the vessel's electrical loads and, in some cases, the vessel is able to utilize the exhaust energy to increase the overall efficiency of the application, thereby reducing overall fuel consumption and emissions. Another feasible application is similar to our HEV application where the vessel is driven by an electric propulsion system and the microturbine serves as an on board range extender. Transportation is a developing market segment for us. In Fiscal 2019, transportation products were only for customer demonstrations.

*Backlog*

Net product orders were approximately $46.2 million and $42.3 million for Fiscal 2019 and Fiscal 2018, respectively. Ending backlog was approximately $71.3 million at March 31, 2019 compared to $97.3 million at March 31, 2018. Book-to-bill ratio was 1.1:1 and 1.0:1 for Fiscal 2019 and Fiscal 2018, respectively. Book-to-bill ratio is the ratio of new orders we received to units shipped and billed during a period.

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

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

Pursuant to the terms of the Assignment Agreement, we agreed to assign to TI the right, title and interest to receivables owed to us from BPC Engineering, our former Russian distributor ("BPC"), upon TI's payment to us of $2.5 million in three payments by February 1, 2018. We received payments from TI of approximately $1.0 million under the Assignment Agreement during Fiscal 2018 which was recorded as bad debt recovery. The receivables owed to us from BPC had a balance of $5.3 million as of March 31, 2018, and this balance was fully reserved.

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

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

On June 5, 2018, we entered into an amendment to the Assignment Agreement (the "Amended Assignment Agreement") and the Note (the "Amended Note") with TI. Pursuant to the terms of the Amended Assignment Agreement, the right, title and interest to receivables owed to us from BPC will be contingent upon TI's payment to us of the remaining approximately $1.5 million in five payments by September 20, 2019. We collected approximately $0.5 million from TI during Fiscal 2019, under the terms of the Amended Assignment Agreement. 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. As of March 31, 2019, the right, title and interest to the accounts receivables owed to us from BPC had not been assigned to TI, as TI had not yet made all payments as required under the Amended Assignment Agreement. Under the terms of the Amended Note, TI agreed to pay us $3.8 million over a three-year period in 13 equal quarterly installments starting in December 20, 2019.

Due to the above agreements, 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. This removal was the result of our continuous review of BPC related backlog with TI which resulted in us no longer honoring the product pricing. After removal of the foregoing orders, the remaining backlog related to BPC as of March 31, 2019 comprises up to approximately 42% of our total backlog. This remaining backlog related to BPC continues to be reviewed with TI and the other new distributors in the region, and they have the right to request delivery of those backlog orders if the associated projects proceed. Nonetheless, the remaining backlog related to BPC may be negatively impacted.

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

2) ***Sales and Distribution Channels*** We seek out distributors that have business experience and capabilities to support our growth plans in our targeted markets. A significant portion of our revenue is derived from sales to distributors who resell our products to end users. We have a total of 88 distributors, Original Equipment Manufacturers ("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 2019 and Fiscal 2018 was approximately $78.9 million and $75.6 million, respectively, which represents the value of the contractual agreement for FPP services that has not been earned and extends through Fiscal 2034. Additionally, we offer new and remanufactured parts through our global distribution network. Service revenue in Fiscal 2019 was approximately 21% 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 2019, we received support from the Department of Energy Technology Commercialization to refine Argonne National Laboratory's ("Argonne") high-efficiency, fast-charging and fast-discharging thermal energy-storage system ("TESS") for use in CHP systems. The new Capstone CHP system will incorporate Argonne's high-efficiency, fast-charging, and fast-discharging TESS for waste heat recovery and reuse in projects that require process heat and industrial manufacturing environments. This new project focuses on integrating Argonne's TESS into a C200 CHP system, specifically, using thermal modeling and simulations to optimize system design; fabricating and integrating the TESS into the C200 system; testing the performance of the integrated TESS-C200 CHP system and conducting both a technology and economic analysis to establish performance and cost benefits of the new integrated microturbine and thermal battery solution

Our product development activities during Fiscal 2019 included the successful launch of the new family of PowerSync controllers used for Capstone microturbines. We also continued development and testing 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 electronics to today's standards, providing common functionality and enabling long term support. In addition, our product development activities during Fiscal 2019 included certification of our C65, C200S, and C1000S series microturbines to the latest UL 1741 interconnection standards.

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. Due to their capacity issues, it is uncertain if we will experience an interruption in parts from this supplier or be able to fully offset or recover any resulting component price increases. This could impact margins or sales in future quarters. During the first quarter of Fiscal 2019, we issued a prepayment of approximately $2.2 million to this single source supplier. As of March 31, 2019, there were gradual improvement trends in the capacity issues at the supplier. A new supplier has been identified and has been fully qualified and is now working towards increasing its capacity and is expected to meet our production volumes during Fiscal 2020.

We believe that effective execution in each of these key areas will be necessary to leverage Capstone's promising technology and early market leadership into achieving positive cash flow with growing market presence and improving financial performance. Based on our recent progress and assuming achievement of targeted cost reductions and product mix, pricing and performance and our increasing accessories, parts and service revenue with improved gross margins, our financial model indicates that we will achieve positive cash flow when we generate $25 million in quarterly revenue with a 25% gross margin. We expect to have costs and operating expenses increase in certain areas in Fiscal 2020, including sales and marketing, which if not offset by an increase in revenue, would reduce margins and profitability as we have limited ability to further reduce costs.

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

**Critical Accounting Policies**

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, 2019 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, 2019 Compared to Year Ended March 31, 2018***

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

| | Year Ended March 31, 2019 Revenue | Year Ended March 31, 2018 Revenue |
|---|---|---|
| United States and Canada | $ 46.3 | $ 39.2 |
| Europe and Russia | 16.1 | 15.6 |
| Latin America | 9.6 | 9.8 |
| Asia and Australia | 9.1 | 13.8 |
| Middle East and Africa | 2.3 | 4.4 |
| Total | $ 83.4 | $ 82.8 |

***Revenue*** Revenue for Fiscal 2019 increased $0.6 million, or 1%, to $83.4 million from $82.8 million for Fiscal 2018. The change in revenue for Fiscal 2019 compared to Fiscal 2018 included increases in revenue of $7.1 million from the United States and Canadian markets and $0.5 million from the European and Russian markets. These overall increases in revenue were offset by decreases in revenue of $4.7 million from the Asian and Australian markets, $2.1 million from the Middle East and African markets and $0.2 million from the Latin American market. The increase in revenue in the United States and Canadian markets during Fiscal 2019 compared to the same period the previous year was primarily because of increases in accessories and parts revenue and product shipments into the energy efficiency vertical market. The increase in revenue in the European and Russian markets during Fiscal 2019 compared to the same period last year was primarily because the European energy efficiency and renewable energy vertical markets continue to improve. While our revenue in the European and Russian markets continues to be negatively impacted by the ongoing geopolitical tensions and a strong U.S. dollar, our revenue from the Russian market increased 11% during Fiscal 2019 compared to the same period last year primarily because of our strategic initiative to improve the diversification of our revenue, the improvement of sales from TI and additional revenue from new distributors in the Russian market. The decrease in revenue in the Asian and Australian markets was primarily because of decreases in accessories and parts revenue and product shipments into the energy efficiency and renewable energy vertical markets during Fiscal 2019 compared to the same period last year. The decrease in revenue in the Middle East and African markets was primarily the result of the shift in certain customers' project timelines during Fiscal 2019 compared to the same period last year. Our revenue in the Middle East and African markets continues to be negatively impacted by the volatility of the global oil and gas markets and ongoing geopolitical tensions in these regions. The decrease in revenue in the Latin American market was primarily because of a decrease in C1000 Signature Series systems shipments into the natural resources market during Fiscal 2019 compared to the same period last year.

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

| | Year Ended March 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2019 | | | 2018 | | |
| | Revenue | Megawatts | Units | Revenue | Megawatts | Units |
| Microturbine Product | $ 51.4 | 51.0 | 270 | $ 50.8 | 49.3 | 264 |
| Accessories and Parts | 14.9 | | | 15.9 | | |
| Service | 17.1 | | | 16.1 | | |
| Total Accessories, Parts and Service | 32.0 | | | 32.0 | | |
| Total | $ 83.4 | | | $ 82.8 | | |

For Fiscal 2019, revenue from microturbine products increased $0.6 million, or 1%, to $51.4 million from $50.8 million for Fiscal 2018. The increase in revenue was primarily because of a favorable shift in product mix, as we shipped a higher number of our C30, C200 and C1000 Signature Series microturbine systems during Fiscal 2019 compared to the same period last year. Megawatts shipped during Fiscal 2019 increased 1.7 megawatts, or 3%, to 51.0

megawatts from 49.3 megawatts during Fiscal 2018. Average revenue per megawatt shipped was approximately $1.0 million during each of Fiscal 2019 and 2018. 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 2019, revenue from our accessories and parts decreased $1.0 million, or 6%, to $14.9 million from $15.9 million for Fiscal 2018. The decrease in revenue from accessories and parts was primarily because of lower accessories shipments of our ORC systems and the timing of certain parts sales promotions.

Service revenue for Fiscal 2019 increased $1.0 million, or 6%, to $17.1 million from $16.1 million for Fiscal 2018. The increase in service revenue was due to increases in revenue from our DSS program, microturbine rental program and microturbine service work, offset by a decrease in revenue from FPP service agreements. The decrease in FPP service revenue was primarily the result of not recognizing revenue on certain service contracts because of the reassignment of those service contracts from Capstone's legacy California distributor to Cal Microturbine ("CAL"), one of our domestic distributors. Earned revenue from our DSS program for Fiscal 2019 was $1.7 million and included under the caption "Service revenue" in the accompanying condensed consolidated statements of operations.

Sales to E-Finity Distributed Generation, LLC ("E-Finity"), of our domestic distributors, accounted for 13% and 16% of our revenue for the years ended March 31, 2019 and 2018. 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. The gross margin was approximately $9.5 million, or 11% of revenue, for Fiscal 2019 compared to a gross margin of $15.0 million, or 18% of revenue, for Fiscal 2018. The decrease in gross margin of $5.5 million during Fiscal 2019 compared to Fiscal 2018 was primarily because of a $3.4 million decrease in our direct material costs margin, increase in warranty expense of $1.3 million and higher production and service center labor and overhead expense of $2.1 million, offset by lower inventory charges of $0.7 million and royalty expense of $0.6 million. Management continues to implement initiatives to improve gross margin in Fiscal 2020 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 $3.4 million during Fiscal 2019 compared to Fiscal 2018 primarily because of an increase of approximately $3.0 million in FPP expenses associated with higher than normal levels of unscheduled maintenance activities primarily as a result of a supplier defect identified during the first quarter of Fiscal 2019 and a lower selling price of two C1000 refurbished systems.

The increase in warranty expense of $1.3 million during Fiscal 2019 compared to Fiscal 2018 was primarily because of an increase in our warranty provision as a result of a supplier defect identified during the first quarter of Fiscal 2019. We recognized approximately $0.7 million of expense related to this defective part. In addition, the increase in warranty expense during Fiscal 2019 was because of the completion of a reliability repair program during Fiscal 2018. During Fiscal 2017, we recorded a one-time non-cash warranty provision of approximately $5.2 million to retrofit proactively select non-Signature Series C200 microturbines with the more robust new Signature Series generator components to improve product performance and reliability. The remaining non-cash warranty provision of approximately $0.6 million for this reliability repair program was reversed during Fiscal 2018 because the program was completed. Management expects the warranty expense in Fiscal 2020 to be inline with Fiscal 2019 primarily because the standard warranty provision will remain elevated as a result of a supplier defect identified during the first quarter of Fiscal 2019.

Production and service center labor and overhead expense increased $2.1 million during Fiscal 2019 compared to Fiscal 2018 primarily because of increases of approximately $1.1 million in freight expense, $0.6 million in overhead allocated to finished goods inventory, $0.5 million in supplies expense, $0.3 million in consulting expense, $0.2 million of depreciation expense, and $0.2 million of product certification expense, offset by a decrease of $0.4 million in salaries expense and less facilities costs allocated to production and service center labor and overhead of $0.4 million due to the exit of our Nordoff facility.

