UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

☑ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2017

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ___________ to ___________

Commission file number 0-24230
ENERGY FOCUS, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	**94-3021850**
(State of incorporation)	(I.R.S. Employer Identification No.)

32000 Aurora Road, Suite B
Solon, Ohio 44139
(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: **440.715.1300**

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

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

Title of Each Class
Common Stock, Par Value $0.0001

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined by Rule 405 of the Securities Act of 1933. Yes ☐No ☑

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange 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 and posted on its corporate Web site, if any, every Interactive Date File required to be submitted and posted 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 and post such files). Yes ☑ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer ☐	Accelerated filer ☐
Non-accelerated filer ☐ (Do not check if a smaller reporting company)	Smaller reporting company ☑

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 value of the Company's common stock held by non-affiliates of the Company was approximately $29.1 million as of June 30, 2017, the last day of the Company's most recently completed second fiscal quarter, when the last reported sales price was $2.63 per share.

Number of the registrant's shares of common stock outstanding as of February 16, 2018: 11,889,517

Documents Incorporated by Reference

Portions of the Company's definitive Proxy Statement for its 2017 Annual Meeting of Stockholders are incorporated by reference into Part III, Items 10-14 of this Annual Report on Form 10-K.

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PART I

Forward-looking statements

Unless the context otherwise requires, all references to "Energy Focus," "we," "us," "our," "our company," or "the Company" refer to Energy Focus, Inc., a Delaware corporation, and its subsidiaries, and their respective predecessor entities for the applicable periods, considered as a single enterprise.

This Annual Report on Form 10-K ("Annual Report") includes statements that express our opinions, expectations, beliefs, plans, objectives, assumptions or projections regarding future events or future results and therefore are, or may be deemed to be, "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements can generally be identified by the use of forward-looking terminology, including the terms "believes," "estimates," "anticipates," "expects," "feels," "seeks," "forecasts," "projects," "intends," "plans," "may," "will," "should," "could" or "would" or, in each case, their negative or other variations or comparable terminology. These forward-looking statements include all matters that are not historical facts. They appear in a number of places throughout this Annual Report and include statements regarding our intentions, beliefs, or current expectations concerning, among other things, our results of operations, financial condition, liquidity, prospects, growth, strategies, capital expenditures, and the industry in which we operate.

By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future. Although we base these forward-looking statements on assumptions that we believe are reasonable when made, we caution you that forward-looking statements are not guarantees of future performance and that our actual results of operations, financial condition and liquidity, and industry developments may differ materially from statements made in or suggested by the forward-looking statements contained in this Annual Report. In addition, even if our results of operations, financial condition and liquidity, and industry developments are consistent with the forward-looking statements contained in this Annual Report, those results or developments may not be indicative of results or developments in subsequent periods.

We believe that important factors that could cause our actual results to differ materially from forward-looking statements include, but are not limited to, the risks and uncertainties outlined under "Risk Factors" under Item 1A and other matters described in this Annual Report generally. Some of these factors include:

- *our history of operating losses and our ability to effectively implement cost-cutting measures and generate sufficient cash from operations or receive sufficient financing, on acceptable terms, to continue our operations;*
- *our reliance on a limited number of customers for a significant portion of our revenue, and our ability to maintain or grow such sales levels;*
- *our ability to implement and manage our growth plans to diversify our customer base, increase sales, and control expenses;*
- *our ability to increase demand in our targeted markets and to manage sales cycles that are difficult to predict and may span several quarters;*
- *our dependence on distributors and sales representatives, whose sales efforts may fluctuate and are not bound by long term commitments;*
- *the timing of large customer orders and significant expenses, and fluctuations between demand and capacity, as we invest in growth opportunities;*
- *our dependence on military maritime customers and on the levels of government funding available to such customers, as well as funding resources of our other customers in the public sector and commercial markets;*
- *general economic conditions in the United States and in other markets in which we sell our products;*
- *market acceptance of LED lighting technology;*
- *the entrance of competitors in the market for the U.S. Navy products;*
- *our ability to respond to new lighting technologies and market trends, and fulfill our warranty obligations with safe and reliable products;*
- *any delays we may encounter in making new products available or fulfilling customer specifications;*
- *our ability to compete effectively against companies with greater resources, lower cost structures, or more rapid development efforts;*
- *our ability to protect our intellectual property rights and other confidential information, manage infringement claims by others, and the impact of any type of legal claim or dispute;*
- *our reliance on a limited number of third-party suppliers, our ability to obtain critical components and finished products from such suppliers on acceptable terms, and the impact of our fluctuating demand on the stability of such suppliers;*

- *our ability to timely and efficiently transport products from our third-party suppliers to our facility by ocean marine channels;*
- *any flaws or defects in our products or in the manner in which they are used or installed;*
- *our compliance with government contracting laws and regulations, through both direct and indirect sale channels, as well as other laws, such as those relating to the environment and health and safety;*
- *risks inherent in international markets, such as economic and political uncertainty, changing regulatory and tax requirements and currency fluctuations;*
- *our ability to attract and retain qualified personnel, and to do so in a timely manner; and*
- *our ability to maintain effective internal controls and otherwise comply with our obligations as a public company.*

In light of the foregoing, we caution you not to place undue reliance on our forward-looking statements. Any forward-looking statement that we make in this Annual Report speaks only as of the date of such statement, and we undertake no obligation to update any forward-looking statement or to publicly announce the results of any revision to any of those statements to reflect future events or developments. Comparisons of results for current and any prior periods are not intended to express any future trends or indications of future performance, unless specifically expressed as such, and should only be viewed as historical data.

Energy Focus® and Intellitube® are our registered trademarks. We may also refer to trademarks of other corporations and organizations in this document.

ITEM 1. BUSINESS

Overview

The Company was founded in 1985 as Fiberstars, Inc., a California corporation, and reincorporated in Delaware in November 2006. In May 2007, Fiberstars, Inc. merged with and became Energy Focus, Inc., also a Delaware corporation. Our principal executive offices are located at 32000 Aurora Road, Suite B, Solon, Ohio 44139. Our telephone number is 440.715.1300. Our website address is www.energyfocus.com. Information on our website is not part of this Annual Report.

Energy Focus, Inc. and its subsidiary engage in the design, development, manufacturing, marketing, and sale of energy-efficient lighting systems. We operate in a single industry segment, developing and selling our energy-efficient light-emitting diode ("LED") lighting products into the general commercial, industrial and military maritime markets. Our goal is to become a trusted leader in the LED lighting retrofit market by replacing fluorescent lamps in institutional buildings and high-intensity discharge ("HID") lighting in low-bay and high-bay applications with our innovative, high-quality commercial and military tubular LED ("TLED") products.

Over the past few years we have exited non-core businesses to focus our efforts on TLED products, starting with the sale of our pool lighting products business in 2013. During 2015 we exited our turnkey solutions business operated by our subsidiary, Energy Focus LED Solutions, LLC ("EFLS"), and exited our United Kingdom business through the sale of Crescent Lighting Limited ("CLL"), our wholly-owned subsidiary. As a result, we have reclassified all net sales and expenses associated with both EFLS and CLL from the Consolidated Statements of Operations and have reported the related net income (loss) as discontinued operations. Please refer to Note 4, "Discontinued Operations," for more information on our disposition of these businesses.

Given the decline in our military maritime business, the changing competitive landscape of the U.S. Navy sales channel and the timing uncertainty of commercial sales growth, we implemented a restructuring initiative during the first quarter of 2017. The intent of the restructuring strategy was to maximize operating cost reductions without sacrificing either our new product pipeline or potential long-term revenue growth and return the Company to profitability. On February 19, 2017, the Board appointed Dr. Ted Tewksbury to serve as the Company's Chairman of the Board, Chief Executive Officer and President to lead the Company's restructuring efforts. Dr. Tewksbury, who holds M.S. and Ph.D. degrees in Electrical Engineering from MIT, is a well-seasoned semiconductor industry executive with experience in implementing and managing successful business restructurings.

The restructuring initiative included an organizational consolidation of management functions in order to streamline and better align the Company into a more focused, efficient, and cost-effective organization. The initiative also included the transition from our historical direct sales model, to an agency driven sales channel strategy in order to expand our market presence throughout the United States ("U.S."). During 2017 we closed our New York, New York, Arlington, Virginia and Rochester, Minnesota and offices, reduced full-time equivalent headcount by 51 percent and significantly decreased operating expenses from 2016 levels (a net reduction of $8.4 million, which includes $1.8 million in offsetting restructuring and impairment charges). As of December 31, 2017, we had effectively transitioned our sales force to an agency driven sales channel, expanding our sales coverage to the entire U.S. through 6 geographic regions and 30 sales agents. As a result of this transition, we have substantially expanded from a primarily Midwest focus to build market presence and awareness in other regions of the U.S. with significant demand potential, including the Northeast, Southeast and California.

Our industry

We are committed to developing advanced LED technology solutions that enable our customers to run their facilities with greater energy efficiency, productivity and employee wellness. We strive to be the lighting retrofit technology solutions leader, providing high-quality, energy-efficient, "flicker-free", long-lived, and mercury-free TLED products as retrofit solutions to replace existing linear fluorescent lamp products in general purpose lighting applications and HID lamps in low-bay and high bay lighting applications. We believe these applications represent a dominant portion of the LED lighting market and energy savings potential for our targeted commercial, industrial and military maritime markets.

The U.S. Department of Energy ("DOE") has been a leading advocate of the solid-state lighting ("SSL") revolution and has supported various studies forecasting the market penetration of LEDs in general lighting applications since 2002. Based on the DOE's research, the case for the transition to LED lighting technology solutions is compelling. The DOE published their "Energy Saving Forecast of Solid-State Lighting in General Illumination Applications" in September 2016 ("DOE Report"), outlining the future path for SSL. Currently, fluorescent lighting systems represent almost half of all lighting energy consumption across all U.S. markets, creating a significant energy savings opportunity for LED lighting. The DOE's market analysis assumes the market adoption of LED lighting will be driven by improvements in LED product efficacy, price and technological improvements, including connected lighting. The DOE Report defines connected lighting as an LED lighting system with integrated sensors and controllers that are networked, enabling lighting products within the system to communicate with each other and transmit data. If the DOE's SSL Program Goal for LED efficacy for the U.S. are met and accelerated consumer adoption of connected lighting is achieved, the market penetration of LEDs is projected to drive a 75 percent reduction in U.S. energy consumption, the equivalent to the energy consumed by 45 million U.S. homes, in 2035 alone.

According to the DOE Report, the 75 percent reduction in energy will be driven largely by linear fixtures, including retrofit applications, and low and high bay product categories, principally in the commercial and industrial markets. The DOE Report further estimated the 2015 LED penetration rates in the U.S. for fixtures and low and high bay products was approximately three percent and six percent, respectively, increasing to penetration rates of 77 percent for fixtures and 86 percent for low and high bay products by 2035. The DOE Report further estimated commercial and industrial penetration rates between 8 and 12 percent in 2015, increasing to between 83 percent and 86 percent by 2035.

We estimate the 2017 North American commercial and industrial linear fixtures market, including retrofit applications, to be approximately $16.0 billion. While the overall revenue within linear fixture market is forecasted to decline at a 0.5 percent CAGR through 2026, LED lamps within this product category are forecast to increase at a 5.7 percent CAGR for the same time period. Within the commercial and industrial markets we estimate the 2017 overall penetration rate for LED lamps to approximate 21 percent. The estimated penetration rates for healthcare and education markets, two markets that value our high quality, high efficacy and less than one percent flicker, are estimated to be 14 percent and 26 percent, respectively. As the efficiency and cost of LED lighting continue to improve, we believe that market adoption will accelerate, particularly in commercial and industrial applications and that we are well positioned to capitalize on this market opportunity.

Our products

We design, develop, manufacture and market a wide variety of LED lighting technologies to serve our primary end markets, including the following:

Commercial products to serve our targeted commercial markets:

- Direct-wire TLED replacements for linear fluorescent lamps;
- Commercial Intellitube® TLED replacement for linear fluorescent lamps;
- LED fixtures and panels for fluorescent replacement or HID replacement in low-bay and high-bay applications;
- LED down-lights;
- LED dock lights and wall-packs;
- LED vapor tight lighting fixtures; and
- LED retrofit kits.

Military maritime LED lighting products to serve the U.S. Navy and allied foreign navies:

- Military Intellitube®;
- Military globe lights;
- Military berth lights; and
- Military fixtures.

The key features of our products are as follows:

- Many of our products make use of proprietary optical and electronics delivery systems that enable high efficiencies with superior lighting qualities and proven records of extremely high product reliability.
- Our products have exceptionally long life and are backed by a 10-year warranty.
- Our products have extremely low flicker. Optical flicker, or fluctuations in brightness over time, is largely invisible to the human eye, but has been proven to exert stress on the human brain, causing headaches and eye strain, which reduce occupant comfort and productivity. The Institute of Electrical and Electronics Engineers ("IEEE") one of the world's largest technical professional society promoting the development and application of electrotechnology and allied sciences for the benefit of humanity, recommends optical flicker of five percent or less. Our 500D series TLED products are certified by Underwriters Laboratories ("UL®") as "low optical flicker, less than 1%".
- Many of our products meet the lighting efficiency standards mandated by the Energy Independence and Security Act of 2007.

- Many of our products qualify for federal and state tax and rebate incentives for commercial consumers available in certain states.

We continue to invest in connected lighting research and development activities and partnerships as we seek to develop new connected lighting LED solutions. The DOE Report estimated that as of 2015 the penetration rates for any type of lighting controls to be 32 percent for commercial applications and six percent for industrial applications. Lighting controls, including dimming, sensor and daylighting technologies, can yield significant energy savings. The controllability of LED technology and the ability to integrate sensing, data processing and network interface hardware into our existing products will allow us to further differentiate our LED solutions and provide greater value to our customers.

Our strengths and strategy

Our LED products are more energy-efficient than traditional lighting products, such as incandescent bulbs and fluorescent lamps, and we believe they can provide significant long-term energy and maintenance cost savings, reduce carbon emissions and improve the sustainability profile of our customers.

Our strengths, which we believe provide a strategic competitive advantage, include the following:

- a long research, engineering, and market developmental history, with broad and intimate understanding of lighting technologies and LED lighting applications;
- owning and controlling the development, design, and construction of our TLED products to ensure we provide industry-leading LED products that offer premium performance with respect optical quality, efficacy, efficiency and power factor;
- leading the industry in the development of ultra-low flicker TLEDs with less than one percent flicker
- concentration on developing and providing high-quality, price competitive TLED lamps to replace fluorescent and HID lamps for commercial markets;
- providing high quality and high performing LED and TLED products with a proven history of reliability; and
- a deep understanding of the adoption dynamics and decision-making process for LED lighting products in existing commercial building markets.

Through our strengths, we seek to achieve the following objectives:

- to be a streamlined and high-performing organization, focused on providing industry-leading LED lighting products with compelling, superior value propositions that generate energy savings, reduce carbon emissions, and improve health and well-being for our customers;
- expand our market reach to further penetrate our target markets including healthcare, education, commercial, industrial and military maritime; and
- sales growth to support sustainable and profitable financial performance.

Our strategy to achieve these objectives includes the following actions:

- to utilize our patents and proprietary know-how to develop innovative LED lighting products that are differentiated by their quality, efficiency, reliability, adaptability and cost of ownership;
- invest in product development resources and partnerships to develop and execute a strategic product pipeline for profitable and compelling energy-efficient LED lighting products;
- expand our market presence through a network of trusted relationships with key sales agents throughout the United States in order to increase awareness and knowledge of our technology, product offerings and value proposition within our targeted markets;
- maintain cost control discipline without sacrificing either new product pipeline or potential long-term revenue growth; and
- continue our efforts to reduce product cost and drive further operating efficiencies.

Sales and marketing

Historically our products were sold through a direct sales model, which included a combination of direct sales employees, electrical and lighting contractors, and distributors. The 2017 restructuring initiative included the transition to an agency driven sales channel strategy in order to expand our market presence throughout the U.S. As of December 31, 2017, we had effectively transitioned our sales force to an agency driven sales channel, expanding our sales coverage to the entire U.S. through six geographic regions and 30 sales agents. As a result of this transition, we have substantially expanded from a primarily Midwest focus to build market presence and awareness in other regions of the U.S. with significant demand potential, including the Northeast, Southeast and California.

Targeted vertical markets

We focus on markets where the economic benefits and technical specifications of our lighting product offerings are most compelling. Our LED lighting products fall into two separate applications, commercial markets, focused on quality, efficacy, total cost of ownership and return on investment, and military maritime markets, requiring higher military specifications for durability and dependability.