On July 25, 2018, we and Carrier entered into a Second Amendment whereby we agreed to pay Carrier approximately $3.0 million to conclude our current royalty obligation under the Development Agreement and release us from any future royalty payment obligations. The Second Amendment also removed non-compete provisions from the Development Agreement, allowing us to design, market or sell our C200 System in conjunction with any energy system and compete with Carrier products in the CCHP market. On September 19, 2018, we paid in full the negotiated royalty settlement of $3.0 million to Carrier, and as such, there is no further royalty obligation to Carrier. The prepaid royalty of $3.0 million has been recorded under the captions “Prepaid expenses and other current assets” and “Other assets” in the accompanying condensed consolidated balance sheets and will be amortized in the accompanying condensed consolidated statement of operations over a 15-year amortization period through September 2033 using an effective royalty rate. 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. Royalty expense decreased $0.6 million during Fiscal 2019 compared to Fiscal 2018 primarily because we concluded our royalty obligation under the Development Agreement.

Inventory charges decreased $0.7 million during Fiscal 2019 compared to Fiscal 2018 primarily as the result of a decrease in provision for obsolete inventory.

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

| | Year Ended March 31, 2019 | Year Ended March 31, 2018 |
|---|---|---|
| **Gross Margin** | | |
| Product | $ 0.2 | $ 2.9 |
| As a percentage of product revenue | 0 % | 6 % |
| Accessories, parts and service | $ 9.3 | $ 12.1 |
| As a percentage of accessories, parts and service revenue | 29 % | 38 % |
| Total Gross Margin | $ 9.5 | $ 15.0 |
| As a percentage of total revenue | 11 % | 18 % |

The decrease in product gross margin during Fiscal 2019 compared to Fiscal 2018 was primarily because of an increase in warranty expense and an increase in direct material costs. Accessories, parts and service gross margin decreased during Fiscal 2019 compared to Fiscal 2018 primarily because of higher than normal levels of scheduled and unscheduled maintenance activities primarily as a result of a supplier defect identified during the first quarter of Fiscal 2019. Additionally, we did not recognize revenue on certain service contracts as a result of the reassignment of those service contracts from Capstone’s legacy California distributor to Cal Microturbine.

***Research and Development Expenses (“R&D”)*** R&D expenses for Fiscal 2019 decreased $0.4 million, or 10%, to $3.6 million from $4.0 million in Fiscal 2018. The overall decrease in R&D expenses of approximately $0.4 million resulted from decreases in salaries expense of approximately $0.4 million, supplies expense of $0.1 million and intellectual property patent legal expense of $0.1 million, offset by an increase in consulting expense of approximately $0.2 million during Fiscal 2019 compared to the same period last year. Management expects R&D expenses in Fiscal 2020 to be slightly higher than in Fiscal 2019 as a result of ongoing product development costs.

***Selling, General and Administrative (“SG&A”) Expenses*** SG&A expenses for Fiscal 2019 increased $1.4 million, or 7%, to $21.0 million from $19.6 million for Fiscal 2018. The net increase in SG&A expenses was comprised of increases of approximately $0.4 million in allocated facilities costs due to the exit of our Nordoff facility, $0.4 million in marketing expense and $0.3 million in business travel expense. In addition, the increase in SG&A expense resulted from lower bad debt recoveries of $0.8 million during Fiscal 2019 compared to the same period last year. These increases were offset by a decrease of $0.5 million in salaries expense, which was primarily because of our one-time Leadership Incentive Program recorded during Fiscal 2018. Excluding bad debt recovery recorded in Fiscal 2019, management expects SG&A expenses in Fiscal 2020 to be slightly higher than in Fiscal 2019 primarily as a result of increases in salaries expense, marketing expense and professional services, including legal expenses.

***Interest Expense*** Interest expense increased $0.9 million, or 150%, to $1.5 million during Fiscal 2019 from $0.6 million for Fiscal 2018. Interest expense increased because of higher debt outstanding and a higher interest rate. As of March 31, 2019, we had total debt of $27.1 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—New Credit Facility below for additional discussion on our three-year term note with Goldman Sachs.

***Income Tax Provision*** Income tax expense decreased $10,000, or 56%, to $8,000 during Fiscal 2019 from $18,000 during Fiscal 2018. Income tax expense incurred was related to state and foreign taxes. The effective income tax rate of -0.2% differs from the federal and state blended statutory rate of approximately 23.9% primarily as a result of maintaining a full valuation allowance against net deferred tax assets. At March 31, 2019, we had federal and state net operating loss carryforwards of approximately $643.2 million and $153.6 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 $171.6 million at March 31, 2019 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, 2018, the net deferred tax asset was fully reserved.

*Impacts of Tax Legislation*

The Tax Cuts and Jobs Act (the "Act") was enacted in December 2017. The Act reduces the U.S. federal corporate tax rate from 34% to 21%. As of March 31, 2019, upon completing its analysis of tax reform, the Company believes that the amount booked as provisional in its financial statements as of March 31, 2018 under SAB 118 is accurate and can now be considered finalized.

### 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)

| | Year Ended March 31, 2019 | | | | Year Ended March 31, 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| **(Unaudited)** | **Fourth Quarter** | **Third Quarter** | **Second Quarter** | **First Quarter** | **Fourth Quarter** | **Third Quarter** | **Second Quarter** | **First Quarter** |
| Revenue | $ 22,019 | $ 18,030 | $ 22,174 | $ 21,189 | $ 21,061 | $ 22,761 | $ 19,774 | $ 19,240 |
| Cost of goods sold | 18,665 | 15,790 | 20,137 | 19,367 | 16,292 | 17,804 | 16,758 | 17,001 |
| Gross margin | 3,354 | 2,240 | 2,037 | 1,822 | 4,769 | 4,957 | 3,016 | 2,239 |
| Operating expenses: | | | | | | | | |
| R&D | 887 | 891 | 891 | 932 | 796 | 957 | 1,139 | 1,149 |
| SG&A | 5,424 | 4,574 | 5,308 | 5,651 | 5,795 | 4,057 | 4,796 | 4,960 |
| Loss from operations | (2,957) | (3,225) | (4,162) | (4,761) | (1,822) | (57) | (2,919) | (3,870) |
| Net loss | $ (3,954) | $ (3,450) | $ (4,357) | $ (4,897) | $ (1,942) | $ (323) | $ (3,668) | $ (4,093) |
| Net loss per common share—basic and diluted | $ (0.06) | $ (0.05) | $ (0.07) | $ (0.08) | $ (0.04) | $ (0.01) | $ (0.09) | $ (0.10) |

During the three months ended March 31, 2018, we received approximately $0.3 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, 2018, we recorded approximately $0.9 million in compensation expense with respect to our one-time Leadership Incentive Program which was primarily included under SG&A. No such expense was recorded during the three months ended March 31, 2019.

### 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, 2020 include approximately $3.0 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 increased $10.3 million during the fiscal year ended March 31, 2019, compared to a decrease of $0.3 million during the fiscal year ended March 31, 2018. The increase in cash, cash equivalents and restricted cash during Fiscal 2019 compared to the decrease 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.

***Operating Activities*** 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 (primarily warranty provision, accounts receivable allowances, depreciation and amortization, stock based compensation and inventory provision) of $5.1 million. During the fiscal year ended

March 31, 2018, we used $8.6 million in cash in our operating activities, which consisted of a net loss for the period of $10.0 million and cash used for working capital of $2.8 million, offset by non-cash adjustments of $4.2 million.

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

| | Year Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Net loss | $ (16,659) | $ (10,026) |
| Non-cash operating activities(1) | 5,115 | 4,172 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 91 | 3,222 |
| Inventories | (5,850) | (2,595) |
| Accounts payable and accrued expenses | 3,048 | (866) |
| Prepaid expenses, other current assets and other assets | (3,813) | 10 |
| Other changes in operating assets and liabilities | 365 | (2,558) |
| Net cash used in operating activities | $ (17,703) | $ (8,641) |

(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, 2019 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. The change in accounts receivable during the fiscal year ended March 31, 2019 was lower compared to fiscal year ended March 31, 2018, primarily the result of higher revenue in Fiscal 2019 and higher collections in Fiscal 2018. The change in inventory increased primarily due to an increase in raw materials during the fiscal year ended March 31, 2019 compared to the fiscal year ended March 31, 2018. 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, 2019 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, 2019 was primarily because of a negotiated royalty settlement to Carrier and a supplier prepayment obligation, each described below. The change in other operating assets and liabilities during the fiscal year ended March 31, 2019 compared to fiscal year ended March 31, 2018, was primarily the result of warranty payments for the proactive retrofit of certain non-Signature Series C200 microturbines and this warranty program was completed during the three months ended December 31, 2017.

***Investing Activities*** Net cash used in investing activities of $3.4 million and $1.8 million during the fiscal year ended March 31, 2019 and 2018, 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, 2019 we deployed approximately $2.8 million of our C1000 Signature Series systems under our factory rental program. During the fiscal year ended March 31, 2018, we consolidated our operations and offices into our Van Nuys, California location from our Chatsworth, California location.

***Financing Activities*** During the fiscal year ended March 31, 2019, we generated approximately $31.4 million in financing activities compared to cash generated during the fiscal year ended March 31, 2018 of approximately $10.1 million. 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. The funds generated from financing activities during the fiscal year ended March 31, 2018 were primarily the result of proceeds from the October 2017 exercise of warrants and the at-the-market offering program described below, offset by net repayments under the credit facility and the 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 its sole discretion, shares of our common stock, having an aggregate offering price of up to $30.0 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 year ended March 31, 2018, we issued 16.0 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 $11.9 million after deducting commissions paid of approximately $0.3 million. As of March 31, 2018, 23.3 million shares of our common stock were cumulatively sold pursuant to the at-the-market offering program and the net proceeds to us from the sale of the common stock were approximately $24.6 million after deducting commissions paid of approximately $0.7 million. As of March 31, 2018, $4.1 million remained available for issuance with respect to the at-the-market offering program. During the fiscal year ended March 31, 2019, we issued 2.8 million shares of our common stock under the at-the-market offering program and the net proceeds to us from the sale of our common stock were approximately $4.0 million after deducting commissions paid of approximately $0.1 million. This completed the at-the-market offering program with Cowen.

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, 2019, we issued 7.6 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 $6.9 million after deducting commissions paid of approximately $0.2 million. As of March 31, 2019, approximately $17.8 million remained available for issuance with respect to this at-the-market offering program.

*Warrants*

On October 18, 2016, we entered into a securities purchase agreement with certain accredited investors, pursuant to which we agreed to sell 3,600,000 shares of common stock, pre-funded Series B warrants to purchase up to 2,700,000 shares of common stock (“the October 2016 Offering”), and Series A warrants to purchase up to 6,300,000 shares of common stock. Pursuant to a placement agent agreement, dated as of October 18, 2016, we engaged Oppenheimer & Co. Inc. as the lead placement agent for the offering and ROTH Capital Partners, LLC as co-placement agent for the offering. Each share of common stock was sold at a price of $1.20. Each Series B warrant was issued with an exercise price of $1.20 per share of common stock, $1.19 of which was pre-funded at closing and $0.01 of which is payable upon exercise. Each Series A warrant was issued with an initial exercise price of $1.34 per share of common stock. These Series A warrants contain anti-dilution provisions that reduce the exercise price of the warrants if certain dilutive issuances occur. The anti-dilution provisions of the Series A warrants were approved by our stockholders at the 2017 annual meeting of stockholders held on August 31, 2017 and exercise price of the warrants were adjusted to $0.60 per share. The value of this down round feature was measured using the Binomial valuation model and resulted in a loss of approximately and $0.7 million during the fiscal year ended March 31, 2018. The net proceeds to us from this offering, after deducting the placement agent fees and other estimated offering expenses, were approximately $6.8 million. The offering closed on October 21, 2016. On April 13, 2018, a warrant holder exercised its rights to the warrant agreement to exercise on a cashless basis 5,760,000 Series A warrants at an exercise price of $0.60 per share under the warrant agreement. In accordance with terms of the warrant agreement, after taking into account the shares withheld to satisfy the cashless exercise option, we issued 3,806,243 shares of common stock.

On October 26, 2017, the Company entered into a Warrant Exercise Agreement (the “Exercise Agreement”) with a holder of the Series A warrants (the “Exercising Holder”), which Exercising Holder owns Series A warrants exercisable for 1,928,750 shares of Common Stock. Pursuant to the Exercise Agreement, the Exercising Holder and the Company agreed that the Exercising Holder would exercise its Series A warrants with respect to 1,928,750 shares of Common Stock underlying such Series A warrants for a reduced exercise price equal to $0.90 per share. On October 27, 2017, the Company received net proceeds of approximately $1.7 million from the exercise of the Series A warrants by the Exercising Holder. The Company did not pay any financial advisory fees in connection with the exercise of the Series A warrants by the Exercising Holder. In addition, the exercise resulted in the reduction of warrants to purchase common stock, par value $0.001 per share, of the Company by approximately 19% and was not dilutive to existing stockholders of the Company calculated on a fully diluted basis for outstanding warrants.