With the introduction of our military Intellitube® product in 2011, our results had been driven by our military maritime market, accounting for approximately 78 percent of our net sales for the year-ended December 31, 2015. The military maritime competitive landscape changed in late 2016 and we are no longer the only qualified TLED provider for the U.S. Navy. Additionally, we believe that the military maritime market for our military Intellitube® product is limited as we estimate that 50 percent of the Navy's potentially replaceable fluorescent tubes had been retrofitted with our military Intellitube® product through December 31, 2017. Accordingly, for the years ended December 31, 2017 and 2016 our military maritime market accounted for 23 percent and 52 percent of our net sales, respectively. We continue to diversify our military maritime business through the development of LED fixtures, globe and berth lights and our continued efforts to expand sales beyond the U.S. Navy into foreign navies, the military sealift command, U.S. Coast Guard, commercial shipping companies, and military bases.

In light of the changing military maritime market, over the past three years we have been focused on expanding our commercial and industrial market presence where the economic benefits and technical specifications of our lighting product offerings are compelling, such as the healthcare, education and industrial verticals.

Given the 24/7 lighting requirements of hospital systems we believe that our LED solutions offer the quality, performance, long lifetime, return on investment and low flicker lightning that is particularly attractive to this target market. Since 2015 we have been the trusted LED lighting partner for a major northeast Ohio hospital system and as a result of our continued success, we have been able to leverage this relationship to introduce our lighting solutions and value proposition to an increasing number of hospital systems. We further believe that the strength of our agency relationships will allow us to further penetrate this market on a regional basis. As of December 31, 2017, we estimate that the LED penetration rate within the healthcare market is approximately 14 percent.

As we advocate for the benefits of low flicker LED lighting in schools, both in terms of energy-efficiency and in creating a healthy and effective learning environment, we continue to receive orders to retrofit local school districts, colleges and universities. Again, we believe that our relationships with our sales agents will allow us to further build awareness of the benefits of low flicker LED lighting, helping us to drive further penetration in this market. As of December 31, 2017, we estimate that the LED penetration rate within the education market is approximately 26 percent.

Low and high bay applications are generally used in commercial and industrial markets to provide light to large open areas like big-box retail stores, warehouses and manufacturing facilities. In the past few years, technological and cost improvements have allowed LED low and high bay applications to be more competitive against traditional low and high bay applications. In the industrial market in particular, due to the usage of HID lighting, the energy savings that can be achieved by switching to our LED products could be substantial and we believe we have attractive product offerings in this space.

Concentration of sales

Consistent with our efforts to diversify our customer base, three customers accounted for 48.4 percent, of net sales in 2017, compared to two customers accounting for 47.4 percent of net sales in 2016. In 2017, our commercial sales accounted for 76.7 percent of net sales while sales of our military maritime products accounted for 23.3 percent. In 2017, two commercial customers, a major northeastern Ohio hospital system and a large regional retrofit company accounted for 18.3 percent, and 12.8 percent of net sales, respectively, while sales to distributors to the U.S. Navy represented 22.0 percent of net sales. No other customers accounted for more than 10 percent of our net sales in 2017.

Competition

Our LED lighting products compete against a variety of lighting products, including conventional light sources such as compact fluorescent lamps and HID lamps, as well as other TLEDs and full fixture lighting products. Our ability to compete depends substantially upon the superior performance and lower total cost of ownership of our products. Principal competitors in our markets include large lamp manufacturers and lighting fixture companies based in the U.S., as well as TLED manufacturers mostly based in Asia, whose financial resources may substantially exceed and cost structure may be well below ours. These competitors may introduce new or improved products that may reduce or eliminate some of the competitive advantage of our products. We anticipate that the competition for our products will also come from new technologies that offer increased energy efficiency, lower maintenance costs, and/or advanced features. We compete with LED systems produced by large lighting companies such as Philips Lighting, CREE, Osram Sylvania and GE Lighting, as well as, smaller manufacturers or distributors such as LED Smart, Revolution Lighting Technologies and Orion Energy Systems. Some of these competitors offer products with performance characteristics similar to those of our products.

Manufacturing and suppliers

We produce our lighting products and systems through a combination of internal manufacturing and assembly at our Solon, Ohio facility, and sourced finished goods, manufactured to our specifications. Our internal lighting system manufacturing consists primarily of final assembly, testing, and quality control. We have worked with several vendors to design custom components to meet our specific needs. Our quality assurance program provides for testing of all sub-assemblies at key stages in the assembly process, as well as testing of finished products produced both internally and sourced through third parties.

Manufacturing costs are managed through the balance of internal production and an outsourced production model for certain parts and components, as well as finished goods in specific product lines, to a small number of vendors in various locations throughout the world, primarily in the United States, Taiwan, and China. In some cases, we rely upon a single supplier to source certain components, sub-assemblies, or finished goods. We continually attempt to improve our global supply chain practices to satisfy client demands in terms of quality and volumes, while controlling our costs and achieving targeted gross margins.

Product development

Product development is a key area of operating focus and competitive differentiation for us and we are dedicated to designing and developing industry leading LED lighting products. Gross product development expenses for the years ended December 31, 2017, 2016, and 2015 were $2.9 million, $3.6 million, and $3.0 million respectively.

Intellectual property

We have a policy of seeking to protect our intellectual property through patents, license agreements, trademark registrations, confidential disclosure agreements, and trade secrets as management deems appropriate. We have approximately 10 patents that we consider key to our current product lines. Additionally, we have various pending United States patent applications, and various pending Patent Cooperation Treaty patent applications filed with the World Intellectual Property Organization that serve as the basis for national patent filings in countries of interest. Our issued patents expire at various times through July 2032. Generally, the term of patent protection is twenty years from the earliest effective filing date of the patent application. There can be no assurance; however, that our issued patents are valid or that any patents applied for will be issued, and that our competitors or clients will not copy aspects of our lighting systems or obtain information that we regard as proprietary. There can also be no assurance that others will not independently develop products similar to ours. The laws of some foreign countries in which we manufacture, sell or may sell our products do not protect proprietary rights to products to the same extent as the laws of the United States.

Insurance

All of our properties and equipment are covered by insurance and we believe that such insurance is adequate. In addition, we maintain general liability and workers' compensation insurance in amounts we believe to be consistent with our risk of loss and industry practice.

Employees

At December 31, 2017, we had 74 full-time employees, seven of whom were located in Taiwan and 67 in the United States. None of our employees are subject to collective bargaining agreements.

Business segments

We currently operate in a single business segment that includes the marketing and sale of commercial and military maritime lighting products. Please refer to Note 4, “Discontinued Operations” and Note 12, “Product and Geographic Information,” included in Item 8 of this Annual Report, for additional information.

Available information

Our website is located at www.energyfocus.com. We make available free of charge, on or through our website, our annual, quarterly, and current reports, as well as any amendments to those reports, as soon as reasonably practicable after electronically filing such reports with the Securities and Exchange Commission. Information contained on our website is not part of this Annual Report.

ITEM 1A. RISK FACTORS

Risks associated with our business

We have a history of operating losses and may incur losses in the future.

We have incurred substantial losses in the past and reported net losses from continuing operations of $11.3 million and $16.9 million for the years ended December 31, 2017 and 2016. As of December 31, 2017, we had cash and cash equivalents of approximately $10.8 million and an accumulated deficit of $108.2 million.

In order for us to operate our business profitably, we need to continue to expand our market presence to further penetrate our targeted vertical markets, maintain cost control discipline without sacrificing either new product pipeline or potential long-term revenue growth, continue our efforts to reduce product cost, drive further operating efficiencies and develop and execute a strategic product pipeline for profitable and compelling energy-efficient LED lighting products. There is a risk that our strategy to return to profitability may not be as successful as we envision. If our operations do not achieve, or we experience an unanticipated delay in achieving, our intended level and pace of profitability, we may require additional funding.

We may require additional financing, and we may not be able to raise funds on favorable terms or at all.

As of December 31, 2017, we had cash and cash equivalents of approximately $10.8 million, and for the year ended December 31, 2017, we reported a net loss from continuing operations of $11.3 million. During the quarter ended September 30, 2015, we raised approximately $23.6 million from a follow-on offering of 1,500,000 shares of common stock. The proceeds from that offering will continue to provide funding for the near-term, however, there is a risk that we will require additional external financing if our business does not generate adequate cash flow or if our business plans change or require more investment than we currently anticipate.

In addition, we terminated our revolving credit facility effective December 31, 2015 and do not have current plans to enter into a replacement facility.

If we require additional financing, we will evaluate all available external funding sources, but there can be no assurance that we will obtain funding on acceptable terms, in a timely fashion, or at all. Obtaining additional financing contains risks, including:

- additional equity financing may not be available to us on satisfactory terms and any equity we are able to issue could lead to dilution for current stockholders;
- loans or other debt instruments may have terms and/or conditions, such as interest rate, restrictive covenants and control or revocation provisions, which are not acceptable to management or our Board of Directors; and
- the current environment in capital markets combined with our capital constraints may prevent us from being able to obtain adequate debt financing.

If we fail to obtain required additional financing to grow our business, we would need to delay or scale back our business plan, further reduce our operating costs, or reduce our headcount, each of which would have a material adverse effect on our business, future prospects, and financial condition.

We derive a significant portion of our revenue from a few customers and the loss of one of these customers, or a reduction in their demand for our products, could adversely affect our business, financial condition, results of operations, and prospects.

Historically our customer base has been highly concentrated and one or a few customers have represented a substantial portion of our net sales. In 2017, two commercial customers, a major northeastern Ohio hospital system and a large regional retrofit company accounted for 18.3 percent, and 12.8 percent of net sales, respectively, while sales to distributors to the U.S. Navy represented 22.0 percent of net sales. We generally do not have long-term contracts with our customers that commit them to purchase any minimum amount of our products or require them to continue to do business with us. We could lose business from any one of our significant customer for a variety of reasons, many of which are outside of our control, including, changes in levels of government funding and rebate programs, our inability to comply with government contracting laws and regulations, changes in customers' procurement strategies or their lighting retrofit plans, changes in product specifications, additional competitors entering particular markets, our failure to keep pace with technological advances and cost reductions, and damage to our professional reputation, among others.

We are attempting to expand and diversify our customer base, reducing the dependence on one or a few customers, through the implementation of our agency driven sales channel strategy. Although as of December 31, 2017, we had effectively transitioned our sales force to an agency driven sales channel, expanding our sales coverage to the entire U.S. through six geographic regions and 30 sales agents, our efforts to expand our customer base are generally in the early stages, and we cannot provide any assurance we will be successful. We anticipate that a limited number of customers could continue to comprise a substantial portion of our revenue for the foreseeable future. If we continue to do business with our significant customers, our concentration can cause variability in our results because we cannot control the timing or amounts of their purchases. If a significant customer ceases to do or drastically reduces its business with us, these events can occur with little or no notice and could adversely affect our results of operations and cash flows in particular periods.

Our inability to diversify our customer base could adversely impact our business and operating results, and expanding to new target markets may open us up to additional risks and challenges.

Our efforts to penetrate additional markets are generally in the early stages, and we cannot provide any assurance we will be successful. Our initial sales cycle is long, generally six to twelve months or more, and each targeted market may require us to develop different expertise and sales, supply, or distribution channels. We may dedicate significant resources to a targeted customer or industry before we achieve meaningful results or are able to effectively evaluate our success. As we target new customers and industries, we will also face different technological, pricing, supply, regulatory and competitive challenges that we may not have experience with, or that may evolve more rapidly than we can address. As a result, our efforts to expand to new markets may not succeed, may divert management resources from our existing operations and may require significant financial commitments to unproven areas of our business, all of which may harm our financial performance.

If we are unable to manage future growth effectively, our profitability and liquidity could be adversely affected.

Our ability to achieve our desired growth depends on the adoption of LEDs within the general lighting market and our ability to affect and adapt to this rate of adoption. The pace of continued growth in this market is uncertain, and in order to grow, we may need to:

- manage organizational complexity and communication;
- expand the skills and capabilities of our current management team;
- add experienced senior level managers;
- attract and retain qualified employees;
- adequately maintain and adjust the operational and financial controls that support our business;
- expand research and development, sales and marketing, technical support, distribution capabilities, manufacturing planning and administrative functions;
- maintain or establish additional manufacturing facilities and equipment, as well as secure sufficient third-party manufacturing resources, to adequately meet customer demand; and
- manage an increasingly complex supply chain that has the ability to maintain a sufficient supply of materials and deliver on time to our manufacturing facilities.

These efforts to grow our business, both in terms of size and in diversity of customer bases served, may put a significant strain on our resources. During 2017, we implemented comprehensive cost-saving initiatives to reduce our net loss and mitigate doubt about our ability to continue as a going concern. These initiatives have improved efficiency and streamlined our operations, but future growth may exceed our current capacity and require rapid expansion in certain functional areas.

We may lack sufficient funding to appropriately expand or incur significant expenses as we attempt to scale our resources and make investments in our business that we believe are necessary to achieve long-term growth goals. Such investments take time to become fully operational, and we may not be able to expand quickly enough to exploit targeted market opportunities. In addition to our own manufacturing capacity, we are increasingly utilizing contract manufacturers and original design manufacturers (“ODMs”) to produce our products for us. There are also inherent execution risks in expanding product lines and production capacity, whether through our facilities or that of a third-party manufacturer, that could increase costs and reduce our operating results, including design and construction cost overruns, poor production process yields and reduced quality control. If we are unable to fund any necessary expansion or manage our growth effectively, we may not be able to adequately meet demand, our expenses could increase without a proportionate increase in revenue, our margins could decrease, and our business and results of operations could be adversely affected.

Our results of operations, financial condition and business could be harmed if we are unable to balance customer demand and capacity.

As customer demand for our products changes, we must be able to adjust our production capacity to meet demand. We are continually taking steps to address our manufacturing capacity needs for our products. If we are not able to increase or decrease our production capacity at our targeted rate or if there are unforeseen costs associated with adjusting our capacity levels, we may not be able to achieve our financial targets. In addition, as we introduce new products and further develop product generations, we must balance the production and inventory of prior generation products with the production and inventory of new generation products, whether manufactured by us or our contract manufacturers, to maintain a product mix that will satisfy customer demand and mitigate the risk of incurring cost write-downs on the previous generation products, related raw materials and tooling.

If customer demand does not materialize at the rate forecasted, we may not be able to scale back our manufacturing expenses or overhead costs to correspond to the demand. This could result in lower margins and adversely impact our business and results of operations. Additionally, if product demand decreases or we fail to forecast demand accurately, our results may be adversely impacted due to higher costs resulting from lower factory utilization, causing higher fixed costs per unit produced. In addition, our efforts to improve quoted delivery lead-time performance may result in corresponding reductions in order backlog. A decline in backlog levels could result in more variability and less predictability in our quarter-to-quarter net sales and operating results.

Our operating results may fluctuate due to factors that are difficult to forecast and not within our control.

Our past operating results may not be accurate indicators of future performance, and you should not rely on such results to predict our future performance. Our operating results have fluctuated significantly in the past, and could fluctuate in the future. Factors that may contribute to fluctuations include:

- changes in aggregate capital spending, cyclicality and other economic conditions, or domestic and international demand in the industries;
- the timing of large customer orders to which we may have limited visibility and cannot control;
- competition for our products, including the entry of new competitors and significant declines in competitive pricing;
- our ability to effectively manage our working capital;
- our ability to generate increased demand in our targeted markets, particularly those in which we have limited experience;
- our ability to satisfy consumer demands in a timely and cost-effective manner;
- pricing and availability of labor and materials;
- quality testing and reliability of new products;
- our inability to adjust certain fixed costs and expenses for changes in demand and the timing and significance of expenditures that may be incurred to facilitate our growth;
- seasonal fluctuations in demand and our revenue; and
- disruption in component supply from foreign vendors.

Depressed general economic conditions may adversely affect our operating results and financial condition.

Our business is sensitive to changes in general economic conditions, both inside and outside the United States. Slow growth in the economy or an economic downturn, particularly one affecting construction and building renovation, or that cause end-users to reduce or delay their purchases of lighting products, services, or retrofit activities, would have a material adverse effect on our business, cash flows, financial condition and results of operations. LED lighting retrofit projects, in particular, tend to require a significant capital commitment, which is offset by cost savings achieved over time. As such, a lack of available capital, whether due to economic factors or conditions in the capital or debt markets, could have the effect of reducing demand for our products. A decrease in demand could adversely affect our ability to meet our working capital requirements and growth objectives, or could otherwise adversely affect our business, financial condition, and results of operations.

Customers may be unable to obtain financing to make purchases from us.

Some of our customers require financing in order to purchase our products and the initial investment is higher than is required with traditional lighting products. The potential inability of these customers to access the capital needed to finance purchases of our products and meet their payment obligations to us could adversely impact the appeal of our products relative to those with lower upfront costs and have a negative impact on our financial condition and results of operations. There can be no assurance that third party finance companies will provide capital to our customers.

A portion of our business is dependent upon the existence of government funding, which may not be available into the future and could result in a reduction in sales and harm to our business.

Some of our customers are dependent on governmental funding, including foreign allied navies and U.S. military bases. If any of these other target customers abandon, curtail, or delay planned LED lighting retrofit projects as a result of the levels of funding available to them or changes in budget priorities, it would adversely affect our opportunities to generate product sales.

If LED lighting technology fails to gain widespread market acceptance or we are unable to respond effectively as new lighting technologies and market trends emerge, our competitive position and our ability to generate revenue, and profits may be harmed.

To be successful, we depend on continued market acceptance of our existing LED technology. Although adoption of LED lighting continues to grow, the use of LED lighting products for general illumination is in its early stages, is still limited, and faces significant challenges. Potential customers may be reluctant to adopt LED lighting products as an alternative to traditional lighting technology because of its higher initial cost or perceived risks relating to its novelty, reliability, usefulness, light quality, and cost-effectiveness when compared to other established lighting sources available in the market. Changes in economic and market conditions may also make traditional lighting technologies more appealing. For example, declining energy prices in certain regions or countries may favor existing lighting technologies that are less energy-efficient, reducing the rate of adoption for LED lighting products in those areas. Notwithstanding continued performance improvements and cost reductions of LED lighting, limited customer awareness of the benefits of LED lighting products, lack of widely accepted standards governing LED lighting products and customer unwillingness to adopt LED lighting products could significantly limit the demand for LED lighting products. Even potential customers that are inclined to adopt energy-efficient lighting technology may defer investment as LED lighting products continue to experience rapid technological advances. Any of the foregoing could adversely impact our results of operations and limit our market opportunities.

In addition, we will need to keep pace with rapid changes in LED technology, changing customer requirements, new product introductions by competitors and evolving industry standards, any of which could render our existing products obsolete if we fail to respond in a timely manner. The development, introduction, and acceptance of new products incorporating advanced technology is a complex process subject to numerous uncertainties, including:

- achievement of technology breakthroughs required to make commercially viable devices;
- the accuracy of our predictions for market requirements;
- our ability to predict, influence, and/or react to evolving standards;
- acceptance of our new product designs;
- acceptance of new technologies in certain markets;
- the combination of other desired technological advances with lighting products, such as controls;
- the availability of qualified research and development personnel;
- our timely completion of product designs and development;
- our ability to develop repeatable processes to manufacture new products in sufficient quantities, with the desired specifications, and at competitive costs;
- our ability to effectively transfer products and technology from development to manufacturing; and
- market acceptance of our products.

We could experience delays in the introduction of new products. We could also devote substantial resources to the development of new technologies or products that are ultimately not successful.

If effective new sources of light other than LEDs are discovered, our current products and technologies could become less competitive or obsolete. If others develop innovative proprietary lighting technology that is superior to ours, or if we fail to accurately anticipate technology and market trends, respond on a timely basis with our own development of new and reliable products and enhancements to existing products, and achieve broad market acceptance of these products and enhancements, our competitive position may be harmed and we may not achieve sufficient growth in our net sales to attain or sustain profitability.

If we are not able to compete effectively against companies with greater resources, our prospects for future success will be jeopardized.

The lighting industry is highly competitive. In the high-performance lighting markets in which we sell our advanced lighting systems, our products compete with lighting products utilizing traditional lighting technology provided by many vendors. For sales of military maritime products, we compete with a small number of qualified military lighting lamp and fixture suppliers. In certain commercial applications, we typically compete with LED systems produced by large lighting companies. Our primary competitors include Royal Philips, CREE, Inc., Osram Sylvania, LED Smart, Revolution Lighting Technologies and Orion Energy Systems, Inc. Some of these competitors offer products with performance characteristics similar to those of our products. Many of our competitors are larger, more established companies with greater resources to devote to research and development, manufacturing and marketing, as well as greater brand recognition. In addition, larger competitors who purchase greater unit volumes from component suppliers may be able to negotiate lower bill of material costs, thereby enabling them to offer lower pricing to end customers. Moreover, the relatively low barriers to entry into the lighting industry and the limited proprietary nature of many lighting products also permit new competitors to enter the industry easily and with lower costs.

In each of our markets, we also anticipate the possibility that LED manufacturers, including those that currently supply us with LEDs, may seek to compete with us. Our competitors' lighting technologies and products may be more readily accepted by customers than our products will be. Moreover, if one or more of our competitors or suppliers were to merge, the change in the competitive landscape could adversely affect our competitive position. Additionally, to the extent that competition in our markets intensifies, we may be required to reduce our prices in order to remain competitive. If we do not compete effectively, or if we reduce our prices without making commensurate reductions in our costs, our net sales, margins, and profitability and our future prospects for success may be harmed.

If we are unable to obtain and adequately protect our intellectual property rights or are subject to claims that our products infringe on the intellectual property rights of others, our ability to commercialize our products could be substantially limited.

We consider our technology and processes proprietary. If we are not able to adequately protect or enforce the proprietary aspects of our technology, competitors may utilize our proprietary technology. As a result, our business, financial condition, and results of operations could be adversely affected. We protect our technology through a combination of patent, copyright, trademark and trade secret laws, employee and third-party nondisclosure agreements, and similar means. Despite our efforts, other parties may attempt to disclose, obtain, or use our technologies. Our competitors may also be able to independently develop products that are substantially equivalent or superior to our products or slightly modify our products. In addition, the laws of some foreign countries do not protect our proprietary rights as fully as do the laws of the United States. As a result, we may not be able to protect our proprietary rights adequately in the United States or abroad. Furthermore, there can be no assurance that we will be issued patents for which we have applied or obtain additional patents, or that we will be able to obtain licenses to patents or other intellectual property rights of third parties that we may need to support our business in the future. The inability to obtain certain patents or rights to third-party patents and other intellectual property rights in the future could have a material adverse effect on our business.

Our industry is characterized by vigorous protection and pursuit of intellectual property rights and positions, which may result in protracted and expensive litigation. We have engaged in litigation in the past and litigation may be necessary in the future to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others. Litigation may also be necessary to defend against claims of infringement or invalidity by others. Additionally, we could be required to defend against individuals and groups who have been purchasing intellectual property assets for the sole purpose of making claims of infringement and attempting to extract settlements from companies like ours. Litigation could delay development or sales efforts and an adverse outcome in litigation or any similar proceedings could subject us to significant liabilities, require us to license disputed rights from others or require us to cease marketing or using certain products or technologies. We may not be able to obtain any licenses on acceptable terms, if at all, and may attempt to redesign those products that contain allegedly infringing intellectual property, which may not be possible. We also may have to indemnify certain customers if it is determined that we have infringed upon or misappropriated another party's intellectual property. The costs of addressing any intellectual property litigation claim, including legal fees and expenses and the diversion of management resources, regardless of whether the claim is valid, could be significant and could materially harm our business, financial condition, and results of operations.

We may be subject to confidential information theft or misuse, which could harm our business and results of operations.

We face attempts by others to gain unauthorized access to our information technology systems on which we maintain proprietary and other confidential information. Our security measures may be breached as the result of industrial or other espionage actions of outside parties, employee error, malfeasance or otherwise, and as a result, an unauthorized party may obtain access to our systems. Additionally, outside parties may attempt to access our confidential information through other means, for example by fraudulently inducing our employees to disclose confidential information. We actively seek to prevent, detect and investigate any unauthorized access, which occasionally occurs despite our best efforts. We might be unaware of any such access or unable to determine its magnitude and effects. The theft, corruption and/or unauthorized use or publication of our trade secrets and other confidential business information as a result of such an incident could adversely affect our competitive position and the value of our investment in research and development could be reduced. Our business could be subject to significant disruption, widespread negative publicity and a loss of customers, and we could suffer legal liabilities and monetary or other losses.

If critical components and finished products that we currently purchase from a small number of third-party suppliers become unavailable or increase in price, or if our suppliers or delivery channels fail to meet our requirements for quality, quantity, and timeliness, our revenue and reputation in the marketplace could be harmed, which would damage our business.

In an effort to reduce manufacturing costs, we have outsourced the production of certain parts and components, as well as finished goods in our product lines, to a small number of vendors in various locations throughout the world, primarily in the United States, Taiwan and China. We generally purchase these sole or limited source items with purchase orders, and we have limited guaranteed supply arrangements with such suppliers. While we believe alternative sources for these components and products are available, we have selected these particular suppliers based on their ability to consistently provide the best quality product at the most cost-effective price, to meet our specifications, and to deliver within scheduled time frames. We do not control the time and resources that these suppliers devote to our business, and we cannot be sure that these suppliers will perform their obligations to us. If our suppliers fail to perform their obligations in a timely manner or at satisfactory quality levels, we may suffer lost sales, reductions in revenue and damage to our reputation in the market, all of which would adversely affect our business. As our demand for our products fluctuates and can be hard to predict, we may not need a sustained level of inventory, which may cause financial hardship for our suppliers or they may need to divert production capacity elsewhere. In the past, we have had to purchase quantities of certain components that are critical to our product manufacturing and were in excess of our estimated near-term requirements as a result of supplier delivery constraints and concerns over component availability, and we may need to do so in the future. As a result, we have had, and may need to continue, to devote additional working capital to support a large amount of component and raw material inventory that may not be used over a reasonable period to produce saleable products, and we may be required to increase our excess and obsolete inventory reserves to provide for these excess quantities, particularly if demand for our products does not meet our expectations.

We may be vulnerable to unanticipated price increases and payment term changes. Significant increases in the prices of sourced components and products could cause our product prices to increase, which may reduce demand for our products or make us more susceptible to competition. Furthermore, in the event that we are unable to pass along increases in operating costs to our customers, margins and profitability may be adversely affected. Accordingly, the loss of all or one of these suppliers could have a material adverse effect on our operations until such time as an alternative supplier could be found.

Additionally, consolidation in the lighting industry could result in one or more current suppliers being acquired by a competitor, rendering us unable to continue purchasing key components and products at competitive prices. We may be subject to various import duties applicable to materials manufactured in foreign countries and may be affected by various other import and export restrictions, as well as other considerations or developments impacting upon international trade, including economic or political instability, shipping delays and product quotas. These international trade factors will, under certain circumstances, have an impact on the cost of components, which will have an impact on the cost to us of the manufactured product and the wholesale and retail prices of our products.

We rely on arrangements with independent shipping companies for the delivery of our products from vendors abroad. The failure or inability of these shipping companies to deliver products or the unavailability of shipping or port services, even temporarily, could have a material adverse effect on our business. We may also be adversely affected by an increase in freight surcharges due to rising fuel costs and added security costs.

We depend on independent agents and sales representatives for a substantial portion of our net sales, and the failure to manage our relationships with these third parties, or the termination of these relationships, could cause our net sales to decline and harm our business.

Our 2017 restructuring initiative included the transition to an agency driven sales channel strategy in order to expand our market presence throughout the U.S. As of December 31, 2017, we had effectively transitioned our sales force to an agency driven sales channel, expanding our sales coverage to the entire U.S. through six geographic regions and 30 sales agents. As a result, we have increased our reliance on independent sales agent channels to market and sell our products. In addition, these parties provide technical sales support to end-users. The current agreements with our agents are generally non-exclusive, meaning they can sell products of our competitors. Any such agreements we enter into in the future may be on similar terms. Our agents may not be motivated to or successfully pursue the sales opportunities available to them, or they may prefer to sell or be more familiar with the products of our competitors. If our agents do not achieve our sales objectives or these relationships take significant time to develop, our revenue may decline, fail to grow or not increase as rapidly as we intend in order to achieve profitability and grow our business.

Furthermore, our agreements are generally short-term, and can be cancelled by either party without significant financial consequence. The termination of or the inability to negotiate extensions of these contracts on acceptable terms could adversely impact sales of our products. Additionally, we cannot be certain that we or end-users will be satisfied by their performance. If these agents significantly change their terms with us, or change their end-user relationships, there could be a significant impact on our net sales and profits.

Our products could contain defects or they may be installed or operated incorrectly, which could reduce sales of those products or result in claims against us.

Despite product testing, defects may be found in our existing or future products. This could result in, among other things, a delay in the recognition or loss of net sales, the write-down or destruction of existing inventory, insurance recoveries that fail to cover the full costs associated with product recalls, significant warranty, support, and repair costs, diversion of the attention of our engineering personnel from our product development efforts, and damage to our relationships with our customers. The occurrence of these problems could also result in reputational damage or the delay or loss of market acceptance of our lighting products, and would likely harm our business. In addition, our customers may specify quality, performance, and reliability standards that we must meet. If our products do not meet these standards, we may be required to replace or rework the products. In some cases, our products may contain undetected defects or flaws that only become evident after shipment. Even if our products meet standard specifications, our customers may attempt to use our products in applications for which they were not designed or in products that were not designed or manufactured properly, resulting in product failures and creating customer satisfaction issues.

Some of our products use line voltages (such as 120 or 240 AC), which involve enhanced risk of electrical shock, injury or death in the event of a short circuit or other malfunction. Defects, integration issues or other performance problems in our lighting products could result in personal injury or financial or other damages to end-users or could damage market acceptance of our products. Our customers and end-users could also seek damages from us for their losses. A product liability claim brought against us, even if unsuccessful, would likely be time consuming and costly to defend and the adverse publicity generated by such a claim against us or others in our industry could negatively impact our reputation.

We provide warranty periods ranging from one to ten years on our products. The standard warranty on nearly all of our new LED lighting products, which now represent the majority of our revenue, is ten years. Although we believe our reserves are appropriate, we are making projections about the future reliability of new products and technologies, and we may experience increased variability in warranty claims. Increased warranty claims could result in significant losses due to a rise in warranty expense and costs associated with customer support.

We may be subject to legal claims against us or claims by us which could have a significant impact on our resulting financial performance.

At any given time, we may be subject to litigation or claims related to our products, suppliers, customers, employees, stockholders, distributors, sales representatives, intellectual property, and sales of our assets, among other things, the disposition of which may have an adverse effect upon our business, financial condition, or results of operation. The outcome of litigation is difficult to assess or quantify. Lawsuits can result in the payment of substantial damages by defendants. If we are required to pay substantial damages and expenses as a result of these or other types of lawsuits our business and results of operations would be adversely affected. Regardless of whether any claims against us are valid or whether we are liable, claims may be expensive to defend and may divert time and money away from our operations. Insurance may not be available at all or in sufficient amounts to cover any liabilities with respect to these or other matters. A judgment or other liability in excess of our insurance coverage for any claims could adversely affect our business and the results of our operations.

Our business may suffer if we fail to comply with government contracting laws and regulations.

We derive a portion of our revenues from direct and indirect sales to U.S., state, local, and foreign governments and their respective agencies. Contracts with government customers are subject to various procurement laws and regulations, business prerequisites to qualify for such contracts, accounting procedures, intellectual property process, and contract provisions relating to their formation, administration and performance, which may provide for various rights and remedies in favor of the governments that are not typically applicable to or found in commercial contracts. Failure to comply with these laws, regulations, or provisions in our government contracts could result in litigation, the imposition of various civil and criminal penalties, termination of contracts, forfeiture of profits, suspension of payments, or suspension from future government contracting. If our government contracts are terminated, if we are suspended from government work, or if our ability to compete for new contracts is adversely affected, our business could suffer due to, among other factors, lost sales, the costs of any government action or penalties, damages to our reputation and the inability to recover our investment in developing and marketing products for military maritime use.

The ability to use our net operating loss carryforwards and certain other tax attributes may be limited.

We have significant U.S. net operating loss and tax credit carryforwards (the “Tax Attributes”). Under federal tax laws, we can carry forward and use our Tax Attributes to reduce our future U.S. taxable income and tax liabilities until such Tax Attributes expire in accordance with the Internal Revenue Code of 1986, as amended (the “IRC”). Section 382 and Section 383 of the IRC provide an annual limitation on our ability to utilize our Tax Attributes, as well as certain built-in-losses, against future U.S. taxable income in the event of a change in ownership, as defined under the IRC. Share issuances in connection with our past financing transactions or other future changes in our stock ownership, which may be beyond our control, could result in changes in ownership for purposes of the IRC. Such changes in ownership could further limit our ability to use our Tax Attributes. Accordingly, any such occurrences could adversely affect our financial condition, operating results and cash flows.