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

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 4,046,337 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 $0.8859 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.

There were no stock options exercised during the years ended March 31, 2019 and 2018, 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, 2019, compared with $22,000 of net cash used during the fiscal year ended March 31, 2018.

***Former Credit Facility*** On June 2, 2017, we entered into two secured credit facilities (the "Bridge Bank Credit Agreements") with Western Alliance Bank through its Bridge Bank division ("Bridge Bank"), with credit support provided by the Export-Import Bank of the United States through its working capital guarantee program. Under the terms of the Bridge Bank Credit Agreements, we may borrow up to $12.0 million on a revolving basis depending on, among other factors, the amount of our eligible inventory and accounts receivable. The Bridge Bank Credit Agreements are for a two-year period ending June 2, 2019. As of March 31, 2018, $8.5 million in borrowings were outstanding under the former credit facility.

Total borrowings, letter of credit obligations and the then aggregate committed amount of cash management services under the Bridge Bank Credit Agreements may not exceed 85% of the sum of unrestricted cash and the amount of cash collateral held at Bridge Bank. As a condition of the Bridge Bank Credit Agreements, we have restricted $5.0 million of cash equivalents as additional security for the credit facility. Borrowings under the Bridge Bank Credit Agreements will bear per annum interest at the prime rate plus 1.5 percent, subject to increase during the occurrence of an event of default. Obligations under the Bridge Bank Credit Agreements are secured by all of our assets, including intellectual property and general intangibles.

On June 1, 2018, the Company entered into a letter agreement (the "Letter Agreement") with Bridge Bank. The Letter Agreement extended the maturity date under the Company's Bridge Bank Credit Agreements from June 2, 2019 to June 2, 2021. The Letter Agreement increased the line of credit to an amount up to $15.0 million from $12.0 million. Additionally, the Letter Agreement reduced the per annum interest from prime rate plus 1.50 percent to 1.0 percent; the facility fee from 0.625% to 0.5%; and the cash collateral held at Bridge Bank from 42% to 40%, which is $6.0 million of the $15.0 million facility, as well as eliminated the early termination fee.

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

The financial covenants of the domestic credit agreement with Bridge Bank (the “Domestic Facility”) requires us not to exceed specified levels of losses relative to our financial model and the outstanding line of credit advances may not exceed 85% of the sum of unrestricted cash and the amount of cash collateral held at Bridge Bank. The Domestic Facility also defines an event of default to include a material adverse effect on our business. An event of default for this or any other reason, if not waived, could have a material adverse effect on us. As of March 31, 2018 we were in compliance with the covenants contained in the Bridge Bank Credit Agreements for Fiscal 2018. Upon closing with Goldman Sachs Specialty Lending Holdings, Inc., our Bridge Bank Credit Agreements 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 of 1933, as amended. 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.

In addition to the Note Purchase Agreement, 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 4,046,337 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 $0.8859 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.

***Working Capital*** Cash used in working capital was $6.2 million during the fiscal year ended March 31, 2019, an increase of $3.4 million from the $2.8 million cash used during the fiscal year ended March 31, 2018. We attribute the increase in our working capital requirements primarily to higher raw materials inventory, a negotiated royalty settlement agreement payment to Carrier, prepayments to one of our single source suppliers that notified us that they were at maximum capacity and would require prepayment and a significant increase in the price of multiple components in order to fulfill our supply requirements for Fiscal 2019. These increases in working capital requirements were offset by a decrease in accounts payable payments and cash received for our DSS program and FPP services. The increase in raw materials was primarily because we didn’t fully achieve our planned number of product shipments during the fiscal year ended March 31, 2019.

***Evaluation of Ability to Maintain Current Level of Operations*** In connection with preparing the consolidated financial statements for the fiscal year ended March 31, 2019, management evaluated whether there were conditions and events, considered in the aggregate, that raised substantial doubt about our ability to meet our obligations as they became due for the next twelve months from the date of issuance of our Fiscal 2019 financial statements. Management assessed that there were such conditions and events, including a history of recurring operating losses, negative cash flows from operating activities, the continued negative impact by the volatility of the global oil and gas markets, a strong U.S. dollar in certain markets making our products more expensive in such markets and ongoing global geopolitical tensions. We incurred a net loss of $16.7 million and used cash in operating activities of $17.7 million during the fiscal year ended March 31, 2019. Our working capital requirements during the fiscal year ended March 31, 2019 were in line with management’s expectations, which included higher raw materials inventory, prepayments for certain raw materials, royalty settlement payment and higher warranty payments. Our net loss expanded during the year ended March 31, 2019 primarily because of an increase in our warranty provision 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, 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. As of March 31, 2019, we had cash and cash equivalents of $29.7 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 2019 financial statements, we will be able to meet our financial obligations as they become due over the next twelve months from the date of issuance of our Fiscal 2019 financial statements.

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

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

Our accounts receivable balance, net of allowances, was $16.2 million and $16.0 million as of March 31, 2019 and March 31, 2018, respectively. Days sales outstanding in accounts receivable, ("DSO"), increased by one day to 70 days as of March 31, 2019 compared to 69 days as of March 31, 2018. We recorded net bad debt recovery of approximately $0.3 million and $1.1 million for the years ended March 31, 2019 and 2018, 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.

## 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, 2019 and 2018. 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 May 2014, the Financial Accounting Standards Board ("FASB") issued ASU, 2014-09, Revenue from Contracts with Customers (Topic 606), ("ASU 2014-09"). ASU 2014-09 outlines a single, comprehensive model for accounting for revenue from contracts with customers and requires more detailed disclosure to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from such contracts. ASU 2014-09 provides a five-step analysis of transactions to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods and services. On April 1, 2018, we adopted ASU 2014-09 under the modified retrospective transition method. This method was applied to contracts that were not complete as of the date of initial application of ASU 2014-09.

During Fiscal 2019, we recognized revenue based on ASU 2014-09, however revenue for Fiscal 2018 was recognized based on Accounting Standards Codification, Topic 605, Revenue Recognition. See Note 7—Revenue Recognition for additional discussion of the impact of the adoption of ASU 2014-09.

On December 22, 2017, the SEC issued guidance under Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act ("SAB 118") directing taxpayers to consider the impact of the U.S. legislation as "provisional" when it does not have the necessary information available, prepared or analyzed (including computations) in reasonable detail to complete its accounting for the change in tax law. As of December 31, 2018, upon completing its analysis, we believe that the amount recorded as provisional in our financial statements as of March 31, 2018 under SAB 118 is final.

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 and it did not have a material impact on our consolidated financial position and results of operations.

*Not yet adopted*

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

On June 2018, the FASB issued ASU 2018-07, "Shared-Based Payment Arrangements with Nonemployees" (Topic 505), ("ASU 2018-07"). ASU 2018-07 simplifies the accounting for share-based payments granted to nonemployees for goods and services. Under ASU 2018-07, most of the guidance on such payments to nonemployees will be aligned with the requirements for share-based payments granted to employees. Under the ASU 2018-07, the measurement of equity-classified nonemployee share-based payments will be fixed on the grant date, as defined in ASC 718, and will use the term nonemployee vesting period, rather than requisite service period. The amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted if financial statements have not yet been issued. We are currently evaluating the impact of ASU 2018-07 on our consolidated financial position and results of operations.

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, 2019, 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, 2019 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, 2019.

*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 2019 Proxy Statement to be filed with the U.S. Securities and Exchange Commission ("SEC") in connection with the solicitation of proxies for the Company's 2019 Annual Meeting of Shareholders ("2019 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 2019 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 2019 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 2019 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 2019 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 2019 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**



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, 2019 and 2018, the related consolidated statements of operations, stockholders’ equity and cash flows for each of the two years in the period ended March 31, 2019, 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, 2019 and 2018, and the results of its operations and its cash flows for each of the two years in the period ended March 31, 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 11, 2019

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

**(In thousands, except share amounts)**

| | March 31, 2019 | March 31, 2018 |
|---|---|---|
| **Assets** | | |
| Current Assets: | | |
| Cash and cash equivalents | $ 29,727 | $ 14,408 |
| Restricted cash | — | 5,000 |
| Accounts receivable, net of allowances of $5,298 at March 31, 2019 and $5,744 at March 31, 2018 | 16,222 | 15,968 |
| Inventories, net | 20,343 | 15,633 |
| Prepaid expenses and other current assets | 3,818 | 2,803 |
| Total current assets | 70,110 | 53,812 |
| Property, plant, equipment and rental assets, net | 5,291 | 2,859 |
| Non-current portion of inventories | 1,403 | 1,041 |
| Intangible assets, net | 187 | 411 |
| Other assets | 2,972 | 250 |
| Total assets | $ 79,963 | $ 58,373 |
| **Liabilities and Stockholders' Equity** | | |
| Current Liabilities: | | |
| Accounts payable and accrued expenses | $ 16,638 | $ 13,503 |
| Accrued salaries and wages | 1,637 | 1,588 |
| Accrued warranty reserve | 2,614 | 1,682 |
| Deferred revenue | 7,167 | 6,596 |
| Revolving credit facility | — | 8,527 |
| Current portion of notes payable and capital lease obligations | 31 | 192 |
| Total current liabilities | 28,087 | 32,088 |
| Deferred revenue - non-current | 1,069 | — |
| Term note payable, net | 27,099 | — |
| Long-term portion of notes payable and capital lease obligations | 212 | 130 |
| Other long-term liabilities | 342 | 396 |
| Total liabilities | 56,809 | 32,614 |
| Commitments and contingencies (Note 13) | | |
| Stockholders' Equity: | | |
| Preferred stock, $.001 par value; 10,000,000 shares authorized; none issued | — | — |
| Common stock, $.001 par value; 515,000,000 shares authorized, 71,971,586 shares issued and 71,709,203 shares outstanding at March 31, 2019; 57,062,598 shares issued and 56,916,646 shares outstanding at March 31, 2018 | 72 | 57 |
| Additional paid-in capital | 903,738 | 889,585 |
| Accumulated deficit | (878,884) | (862,225) |
| Treasury stock, at cost; 262,383 shares at March 31, 2019 and 145,952 shares at March 31, 2018 | (1,772) | (1,658) |
| Total stockholders' equity | 23,154 | 25,759 |
| Total liabilities and stockholders' equity | $ 79,963 | $ 58,373 |

See accompanying notes to consolidated financial statements.

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

**(In thousands, except per share amounts)**

| | Years Ended March 31, 2019 | Years Ended March 31, 2018 |
|---|---|---|
| Revenue: | | |
| Product, accessories and parts | $ 66,303 | $ 66,754 |
| Service | 17,109 | 16,083 |
| Total revenue | 83,412 | 82,837 |
| Cost of goods sold: | | |
| Product, accessories and parts | 60,149 | 56,590 |
| Service | 13,811 | 11,266 |
| Total cost of goods sold | 73,960 | 67,856 |
| Gross margin | 9,452 | 14,981 |
| Operating expenses: | | |
| Research and development | 3,600 | 4,040 |
| Selling, general and administrative | 20,958 | 19,609 |
| Total operating expenses | 24,558 | 23,649 |
| Loss from operations | (15,106) | (8,668) |
| Other income (expense) | (43) | (2) |
| Interest income | — | 9 |
| Interest expense | (1,502) | (606) |
| Change in warrant valuation | — | (741) |
| Loss before provision for income taxes | (16,651) | (10,008) |
| Provision for income taxes | 8 | 18 |
| Net loss | $ (16,659) | $ (10,026) |
| Net loss per common share—basic and diluted | $ (0.25) | $ (0.20) |
| Weighted average shares used to calculate basic and diluted net loss per common share | 66,994 | 51,339 |

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 | Accumulated | Treasury Stock | | Total Stockholders' |
|---|---|---|---|---|---|---|---|
| | Shares | Amount | Capital | Deficit | Shares | Amount | Equity |
| Balance, March 31, 2017 | 38,920,174 | $ 39 | $ 874,697 | $ (852,199) | 116,544 | $ (1,639) | $ 20,898 |
| Purchase of treasury stock | — | — | — | — | 29,408 | (19) | (19) |
| Vested restricted stock awards | 239,742 | — | 17 | — | — | — | 17 |
| Stock-based compensation | — | — | 586 | — | — | — | 586 |
| Exercise of stock options and employee stock purchases | 5,836 | — | 4 | — | — | — | 4 |
| Stock awards to Board of Directors | 3,969 | — | (14) | — | — | — | (14) |
| Issuance of common stock, net of issuance costs | 15,964,127 | 16 | 11,820 | — | — | — | 11,836 |
| Warrants exercised | 1,928,750 | 2 | 1,734 | — | — | — | 1,736 |
| Change in warrants valuation | — | — | 741 | — | — | — | 741 |
| Net loss | — | — | — | (10,026) | — | — | (10,026) |
| Balance, March 31, 2018 | 57,062,598 | 57 | 889,585 | (862,225) | 145,952 | (1,658) | 25,759 |
| Purchase of treasury stock | — | — | — | — | 116,431 | (114) | (114) |
| Vested restricted stock awards | 296,991 | — | 113 | — | — | — | 113 |
| Stock-based compensation | — | — | 907 | — | — | — | 907 |
| Exercise of stock options and employee stock purchases | 1,012 | — | 1 | — | — | — | 1 |
| Stock awards to Board of Directors | 457,183 | — | (70) | — | — | — | (70) |
| Issuance of common stock, net of issuance costs | 10,347,559 | 11 | 10,934 | — | — | — | 10,945 |
| Warrants exercised | 3,806,243 | 4 | (4) | — | — | — | — |
| Warrants issued | — | — | 2,272 | — | — | — | 2,272 |
| Change in warrants valuation | — | — | — | — | — | — | — |
| Net loss | — | — | — | (16,659) | — | — | (16,659) |
| Balance, March 31, 2019 | 71,971,586 | $ 72 | $ 903,738 | $ (878,884) | 262,383 | $ (1,772) | $ 23,154 |

See accompanying notes to consolidated financial statements.

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In thousands)**

| | Year Ended March 31, | |
|---|---|---|
| | **2019** | **2018** |
| **Cash Flows from Operating Activities:** | | |
| Net loss | $ (16,659) | (10,026) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 1,261 | 1,170 |
| Amortization of deferred financing costs | 311 | 202 |
| Reduction in accounts receivable allowances | (345) | (1,099) |
| Inventory provision | 778 | 1,420 |
| Provision for warranty expenses | 2,201 | 942 |
| Loss on disposal of equipment | 2 | 210 |
| Stock-based compensation | 907 | 586 |
| Change in warrant valuation | — | 741 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 91 | 3,222 |
| Inventories | (5,850) | (2,595) |
| Prepaid expenses, other current assets and other assets | (3,813) | 10 |
| Accounts payable and accrued expenses | 3,048 | (866) |
| Accrued salaries and wages and long term liabilities | (6) | 9 |
| Accrued warranty reserve | (1,269) | (3,026) |
| Deferred revenue | 1,640 | 459 |
| Net cash used in operating activities | (17,703) | (8,641) |
| **Cash Flows from Investing Activities:** | | |
| Expenditures for property, equipment and rental assets | (3,360) | (1,752) |
| Net cash used in investing activities | (3,360) | (1,752) |
| **Cash Flows from Financing Activities:** | | |
| Net repayments of revolving credit facility | (8,527) | (3,006) |
| Net proceeds from term note payable | 29,262 | — |
| Repayment of notes payable and capital lease obligations | (337) | (457) |
| Cash used in employee stock-based transactions | (114) | (22) |
| Net proceeds from issuance of common stock and warrants | 11,098 | 13,581 |
| Net cash provided by financing activities | 31,382 | 10,096 |
| Net increase (decrease) in Cash, Cash Equivalents and Restricted Cash | 10,319 | (297) |
| Cash, Cash Equivalents and Restricted Cash, Beginning of Year | 19,408 | 19,705 |
| Cash, Cash Equivalents and Restricted Cash, End of Year | $ 29,727 | $ 19,408 |
| **Supplemental Disclosures of Cash Flow Information:** | | |
| Cash paid during the period for: | | |
| Interest | $ 453 | 414 |
| Income taxes | $ 6 | 30 |
| **Supplemental Disclosures of Non-Cash Information:** | | |
| Renewal of insurance contracts which was financed by notes payable | $ — | 422 |

See accompanying 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, 2019 and 2018 (in thousands):

| | |
|---|---|
| **Balance, March 31, 2017** | $ 6,845 |
| Additions charged to costs and expenses | (1,099) |
| Bad debt write-off | (2) |
| **Balance, March 31, 2018** | $ 5,744 |
| Additions charged to costs and expenses | (345) |
| Bad debt write-off | (101) |
| **Balance, March 31, 2019** | $ 5,298 |

***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.

***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, 2019 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 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.

**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, 2019 and 2018.

***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 potions that no longer meet the more-likely-than-not threshold are derecognized in the first subsequent financial reporting period in which that threshold is not 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, 2019, 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 $29.1 million as of March 31, 2019. 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.

Sales to E-Finity Distributed Generation, LLC ("E-Finity"), one of the Company's domestic distributors, accounted for 13% and 16% of the Company's revenue for the fiscal years ended March 31, 2019 and 2018, 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, 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. Serba Dinamik Sdn Bhd ("Serba"), one of the Company's Malaysian distributors, E-Finity, and Supernova Energy Services SAS ("Supernova"), one of the Company's Colombian distributors, accounted for 20%, 18% and 10%, respectively, of net accounts receivable as of March 31, 2018.

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. The receivables owed to the Company from BPC had a balance of $4.8 million as of March 31, 2019, and this balance was fully reserved.

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 will 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 in December 20, 2019. As of March 31, 2019, the right, title and interest to the accounts receivables owed to the Company from BPC had not been assigned to TI, as TI had not yet made all payments as required under the Amended Assignment Agreement. The payment of $0.4 million, due March 20, 2019 under the Amended Assignment Agreement, has not been received at the date of this filing.

The Company recorded bad debt recoveries of approximately $0.3 million and $1.1 million for the fiscal years ended March 31, 2019 and 2018, respectively. As of March 31, 2019, the Company collected cumulatively approximately $1.8 million from BPC on their previously reserved accounts receivable. Additionally, the Company collected approximately $1.5 million from TI, under the terms of the Assignment Agreement. The remaining balance is $4.8 million as of March 31, 2019 and this balance was fully reserved.

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 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 at March 31, 2019 and 2018 were 0.2 million. Outstanding restricted stock units at March 31, 2019 and 2018 were 2.4 million and 2.0 million, respectively. As of March 31, 2019 and 2018, the number of warrants excluded from diluted net loss per common share computations was approximately 6.8 million and 8.5 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.

***Evaluation of Ability to Maintain Current Level of Operations*** In connection with preparing the consolidated financial statements for the fiscal year ended March 31, 2019, management evaluated whether there were conditions and events, considered in the aggregate, that raised substantial doubt about our ability to meet our obligations as they became due for the next twelve months from the date of issuance of our Fiscal 2019 financial statements. Management assessed that there were such conditions and events, including a history of recurring operating losses, negative cash flows from operating activities, the continued negative impact by the volatility of the global oil and gas markets, a strong U.S. dollar in certain markets making the Company's products more expensive in such markets and ongoing global geopolitical tensions. The Company incurred a net loss of $16.7 million and used cash in operating activities of $17.7 million during the fiscal year ended March 31, 2019. The Company's working capital requirements during the fiscal year ended March 31, 2019 were in line with management's expectations, which included higher raw materials inventory, prepayments for certain raw materials, royalty settlement payment and higher warranty payments. Our net loss expanded during the year ended March 31, 2019 primarily because of an approximate increase of $0.7 million in our warranty provision and $3.0 million higher FPP scheduled and unscheduled maintenance costs primarily as a result of a supplier defect identified during the first quarter of Fiscal 2019. Additionally, 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. As of March 31, 2019, the Company had cash and cash equivalents of $29.7 million, and outstanding borrowings under its credit facility of $30.0 million.

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

On February 4, 2019, the Company, entered into Note Purchase Agreements with Goldman Sachs Specialty Lending Holdings, Inc. ("Goldman Sachs"). Under the Note Purchase Agreement, the Company sold to the Purchaser $30.0 million aggregate principal amount of senior secured notes. The entire principal amount of the Notes is due and payable on February 4, 2022. See Note 12—Term Note Payable, for discussion of the three-year term note with Goldman Sachs. 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.

The Company maintained two secured credit facilities (the "Bridge Bank Credit Agreements") with Western Alliance Bank through its Bridge Bank division ("Bridge Bank"), with credit support provided by the Export-Import Bank of the United States through its working capital guarantee program, which provided the Company with a credit facility up to $15.0 million in the aggregate. Upon closing with Goldman Sachs, the Company's Bridge Bank Credit Agreements with Bridge Bank were paid off in full.

Based on the Company's current operating plan, management anticipates that, given current working capital levels, current financial projections, the new term note with Goldman Sachs, and the funds raised by selling additional securities through the at-the-market offering as of the date of issuance of its Fiscal 2019 financial statements, the Company will be able to meet its financial obligations as they become due over the next twelve months from the date of issuance of its Fiscal 2019 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, 2019 | Year Ended March 31, 2018 |
|---|---|---|
| United States | $ 45,480 | $ 39,100 |
| Mexico | 5,005 | 2,007 |
| All other North America | 791 | 158 |
| Total North America | 51,276 | 41,265 |
| Russia | 3,176 | 2,824 |
| All other Europe | 12,886 | 12,762 |
| Total Europe | 16,062 | 15,586 |
| Asia | 5,229 | 8,378 |
| Australia | 3,874 | 5,443 |
| All other | 6,971 | 12,165 |
| Total Revenue | $ 83,412 | $ 82,837 |

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

| | Year Ended March 31, 2019 | Year Ended March 31, 2018 |
|---|---|---|
| C30 | $ 1,810 | $ 1,694 |
| C65 | 11,719 | 12,740 |
| C200 | 5,218 | 2,832 |
| C600 | 6,286 | 9,057 |
| C800 | 5,846 | 6,461 |
| C1000 | 20,538 | 17,886 |
| Unit upgrades | — | 143 |
| Microturbine Products | $ 51,417 | $ 50,813 |
| Accessories and Parts | 14,886 | 15,941 |
| Total Product, Accessories and Parts | 66,303 | 66,754 |
| Service | 17,109 | 16,083 |
| Total Revenue | $ 83,412 | $ 82,837 |

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

***Recent Accounting Pronouncements*** On December 22, 2017, the SEC issued guidance under Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act ("SAB 118") directing taxpayers to consider the impact of the U.S. legislation as "provisional" when it does not have the necessary information available, prepared or analyzed (including computations) in reasonable detail to complete its accounting for the change in tax law. As of March 31, 2019, upon completing its analysis, we believe that the amount recorded as provisional in our financial statements as of March 31, 2018 under SAB 118 is final.

In July 2017, the FASB issued a two-part ASU No. 2017-11, I. Accounting for Certain Financial Instruments With Down Round Features and II. Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests With a Scope Exception ("ASU 2017-11"). ASU 2017-11 amends guidance in FASB ASC 260, Earnings Per Share, FASB ASC 480, Distinguishing Liabilities from Equity, and FASB ASC 815, Derivatives and Hedging. The amendments in Part I of

ASU 2017-11 change the classification analysis of certain equity-linked financial instruments (or embedded features) with down round features. The amendments in Part II of ASU 2017-11 re-characterize the indefinite deferral of certain provisions of Topic 480 that now are presented as pending content in the Codification, to a scope exception. Those amendments do not have an accounting effect. ASU 2017-11 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted. The Company adopted ASU 2017-11 for the three months ended June 30, 2017, and retrospectively applied ASU 2017-11 as required. See Note 10—Fair Value Measurements for further discussion on changes as a result of the adoption of ASU 2017-11.

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 and it did not have a material impact on our consolidated financial position and results of operations.

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

During Fiscal 2019, we recognized revenue based on ASU 2014-09, however revenue for Fiscal 2018 was recognized based on Accounting Standards Codification, Topic 605, Revenue Recognition. See Note 7—Revenue Recognition for additional discussion of the impact of the adoption of ASU 2014-09.