The cost of compliance with environmental, health, safety, and other laws and regulations could adversely affect our results of operations or financial condition.

We are subject to a broad range of environmental, health, safety, and other laws and regulations. These laws and regulations impose increasingly stringent environmental, health, and safety protection standards and permit requirements regarding, among other things, air emissions, wastewater storage, treatment, and discharges, the use and handling of hazardous or toxic materials, waste disposal practices, the remediation of environmental contamination, and working conditions for our employees. Some environmental laws, such as Superfund, the Clean Water Act, and comparable laws in U.S. states and other jurisdictions world-wide, impose joint and several liability for the cost of environmental remediation, natural resource damages, third party claims, and other expenses, without regard to the fault or the legality of the original conduct, on those persons who contributed to the release of a hazardous substance into the environment. We may also be affected by future laws or regulations, including those imposed in response to energy, climate change, geopolitical, or similar concerns. These laws may impact the sourcing of raw materials and the manufacture and distribution of our products and place restrictions and other requirements on the products that we can sell in certain geographical locations.

We have international operations and are subject to risks associated with operating in international markets.

We outsource the production of certain parts and components, as well as finished goods in certain product lines, to a small number of vendors in various locations outside of the United States, including Taiwan and China. Although we do not currently generate significant sales from customers outside the United States, we are targeting foreign allied navies as a potential opportunity to generate additional sales of our military products.

International business operations are subject to inherent risks, including, among others:

- difficulty in enforcing agreements and collecting receivables through foreign legal systems;
- unexpected changes in regulatory requirements, tariffs, and other trade barriers or restrictions;
- potentially adverse tax consequences;
- the burdens of compliance with the U.S. Foreign Corrupt Practices Act, similar anti-bribery laws in other countries, and a wide variety of laws;
- import and export license requirements and restrictions of the United States and each other country in which we operate;
- exposure to different legal standards and reduced protection for intellectual property rights in some countries;
- currency fluctuations and restrictions; and
- political, social, and economic instability, including war and the threat of war, acts of terrorism, pandemics, boycotts, curtailment of trade, or other business restrictions.

If we do not anticipate and effectively manage these risks, these factors may have a material adverse impact on our business operations.

If we are unable to attract or retain qualified personnel, our business and product development efforts could be harmed.

To a large extent, our future success will depend on the continued contributions of certain employees, such as our current Executive Chairman, Chief Executive Officer and President and Chief Financial Officer. We have had significant turnover in our management team and other employees since 2013 and cannot be certain that these and other key employees will continue in their respective capacities for any period of time, and these employees may be difficult to replace. Our future success will also depend on our ability to attract and retain qualified technical, sales, marketing, and management personnel, for whom competition is very intense. As we attempt to rapidly grow our business, it could be especially difficult to attract and retain sufficient qualified personnel, especially in light of our lean cost-structure. The loss of, or failure to attract, hire, and retain any such persons could delay product development cycles, disrupt our operations, increase our costs, or otherwise harm our business or results of operations.

We believe that certification and compliance issues are critical to adoption of our lighting systems, and failure to obtain such certification or compliance would harm our business.

We are required to comply with certain legal requirements governing the materials in our products. Although we are not aware of any efforts to amend any existing legal requirements or implement new legal requirements in a manner with which we cannot comply, our net sales might be adversely affected if such an amendment or implementation were to occur.

Moreover, although not legally required to do so, we strive to obtain certification for substantially all our products. In the United States, we seek certification on substantially all of our products from UL®, Intertek Testing Services (ETL®), or DesignLights Consortium (DLC™). Where appropriate in jurisdictions outside the United States and Europe, we seek to obtain other similar national or regional certifications for our products. Although we believe that our broad knowledge and experience with electrical codes and safety standards have facilitated certification approvals, we cannot ensure that we will be able to obtain any such certifications for our new products or that, if certification standards are amended, that we will be able to maintain such certifications for our existing products. Moreover, although we are not aware of any effort to amend any existing certification standard or implement a new certification standard in a manner that would render us unable to maintain certification for our existing products or obtain ratification for new products, our net sales might be adversely affected if such an amendment or implementation were to occur.

As a public reporting company, we are subject to complex regulations concerning corporate governance and public disclosure that require us to incur significant expenses, divert management resources, and expose us to risks of non-compliance.

We are faced with complicated and evolving laws, regulations and standards relating to corporate governance and public disclosure. To comply with these requirements and operate as a public company, we incur legal, financial, accounting and administrative costs and other related expenses. As a smaller reporting company, these expenses may be significant to our financial results. In addition, due to our limited internal resources, we must devote substantial management and other resources to compliance efforts. As we attempt to rapidly grow our business, compliance efforts could become more complex and put additional strain on our resources. Despite our efforts, we cannot guarantee that we will effectively meet all of the requirements of these laws and regulations. If we fail to comply with any of the laws, rules and regulations applicable to U.S. public companies or with respect to publicly-traded stock, we may be subject to regulatory scrutiny, possible sanctions or higher risks of shareholder litigation, all of which could harm our reputation, lower our stock price or cause us to incur additional expenses.

Any material weaknesses in our internal control over financial reporting could, if not remediated, result in material misstatements in our financial statements.

As a public company reporting to the Securities and Exchange Commission, we are subject to the reporting requirements of the Securities Exchange Act of 1934, and the Sarbanes-Oxley Act of 2002, including section 404(a) that requires that we annually evaluate and report on our systems of internal controls. If material weaknesses or significant deficiencies in our internal controls are discovered or occur in the future, our financial statements may contain material misstatements and we could be required to restate our financial results. This could result in a decrease in our stock price, securities litigation, and the diversion of significant management and financial resources.

If we cease to meet the criteria to be considered a “smaller reporting company,” we will also become subject to section 404(b) of the Sarbanes-Oxley Act, which requires an auditor attestation of the effectiveness of our internal controls over financial reporting. This additional requirement will increase our financial, accounting and administrative costs, and other related expenses, which may be significant to our financial results. In addition, due to our limited internal resources, further compliance efforts put additional strain on our resources. Despite our efforts, if our auditors are unable to attest to the effectiveness of our internal controls, we may be subject to regulatory scrutiny and higher risk of shareholder litigation, which could harm our reputation, lower our stock price or cause us to incur additional expenses.

We rely heavily on information technology in our operations and any material failure, weakness, interruption or breach of security could prevent us from effectively operating our business, which could have a material adverse effect on our business, financial condition, and results of operations.

We rely heavily on our information technology systems, including our enterprise resource planning (“ERP”) software, across our operations and corporate functions, including for management of our supply chain, payment of obligations, data warehousing to support analytics, finance systems, accounting systems, and other various processes and procedures, some of which are handled by third parties.

Our ability to efficiently and effectively manage our business depends significantly on the reliability and capacity of these systems. Our business and results of operations may be adversely affected if we experience system usage problems. The failure of these systems to operate effectively, maintenance problems, system conversions, back-up failures, problems or lack of resources for upgrading or transitioning to new platforms or damage or interruption from circumstances beyond our control, including, without limitation, fire, natural disasters, power outages, systems failure, security breaches, cyber-attacks, viruses or human error could result in, among other things, transaction errors, processing inefficiencies, loss of data, inability to generate timely SEC reports, loss of sales and customers and reduce efficiency in our operations. Additionally, we and our customers could suffer financial and reputational harm if customer or Company proprietary information is compromised by such events. Remediation of such problems could result in significant unplanned capital investments and any damage or interruption could have a material adverse effect on our business, financial condition, and results of operations.

Risks associated with an investment in our common stock

As a "thinly-traded" stock with a relatively small public float, the market price of our common stock is highly volatile and may decline regardless of our operating performance.

Our common stock is "thinly-traded" and we have a relatively small public float, which increases volatility in the share price and makes it difficult for investors to buy or sell shares in the public market without materially affecting our share price. Since our listing on the NASDAQ Capital Market in August 2014, our market price has ranged from a low of $1.51 to a high of $29.20 and continues to experience significant volatility. Broad market and industry factors also may adversely affect the market price of our common stock, regardless of our actual operating performance. Factors that could cause wide fluctuations in our stock price may include, among other things:

- general economic conditions and trends;
- addition or loss of significant customers and the timing of significant customer purchases;
- actual or anticipated variations in our financial condition and operating results;
- market expectations following period of rapid growth;
- our ability to effectively manage our growth and the significance and timing of associated expenses;
- unanticipated impairments and other changes that reduce our earnings;
- overall conditions or trends in our industry;
- the entry or exit of new competitors into our target markets;
- any litigation or legal claims;
- the terms and amount of any additional financing that we may obtain, if any;
- unfavorable publicity;
- additions or departures of key personnel;
- changes in the estimates of our operating results or changes in recommendations by any securities or industry analysts that elect to follow our common stock; and
- sales of our common stock by us or our stockholders, including sales by our directors and officers.

Because our common stock is thinly-traded, investors seeking to buy or sell a certain quantity of our shares in the public market may be unable to do so within one or more trading days and it may be difficult for stockholders to sell all of their shares in the market at any given time at prevailing prices. Any attempts to buy or sell a significant quantity of our shares could materially affect our share price. In addition, because our common stock is thinly-traded and we have a relatively small public float, the market price of our shares may be disproportionately affected by any news, commentary or rumors regarding us or our industry, regardless of the source or veracity, which could also result in increased volatility.

In addition, in the past, following periods of volatility in the market price of a company's securities, securities litigation has often been instituted against these companies. Volatility in the market price of our shares could also increase the likelihood of regulatory scrutiny. Securities litigation, if instituted against us, or any regulatory inquiries or actions that we face could result in substantial costs, diversion of our management's attention and resources and unfavorable publicity, regardless of the merits of any claims made against us or the ultimate outcome of any such litigation or action.

We could issue additional shares of common stock without stockholder approval.

We are authorized to issue 30,000,000 shares of common stock, of which 11,889,517 shares were issued and outstanding as of December 31, 2017. Our Board of Directors has the authority, without action or vote of our stockholders, to issue authorized but unissued shares subject to the rules of the NASDAQ Capital Market. In addition, in order to raise capital or acquire businesses in the future, we may need to issue securities that are convertible or exchangeable for shares of our common stock. Any such issuances could be made at a price that reflects a discount to the then-current trading price of our common stock. These issuances could be dilutive to our existing stockholders and cause the market price of our common stock to decline.

If securities analysts do not publish research or reports about our business, or if they downgrade our stock, the price of our stock could decline.

The trading market for our common stock is likely to be influenced by any research and reports that securities or industry analysts publish about us or our business. If one or more of these analysts downgrades our stock or publish unfavorable research about our business, our stock price would likely decline. There are currently a limited number of analysts covering us, which could increase the influence of particular analysts or reports. 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 and cause our stock price and trading volume to decline. Any of these effects could be especially significant because our common stock is “thinly-traded” and we have a relatively small public float.

Our failure to comply with the continued listing requirements of the NASDAQ Capital Market could adversely affect the price of our common stock and its liquidity.

We must comply with NASDAQ’s continued listing requirements related to, among other things, stockholders’ equity, market value, minimum bid price, and corporate governance in order to remain listed on the NASDAQ Capital Market. Although we expect to meet the continued listing requirements, there can be no assurance we will continue to do so in the future. If we do not remain compliant with these continued listing requirements, we could be delisted. If we were delisted, it would be likely to have a negative impact on our stock price and liquidity. The delisting of our common stock could also deter broker-dealers from making a market in or otherwise generating interest in or recommending our common stock, and would adversely affect our ability to attract investors in our common stock. Furthermore, our ability to raise additional capital would be impaired. As a result of these factors, the value of the common stock could decline significantly.

We have never paid dividends on our common stock, and we do not anticipate paying any cash dividends in the foreseeable future.

We have never declared or paid dividends on our common stock, nor do we anticipate paying any cash dividends for the foreseeable future. We currently intend to retain future earnings, if any, to finance the operations and expansion of our business. Any future determination to pay cash dividends will be at the discretion of our Board of Directors and will be dependent upon the earnings, financial condition, operating results, capital requirements and other factors as deemed necessary by our Board of Directors.

The elimination of monetary liability against our directors under Delaware law and the existence of indemnification rights held by our directors, officers, and employees may result in substantial expenditures by the Company and may discourage lawsuits against our directors, officers, and employees.

Our Certificate of Incorporation eliminates the personal liability of our directors to our Company and our stockholders for damages for breach of fiduciary duty as a director to the extent permissible under Delaware law. Further, our Bylaws provide that we are obligated to indemnify any of our directors or officers to the fullest extent authorized by Delaware law and, subject to certain conditions, advance the expenses incurred by any director or officer in defending any action, suit or proceeding prior to its final disposition. Those indemnification obligations could result in the Company incurring substantial expenditures to cover the cost of settlement or damage awards against our directors or officers, which we may be unable to recoup. These provisions and resultant costs may also discourage us from bringing a lawsuit against any of our current or former directors or officers for breaches of their fiduciary duties, and may similarly discourage the filing of derivative litigation by our stockholders against our directors and officers even though such actions, if successful, might otherwise benefit us or our stockholders.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our principal executive offices and our manufacturing facility are located in an approximately 117,000 square foot facility in Solon, Ohio, under a lease agreement expiring on June 30, 2022. We believe this facility is adequate to support our current and anticipated operations.

As part of our 2017 restructuring initiatives, we closed our New York, New York, Arlington, Virginia and Rochester, Minnesota offices.

ITEM 3. LEGAL PROCEEDINGS

From time to time, we may be involved in legal proceedings arising from the normal course of business. See Note 14, "Legal Matters," included in Item 8 of this Annual Report.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

Executive officers of the registrant

The following is the name, age, and present position of each of our current executive officers, as well as all prior positions held by each of them during the last five years and when each of them was first elected or appointed as an executive officer:

Name	Age	Current position and business experience
Theodore L. Tewksbury III, Ph.D.	**61**	**Chairman of the Board, Chief Executive Officer and President – February 2017 to present** **Executive Chairman of the Board – December 2016 to February 2017** Dr. Tewksbury has been Founder and CEO of Tewksbury Partners, LLC, providing strategic consulting, advisory and board services to private and public technology companies, venture capital and private equity firms, since 2013. He had served as President and Chief Executive Officer (from November 2014) and a director (from September 2010) of Entropic Communications, a public company specializing in semiconductor solutions for the connected home, until its sale to MaxLinear, Inc., another public semiconductor company, in April 2015, and he remains a director of MaxLinear, Inc. He is also a director of Jariet Technologies, a private company specializing in digital microwave integrated circuits for wireless infrastructure, backhaul and military applications. From 2008 to 2013, Dr. Tewksbury served as President and Chief Executive Officer and a director of Integrated Device Corporation, a public semiconductor company.
Michael H. Port	**53**	**Chief Financial Officer – March 2017 to present** **Interim Chief Financial Officer – August 2016 to December 2016** **Corporate Controller – July 2015 to March 2017** Mr. Port served as Energy Focus's Controller from July 2015 to March 2017 and as Interim Chief Financial Officer and Secretary from August to December 2016. From 2010 to July 2015, Mr. Port was a consultant with Resources Global Professionals, a multinational professional services firm, during which time he specialized in filling roles such as Interim CFO, Controller and Director of External Reporting for industrial and manufacturing customers, including interim Controller of the Company from April to July 2015. Prior to joining Resources Global Professionals, Mr. Port held various senior level executive positions at both private and public companies, including Mork Process, Inc., an international manufacturer of industrial cleaning equipment, Oglebay Norton Company, a shipping and industrial minerals company, and Hitachi Medical Systems of America, a distributor of diagnostic imaging products. He began his career at Ernst & Young, focusing on entrepreneurial growth companies. Mr. Port, a certified public accountant, received a B.S.B.A. degree in Accounting from The Ohio State University and earned his Master's degree in Business Administration from Case Western Reserve University.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock trades on The NASDAQ Capital Market ("NASDAQ") under the symbol "EFOI."

The following table sets forth the high and low market sales prices per share for our common stock for the years ended December 31, 2017 and 2016 as reported by NASDAQ:

	High	Low
First quarter 2017	$ 5.18	$ 3.03
Second quarter 2017	3.52	2.32
Third quarter 2017	3.24	1.51
Fourth quarter 2017	3.46	2.00
First quarter 2016	$ 13.80	$ 6.55
Second quarter 2016	8.54	5.50
Third quarter 2016	6.32	3.61
Fourth quarter 2016	5.37	2.95

Stockholders

There were approximately 86 holders of record of our common stock as of February 16, 2018, however, a large number of our stockholders hold their stock in "street name" in brokerage accounts. Therefore, they do not appear on the stockholder list maintained by our transfer agent.