## 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, 2019 and 2018 (in thousands):

| | March 31, 2019 | March 31, 2018 |
|---|---|---|
| Raw materials | $ 24,426 | $ 17,981 |
| Work in process | — | 111 |
| Finished goods | 1,207 | 4,076 |
| Total | 25,633 | 22,168 |
| Less inventory reserve | (3,887) | (5,494) |
| Less non-current portion | (1,403) | (1,041) |
| Current portion | $ 20,343 | $ 15,633 |

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, 2019 is 1.0 years. The Company expects to use the non-current portion of the inventories on hand as of March 31, 2019 over the periods presented in the following table (in thousands):

| Expected Period of Use | Non-current Inventory Balance Expected to be Used |
|---|---|
| 13 to 24 months | $ 727 |
| 25 to 36 months | 676 |
| Total | $ 1,403 |

## 4. Property, Plant and Equipment

Property, plant and equipment as of March 31, 2019 and 2018 consisted of the following (in thousands):

| | March 31, 2019 | March 31, 2018 |
|---|---|---|
| Machinery, equipment, automobiles and furniture | $ 15,344 | $ 15,302 |
| Leasehold improvements | 11,074 | 10,949 |
| Molds and tooling | 2,893 | 2,904 |
| Rental assets | 2,818 | 179 |
| | 32,129 | 29,334 |
| Less, accumulated depreciation | (26,838) | (26,475) |
| Total property, plant, equipment and rental assets, net | $ 5,291 | $ 2,859 |

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 $1.0 million and $0.9 million for the fiscal years ended March 31, 2019 and 2018, respectively.

## 5. Intangible Assets

Intangible assets consisted of the following (in thousands):

| | 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 | | $ 7,706 | $ 7,519 | $ 187 |

| | March 31, 2018 | | | |
|---|---|---|---|---|
| | 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 | 1,829 | 411 |
| Trade name & parts, service and TA100 customer relationships | 1.2 to 5 years | 1,766 | 1,766 | — |
| Total | | $ 7,706 | $ 7,295 | $ 411 |

Amortization expense for the intangible assets was $0.2 million and $0.3 million for the fiscal years ended March 31, 2019 and 2018, respectively.

Expected future amortization expense of intangible assets as of March 31, 2019 is as follows (in thousands):

| Year Ending March 31, | Amortization Expense |
|---|---|
| 2020 | $ 187 |
| Total expected future amortization | $ 187 |

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 $33,200 and $30,900 were earned by Solar for the fiscal years ended March 31, 2019 and 2018, respectively. Earned royalties of approximately $26,100 and $8,000 were unpaid as of March 31, 2019 and 2018, respectively, and are included in accrued expenses in the accompanying balance sheets.

## 6. Accrued Warranty Reserve

During the fiscal year ended March 31, 2017, the Company recorded a one-time non-cash warranty provision of approximately $5.2 million to proactively retrofit selected non-Signature Series C200 microturbines with the more robust new Signature Series generator components to improve product performance and reliability. The remaining non-cash warranty provision of approximately $0.6 million for this reliability repair program was reversed during the fiscal year ended March 31, 2018 because the program was completed. Changes in the accrued warranty reserve are as follows as of March 31, 2019 and 2018 (in thousands):

| | 2019 | 2018 |
|---|---|---|
| Balance, beginning of the period | $ 1,682 | $ 3,766 |
| Standard warranty provision | 2,200 | 1,702 |
| Accrual related to reliability repair programs | — | (760) |
| Deductions for warranty claims | (1,268) | (3,026) |
| Balance, end of the period | $ 2,614 | $ 1,682 |

**7. Revenue Recognition**

The following table presents disaggregated revenue by business group for the fiscal year ended March 31, 2019 (in thousands):

| | Fiscal Year Ended March 31, 2019 |
|---|---|
| Microturbine Products | $ 51,417 |
| Accessories and Parts | 14,886 |
| Total Product, Accessories and Parts | 66,303 |
| Service | 17,109 |
| Total Revenue | $ 83,412 |

Following is the geographic revenue information based on the primary operating location of the Company's customers for the fiscal year ended March 31, 2019 (in thousands):

| | Fiscal Year Ended March 31, 2019 |
|---|---|
| United States | $ 45,480 |
| Mexico | 5,005 |
| All other North America | 791 |
| Total North America | 51,276 |
| Europe | 3,176 |
| All other Europe | 12,886 |
| Total Europe | 16,062 |
| Asia | 5,229 |
| Australia | 3,874 |
| All other | 6,971 |
| Total Revenue | $ 83,412 |

**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, 2019 the balance of deferred revenue was approximately $8.2 million compared to $6.6 million as of March 31, 2018. This overall increase in the balance of deferred revenue of $1.6 million during the fiscal year ended March 31, 2019 was comprised of increases in deferred revenue attributable to FPP contracts of $1.3 million, increases in deferred revenue attributable to the DSS program of $0.6 million, offset by a decrease in deferred revenue attributable to deposits of $0.3 million. Changes in deferred revenue during the fiscal year ended March 31, 2019 and 2018 are as follows (in thousands):

| | 2019 | 2018 |
|---|---|---|
| FPP Balance, beginning of the period | $ 3,549 | $ 3,414 |
| FPP Billings | 15,650 | 15,138 |
| FPP Revenue recognized | (14,318) | (15,003) |
| Balance attributed to FPP contracts | 4,881 | 3,549 |
| DSS program | 1,689 | 1,087 |
| Deposits | 1,666 | 1,960 |
| Deferred revenue balance, end of the period | $ 8,236 | $ 6,596 |

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, 2019, approximately $4.9 million of revenue is expected to be recognized from remaining performance obligations for FPP service contracts. The Company expects to recognize revenue on approximately $3.8 million of these remaining performance obligations over the next 12 months and the balance of $1.1 million will be recognized thereafter. Revenue from remaining performance obligations for professional services contracts as of March 31, 2019 was not material.

## 8. Income Taxes

Loss before provision for income taxes consisted of the following for the years ended March 31, 2019 and 2018 (in thousands):

| | Year Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| United States | $ (16,678) | $ (10,041) |
| Foreign | 27 | 33 |
| Loss before provision for income taxes | $ (16,651) | $ (10,008) |

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 $8,000 and $18,000 for the years ended March 31, 2019 and March 31, 2018, 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, 2019.

The Tax Cuts and Jobs Act (the "Act") was enacted in December 2017. The Act reduces the U.S. federal corporate tax rate from 34% to 21%. As of March 31, 2019, upon completing its analysis of tax reform, the Company believes that the amount recorded as provisional in its financial statements as of March 31, 2018 under SAB 118 is accurate and can now be considered finalized.

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):

| | Year Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Federal income tax benefit at the statutory rate | $ (3,497) | $ (3,082) |
| State taxes, net of federal effect | (583) | (376) |
| Foreign taxes | 3 | 10 |
| Expiring NOLs and tax credits | 6,137 | 12,115 |
| Impact of state rate change | (67) | — |
| Valuation allowance | (2,135) | (95,547) |
| Enactment of Tax Cuts and Jobs Act | — | 87,697 |
| Shortfall in tax benefit—stock compensation | 111 | 11 |
| True-up | 2 | (1,217) |
| Other | 37 | 407 |
| Income tax expense | $ 8 | $ 18 |

The Company's deferred tax assets and liabilities consisted of the following at March 31, 2019 and 2018 (in thousands):

| | Year Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Deferred tax assets: | | |
| Inventories | $ 1,842 | $ 1,893 |
| Warranty reserve | 630 | 402 |
| Bad debt reserve | 1,245 | 1,373 |
| Deferred revenue | 1,584 | 1,108 |
| Net operating loss ("NOL") carryforwards | 145,835 | 148,405 |
| Tax credit carryforwards | 16,021 | 16,627 |
| Depreciation, amortization and impairment loss | 2,734 | 2,673 |
| Other | 1,726 | 1,271 |
| Deferred tax assets | 171,617 | 173,752 |
| Valuation allowance for deferred tax assets | (171,617) | (173,752) |
| Deferred tax assets, net of valuation allowance | — | — |
| Deferred tax liabilities: | | |
| Federal benefit of state taxes | — | — |
| Net deferred tax assets | $ — | $ — |

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, 2019 and 2018 was $2.1 million and $95.5 million, respectively.

The Company's NOL and tax credit carryforwards for federal and state income tax purposes at March 31, 2019 were as follows (in thousands):

| | Amount | Expiration Period |
|---|---|---|
| Federal NOL generated before April 1, 2018 | $ 631,046 | 2020 - 2038 |
| Federal NOL generated after March 31, 2018 | $ 12,200 | Indefinite |
| State NOL | $ 153,585 | 2028 - 2039 |
| Federal tax credit carryforwards | $ 8,365 | 2020 - 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, 2019 and 2018 was $2.4 million and $2.5 million, respectively. There were no interest or penalties related to unrecognized tax benefits as of March 31, 2019 or March 31, 2018. The amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate as of March 31, 2019 and March 31, 2018 was $2.4 million and $2.5 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, 2019 and 2018 was $8.4 million and $9.0 million, and $9.0 million and $10.2 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, 2017 | $ 2,825 |
| Gross increase related to prior year tax positions | — |
| Gross increase related to current year tax positions | — |
| Lapse of statute of limitations | (358) |
| 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 | (77) |
| Balance at March 31, 2019 | $ 2,390 |

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 2013. 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 of March 31, 2019. When applicable, the Company accounts for interest and penalties generated by tax contingencies as interest and other expense, net in the statements of operations.

**9. Stockholders' Equity**

The following table summarizes, by statement of operations line item, stock-based compensation expense for the fiscal years ended March 31, 2019 and 2018 (in thousands):

| | Year Ended March 31, 2019 | Year Ended March 31, 2018 |
|---|---|---|
| Cost of goods sold | $ 51 | $ 52 |
| Research and development | 32 | 21 |
| Selling, general and administrative | 824 | 513 |
| Stock-based compensation expense | $ 907 | $ 586 |

**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 1,849,000 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 3,000,000 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 3,000,000 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. As of March 31, 2019, there were 3,085,347 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 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, 2019, is as follows:

| | Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Options outstanding at March 31, 2018 | 212,392 | $ 20.71 | | |
| Granted | — | $ — | | |
| Exercised | — | $ — | | |
| Forfeited, cancelled or expired | (37,448) | $ 19.64 | | |
| Options outstanding at March 31, 2019 | 174,944 | $ 20.94 | 2.3 | — |
| Options fully vested at March 31, 2019 and those expected to vest beyond March 31, 2019 | 174,944 | $ 20.94 | 2.3 | — |
| Options exercisable at March 31, 2019 | 174,944 | $ 20.94 | 2.3 | — |

*Black-Scholes Model Valuation Assumptions*

There were no stock options granted during the fiscal year ended March 31, 2019 or 2018. There was no expense associated with stock options during the fiscal year ended March 31, 2019. The Company recorded expense of approximately $16,900 fiscal year ended March 31, 2018. There were no unvested stock option awards as of March 31, 2019.

*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 activity:

| Restricted Stock Units and Performance Restricted Stock Units | Shares | Weighted Average Grant Date Fair Value |
|---|---|---|
| Nonvested restricted stock units outstanding at March 31, 2018 | 2,011,611 | $ 0.90 |
| Granted | 1,011,356 | 1.16 |
| Vested and issued | (754,174) | 0.90 |
| Forfeited | (51,360) | 0.93 |
| Nonvested restricted stock units outstanding at March 31, 2019 | 2,217,433 | 1.02 |
| Restricted stock units expected to vest beyond March 31, 2019 | 2,217,410 | $ 1.02 |

The following table provides additional information on restricted stock units for the Company's fiscal years ended March 31, 2019 and 2018:

| | Year Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Restricted stock compensation expense (in thousands) | $ 907 | $ 566 |
| Aggregate fair value of restricted stock units vested and issued (in thousands) | $ 748 | $ 157 |
| Weighted average grant date fair value of restricted stock units granted during the period | $ 0.98 | $ 0.83 |

As of March 31, 2019, 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 1.8 years.

*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, 2019. During the fiscal year ended March 31, 2018, the Company issued a total of 3,969 shares of stock, to non-employee directors who elected to take payment of all or any part of the directors' fees in stock in lieu of cash. The weighted average per share grant date fair value of shares of stock issued during the fiscal year ended March 31, 2018 was $0.63. No expense was recorded associated with its restricted stock awards during the fiscal year ended March 31, 2019. The Company recorded expense of approximately $3,000 associated with its restricted stock awards during the fiscal year ended March 31, 2018.

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.

*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, 70,000 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 500,000 shares which reserved for issuance a total of 570,000 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, 2019 and 2018, the Company issued a total of 1,012 shares and 5,836 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, 2019, there were 497,909 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 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 2.8 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 approximately $4.0 million after deducting commissions paid of approximately $0.1 million. As of March 31, 2019, 26.0 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, 2019, the Company issued 7.6 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 $6.9 million after deducting commissions paid of approximately $0.2 million. As of March 31, 2019, approximately $17.8 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 5,760,000 Series A warrants at an exercise price of $0.60 per share under the warrant agreement. In accordance with terms of the warrant agreement, after taking into account the shares withheld to satisfy the cashless exercise option, the Company issued 3,806,243 shares of common stock.

As of March 31, 2019, there were 2,718,750 Series A warrants outstanding and there are no Series B warrants outstanding. Of the total Series A warrants outstanding, 2,178,750 Series A warrants were issued with an exercise price of $2.55 per share of common stock, and have an expiration date of October 25, 2021, and 540,000 Series A warrants with anti-dilution provisions were issued with an initial exercise price of $1.34 per share of common stock, and have an expiration date of April 22, 2021. As of March 31, 2019, the 540,000 Series A warrants with anti-dilution provisions had an exercise price of $0.57 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 4,046,337 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 $0.8859 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% |

## 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.

The table below presents our assets and liabilities that are measured at fair value on a recurring basis during Fiscal 2018 and are categorized using the fair value hierarchy (in thousands):

| | Fair Value Measurements at March 31, 2018 | | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Restricted cash. . . . . . . . . . . . . . . . | $ 5,000 | $ 5,000 | $ — | $ — |

*Basis for Valuation*

The carrying values reported in the consolidated balance sheets for cash and cash equivalents, restricted cash, accounts receivable and accounts payable approximate fair values because of the immediate or short-term maturities of these financial instruments. As the Company's obligations under the Credit Facility are based on adjustable market interest rates, the Company has determined that the carrying value approximates the fair value. 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, 2019 | | As of March 31, 2018 | |
|---|---|---|---|---|
| | Carrying Value | Estimated Fair Value | Carrying Value | Estimated Fair Value |
| Term note payable. . . . . . . . . . . . . . . . . . . . . . . . . . | $ 27,099 | $ 30,000 | $ — | $ — |
| Obligations under the credit facility. . . . . . . . . . . . | $ — | $ — | $ 8,527 | $ 8,527 |

## 11. Revolving Credit Facility

On June 2, 2017, the Company, entered into two secured credit facilities (the "Bridge Bank Credit Agreements") with Western Alliance Bank through its Bridge Bank division ("Bridge Bank"), with credit support provided by the Export-Import Bank of the United States through its working capital guarantee program. Under the terms of the Bridge Bank Credit Agreements, the Company may borrow up to $12.0 million on a revolving basis depending on, among other factors, the amount of its eligible inventory and accounts receivable. The Bridge Bank Credit Agreements are for a two-year period ending June 2, 2019. Interest expense related to the former credit facility during the fiscal year ended March 31, 2018 was $0.2 million, which includes $0.1 million in amortization of deferred financing costs.

Total borrowings, letter of credit obligations and the then aggregate committed amount of cash management services under the Bridge Bank Credit Agreements may not exceed 85% of the sum of unrestricted cash and the amount of cash collateral held at Bridge Bank. As a condition of the Bridge Bank Credit Agreements, the Company has restricted $5.0 million of cash equivalents as additional security for the credit facility. Borrowings under the Bridge Bank Credit Agreements will bear per annum interest at the prime rate plus 1.5 percent, subject to increase during the occurrence of an event of default. Obligations under the Bridge Bank Credit Agreements are secured by all of the Company's assets, including intellectual property and general intangibles. The Company has incurred $0.2 million in origination fees. These fees have been recorded under the caption "Prepaid expenses and other current assets" in the accompanying condensed consolidated balance sheets and amortized to interest expense. As of March 31, 2018, $8.5 million in borrowings were outstanding and $3.5 million borrowings available under the credit facility. Interest expense related to the credit facility during the fiscal year ended March 31, 2018 was $0.4 million, which includes $0.1 million in amortization of deferred financing costs. The Company's borrowing rate was 6.3% per annum at March 31, 2018.

On June 1, 2018, the Company entered into a letter agreement (the "Letter Agreement") with Bridge Bank. The Letter Agreement extended the maturity date under the Company's Bridge Bank Credit Agreements from June 2, 2019 to June 2, 2021. The Letter Agreement increased the line of credit to an amount up to $15.0 million from $12.0 million. Additionally, the Letter Agreement reduced the per annum interest rate from prime rate plus 1.50 percent to 1.00 percent; the facility fee from 0.625% to 0.5%, and the cash collateral held at Bridge Bank from 42% to 40%, which is $6.0 million of the $15.0 million facility, as well as eliminated the early termination fee.

On February 4, 2019, we entered into a Note Purchase Agreement (See Note 12—Term Note Payable) and at that time the Credit Facility was paid in full. There were no amounts outstanding under the Credit Facility as of March 31, 2019. 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 deferred financing costs, and $0.2 million of accelerated amortization related to the pay-off and closing of the Credit Facility.

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

The financial covenants of the domestic credit agreement with Bridge Bank (the "Domestic Facility") requires the Company not to exceed specified levels of losses relative to its financial model and the outstanding line of credit advances may not exceed 85% of the sum of unrestricted cash and the amount of cash collateral held at Bridge Bank. The Domestic Facility also defines an event of default to include a material adverse effect on the Company's business. An event of default for this or any other reason, if not waived, could have a material adverse effect on the Company. As of March 31, 2018 the Company was in compliance with the covenants contained in the Bridge Bank Credit Agreements. Upon closing with Goldman Sachs Specialty Lending Holdings, Inc., our Bridge Bank Credit Agreements with Bridge Bank were paid off in full.

## 12. 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.

The financial covenants of the Note Purchase Agreement requires the Company not to exceed specified levels of 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, 2019, 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 deferred financing costs totaling $3.2 million. Amortization of the debt discount and deferred costs was $0.2 million for the fiscal year ended March 31, 2019, 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, 2019 was $0.8 million, which includes $0.2 million in amortization of deferred financing costs.

## 13. Commitments and Contingencies

### Purchase Commitments

As of March 31, 2019, the Company had firm commitments to purchase inventories of approximately $33.4 million through Fiscal 2020. 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

The Company leases offices and manufacturing facilities under various non-cancelable operating leases expiring at various times through the fiscal year ending July 2, 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 lease term and renewal options for five-year periods. Rent expense is recognized on a straight-line basis over the term of the lease. The difference between rent expense recorded and the amount paid is credited or charged to deferred rent, which is included in other long-term liabilities in the accompanying consolidated balance sheets. The balance of deferred rent was approximately $0.3 million and $0.4 million as of March 31, 2019 and 2018, respectively. Rent expense was approximately $2.3 million and $2.2 million for the fiscal years ended March 31, 2019 and 2018, respectively.

On July 31, 2014, the Company and Northpark Industrial ("Northpark") entered into a Third Amendment to Lease (the "Third Amendment") to amend the Standard Industrial/Commercial Single-Tenant Lease - Net, dated December 1, 1999, as amended (the "Lease"), pursuant to which the Company leases the premises located at 21211 Nordhoff Street, Chatsworth, California. During the fiscal year ended March 31, 2019, the Company consolidated its operations and offices into its leased premises located in Van Nuys, California. The Third Amendment extended the term of the Lease for a period of two months commencing on August 1, 2014 and ending on September 30, 2014 and set the monthly base rent payable by the Company under the Lease at $81,001 per month.

On September 30, 2014, the Company and Northpark entered into a Fourth Amendment to Lease (the "Fourth Amendment") to amend the Lease by extending the term of the Lease for a period of five years commencing on October 1, 2014 and ending on September 30, 2019. The Fourth Amendment also adjusts the monthly base rent payable by the Company under the Lease to the following: $39,500 per month from October 1, 2014 through November 30, 2014; $79,000 per month from December 1, 2014 through September 30, 2015; $81,225 per month from October 1, 2015 through September 30, 2016; $83,600 per month from October 1, 2016 through September 30, 2017; $86,000 per month from October 1, 2017 through September 30, 2018; and $88,500 per month from October 1, 2018 through September 30, 2019. The Fourth Amendment also provides the Company with an option to extend the Lease by an additional five-year term following the expiration of the term of the Lease as amended by the Fourth Amendment and provides that Northpark will perform certain capital improvements to the leased premises' HVAC system.

On March 28, 2013, the Company and Prologis, L.P., formerly known as AMB Property, L.P., entered into a third amendment (the "Van Nuys Third Amendment") to the Lease Agreement dated September 25, 2000, for leased premises located at 16640 Stagg Street, Van Nuys, California for use as primary office space, engineering testing and manufacturing. The Van Nuys Third Amendment extends the term of the Lease Agreement from December 31, 2012 to December 31, 2017. The Van Nuys Third Amendment also adjusts the monthly base rent payable by the Company under the Lease Agreement to the following: $60,000 per month from January 1, 2013 through June 30, 2015 and $65,000 per month from July 1, 2015 through December 31, 2017.

On June 7, 2017 the Company and Prologis, L.P entered into a Fourth Amendment to Lease (the "Van Nuys Fourth Amendment") to amend the Lease by extending the term of the Lease for a period of sixty-two (62) months commencing on December 31, 2017 to February 28, 2023. The Van Nuys Fourth Amendment also adjusts the monthly base rent payable by the Company under the Lease Agreement to the following: $0 per month from January 1, 2018 through February 28, 2018; $66,846 per month from March 1, 2018 through December 31, 2018; $68,852 per month from January 1, 2019 through December 31, 2019; $70,917 per month from January 1, 2020 through December 31, 2020; $73,045 per month from January 1, 2021 through December 31, 2021; $75,236 per month from January 1, 2022 through December 31, 2022; and $77,493 per month from January 1, 2023 through February 28, 2023. The Van Nuys Fourth Amendment also provides the Company with an option to extend the Lease by an additional five year term following the expiration of the term of the Lease as amended by the Lease Amendment and provides that Prologis, L.P. will contribute a tenant improvement allowance toward the Company's approved alterations to the premises.

At March 31, 2019, the Company's minimum commitments under non-cancelable operating leases were as follows (in thousands):

| Year Ending March 31, | Operating Leases |
|---|---|
| 2020 | $ 1,464 |
| 2021 | 958 |
| 2022 | 984 |
| 2023 | 933 |
| 2024 | 101 |
| Thereafter | 126 |
| Total minimum lease payments | $ 4,566 |

**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, 2019, no significant inventories were held at distributors.

**Legal Matters**

*Federal Securities Class Action*

Two putative securities class action complaints were filed against the Company and certain of its 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 December 18, 2015 (the "Grooms Complaint").

The putative class in the Kinney Complaint is comprised of all purchasers of the Company's securities between November 7, 2013 and November 5, 2015. The Kinney Complaint alleges 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 the Company. The Kinney Complaint also alleges that the Company's financial statements were not appropriately adjusted in light of this situation and were not maintained in accordance with GAAP, and that the Company lacked adequate internal controls over accounting. The Kinney Complaint alleges 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 makes allegations and claims that are substantially identical to those in the Kinney Complaint, and both complaints seek 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 is 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. 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 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. 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. A hearing on the motion for preliminary approval of the settlement is scheduled for May 17, 2019. If the settlement is finalized and approved by the Court, the Company's insurance carrier will fund the settlement amount. We have not recorded any liability as of March 31, 2019 since any potential loss is not considered material as our insurance carrier will fund 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 alleges 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. We have not recorded any liability as of March 31, 2019 as our insurance carrier will fund 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 are 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 29, 2019.

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 are 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 July 29, 2019.

The parties in both of the above state derivative lawsuits participated in a mediation held on September 24, 2018. The parties did not reach a settlement on the day of the mediation and negotiations are ongoing.

*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 are 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 are 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 both of the above federal derivative lawsuits participated in a mediation held on September 24, 2018. The parties did not reach a settlement on the day of the mediation and negotiations are ongoing.

*Shareholder Demand*

By letter dated July 7, 2017 (the "Shareholder Demand"), Andre Rosowsky demanded that the Board of Directors take action to remedy purported breaches of fiduciary duties allegedly related to the claims asserted in the above-discussed securities class action and derivative actions. On July 25, 2017, the Company acknowledged receipt of the Shareholder Demand and requested information from Mr. Rosowsky sufficient to show that he had standing to make the demand. The Board of Directors formed a committee to evaluate the Shareholder Demand in anticipation of receiving the requested information from Mr. Rosowsky. Mr. Rosowsky has failed to respond to the request for information and therefore the Company believes that Mr. Rosowsky abandoned the Shareholder Demand.