Dividends

We have not declared or paid any cash dividends, and do not anticipate paying cash dividends in the near future.

Securities authorized for issuance under equity compensation plans

The following table details information regarding our existing equity compensation plans as of December 31, 2017:

	Equity Compensation Plan Information		
Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	554,654	$ 5.76 (2)	2,226,130 (1)

(1) Includes 427,437 shares available for issuance under the 2013 Employee Stock Purchase Plan and 1,798,693 shares available for issuance under our 2014 Stock Incentive Plan, which may be issued in the form of options, restricted stock, restricted stock units, and other equity-based awards.

(2) Does not include 306,142 shares that are restricted stock units and do not have an exercise price.

ITEM 6. SELECTED FINANCIAL DATA

The Selected Consolidated Financial Data set forth below have been derived from our financial statements. It should be read in conjunction with the information appearing under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in Item 7 of this report and the Consolidated Financial Statements and related notes found in Item 8 of this report.

SELECTED FINANCIAL DATA
(amounts in thousands, except per share data)

	2017	2016	2015	2014	2013
OPERATING SUMMARY					
Net sales	$ 19,846	$ 30,998	$ 64,403	$ 22,700	$ 9,423
Gross profit	4,821	7,677	29,292	7,778	2,078
Loss on impairment	185	857	—	—	608
Restructuring	1,662	—	—	—	—
Net (loss) income from continuing operations	(11,267)	(16,875)	9,471	(4,246)	(5,907)
(Loss) income from discontinued operations	—	(12)	(691)	(1,599)	3,546
Net (loss) income	(11,267)	(16,887)	8,780	(5,845)	(2,361)
Net (loss) income per share - basic:					
From continuing operations	$ (0.95)	$ (1.45)	$ 0.91	$ (0.55)	$ (1.24)
From discontinued operations	—	—	(0.07)	(0.20)	0.74
Total	(0.95)	(1.45)	0.84	(0.75)	(0.50)
Net (loss) income per share - diluted:					
From continuing operations	$ (0.95)	$ (1.45)	$ 0.88	$ (0.55)	$ (1.24)
From discontinued operations	—	—	(0.06)	(0.20)	0.74
Total	(0.95)	(1.45)	0.82	(0.75)	(0.50)
Shares used in net (loss) income per share calculation:					
Basic	11,806	11,673	10,413	7,816	4,779
Diluted	11,806	11,673	10,752	7,816	4,779
FINANCIAL POSITION SUMMARY					
Total assets	$ 22,151	$ 34,978	$ 55,702	$ 19,496	$ 12,808
Cash and cash equivalents	10,761	16,629	34,640	7,435	1,890
Credit line borrowings	—	—	—	453	—
Current maturities of long-term debt	—	—	—	—	59
Long-term debt, net of current maturities	—	—	—	70	4,011
Stockholders' equity	19,292	29,938	45,320	9,773	2,924
Common shares outstanding	11,890	11,711	11,649	9,424	5,142

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our Consolidated Financial Statements ("financial statements") and related notes thereto, included in Item 8 of this Annual Report.

Overview

Energy Focus, Inc. and its subsidiary engage in the design, development, manufacturing, marketing, and sale of energy-efficient lighting systems. We operate in a single industry segment, developing and selling our energy-efficient light-emitting diode ("LED") lighting products into the general commercial, industrial and military maritime markets. Our goal is to become a trusted leader in the LED lighting retrofit market by replacing fluorescent lamps in institutional buildings and high-intensity discharge ("HID") lighting in low-bay and high-bay applications with our innovative, high-quality commercial and military tubular LED ("TLED") products.

Over the past few years we have exited non-core businesses to focus our efforts on TLED products, starting with the sale of our pool lighting products business in 2013. During 2015 we exited our turnkey solutions business operated by our subsidiary, Energy Focus LED Solutions, LLC ("EFLS"), and exited our United Kingdom business through the sale of Crescent Lighting Limited ("CLL"), our wholly-owned subsidiary. As a result, we have reclassified all net sales and expenses associated with both EFLS and CLL from the Consolidated Statements of Operations and have reported the related net income (loss) as discontinued operations. Please refer to Note 4, "Discontinued Operations," for more information on our disposition of these businesses.

During 2016, we were impacted by a slowdown in demand from U.S. Navy compared to the rapid pace of 2015 when we experienced record high military maritime sales of $50.1 million. We experienced a year-over-year decrease in military maritime sales of 67.7 percent from 2015 to 2016 and, as a result we re-evaluated the economics of manufacturing components versus purchasing them and ceased using certain specialized manufacturing equipment and software used in the manufacture of our military Intellitube® product. Accordingly, we recorded an impairment loss of $0.9 million to adjust the carrying value of the equipment and software to its net realizable value, as of December 31, 2016. In 2017, we recorded an additional impairment loss of $0.2 million to adjust the carrying value of the equipment and software to the current expected net realizable value. We continue to actively market the equipment and software for sale and expect to complete a sale in the first quarter of 2018.

Additionally, we had initiated an aggressive inventory procurement plan during 2016 in order to meet expected commercial sales growth, which did not materialize. As a result, our gross inventory levels increased $5.0 million as of December 31, 2016 compared to December 31, 2015. In accordance with accounting principles generally accepted in the United States ("U.S. GAAP"), we evaluated our 2016 year-end inventory quantities for excess levels and potential obsolescence after evaluation of historical sales, current economic trends, forecasted sales and product lifecycles and charged $3.3 million to cost of sales from continuing operations for excess and obsolete inventories, as compared to $1.7 million in 2015.

Given the decline in our military maritime business, the changing competitive landscape of the U.S. Navy sales channel and the timing uncertainty of commercial sales growth, we implemented a restructuring initiative during the first quarter of 2017. The intent of the restructuring strategy was to maximize operating cost reductions without sacrificing either our new product pipeline or potential long-term revenue growth and return the Company to profitability. On February 19, 2017, the Board appointed Dr. Ted Tewksbury to serve as the Company's Chairman of the Board, Chief Executive Officer and President to lead the Company's restructuring efforts. Dr. Tewksbury, who holds M.S. and Ph.D. degrees in Electrical Engineering from MIT, is a well-seasoned semiconductor industry executive with experience in implementing and managing successful business restructurings.

The restructuring initiative included an organizational consolidation of management functions in order to streamline and better align the Company into a more focused, efficient, and cost-effective organization. The initiative also included the transition from our historical direct sales model to an agency driven sales channel strategy in order to expand our market presence throughout the U.S. During 2017 we closed our New York, New York, Arlington, Virginia and Rochester, Minnesota offices, reduced full-time equivalent headcount by 51% and significantly decreased operating expenses from 2016 levels (a net reduction of $8.4 million, which includes $1.8 million in offsetting restructuring and impairment charges). As of December 31, 2017, we had effectively transitioned our sales force to an agency driven sales channel, expanding our sales coverage to the entire U.S. through six geographic regions and 30 sales agents. As a result of this transition, we have substantially expanded from a primarily Midwest focus to build market presence and awareness in other regions of the U.S. with significant demand potential, including the Northeast, Southeast and California.

While substantial doubt about our ability to continue as a going concern continued to exist at December 31, 2017, we had $10.8 million in cash and no debt obligations at the end of the year. Consequently, considering both quantitative and qualitative information, we continue to believe that the combination of our restructuring actions, current financial position, liquid resources, obligations due or anticipated within the next year, executive reorganization, and implementation of our sales channel strategy will return us to profitability in 2018 and effectively mitigate the substantial doubt about our ability to continue as a going concern.

Results of operations

The following table sets forth the percentage of net sales represented by certain items reflected on our Consolidated Statements of Operations for the following periods:

	2017	2016	2015
Net sales	100.0 %	100.0 %	100.0 %
Cost of sales	75.7	75.2	54.5
Gross profit	24.3	24.8	45.5
Operating expenses:			
Product development	14.8	11.4	4.4
Selling, general, and administrative	57.0	64.9	26.1
Loss on impairment	0.9	2.8	—
Restructuring	8.4	—	—
Total operating expenses	81.1	79.1	30.5
(Loss) income from operations	(56.8)	(54.3)	15.0
Other expense (income):			
Interest expense	—	—	0.1
Other expenses (income)	0.4	—	(0.1)
(Loss) income from continuing operations before income taxes	(57.3)	(54.3)	15.0
(Benefit from) provision for income taxes	(0.5)	0.2	0.2
Net (loss) income from continuing operations	(56.8)	(54.5)	14.8
Discontinued operations:			
Loss from discontinued operations	—	—	(0.3)
Loss on sale of discontinued operations	—	—	(0.8)
(Loss) income from discontinued operations before income taxes	—	—	(1.1)
Benefit from income taxes	—	—	—
Loss from discontinued operations	—	—	(1.1)
Net (loss) income	(56.8)%	(54.5)%	13.7 %

Net sales

A further breakdown of our net sales by product line is as follows (in thousands):

	2017	2016	2015
Commercial	$ 15,217	$ 14,809	$ 14,156
Military maritime	4,629	16,189	50,128
R&D Services	—	—	119
Total net sales	$ 19,846	$ 30,998	$ 64,403

While our net sales of $19.8 million in 2017 decreased 36.0 percent compared to 2016, our commercial sales increased 2.8 percent reflecting our continued efforts to penetrate our targeted vertical markets. Overall demand for our military maritime products increased during 2017 compared to 2016, but our distributor for the U.S. Navy had the ability to satisfy that demand with inventory they had purchased during 2016 under an exclusive distribution agreement that ended on March 31, 2017. As a result, our 2017 military maritime sales decreased 71.4 percent compared 2016.

Net sales of $31.0 million in 2016 decreased 51.9 percent in comparison to $64.4 million in 2015, primarily due to a $33.9 million decrease in military maritime sales. This decrease was the result of high-volume sales to distributors for the U.S. Navy during 2015. Commercial sales increased $0.7 million, or 4.6 percent, in 2016 compared to 2015, as we continued our efforts to diversify and expand our commercial market. R&D services decreased by $0.1 million, as we completed work on research contracts and grants in 2015.

International sales

With the sale of our United Kingdom subsidiary CLL in 2015, we no longer generate significant sales from customers outside the United States. International net sales accounted for approximately two percent, four percent, and less than one percent of net sales in 2017, 2016, and 2015, respectively. The effect of changes in currency exchange rates was not material in 2017, 2016, and 2015.

Gross profit

Gross profit was $4.8 million in 2017, compared to $7.7 million in 2016. The year-over-year decline in gross profit was principally driven by lower sales volumes and changes in mix between our commercial and military maritime products, as sales of our commercial products represented 76.7 percent of total net sales in 2017 compared to 47.8 percent in 2016. Our 2017 gross profit as a percent of net sales of 24.3 percent was comparable with our 2016 gross profit as a percent of net sales of 24.8 percent. As a result of our 2017 restructuring initiative and our efforts to improve operating efficiencies, we were successful in maintaining our manufacturing overhead as a percentage of net sales to 2016 levels, in spite of lower sales volumes. Additionally, during 2017 we implemented a strategic sales initiative to sell certain excess inventory that had previously been written-down in conjunction with our excess inventory reserve analysis in prior years, as required by U.S. GAAP. This initiative resulted in reduction of our excess inventory reserves of $1.4 million. Our 2016 gross margin was driven by product mix, as our commercial products, which had lower margins than our military maritime products, represented 47.8 percent of total net sales in 2016. The 2016 gross margin was negatively impacted by the recognition of a $3.3 million excess inventory reserve based on our year-end excess inventory reserve analysis.

Gross profit in 2016 decreased $21.6 million from the gross profit of $29.3 million in 2015. Gross margins declined 20.7 percentage points as a result of lower sales and changes in product mix, as our commercial products had lower margins than our military maritime products. In addition to the gross margin impact of lower sales and product mix, our 2016 gross margin was negatively impacted by the recognition of a $3.3 million excess inventory reserve based on our year-end excess inventory reserve analysis.

Operating expenses

Product development

Product development expenses include salaries, including stock-based compensation and related benefits, contractor and consulting fees, legal fees, supplies and materials, as well as overhead items, such as depreciation and facilities costs. Product development costs are expensed as they are incurred. Cost recovery represents the combination of revenues and credits from government contracts.

Total gross and net product development spending, including credits from government contracts, is shown in the following table (in thousands):

	For the year ended December 31,		
	2017	2016	2015
Total gross product development expenses	$ 2,940	$ 3,630	$ 3,005
Cost recovery through cost of sales	—	—	(25)
Cost recovery and other credits	—	(93)	(170)
Net product development expense	$ 2,940	$ 3,537	$ 2,810

Gross product development expenses were $2.9 million in 2017, a $0.7 million, or 19.0 percent, decrease compared to $3.6 million in 2016. The decrease primarily resulted from restructuring related operating cost reductions of $0.5 million, principally related to salaries, including stock-based compensation and related benefits of approximately $0.3 million and reductions in outside testing and legal fees of approximately $0.2 million, as we focused our efforts on redefining our product road map in light of our restructuring initiative. Gross 2016 product development expenses of $3.6 million increased 20.8 percent compared to $3.0 million in 2015. The increase resulted from higher salaries, including stock-based compensation and related benefits, of approximately $0.8 million, partially offset by a reduction in outside testing and legal fees of approximately $0.1 million.

Selling, general, and administrative

Selling, general, and administrative expenses were $11.3 million, or 57.0 percent, of net sales in 2017, compared to $20.1 million, or 64.9 percent of net sales in 2016. Of the year-over-year $8.8 million decrease, approximately $5.6 million is attributable to our restructuring initiative, resulting in reduced salaries, including stock-based compensation and related benefits, of $2.9 million, consulting fees of $1.1 million, recruiting and relocation expenses of $0.6 million, travel and related expenses of $0.5 million and rent and related expenses of $0.5 million. Additionally, our operating cost control initiatives resulted in an additional $1.5 million in operating expense reductions including decreased trade show and marketing expenses of $0.8 million and legal and professional fees of $0.6 million in 2017, compared to 2016. Due to the overall lower sales volumes and the November 2016 termination of an outside sales representation agreement related to sales to the U.S. Navy, our 2017 sales commission expense decreased $1.0 million compared to 2016.

Selling, general, and administrative expenses in 2016 increased by $3.3 million, or 19.5 percent, from $16.8 million in 2015. The dollar increase resulted from higher salaries, including stock-based compensation and related benefits of approximately $1.2 million, tradeshow and marketing expenses of $0.7 million, legal and professional fees of $0.4 million and travel and related expenses of $0.2 million in our efforts to diversify and expand our commercial markets. In addition, severance and related benefits costs increased $0.4 million as a result of our efforts to align our direct sales force, marketing personnel and administrative talent to support our operations. In October 2015, we began using an outside sales representative who earned a commission on sales for our military maritime products for the U.S. Navy, which resulted in higher sales commission of $0.3 million in 2016 compared to 2015. Partially offsetting these increased costs was a reduction in recruiting and relocation expenses of $0.4 million.

Loss on impairment

As a result of the decline in the level of expected future sales of our military maritime products and reductions in the cost of procuring components from our suppliers, during 2016 we re-evaluated the economics of manufacturing versus purchasing such components and determined that we would no longer use the equipment and software purchased to conduct this manufacturing. As of December 31, 2016, we evaluated the carrying value of the equipment and software compared to its fair value and determined that the equipment and software were impaired, recording an impairment loss of $0.9 million to adjust the carrying value of the equipment and software to its estimated net realizable value. Due to the specialized nature of this equipment we have not been able to find a buyer for this equipment in 2017. As a result, we re-evaluated the carrying value of the equipment and software compared to its fair value and recorded an additional impairment loss of $0.2 million as of December 31, 2017.

Restructuring

In the first quarter of 2017, we announced a restructuring initiative with a goal of significantly reducing our annual operating costs from 2016 levels. This initiative included an organizational consolidation of management and oversight functions in order to streamline and better align the organization into more focused, efficient, and cost-effective reporting relationships.

The actions taken in the first quarter of 2017 included closing our offices in Rochester, Minnesota, New York, New York, and Arlington, Virginia and impacted 20 employees, primarily located in these offices. During the second quarter of 2017, we fully exited the New York and Arlington facilities and took additional actions to improve our operating efficiencies. These actions impacted an additional 17 production and administrative employees in our Solon location.

During 2017, we recorded restructuring charges totaling approximately $1.7 million consisting of approximately $0.8 million in severance and related benefits, approximately $0.7 million in facilities costs related to the termination of the Rochester lease obligations and the remaining lease obligations for the former New York and Arlington offices, and $0.2 million in other restructuring costs primarily related to fixed asset and prepaid expenses write-offs.