*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, 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 has 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 is seeking 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, Executive Vice President of Sales for us, 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 did come to a resolution of the matter. The parties are currently engaged in drafting a more formal settlement agreement that upon execution will require the respective matters to be dismissed. The Company has not recorded any liability as of March 31, 2019, since any potential loss is not probable or reasonably estimable given the current status of the proceedings.

*Capstone Turbine Corporation v. Energy Systems, Inc.*

On August 17, 2018 Capstone initiated arbitration proceedings against its former distributor, Energy Systems of Caribbean, Inc. ("Energy Systems") by seeking declaratory relief that its action in terminating the distributorship was justified under the law. The claim was filed with the American Arbitration Association under the following caption: Capstone Turbine Corp. v. Energy Systems of Caribbean, Inc., Case No. 01-18-0003-1307. As remedies for these claims, we are seeking declaratory relief and attorney's fees, interest and costs.

On August 22, 2018, Energy Systems filed a claim against us in Puerto Rico alleging Breach of Distribution Contract under Law No. 75 of June 24, 1964, as amended, 10 l.p.r.a. §§ 278-278. The case was filed under the caption Energy Systems of Caribbean, Inc., v. Capstone Turbine Corporation, CIVIL NO. SJ2018cv06543 (904). As remedies for these alleged claims, Energy Systems seeks actual damages, injunctive relief, attorney's fees and costs. This matter was subsequently removed to the United States District Court for the District of Puerto Rico based on diversity jurisdiction (Case No. 3:18-cv-01611). The parties have since stipulated to a stay of both the federal litigation and arbitration so that the parties may pursue settlement.

The parties entered into settlement discussions and on April 29, 2019 participated in mediation to resolve the dispute. The mediation was successful and the parties are currently drafting a more formal settlement agreement that upon execution will require the respective matters to be dismissed. We have not recorded any liability as of March 31, 2019 since any potential loss is not considered material.

**14. 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 and $0.2 million for the fiscal year ended March 31, 2019 and 2018, respectively.

**15. Other Current Liabilities**

The Company is 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 $0.4 million and $0.9 million in royalties for C200 and C1000 Series system sales during each of the fiscal years ended March 31, 2019 and 2018, respectively. There were no unpaid, earned royalties as of March 31, 2019. Earned royalties of $0.2 million were unpaid as of March 31, 2018 and are included in accrued expenses in the accompanying balance sheets.

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 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, 2019 |
|---|---|
| Other current assets | $ 124 |
| Other assets | 2,768 |
| Royalty-related assets | $ 2,892 |

## 16. 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, 2019, 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.

## Exhibit Index

| Exhibit Number | Description |
|---|---|
| 2.1 | Asset Purchase Agreement between Capstone Turbine Corporation and Calnetix Power Solutions, Inc., dated February 1, 2010(a) |
| 2.2 | Amendment to Asset Purchase Agreement between Capstone Turbine Corporation and Calnetix Power Solutions, Inc., dated March 31, 2011(b) |
| 2.3 | Second Amendment to Asset Purchase Agreement between Capstone Turbine Corporation and Calnetix Power Solutions, Inc., dated April 28, 2011(b) |
| 3.1 | Fourth Amended and Restated Certificate of Incorporation of Capstone Turbine Corporation(c) |
| 3.2 | Certificate of Amendment to the Second Amended and Restated Certificate of Incorporation of Capstone Turbine Corporation, filed November 6, 2015(d) |
| 3.3 | Second Amended and Restated Bylaws of Capstone Turbine Corporation(e) |
| 3.4 | Certificate of Elimination of Series A Junior Participating Preferred Stock, dated May 9, 2016(f) |
| 3.5 | Certificate of Designations of Series B Junior Participating Preferred Stock of Capstone Turbine Corporation(f) |
| 3.6 | Specimen stock certificate(g) |
| 4.1 | NOL Rights Agreement, dated May 6, 2016, between Capstone Turbine Corporation and Broadridge Financial Solutions, Inc. successor-in-interest to Computershare Inc.(f) |
| 4.2 | Form of Series A Warrant issued to investors in the April 2016 public offering(l) |
| 4.3 | Form of Pre-Funded Series B Warrant issued to investors in the April 2016 public offering(l) |
| 4.4 | Form of Series A Warrant issued to investors in the October 2016 public offering(rr) |
| 4.6 | Form of Pre-Funded Series B Warrant issued to investors in the October 2016 public offering(rr) |
| 4.7 | Form of Senior Indenture by and between Capstone Turbine Corporation and Computershare Trust Company, N.A., Trustee (ddd) |
| 4.8 | Form of Subordinated Indenture by and between Capstone Turbine Corporation and Computershare Trust Company, N.A., Trustee (ddd) |
| 4.9 | 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 (bbb) |
| 4.10 | Purchase Warrant for Common Shares issued in favor of Goldman Sachs & Co. LLC, dated February 4, 2019 (bbb) |
| 4.11 | Rights Agreement by and between Capstone Turbine Corporation and Broadridge Financial Solutions, Inc., dated May 6, 2019 (ccc) |
| 10.1 | Amended and Restated License Agreement, dated August 2, 2000, by and between Solar Turbines Incorporated and Capstone Turbine Corporation(m) |
| 10.2 | Transition Agreement, dated August 2, 2000, by and between Capstone Turbine Corporation and Solar Turbines Incorporated(m) |
| 10.3 | Lease between Capstone Turbine Corporation and Northpark Industrial—Leahy Division LLC, dated December 1, 1999, as amended, for leased premises at 21211 Nordhoff Street, Chatsworth, California(n) |

| Exhibit Number | Description |
|---|---|
| 10.4 | Third Amendment to Lease, dated July 31, 2014, between Capstone Turbine Corporation and Northpark Industrial, for leased premises at 21211 Nordhoff Street, Chatsworth, California(k) |
| 10.5 | Fourth Amendment to Lease, dated September 30, 2014, between Capstone Turbine Corporation and Northpark Industrial, for leased premises at 21211 Nordhoff Street, Chatsworth, California(o) |
| 10.6 | 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(p) |
| 10.7 | 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(vv) |
| 10.8* | Capstone Turbine Corporation 2017 Equity Incentive Plan effective August 30, 2017(q) |
| 10.9* | Capstone Turbine Corporation Employee Stock Purchase Plan effective August 30, 2017(q) |
| 10.10* | Form of Stock Option Agreement for Amended and Restated 2000 Equity Incentive Plan(s) |
| 10.11* | Form of Stock Bonus Agreement for Capstone Turbine Corporation 2000 Equity Incentive Plan(t) |
| 10.12* | Amended and Restated Capstone Turbine Corporation Change of Control Severance Plan(u) |
| 10.13 | Development and License Agreement between Capstone Turbine Corporation and Carrier Corporation, successor-in-interest to UTC Power Corporation, dated September 4, 2007(v) |
| 10.14 | First Amendment to the Development and License Agreement between Capstone Turbine Corporation and Carrier Corporation, successor-in-interest to UTC Power Corporation, dated January 14, 2011(b) |
| 10.15 | Business Financing Agreement between Capstone Turbine Corporation and Western Alliance Bank, dated June 2, 2017(tt) |
| 10.16 | Export-Import Bank of the United States Working Capital Guarantee Program—Borrower Agreement between Capstone Turbine Corporation and Western Alliance Bank, dated June 2, 2017(tt) |
| 10.17 | Intellectual Property Security Agreement between Capstone Turbine Corporation and Western Alliance Bank, dated June 2, 2017(tt) |
| 10.18 | First Amendment to Business Financing Agreement between Capstone Turbine Corporation and Western Alliance Bank, NA, dated June 1, 2018 (xx) |
| 10.19 | Credit and Security Agreement between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated February 9, 2009 (Domestic Facility)(w) |
| 10.20 | Credit and Security Agreement between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated February 9, 2009 (Ex-Im Subfacility)(w) |
| 10.21 | First Amendment to Credit and Security Agreement between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 9, 2009(w) |
| 10.22 | Second Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated November 5, 2009(x) |
| 10.23 | Third Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 11, 2010(t) |
| 10.24 | Fourth Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 29, 2010(y) |
| 10.25 | Fifth Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated November 9, 2010(z) |

| Exhibit Number | Description |
|---|---|
| 10.26 | Sixth Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated March 23, 2011(aa) |
| 10.27 | Seventh Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 9, 2011(b) |
| 10.28 | Eighth Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated September 27, 2011(bb) |
| 10.29 | Ninth Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated February 8, 2012(cc) |
| 10.30 | Tenth Amendment to the Credit and Security Agreements between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 12, 2012(dd) |
| 10.31 | Eleventh Amendment to the Credit and Security Agreements between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 7, 2013(p) |
| 10.32 | Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated April 25, 2014(ee) |
| 10.33 | Twelfth Amendment to the Credit and Security Agreements between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 9, 2014(ff) |
| 10.34 | Letter Agreement, dated September 16, 2014, between by and between Capstone Turbine Corporation and Wells Fargo Bank, NA(gg) |
| 10.35 | Thirteenth Amendment to the Credit and Security Agreements and Waiver of Default between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated November 3, 2014(hh) |
| 10.36 | Fourteenth Amendment to the Credit and Security Agreements, Waiver of Default and Consent between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 10, 2015(ii) |
| 10.37 | Fifteenth Amendment to the Credit and Security Agreements, Waiver of Default and Consent between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated November 2, 2015(jj) |
| 10.38 | Sixteenth Amendment to the Credit and Security Agreements, between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 7, 2016(nn) |
| 10.39 | Seventeenth Amendment to the Credit and Security Agreements, between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated February 7, 2017(ss) |
| 10.40 | Accounts Receivable Assignment Agreement between Capstone Turbine Corporation and Turbine International, LLC, dated October 13, 2017(uu) |
| 10.41 | Promissory Note between Capstone Turbine Corporation and Turbine International, LLC, dated October 13, 2017(uu) |
| 10.42 | Guaranty between Capstone Turbine Corporation and Hispania Petroleum, S.A., dated October 13, 2017(uu) |
| 10.43 | First Amendment to the Accounts Receivable Assignment Agreement and Promissory Note between Capstone Turbine Corporation and Turbine International, LLC, dated June 5, 2018 (xx) |
| 10.44* | Capstone Turbine Corporation Amended and Restated Executive Performance Incentive Plan as amended and restated effective August 29, 2013(kk) |
| 10.45* | Amendment to the Capstone Turbine Corporation Amended and Restated Executive Performance Incentive Plan, dated June 9, 2014(ll) |
| 10.46* | Letter Agreement between Capstone Turbine Corporation and Darren R. Jamison, dated December 1, 2006 (mm) |

| Exhibit Number | Description |
|---|---|
| 10.47* | Amendment to Letter Agreement between Capstone Turbine Corporation and Darren R. Jamison, effective April 8, 2009(w) |
| 10.48* | Form of Inducement Stock Option Agreement(oo) |
| 10.49* | Form of Inducement Restricted Stock Unit Agreement(oo) |
| 10.50* | Amended and Restated Change in Control Severance Agreement with Darren R. Jamison, dated June 14, 2012(dd) |
| 10.51* | First Amendment to Amended and Restated Change in Control Severance Agreement with Darren R. Jamison, effective June 14, 2015(ii) |
| 10.52 | Underwriting Agreement dated May 1, 2014 by and between Capstone Turbine Corporation and Cowen and Company, LLC, as representative of the several underwriters(pp) |
| 10.53* | Capstone Turbine Corporation Severance Pay Plan as amended and restated effective February 1, 2010(ii) |
| 10.54 | Sales Agreement, dated August 28, 2015, by and between Capstone Turbine Corporation and Cowen & Company, LLC(qq) |
| 10.55 | Underwriting Agreement dated April 19, 2016 by and between Capstone Turbine Corporation and Oppenheimer & Co. Inc., as representative of the several underwriters(l) |
| 10.56 | Placement Agent Agreement by and between the Company and Oppenheimer & Co. Inc., as representative of the placement agents named therein, dated October 18, 2016(rr) |
| 10.57 | Form of Securities Purchase Agreement used in the October 2016 offering (rr) |
| 10.58 | At the Market Offering Agreement, dated June 7, 2018, between Capstone and H.C. Wainright & Co., LLC (yy) |
| 10.59 | Second Amendment to the Development and License Agreement, dated July 25, 2018, between Capstone Turbine Corporation and Carrier Corporation (aaa) |
| 10.60* | Capstone Turbine Corporation 2017 Equity Incentive Plan, as amended (ww) |
| 10.61* | Form of Change in Control Agreement (eee) |
| 14.1 | Code of Business Conduct(ee) |
| 14.2 | Code of Ethics for Senior Financial Officers and Chief Executive Officer(ee) |
| 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 |

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*Management contract or compensatory plan or arrangement

(a) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on February 5, 2010 (File No. 001-15957).