We estimated that we would receive a total of approximately $1.2 million in sublease payments to offset our remaining lease obligations, which extend until June 2021, of approximately $1.7 million. We expect to incur insignificant additional costs over the remaining life of our lease obligations, but we do not anticipate further major restructuring activities in the near future. Please refer to Note 3, “Restructuring,” included in Item 8 for further information.

While substantial doubt about our ability to continue as a going concern that existed at December 31, 2016 remained at December 31, 2017, we had $10.8 million in cash and no debt obligations at the end of the year. In addition, the restructuring actions taken in 2017 resulted in a net decrease in operating expenses of $8.4 million, including restructuring and asset impairment charges of $1.8 million in 2017 and impairment charges of $0.9 million in 2016. The intent of the restructuring strategy was to maximize operating cost reductions without sacrificing either our new product pipeline or potential long-term revenue growth. Consequently, considering both quantitative and qualitative information, we continue to believe that the combination of our restructuring actions, current financial position, liquid resources, obligations due or anticipated within the next year, executive reorganization, and implementation of our sales channel strategy will return us to profitability in 2018 and effectively mitigates the substantial doubt about our ability to continue as a going concern.

Other (expense) income

Interest expense

We incurred $2 thousand in interest expense in 2017. As a result of settling our long term debt obligations during the fourth quarter of 2015, we incurred no interest expense for the year ended December 31, 2016. Interest expense for the year ended December 31, 2015 was $0.1 million.

Other expenses

We recognized other expenses of $0.1 million in 2017, compared to other expense of $18 thousand in 2016 and other income of $0.1 million in 2015. The expenses in 2017 and 2016 primarily consisted of losses on the disposal of fixed assets partially offset by interest income on our cash balances. The income in 2015 primarily consisted of recognized foreign currency transaction gains partially offset by the non-cash amortization of fees related to our former revolving credit facility.

Income taxes

For the years ended December 31, 2017 and 2016, our effective tax rate was 1.02 percent and (0.2) percent, respectively.

In 2017, our effective tax rate was lower than the statutory rate due to the remeasurement of our deferred tax assets resulting from the Tax Cuts and Jobs Act of 2017 (the “Act”) and a decrease in the valuation allowance. In 2016, our effective tax rate was lower than the statutory tax rate due primarily due to an increase in the valuation allowance as a result of $10.6 million of additional net operating loss we recognized for that year.

On December 22, 2017, the Act was signed into law making significant changes to the Internal Revenue Code. Changes include, but are not limited to, a corporate tax rate decrease from 35 percent to 21 percent effective for tax years beginning after December 31, 2017, repeal of the corporate Alternative Minimum Tax, elimination of certain deductions, and changes to the carryforward period and utilization of Net Operating Losses generated after December 31, 2017. We have calculated our best estimate of the impact of the Act in our year end income tax provision in accordance with our understanding of the Act and guidance available as of the date of this filing. As a result of the Act, we have recorded $0.1 million as additional income tax benefit in the fourth quarter of 2017, the period in which the legislation was enacted. This amount related to the release of the valuation allowance on our Alternative Minimum Tax Credit carry forward, which is expected to be fully refunded by 2021. We remeasured our deferred tax assets and liabilities, based on the rates at which they are expected to reverse in the future. The impact of the remeasurement was $5.9 million of additional tax expense, which was offset by a $5.9 million valuation allowance reduction resulting in no net impact to the financial statements. The U.S. Treasury Department, the Internal Revenue Service, and other standard-setting bodies could interpret or issue guidance on how provisions of the Act will be applied or otherwise administered that is different from our interpretation. As we complete our analysis of the Act, collect and prepare necessary data, and interpret any additional guidance, we may make adjustments to provisional amounts that we have recorded that may materially impact our provision for income taxes in the period in which the adjustments are made.

Deferred income tax assets are reduced by a valuation allowance when it is more likely than not that some portion of the deferred income tax assets will not be realized. In considering the need for a valuation allowance, we assess all evidence, both positive and negative, available to determine whether all or some portion of the deferred tax assets will not be realized. Such evidence includes, but is not limited to, recent earnings history, projections of future income or loss, reversal patterns of existing taxable and deductible temporary differences, and tax planning strategies. We have recorded a full valuation allowance against our deferred tax assets at December 31, 2017 and 2016, respectively. We had no net deferred liabilities at December 31, 2017 or 2016. We will continue to evaluate the need for a valuation allowance on a quarterly basis.

At December 31, 2017, we had net operating loss carry-forwards of approximately $91.8 million for federal, state, and local income tax purposes. However, due to changes in our capital structure, approximately $37.3 million of this amount is available after the application of IRC Section 382 limitations. If not utilized, these carry-forwards will begin to expire in 2021 for federal purposes and have begun to expire for state and local purposes. Please refer to Note 11, “Income Taxes,” included in Item 8 for further information.

Net (loss) income from continuing operations

Despite an $11.2 million, or 36.0 percent, decline in net sales, our net loss from continuing operations improved $5.6 million to $11.3 million in 2017 compared to $16.9 million in 2016. The improvement in our loss from continuing operations is the direct result of our restructuring initiative, including efforts to improve operating efficiencies, allowing us to maintain consistent gross margin percentages, and control operating costs, resulting in a $8.4 million year-over-year operating expense reduction, including $1.8 million in restructuring and asset impairment charges. Net loss from continuing operations was $16.9 million in 2016, a decrease of $26.3 million compared to 2016 compared to net income of $9.5 million in 2015. Lower net sales, changes in product mix and investments in corporate infrastructure, charges recorded for excess inventory and the asset impairment on certain manufacturing equipment contributed to the difference in operating results.

Discontinued operations

During 2015 we exited our turnkey solutions business operated by our subsidiary, EFLS. There were no assets disposed as a result of the discontinuation, and we did not recognize a gain or loss on disposal or record an income tax expense or benefit. In August 2015, we sold our wholly-owned United Kingdom subsidiary, CLL. The sale was for nominal consideration under the terms of the agreement. As a result of the transaction and the elimination of this foreign subsidiary, we recorded a one-time loss of $44 thousand, which included a $469 thousand accumulated other comprehensive income reclassification adjustment for foreign currency translation adjustments. Accordingly, we have relcassified all net sales and expenses associated with both EFLS and CLL from the Consolidated Statements of Operations and have reported the related net income (loss) as discontinued operations.

In November 2013, we sold our pool products business. In February 2015, the buyer filed an arbitration claim asserting damages under the Purchase Agreement relating to product development and on March 18, 2016, a settlement agreement was executed for this claim. The legal fees incurred for the arbitration are included in the loss on disposal of discontinued operations for all periods presented. See Note 14, “Legal Matters,” included in Item 8 of this Annual Report for more information on this claim.

Revenues from discontinued operations in 2015 were $1.1 million. See Note 4, “Discontinued Operations,” included in Item 8 of this Annual Report for more information.

Net (loss) income

Net (loss) income includes the results from continuing operations as well as the results from discontinued operations. Net loss was $11.3 million in 2017, a decrease of $5.6 million compared to a net loss of $16.9 million in 2016, as a result of the reasons discussed above. Net loss $16.9 million in 2016 represented a decrease of $25.7 million compared to a net income of $8.8 million in 2015, as a result of the reasons discussed above.

Liquidity and capital resources

We generated a net loss of $11.3 million in 2017, compared to net loss of $16.9 million in 2016. We have incurred substantial losses in the past, and as of December 31, 2017, we had an accumulated deficit of $108.2 million. In order for us to operate our business profitably, we need to continue to expand our market presence to further penetrate our targeted vertical markets, maintain cost control discipline without sacrificing either new product pipeline or potential long-term revenue growth, continue our efforts to reduce product cost, drive further operating efficiencies and develop and execute a strategic product pipeline for profitable and compelling energy-efficient LED lighting products. There is a risk that our strategy to return to profitability may not be as successful as we envision. If our operations do not achieve, or we experience an unanticipated delay in achieving, our intended level and pace of profitability, we may require additional funding.

We terminated our revolving credit facility effective December 31, 2015, and are not actively pursuing securing a new line of credit at this time. There can be no assurance that we will generate sufficient cash flows to sustain and grow our operations or, if necessary, obtain funding on acceptable terms or in a timely fashion or at all. As such, we may continue to review and pursue selected external funding sources to execute these objectives including, but not limited to, the following:

- obtain financing from traditional or non-traditional investment capital organizations or individuals; and
- obtain funding from the sale of our common stock or other equity or debt instruments.

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

- additional equity financing may not be available to us on satisfactory terms and any equity that we are able to issue could lead to dilution of stockholder value for current stockholders;
- loans or other debt instruments may have terms and/or conditions, such as interest rate, restrictive covenants and control or revocation provisions, which are not acceptable to management or our Board of Directors or would restrict our growth opportunities; and
- the current environment in capital markets combined with our capital constraints may prevent us from being able to obtain adequate debt financing.

If we fail to generate cash to grow our business, we would need to delay or scale back our business plan or further reduce our operating costs or headcount, each of which could have a material adverse effect on our business, future prospects, and financial condition.

Cash and cash equivalents and debt

At December 31, 2017, our cash and cash equivalents balance was $10.8 million, compared to $16.6 million at December 31, 2016. The balances at December 31, 2017 and 2016 included restricted cash of $0.3 million, which represents a letter of credit requirement under our New York office lease obligation. The restricted cash balance of $0.1 million at December 31, 2015 relates to funds to be used exclusively for a research and development project with the National Shipbuilding Research Program.

On September 11, 2015, we announced the pricing of a registered underwritten follow-on offering of shares of our common stock by us and certain of our stockholders (the “Selling Stockholders”). We sold 1,500,000 shares of our common stock at a price to the public of $17.00 per share and the Selling Stockholders sold an additional 1,500,000 shares of our common stock on the same terms and conditions.

The offering closed on September 16, 2015 and we received $23.6 million in net proceeds from the transaction, after giving effect to underwriting discounts and commissions and estimated expenses. We have used the net proceeds from the offering to finance our growth efforts, for working capital, and other general corporate purposes.

The following is a summary of cash flows from operating, investing, and financing activities, as reflected in the Consolidated Statements of Cash Flows (in thousands):

	2017	2016	2015
Net cash (used in) provided by operating activities	$ (5,874)	$ (16,553)	$ 4,446
Net cash used in investing activities	$ (65)	$ (1,597)	$ (2,242)
Proceeds from warrants exercised	$ —	$ —	$ 2,503
Proceeds from issuances of common stock, net	—	—	23,574
Proceeds from exercise of stock options and purchases through employee stock purchase plan	130	455	346
Common stock withheld in lieu of income tax withholding on vesting of restricted stock units	(49)	(309)	—
Payments on other borrowings	—	—	(13)
Net (repayments) proceeds from credit line borrowings	—	—	(453)
Net cash provided by financing activities	$ 81	$ 146	$ 25,957

Cash (used in) provided by operating activities

Net cash used in operating activities of $5.9 million in 2017 resulted primarily from the net loss incurred of $11.3 million, adjusted for non-cash items, including: depreciation and amortization of $0.7 million, stock-based compensation, net of $0.5 million and fixed asset impairment and disposal losses of $0.4 million. Cash generated by decreases in inventory and accounts receivable of $5.2 million and $2.2 million, respectively further offset cash impact of the net loss incurred. The cash generated by these working capital changes was partially offset by cash used for decreases in trade accounts payable of $1.8 million, primarily related to the timing of inventory purchases and decreased accrued expenses of $0.3 million, primarily related to lower severance, sales commissions, product warranty and payroll accruals.

Net cash used in operating activities in 2016 of $16.6 million resulted from the net loss incurred of $16.9 million, adjusted for non-cash items, including: an adjustment to the reserves for slow-moving and obsolete inventories of $3.3 million, stock-based compensation of $1.4 million, fixed asset impairment and disposal losses of $0.9 million, and depreciation and amortization of $0.8 million. Net cash used in operating activities in 2016 also included an increase in inventories of $5.0 million, and decreases in trade accounts payable of $4.0 million, primarily related to the timing of inventory purchases and accrued expenses of $1.4 million, primarily related to the payment of 2015 sales commissions and incentives that were paid in 2016. The cash used by these working capital changes was partially offset by cash generated by a decrease in accounts receivable of $4.3 million.

Net cash provided by operating activities in 2015 was $4.4 million. In 2015, the net cash from operating activities resulted from the net income generated of $8.8 million, adjusted for non-cash items, including: an adjustment to the reserves for slow-moving and obsolete inventories of $1.7 million, stock-based compensation of $0.8 million, and depreciation and amortization of $0.3 million. Net cash provided by operating activities in 2015 also included an increase in accrued liabilities and federal and state taxes of $1.7 million. The cash provided by these working capital changes was partially offset by cash used by accounts receivable of $7.5 million and inventory of $2.6 million.

Cash (used in) investing activities

Net cash used in investing activities was $0.1 million in 2017, and resulted primarily from the purchase of software and equipment to support our website and marketing efforts, partially offset by proceeds received from the sale of certain computer equipment and reimbursements from our landlord for certain leasehold improvements. We do not expect significant capital expenditures in 2018.

In 2016, net cash used in investing activities of $1.6 million resulted from the acquisition and disposal of various office and operating fixed assets implementation of new modules and capabilities of our surface mount technology equipment purchased in 2015 and our licensed enterprise resource planning (ERP) system, as well as the purchase of tradeshow booths to support our sales and marketing initiatives. In 2015, net cash used in investing activities of $2.2 million primarily resulted from the acquisition of property and equipment related to our “Buy American” product initiative.

Cash provided by financing activities

Net cash provided by financing activities for the years ended December 31, 2017 and 2016 of $0.1 million, resulted from activity related to the Company’s equity award and employee stock purchase plans.

Net cash provided by financing activities in 2015 of $26.0 million included the receipt of $23.6 million related to our follow-on stock offering, $2.5 million from the exercises of outstanding warrants and $0.3 million related to the Company’s equity award and employee stock purchase plans, partially offset by $0.5 million in net payments on the Company’s line of credit and other borrowings.

Credit facilities

We terminated our prior revolving line of credit facility in December 2015. We do not have nor are we actively pursuing a new line of credit at this time.

Contractual obligations

The following summarizes our contractual obligations as of December 31, 2017, consisting of minimum lease payments under operating leases (in thousands):

Year ending December 31,	**Non-Cancellable Operating Leases (Gross)**	**Sublease Income (1)**	**Non-Cancellable Operating Leases (Net)**
2018	$ 1,259	$ 428	$ 831
2019	1,127	399	728
2020	960	267	693
2021	789	134	655
2022 & thereafter	309	—	309
Total contractual obligations	$ 4,444	$ 1,228	$ 3,216

(1) Represents the amount of income expected from sublease agreements executed in 2017 for our former New York, New York and Arlington, Virginia offices.

Off-balance sheet arrangements

We had no off-balance sheet arrangements at December 31, 2017 or 2016.

Critical accounting policies and estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States (“U.S. GAAP”) requires that we make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingencies, and the reported amounts of net sales and expenses in the financial statements. Material differences may result in the amount and timing of net sales and expenses if different judgments or different estimates were utilized. Critical accounting policies, judgments, and estimates that we believe have the most significant impact on our financial statements are set forth below:

- revenue recognition,
- allowances for doubtful accounts, returns and discounts,
- impairment of long-lived assets,
- valuation of inventories,
- accounting for income taxes, and
- share-based compensation.

Revenue recognition

Revenue is recognized when it is realized or realizable, has been earned, and when all of the following have occurred:

- persuasive evidence or an arrangement exists (e.g., a sales order, a purchase order, or a sales agreement),
- shipment has occurred, with the standard shipping term being F.O.B. ship point, or services provided on a proportional performance basis or installation have been completed,
- price to the buyer is fixed or determinable, and
- collectability is reasonably assured.

Revenues from our products are generally recognized upon shipping based upon the following:

- all sales made by us to our customer base are non-contingent, meaning that they are not tied to that customer's resale of products,
- standard terms of sale contain shipping terms of F.O.B. ship point, meaning that title and risk of loss is transferred when shipping occurs, and
- there are no automatic return provisions that allow the customer to return the product in the event that the product does not sell within a defined timeframe.

Revenues from research and development contracts are recognized primarily on the percentage-of-completion method of accounting. Percentage-of-completion is determined by relating the actual cost of the work performed to date to the current estimated total cost of the respective contracts. When the estimate on a contract indicates a loss, our policy is to record the entire loss during the accounting period in which it is estimable. Deferred revenue is recorded for the excess of contract billings over the amount of contract costs and profits. Costs in excess of billings, included in prepaid and other assets, are recorded for contract costs in excess of contract billings.

We warrant our products against defects or workmanship issues. We set up allowances for estimated returns, discounts and warranties upon recognition of revenue, and these allowances are adjusted periodically to reflect actual and anticipated returns, discounts and warranty expenses. These allowances are based on past history and historical trends, and contractual terms. The distributors' obligations to us are not contingent upon the resale of our products and as such do not prohibit revenue recognition.

Allowances for doubtful accounts, returns, and discounts

We establish allowances for doubtful accounts and returns for probable losses based on the customers' loss history with us, the financial condition of the customer, the condition of the general economy and the industry as a whole, and the contractual terms established with the customer. The specific components are as follows:

- Allowance for doubtful accounts for accounts receivable, and
- Allowance for sales returns and discounts.

In 2017, the total allowance was $42 thousand, which was all related to sales returns. In 2016, the total allowance was $236 thousand, with $50 thousand related to accounts receivable and $186 thousand related to sales returns. We review these allowance accounts periodically and adjust them accordingly for current conditions.

Long-lived assets

Property and equipment are stated at cost and include expenditures for additions and major improvements. Expenditures for repairs and maintenance are charged to operations as incurred. We use the straight-line method of depreciation over the estimated useful lives of the related assets (generally two to fifteen years) for financial reporting purposes. Accelerated methods of depreciation are used for federal income tax purposes. When assets are sold or otherwise disposed of, the cost and accumulated depreciation are removed from the accounts and any gain or loss is reflected in the Consolidated Statement of Operations. Refer to Note 5, "Property and Equipment," included in Item 8 for additional information.

Long-lived assets are reviewed for impairment whenever events or circumstances indicate the carrying amount may not be recoverable. Events or circumstances that would result in an impairment review primarily include operations reporting losses, a significant change in the use of an asset, or the planned disposal or sale of the asset. The asset would be considered impaired when the future net undiscounted cash flows generated by the asset are less than its carrying value. An impairment loss would be recognized based on the amount by which the carrying value of the asset exceeds its fair value, as determined by quoted market prices (if available) or the present value of expected future cash flows. At December 31, 2017 and 2016 we recorded a loss on the impairment of our surface mount technology equipment and software of $0.2 million and $0.9 million, respectively. Refer to Note 6, "Property and Equipment," included in Item 8 for additional information.

Valuation of inventories

We state inventories at the lower of standard cost (which approximates actual cost determined using the first-in-first-out method) or net realizable value. We establish provisions for excess and obsolete inventories after evaluation of historical sales, current economic trends, forecasted sales, product lifecycles, and current inventory levels. During 2017, we implemented a strategic sales initiative to sell certain excess inventory that had previously been written-down in conjunction with our excess inventory reserve analysis in prior years, as required by U.S. GAAP. This initiative resulted in a net reduction of our excess inventory reserves of $1.4 million in 2017. During 2016 and 2015, due to the introduction of new products and technological advancements, we charged $3.3 million and $1.7 million, respectively, to cost of sales from continuing operations for excess and obsolete inventories. Adjustments to our estimates, such as forecasted sales and expected product lifecycles, could harm our operating results and financial position. Refer to Note 5, "Inventories," included in Item 8 for additional information.

Accounting for income taxes

As part of the process of preparing the Consolidated Financial Statements, we are required to estimate our income tax liability in each of the jurisdictions in which we do business. This process involves estimating our actual current tax expense together with assessing temporary differences resulting from differing treatment of items, such as deferred revenues, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in our Consolidated Balance Sheets. We then assess the likelihood of the deferred tax assets being recovered from future taxable income and, to the extent we believe it is more likely than not that the deferred tax assets will not be recovered, or is unknown, we establish a valuation allowance.

Significant management judgment is required in determining our provision for income taxes, deferred tax assets and liabilities, and any valuation allowance recorded against our deferred tax assets. At December 31, 2017 and 2016, we have recorded a full valuation allowance against our deferred tax assets in the United States due to uncertainties related to our ability to utilize our deferred tax assets, primarily consisting of certain net operating losses carried forward. The valuation allowance is based upon our estimates of taxable income by jurisdiction and the period over which our deferred tax assets will be recoverable. In considering the need for a valuation allowance, we assess all evidence, both positive and negative, available to determine whether all or some portion of the deferred tax assets will not be realized. Such evidence includes, but is not limited to, recent earnings history, projections of future income or loss, reversal patterns of existing taxable and deductible temporary differences, and tax planning strategies. We continue to evaluate the need for a valuation allowance on a quarterly basis.

At December 31, 2017, we had net operating loss carry-forwards of approximately $91.8 million for federal, state, and local income tax purposes. However, due to changes in our capital structure, approximately $37.3 million of this amount is available after the application of IRC Section 382 limitations. If not utilized, these carry-forwards will begin to expire in 2021 for federal purposes and have begun to expire for state and local purposes. Please refer to Note 11, "Income Taxes," included in Item 8 for further information.

Share-based payments

The cost of employee and director stock options and restricted stock units, as well as other share-based compensation arrangements, is reflected in the Consolidated Financial Statements based on the estimated grant date fair value method under the authoritative guidance. Management applies the Black-Scholes option pricing model to options issued to employees and directors to determine the fair value of stock options and apply judgment in estimating key assumptions that are important elements of the model in expense recognition. These elements include the expected life of the option, the expected stock-price volatility, and expected forfeiture rates. The assumptions used in calculating the fair value of share-based awards under Black-Scholes represent our best estimates, but these estimates involve inherent uncertainties and the application of management judgment. Although we believe the assumptions and estimates we have made are reasonable and appropriate, changes in assumptions could materially impact our reported financial results. Restricted stock units and stock options issued to non-employees are valued based upon the intrinsic value of the award. See Note 10, "Stockholders' Equity," included in Item 8 for additional information.

Recently issued accounting pronouncements

In May 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2017-09, *Compensation—Stock Compensation: Scope of Modification Accounting*, which provides guidance about which changes to the terms or conditions of a share-based payment award would require an entity to apply modification accounting. This standard is effective for fiscal years beginning after December 15, 2017. We have evaluated the accounting guidance and determined that there is no material impact to our consolidated financial position or results of operations.

In November 2016, the FASB issued ASU No. 2016-18, *Restricted Cash*, which requires entities to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flow. This standard is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period, but any adjustments must be reflected as of the beginning of the fiscal year that includes that interim period. The new standard must be adopted retrospectively. We have evaluated the accounting guidance and determined that there is no material impact to our consolidated financial position or results of operations.

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230) Classification of Certain Cash Receipts and Cash Payments*, which is intended to reduce diversity in practice by making eight targeted changes to how cash receipts and cash payments are presented and classified in the statement of cash flows. This ASU is effective for fiscal years beginning after December 15, 2017, and will require adoption on a retrospective basis. We have evaluated the accounting guidance and determined that there is no material impact to our consolidated financial position or results of operations.

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

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, which supersedes the current lease accounting requirements. This standard requires a lessee to record on the balance sheet the assets and liabilities for the rights and obligations created by leases with lease terms of more than 12 months. In addition, this standard requires lessees to disclose certain key information about lease transactions. Upon implementation, a company's lease payment obligations will be recognized at their estimated present value along with a corresponding right-of-use asset. Lease expense recognition will be generally consistent with current practice. This standard will be effective for interim and annual periods beginning after December 15, 2018, and will require adoption on a modified retrospective basis. We are in the process of evaluating the impact of the standard.

In January 2016, the FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*, which amends certain aspects of the recognition, measurement, presentation and disclosure of financial instruments. This amendment requires all equity investments to be measured at fair value with changes in the fair value recognized through net income (other than those accounted for under the equity method of accounting or those that result in the consolidation of the investee). This standard will be effective for interim and annual periods beginning after December 15, 2017, and will require adoption on a prospective basis with a cumulative-effect adjustment to the beginning balance sheet. We have evaluated the accounting guidance and determined that there is no material impact to our consolidated financial position or results of operations.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, as amended by ASU 2015-14, 2016-08, 2016-10, 2016-12, and 2016-20, which is a comprehensive revenue recognition standard which supersedes nearly all of the existing revenue recognition guidance under U.S. GAAP. This standard requires an entity to recognize revenue when it transfers promised goods or services to customers in amounts that reflect the consideration the entity expects for receive in exchange for those goods or services. Entities will need to use more judgments and estimates than under the current guidance, including estimating the amount of variable revenue to recognize for each performance obligation. Additional disclosures regarding the nature, amount, and timing of revenues and cash flows from contracts will also be required. This ASU is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period, using either a full retrospective or a modified retrospective approach. We will adopt the standard on January 1, 2018, as required, using the modified retrospective approach. We have evaluated the accounting guidance and determined that there is no material impact to our consolidated financial position or results of operations, as our revenue arrangements generally consist of a single performance obligation to transfer promised goods. We continue to evaluate the impact the guidance in this ASU will have on our disclosures.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors of Energy Focus, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Energy Focus, Inc. and its subsidiaries (collectively the Company) as of December 31, 2017 and 2016, the related consolidated statements of operations, comprehensive income (loss), stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2017, and the related notes and schedule appearing under Schedule II (collectively referred to as the financial statements). In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

The Company's management is responsible for these financial statements. 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 audit 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.

We have served as the Company’s auditor since 2009.

/s/ Plante & Moran, PLLC

Cleveland, Ohio
February 21, 2018

ENERGY FOCUS, INC.
CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31,
(amounts in thousands except share data)

	2017	2016
ASSETS		
Current assets:		
Cash and cash equivalents	$ 10,761	$ 16,629
Trade accounts receivable, less allowances of $42 and $236, respectively	3,595	5,640
Inventories, net	5,718	9,469
Prepaid and other current assets	596	882
Assets held for sale	225	—
Total current assets	20,895	32,620
Property and equipment, net	1,097	2,325
Other assets	159	33
Total assets	$ 22,151	$ 34,978
LIABILITIES		
Current liabilities:		
Accounts payable	$ 1,630	$ 3,257
Accrued liabilities	992	1,676
Deferred revenue	5	—
Total current liabilities	2,627	4,933
Other liabilities	232	107
Total liabilities	2,859	5,040
STOCKHOLDERS' EQUITY		
Preferred stock, par value $0.0001 per share:		
Authorized: 2,000,000 shares in 2017 and 2016		
Issued and outstanding: no shares in 2017 and 2016	—	—
Common stock, par value $0.0001 per share:		
Authorized: 30,000,000 shares in 2017 and 2016		
Issued and outstanding: 11,868,896 at December 31, 2017 and 11,710,549 at December 31, 2016	1	1
Additional paid-in capital	127,493	126,875
Accumulated other comprehensive loss	2	(1)
Accumulated deficit	(108,204)	(96,937)
Total stockholders' equity	19,292	29,938
Total liabilities and stockholders' equity	$ 22,151	$ 34,978

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

ENERGY FOCUS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31,
(amounts in thousands except per share data)

	2017	2016	2015
Net sales	$ 19,846	$ 30,998	$ 64,403
Cost of sales	15,025	23,321	35,111
Gross profit	4,821	7,677	29,292
Operating expenses:			
Product development	2,940	3,537	2,810
Selling, general, and administrative	11,315	20,113	16,830
Loss on impairment	185	857	—
Restructuring	1,662	—	—
Total operating expenses	16,102	24,507	19,640
(Loss) income from operations	(11,281)	(16,830)	9,652
Other expense (income):			
Interest expense	2	—	85
Other expenses (income)	99	18	(53)
(Loss) income from continuing operations before income taxes	(11,382)	(16,848)	9,620
(Benefit from) provision for income taxes	(115)	27	149
Net (loss) income from continuing operations	$ (11,267)	$ (16,875)	$ 9,471
Discontinued operations:			
Loss from discontinued operations	—	—	(167)
Loss on sale of discontinued operations	—	(12)	(534)
(Loss) income from discontinued operations before income taxes	—	(12)	(701)
Benefit from income taxes	—	—	(10)
(Loss) from discontinued operations	$ —	$ (12)	$ (691)
Net (loss) income	$ (11,267)	$ (16,887)	$ 8,780
Net (loss) income per share - basic:			
Net (loss) income from continuing operations	$ (0.95)	$ (1.45)	$ 0.91
Net loss from discontinued operations	—	—	(0.07)
Net (loss) income	$ (0.95)	$ (1.45)	$ 0.84
Net (loss) income per share - diluted:			
Net (loss) income from continuing operations	$ (0.95)	$ (1.45)	$ 0.88
Net loss from discontinued operations	$ —	$ —	$ (0.06)
Net (loss) income	$ (0.95)	$ (1.45)	$ 0.82
Weighted average common shares outstanding:			
Basic	11,806	11,673	10,413
Diluted	11,806	11,673	10,752

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

ENERGY FOCUS, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME
FOR THE YEARS ENDED DECEMBER 31,
(amounts in thousands)

	2017	2016	2015
Net (loss) income	$ (11,267)	$ (16,887)	$ 8,780
Other comprehensive (loss) income:			
Foreign currency translation adjustments	3	(1)	(469)
Reclassification of foreign currency translation adjustments	—	—	469
Comprehensive (loss) income	$ (11,264)	$ (16,888)	$ 8,780

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

ENERGY FOCUS, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2017, 2016, AND 2015
(amounts in thousands)

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total
	Shares	Amount				
Balance at December 31, 2014	9,424	$ 1	$ 98,133	$ 469	$ (88,830)	$ 9,773
Issuance of common stock under registered follow-on offering, net	1,500		23,574			23,574
Issuance of common stock under employee stock option and stock purchase plans	77		346			346
Stock-based compensation	10		813			813
Warrants exercised	638		2,503			2,503
Reclassification of foreign currency adjustments				(469)		(469)
Net income					8,780	8,780
Balance at December 31, 2015	11,649	$ 1	$ 125,369	$ —	$ (80,050)	$ 45,320
Issuance of common stock under employee stock option and stock purchase plans	113		$ 455			$ 455
Common stock withheld to satisfy exercise price and income tax withholding on option exercises	(51)		$ (309)			$ (309)
Stock-based compensation			$ 1,360			$ 1,360
Foreign currency translation adjustment				$ (1)		$ (1)
Net loss					$ (16,887)	$ (16,887)
Balance at December 31, 2016	11,711	$ 1	$ 126,875	$ (1)	$ (96,937)	$ 29,938
Issuance of common stock under employee stock option and stock purchase plans	173		$ 130			$ 130
Common stock withheld in lieu of income tax withholding on vesting of restricted stock units	(15)		$ (49)			$ (49)
Stock-based compensation			$ 807			$ 807
Stock-based compensation reversal			$ (270)			$ (270)
Foreign currency translation adjustment				$ 3		$ 3
Net loss					$ (11,267)	$ (11,267)
Balance at December 31, 2017	11,869	$ 1	$ 127,493	$ 2	$ (108,204)	$ 19,292

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

ENERGY FOCUS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31,
(amounts in thousands)

	2017	2016	2015
Cash flows from operating activities:			
Net (loss) income	$ (11,267)	$ (16,887)	$ 8,780
Loss from discontinued operations	$ —	$ (12)	$ (691)
(Loss) income from continuing operations	$ (11,267)	$ (16,875)	$ 9,471
Adjustments to reconcile net (loss) income to net cash from operating activities:			
Loss on impairment	185	857	—
Depreciation	681	805	266
Stock-based compensation	807	1,360	813
Stock-based compensation reversal	(270)	—	—
Provision for doubtful accounts receivable	(194)	156	39
Provision for slow-moving and obsolete inventories	(1,400)	3,281	1,739
Provision for warranties	(157)	170	255
Amortization of loan origination fees	—	—	40
Loss (gain) on dispositions of property and equipment	203	38	3
Change in operating assets and liabilities:			
Accounts receivable	2,240	4,313	(7,493)
Inventories	5,151	(5,018)	(2,602)
Prepaid and other assets	161	(123)	146
Accounts payable	(1,759)	(4,035)	135
Accrued and other liabilities	(260)	(1,389)	1,674
Deferred revenue	5	(93)	(40)
Total adjustments	5,393	322	(5,025)
Net cash (used in) provided by operating activities	(5,874)	(16,553)	4,446
Cash flows from investing activities:			
Acquisitions of property and equipment	(162)	(1,624)	(2,242)
Proceeds from the sale of property and equipment	97	27	—
Net cash used in investing activities	(65)	(1,597)	(2,242)
Cash flows from financing activities:			
Proceeds from warrants exercised	—	—	2,503
Proceeds from issuances of common stock, net	—	—	23,574
Proceeds from exercise of stock options and purchases through employee stock purchase plan	130	455	346
Common stock withheld in lieu of income tax withholding on vesting of restricted stock units	(49)	—	—
Common stock withheld to satisfy exercise price and income tax withholding on option exercises	—	(309)	—
Payments on other borrowings	—	—	(13)
Net (repayments) proceeds from credit line borrowings	—	—	(453)
Net cash provided by financing activities	81	146	25,957
Effect of exchange rate changes on cash and cash equivalents	(10)	5	—
Net cash (used in) provided by continuing operations	(5,868)	(17,999)	28,161

(continued on the following page)

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

ENERGY FOCUS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31,
(amounts in thousands)

	2017	2016	2015
Cash flows of discontinued operations:			
Operating cash flows, net	—	(12)	(691)
Investing cash flows, net	—	—	181
Financing cash flows, net	—	—	(446)
Net cash used in discontinued operations	—	(12)	(956)
Net (decrease) increase in cash and cash equivalents	(5,868)	(18,011)	27,205
Cash and cash equivalents, beginning of year	16,629	34,640	7,435
Cash and cash equivalents, end of year	$ 10,761	$ 16,629	$ 34,640
Classification of cash and cash equivalents:			
Cash and cash equivalents	$ 10,419	$ 16,287	$ 34,527
Restricted cash held	342	342	113
Cash and cash equivalents, end of year	$ 10,761	$ 16,629	$ 34,640
Supplemental information:			
Cash paid in year for interest	$ 2	$ 5	$ 84
Cash paid in year for income taxes	$ 14	$ 51	$ 200

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

NOTE 1. NATURE OF OPERATIONS

Energy Focus, Inc. and its subsidiary engage in the design, development, manufacturing, marketing, and sale of energy-efficient lighting systems. We operate in a single industry segment, developing and selling our energy-efficient light-emitting diode (“LED”) lighting products into the general commercial, industrial and military maritime markets. Our goal is to become a trusted leader in the LED lighting retrofit market by replacing fluorescent lamps in institutional buildings and high-intensity discharge (“HID”) lighting in low-bay and high-bay applications with our innovative, high-quality commercial and military tubular LED (“TLED”) products.