(b) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended March 31, 2011 (File No. 001-15957).

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

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

(e) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed March 13, 2017 (File No. 001-15957).

(f) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on May 6, 2016 (File No. 001-15957).

(g) Incorporated by reference to Capstone Turbine Corporation's Registration Statement on Form S-1/A, dated June 21, 2000 (File No. 333-33024).

(h) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on July 8, 2005 (File No. 001-15957).

(i) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on July 10, 2008 (File No. 001-15957).

(j) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on July 2, 2014 (File No. 001-15957).

(k) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on August 5, 2014 (File No. 001-15957).

(l) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on April 21, 2016 (File No. 001-15957).

(m) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on October 16, 2000 (File No. 001-15957).

(n) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on September 2, 2009 (File No. 001-15957).

(o) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on October 6, 2014 (File No. 001-15957).

(p) 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).

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

(r) Incorporated by reference to Appendix B to Capstone Turbine Corporation's Definitive Proxy Statement, filed on July 15, 2015 (File No. 001-15957).

(s) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2005 (File No. 001-15957).

(t) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended March 31, 2010 (File No. 001-15957).

(u) 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).

(v) 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).

(w) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended March 31, 2009 (File No. 001-15957).

(x) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2009 (File No. 001-15957).

(y) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on July 1, 2010 (File No. 001-15957).

(z) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on November 12, 2010 (File No. 001-15957).

(aa) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on March 25, 2011 (File No. 001-15957).

(bb) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on October 3, 2011 (File No. 001-15957).

(cc) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2011 (File No. 001-15957).

(dd) 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).

(ee) 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).

(ff) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on June 10, 2014 (File No. 001-15957).

(gg) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on September 19, 2014 (File No. 001-15957).

(hh) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2014 (File No. 001-15957).

(ii) 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).

(jj) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2015 (File No. 001-15957).

(kk) 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).

(ll) Incorporated by reference to Appendix B to Capstone Turbine Corporation's Definitive Proxy Statement, filed on July 16, 2014 (File No. 001-15957).

(mm) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2006 (File No. 001-15957).

(nn) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended on March 31, 2016 (File No. 001-15957).

(oo) Incorporated by reference to Capstone Turbine Corporation's Registration Statement on Form S-8, dated June 17, 2009 (File No. 333-160049).

(pp) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on May 1, 2014 (File No. 001-15957).

(qq) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on August 28, 2015 (File No. 001-15957).

(rr) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on October 18, 2016 (File No. 001-15957).

(ss) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2016 (File No. 001-15957).

(tt) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on June 7, 2017 (File No. 001-15957).

(uu) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on October 13, 2017 (File No. 001-15957).

(vv) 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).

(ww) Incorporated by reference to Appendix A to Capstone Turbine Corporation's Definitive Proxy Statement, filed July 13, 2018 (File No. 001-15957)

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

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

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

(aaa) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on July 26, 2018 (File No. 001-15957)

(bbb) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K filed on February 5, 2019 (File No. 001-15957)

(ccc) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K filed on May 6, 2019 (File No. 001-15957)

(ddd) Incorporated by reference to Capstone Turbine Corporation's Registration Statement on Form S-3, dated June 7, 2018 (File No. 333-203431)

(eee) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K filed on June 5, 2018 (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 11, 2019

By: /s/ Jayme L. Brooks
Jayme L. Brooks
*Executive Vice President & Chief Financial Officer*
*(Principal Financial 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 Jayme L. Brooks, 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.

| Signature | Title | Date |
|---|---|---|
| /s/ DARREN R. JAMISON<br>Darren R. Jamison | President, Chief Executive Officer and Director (Principal Executive Officer) | June 11, 2019 |
| /s/ JAYME L. BROOKS<br>Jayme L. Brooks | Executive Vice President and Chief Financial Officer (Principal Financial Officer) | June 11, 2019 |
| /s/ FREDERICK S. HENCKEN<br>Frederick S. Hencken | Chief Accounting Officer (Principal Accounting Officer) | June 11, 2019 |
| /s/ HOLLY A. VAN DEURSEN<br>Holly A. Van Deursen | Chairman of the Board of Directors | June 11, 2019 |
| /s/ PAUL DEWEESE<br>Paul DeWeese | Director | June 11, 2019 |
| /s/ ROBERT C. FLEXON<br>Robert C. Flexon | Director | June 11, 2019 |
| /s/ YON Y. JORDEN<br>Yon Y. Jorden | Director | June 11, 2019 |
| /s/ NOAM LOTAN<br>Noam Lotan | Director | June 11, 2019 |
| /s/ GARY J. MAYO<br>Gary J. Mayo | Director | June 11, 2019 |

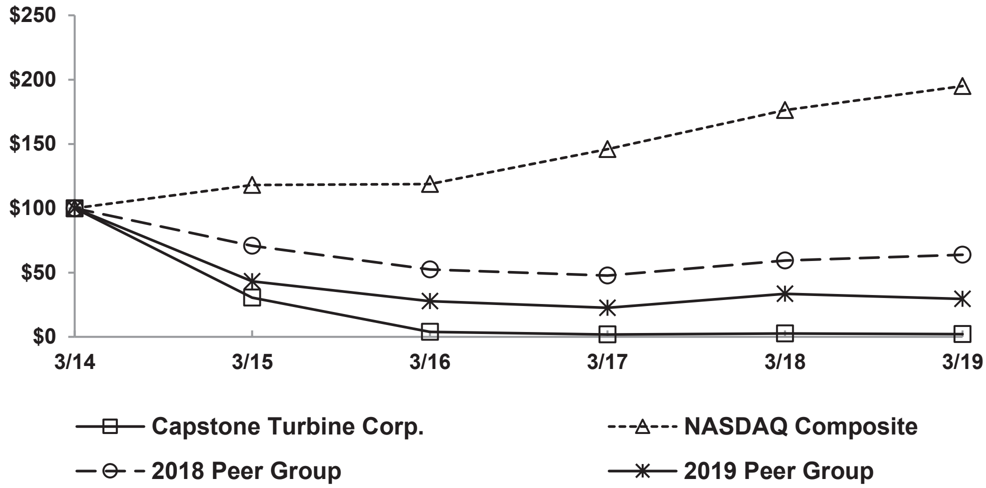
**STOCK PERFORMANCE GRAPH**

The graph below compares the cumulative total stockholder return on Capstone's common stock with the cumulative total return of the NASDAQ Composite Index and a peer group of similar power technology companies ("SPTC")(1). The stock price performance shown in the graph below is not indicative of potential future stock price performance. Management believes that the NASDAQ Composite Index and the SPTC provide an appropriate measure of the Company's common stock price performance.

The graph assumes an initial investment of $100 on March 31, 2014 and reinvestment of quarterly dividends. No cash dividends have been declared on shares of the Company's common stock.

**COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN***

Among Capstone Turbine Corp., the NASDAQ Composite Index, 2018 Peer Group and 2019 Peer Group




*$100 invested on 3/31/14 in stock or index, including reinvestment of dividends.
Fiscal year ending March 31.

| | Fiscal Year Ended | | | | | |
|---|---|---|---|---|---|---|
| | Mar-14 | Mar-15 | Mar-16 | Mar-17 | Mar-18 | Mar-19 |
| **Capstone Turbine Corporation** | 100 | 31 | 4 | 2 | 3 | 2 |
| **NASDAQ Composite Index** | 100 | 118 | 119 | 146 | 176 | 195 |
| **2018 Peer Group** | 100 | 71 | 52 | 48 | 59 | 64 |
| **2019 Peer Group** | 100 | 43 | 28 | 23 | 34 | 30 |

(1) The SPTC for 2019 Peer Group consists of Plug Power, Inc. (PLUG) which is traded on the NASDAQ Capital Market, FuelCell Energy, Inc. (FCEL) and Ballard Power Systems, Inc. (BLDP), which are traded on the NASDAQ Global Market, and Bloom Energy Corporation (BE), which is traded on the New York Stock Exchange. The SPTC also consists of P10 Industries, Inc. (formerly Active Power, Inc.) (PIOI), which is traded on the OTC Pink Market, which is operated by OTC Markets Group. The SPTC for 2018 Peer Group also included Generac Holdings, Inc. (GNRC), which is traded on the New York Stock Exchange. The peer group was adjusted for 2019 as GNRC is no longer relevant peer.

This information shall not be deemed to be "soliciting material" or "filed" with the SEC or incorporated by reference into any filings with the SEC, or subject to the liabilities of Section 18 of the Securities Exchange Act of 1934, except to the extent that the Company specifically requests that it be treated as soliciting material or incorporates it by reference into a document filed under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934.

## BOARD OF DIRECTORS

**Paul DeWeese** [B*]
Chief Executive Officer, Boomerang Tube, LLC
Former Chief Executive Officer, Epic International

**Robert Flexon** [A,C]
Former President & Chief Executive Officer,
Dynegy, Inc.

**Darren Jamison**
President & Chief Executive Officer,
Capstone Turbine Corporation

**Yon Jorden** [A*,C]
Independent Director
Former Executive Vice President & Chief Financial Officer,
AdvancePCS

**Noam Lotan** [A,B]
Former President & Chief Executive Officer,
Resonate Industries, Inc.
Former President & Chief Executive Officer,
MRV Communications, Inc.

**Gary Mayo** [B,C*]
Non-Executive Director
Former Vice President, Corporate Sustainability Strategies,
MGM Resorts International

**Robert Powelson**
President & Chief Executive Officer, National Association of Water Companies (NAWC)
Former Commissioner, Federal Energy Regulatory Commission (FERC)

**Holly Van Deursen**
Chair of the Board, Capstone Turbine Corporation
Non-Executive Director (several companies)
Former Executive, BP plc/Amoco Corporation

**Committee Membership**
**A:** Audit Committee
**B:** Nominating and Corporate Governance Committee
**C:** Compensation Committee

* Chairperson of Committee

## EXECUTIVE OFFICERS

**Darren Jamison**
President & Chief Executive Officer

**Jayme Brooks**
Executive Vice President & Chief Financial Officer

**James Crouse**
Executive Vice President, Sales & Marketing

**Frederick Hencken III**
Chief Accounting Officer

## STOCK LISTING

Common Stock traded on NASDAQ: CPST

## TRANSFER AGENT

Broadridge Corporate Issuer Solutions, Inc.
P.O. Box 1342
Brentwood, NY 11717
www.shareholder.broadridge.com

## CORPORATE COUNSEL

Goodwin Procter LLP
601 South Figueroa Street, 41st Floor
Los Angeles, CA 90017
www.goodwinlaw.com

## INDEPENDENT ACCOUNTANTS

Marcum LLP
600 Anton Blvd Suite 1600
Costa Mesa, CA 92626
www.marcumllp.com

## ANNUAL MEETING OF STOCKHOLDERS

The 2019 Annual Meeting of Stockholders will be held at the offices of Lewitt, Hackman, Shapiro, Marshall & Harlan, 16633 Ventura Boulevard, Eleventh Floor, Encino, CA 91436 on August 29, 2019 at 11:00 a.m. Pacific Time.

This Annual Report contains "forward-looking statements," as that term is used in the federal securities laws. Forward-looking statements may be identified by words such as "believe," "expect," "objective," "intend," "targeted," "plan," "anticipate," "project" and similar phrases. These forward-looking statements are subject to numerous assumptions, risks and uncertainties described in Capstone's Form 10-K filed with the Securities and Exchange Commission on June 11, 2019 with the Securities and Exchange Commission that may cause Capstone's actual results to be materially different from any future results expressed or implied in such statements. Capstone cautions readers not to place undue reliance on these forward-looking statements, which speak only as of the date of this Annual Report. Capstone undertakes no obligation, and specifically disclaims any obligation, to release any revision to any forward-looking statements to reflect events or circumstances after the date of this Annual Report or to reflect the occurrence of unanticipated events.

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