Over the past few years we have exited non-core businesses to focus our efforts on TLED products, starting with the sale of our pool lighting products business in 2013. During 2015 we exited our turnkey solutions business operated by our subsidiary, Energy Focus LED Solutions, LLC (“EFLS”), and exited our United Kingdom business through the sale of Crescent Lighting Limited (“CLL”), our wholly-owned subsidiary. As a result, we have reclassified all net sales and expenses associated with both EFLS and CLL from the Consolidated Statements of Operations and have reported the related net income (loss) as discontinued operations. Please refer to Note 4, “Discontinued Operations,” for more information on our disposition of these businesses.

Given the decline in our military maritime business, the changing competitive landscape of the U.S. Navy sales channel and the timing uncertainty of commercial sales growth, we implemented a restructuring initiative during the first quarter of 2017. The intent of the restructuring strategy was to maximize operating cost reductions without sacrificing either our new product pipeline or potential long-term revenue growth and return the Company to profitability. On February 19, 2017, the Board appointed Dr. Ted Tewksbury to serve as the Company’s Chairman of the Board, Chief Executive Officer and President to lead the Company’s restructuring efforts. Dr. Tewksbury, who holds M.S. and Ph.D. degrees in Electrical Engineering from MIT, is a well-seasoned semiconductor industry executive with experience in implementing and managing successful business restructurings.

The restructuring initiative included an organizational consolidation of management functions in order to streamline and better align the Company into a more focused, efficient, and cost-effective organization. The initiative also included the transition from our historical direct sales model, to an agency driven sales channel strategy in order to expand our market presence throughout the U.S. During 2017 we closed our New York, New York, Arlington, Virginia and Rochester, Minnesota offices, reduced full-time equivalent headcount by 51 percent and significantly decreased operating expenses from 2016 levels (a net reduction of $8.4 million, which includes $1.8 million in offsetting restructuring and impairment charges). As of December 31, 2017, we had effectively transitioned our sales force to an agency driven sales channel, expanding our sales coverage to the entire U.S. through six geographic regions and 30 sales agents. As a result of this transition, we have substantially expanded from a primarily Midwest focus to build market presence and awareness in other regions of the U.S. with significant demand potential, including the Northeast, Southeast and California.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies of our Company, which are summarized below, are consistent with U.S. GAAP and reflect practices appropriate to the business in which we operate.

Use of estimates

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

Reclassifications

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

Basis of presentation

The Consolidated Financial Statements include the accounts of the Company and, until the 2013 disposition of our pool products business and the 2015 dispositions of its subsidiaries EFLS in Solon, Ohio, and CLL in the United Kingdom. All significant inter-company balances and transactions have been eliminated. Therefore, the results of operations and financial position of EFLS, CLL, and the pool products business are included in the Consolidated Financial Statements as Discontinued operations and previously reported financial information for the current and prior years have been adjusted. Unless indicated otherwise, the information in the Notes to Consolidated Financial Statements relates to our continuing operations.

Revenue recognition

Revenue is recognized when it is realized or realizable, has been earned, and when all of the following have occurred:

- persuasive evidence or an arrangement exists (e.g., a sales order, a purchase order, or a sales agreement),
- shipment has occurred, with the standard shipping term being F.O.B. ship point, or services provided on a proportional performance basis or installation have been completed,
- price to the buyer is fixed or determinable, and
- collectability is reasonably assured.

Revenues from sales of our products are generally recognized upon shipping based upon the following:

- all sales made by us to our customer base are non-contingent, meaning that they are not tied to that customer's resale of products,
- standard terms of sale contain shipping terms of F.O.B. ship point, meaning that title and risk of loss is transferred when shipping occurs, and
- there are no automatic return provisions that allow the customer to return the product in the event that the product does not sell within a defined timeframe.

Revenues from research and development contracts are recognized primarily on the percentage-of-completion method of accounting. Deferred revenue is recorded for the excess of contract billings over the amount of contract costs and profits. Costs in excess of billings, included in prepaid and other assets, are recorded for contract costs in excess of contract billings.

We warrant our products against defects or workmanship issues. We set up allowances for estimated returns, discounts and warranties upon recognition of revenue, and these allowances are adjusted periodically to reflect actual and anticipated returns, discounts and warranty expenses. These allowances are based on past history, historical trends, and contractual terms. The distributors' obligations to us are not contingent upon the resale of our products and as such do not prohibit revenue recognition.

Cash and cash equivalents

We consider all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. At December 31, 2017 and 2016, we had $10.8 million and $16.6 million, respectively, in cash on deposit with financial institutions located in the United States. At December 31, 2017 and 2016, $0.3 million of the cash balance amount was designated as restricted cash and relates to a standby letter of credit agreement for the lease of our New York, New York office. Please refer to Note 9, "Commitments and Contingencies," for additional information.

Inventories

We state inventories at the lower of standard cost (which approximates actual cost determined using the first-in-first-out method) or net realizable value. We establish provisions for excess and obsolete inventories after evaluation of historical sales, current economic trends, forecasted sales, product lifecycles, and current inventory levels. During 2017, we implemented a strategic sales initiative to sell certain excess inventory that had previously been written-down in conjunction with our excess inventory reserve analysis in prior years, as required by U.S. GAAP. This initiative resulted in a net reduction of our excess inventory reserves of $1.4 million in 2017. During 2016 and 2015, due to the introduction of new products and technological advancements, we charged $3.3 million, and $1.7 million, respectively, to cost of sales from continuing operations for excess and obsolete inventories. Adjustments to our estimates, such as forecasted sales and expected product lifecycles, could harm our operating results and financial position. Please refer to Note 5, "Inventories," for additional information.

Accounts receivable

Our customers are concentrated in the United States. In the normal course of business, we extend unsecured credit to our customers related to the sale of our services and products. Typical credit terms require payment within 30 to 60 days from the date of delivery or service. We evaluate and monitor the creditworthiness of each customer on a case-by-case basis. We also provide allowances for sales returns and doubtful accounts based on our continuing evaluation of our customers' ongoing requirements and credit risk. We write-off accounts receivable when we deem that they have become uncollectible and payments subsequently received on such receivables are credited to the allowance for doubtful accounts. We do not generally require collateral from our customers.

Income taxes

As part of the process of preparing the Consolidated Financial Statements, we are required to estimate our income tax liability in each of the jurisdictions in which we do business. This process involves estimating our actual current tax expense together with assessing temporary differences resulting from differing treatment of items, such as deferred revenues, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in our Consolidated Balance Sheet. We then assess the likelihood that these deferred tax assets will be recovered from future taxable income and, to the extent that we believe that it is more likely than not that the deferred tax assets will not be recovered, or is unknown, we establish a valuation allowance.

Significant management judgment is required in determining our provision for income taxes, deferred tax assets and liabilities, and any valuation allowance recorded against our deferred tax assets. At December 31, 2017 and 2016, we had a full valuation allowance recorded against our deferred tax assets in the United States due to uncertainties related to our ability to utilize our deferred tax assets, primarily consisting of certain net operating losses carried forward. The valuation allowance is based upon our estimates of taxable income by jurisdiction and the period over which our deferred tax assets will be recoverable.

At December 31, 2017, we had net operating loss carry-forwards of approximately $91.8 million for federal, state, and local income tax purposes. However, due to changes in our capital structure, approximately $37.3 million of this amount is available after the application of IRC Section 382 limitations. In 2018, we expect to have approximately $37.3 million of the net operating loss carry-forward available for use. If not utilized, these carry-forwards will begin to expire in 2021 for federal purposes, and have begun to expire for state and local purposes. Please refer to Note 11, "Income Taxes," for additional information.

Fair value measurements

Fair value is defined as the price that would be received to sell an asset or would be paid to transfer a liability in an orderly transaction between market participants on the measurement date. The fair value of financial assets and liabilities are measured on a recurring or non-recurring basis. Financial assets and liabilities measured on a recurring basis are those that are adjusted to fair value each time a financial statement is prepared. Financial assets and liabilities measured on a non-recurring basis are those that are adjusted to fair value when a significant event occurs.

We utilize valuation techniques that maximize the use of available market information and generally accepted valuation methodologies. We assess the inputs used to measure fair value using a three-tier hierarchy. The hierarchy indicates the extent to which pricing inputs used in measuring fair value are observable in the market. Level 1 inputs include unadjusted quoted prices for identical assets or liabilities and are the most observable. Level 2 inputs include unadjusted quoted prices for similar assets and liabilities that are either directly or indirectly observable, or other observable inputs such as interest rates, foreign currency exchange rates, commodity rates, and yield curves. Level 3 inputs are not observable in the market and include our own judgments about the assumptions market participants would use in pricing the asset or liability.

The carrying amounts of certain financial instruments including cash and equivalents, accounts receivable, accounts payable, and accrued liabilities approximate fair value due to their short maturities.

Long-lived assets

Property and equipment are stated at cost and include expenditures for additions and major improvements. Expenditures for repairs and maintenance are charged to operations as incurred. We use the straight-line method of depreciation over the estimated useful lives of the related assets (generally 2 to 15 years) for financial reporting purposes. Accelerated methods of depreciation are used for federal income tax purposes. When assets are sold or otherwise disposed of, the cost and accumulated depreciation are removed from the accounts and any gain or loss is reflected in the Consolidated Statement of Operations. Refer to Note 6, “Property and Equipment,” for additional information.

Long-lived assets are reviewed for impairment whenever events or circumstances indicate the carrying amount may not be recoverable. Events or circumstances that would result in an impairment review primarily include operations reporting losses, a significant change in the use of an asset, or the planned disposal or sale of the asset. The asset would be considered impaired when the future net undiscounted cash flows generated by the asset are less than its carrying value. An impairment loss would be recognized based on the amount by which the carrying value of the asset exceeds its fair value, as determined by quoted market prices (if available) or the present value of expected future cash flows. At December 31, 2016, we recorded an impairment loss of $0.9 million related to our surface mount technology equipment. Due to the specialized nature of this equipment we were not able to find a buyer for this equipment in 2017. As a result, we re-evaluated the carrying value of the equipment and software compared to its fair value and recorded an additional impairment loss of $0.2 million as of December 31, 2017. We continue to actively market the equipment and software for sale and expect to complete a sale in the first quarter of 2018. Refer to Note 6, “Property and Equipment,” for additional information.

Certain risks and concentrations

Historically our products were sold through a direct sales model, which included a combination of direct sales employees, electrical and lighting contractors, and distributors. The 2017 restructuring initiative included the transition to an agency driven sales channel strategy in order to expand our market presence throughout the U.S. We perform ongoing credit evaluations of our customers and generally do not require collateral. Although we maintain allowances for potential credit losses that we believe to be adequate, a payment default on a significant sale could materially and adversely affect our operating results and financial condition.

We have certain customers whose net sales individually represented 10 percent or more of our total net sales, or whose net trade accounts receivable balance individually represented 10 percent or more of our total net trade accounts receivable, as follows:

Consistent with our efforts to diversify our customer base, three customers accounted for 48.4 percent, of net sales in 2017, compared to two customers accounting for 47.4 percent of net sales in 2016. In 2017, two commercial customers, a major northeastern Ohio hospital system and a large regional retrofit company located in Texas accounted for 18.3 percent, and 12.8 percent of net sales, respectively, while sales to distributors to the U.S. Navy represented 22.0 percent of net sales.

In 2016, two customers, a distributor to the U.S. Navy and a major Northeast Ohio hospital, accounted for 36.5 percent and 10.9 percent of our net sales, respectively. Including sales pursuant to an indefinite duration, indefinite quantity (“IDIQ”) supply contract we were awarded in 2011, total sales of products for the U.S. Navy accounted for 43.1 percent of net sales. This IDIQ contract expired on August 1, 2016. For 2015, two distributors to the U.S. Navy accounted for approximately 59.0 percent and 15.8 percent of our 2016 net sales. Including sales pursuant to the IDIQ contract, total sales of products for the U.S. Navy accounted for 79.7 percent of our 2015 net sales.

At December 31, 2017, two commercial customers, a major Northeast Ohio hospital system and a large regional retrofit company located in Texas, accounted for 21.0 percent and 17.4 percent of our net trade accounts receivable, respectively. In addition, a distributor to the U.S. Navy accounted for 39.0 percent of our net trade accounts receivable at December 31, 2017. At December 31, 2016, two customers, a distributor to the U.S. Navy and a major Northeast Ohio hospital system, accounted for approximately 63.3 percent and 10.1 percent of our net trade accounts receivable, respectively.

We require substantial amounts of purchased materials from selected vendors. With specific materials, all of our purchases are from a single vendor. Substantially all of the materials we require are in adequate supply. However, the availability and costs of materials may be subject to change due to, among other things, new laws or regulations, suppliers’ allocation to other purchasers, interruptions in production by suppliers, and changes in exchange rates and worldwide price and demand levels. Our inability to obtain adequate supplies of materials for our products at favorable prices could have a material adverse effect on our business, financial position, or results of operations by decreasing our profit margins and by hindering our ability to deliver products to our customers on a timely basis.

Product development

Product development expenses include salaries, contractor and consulting fees, supplies and materials, as well as costs related to other overhead items such as depreciation and facilities costs. Research and development costs are expensed as they are incurred.

Net (loss) income per share

Basic (loss) income per share is computed by dividing the net (loss) income available to common stockholders by the weighted average number of common shares outstanding for the period, excluding the effects of any potentially dilutive securities. Diluted (loss) income per share gives effect to all dilutive potential common shares outstanding during the period. Dilutive potential common shares consist of incremental shares upon exercise of stock options and warrants, unless the effect would be anti-dilutive.

The following table presents a reconciliation of basic and diluted (loss) income per share computations (in thousands, except per share amounts):

	For the year ended December 31,		
	2017	**2016**	**2015**
Numerator:			
(Loss) income from continuing operations	$ (11,267)	$ (16,875)	$ 9,471
Loss from discontinued operations	—	(12)	(691)
Net (loss) income	$ (11,267)	$ (16,887)	$ 8,780
Denominator:			
Basic weighted average common shares outstanding	11,806	11,673	10,413
Potential common shares from options and warrants	—	—	339
Diluted weighted average shares	11,806	11,673	10,752

As a result of the net loss we incurred for the years ended December 31, 2017 and 2016, options, warrants and convertible securities representing approximately 60,434 and 139,595 shares of common stock were excluded from the loss per share calculation, respectively, because their inclusion would have been anti-dilutive.

Stock-based compensation

We recognize compensation expense based on the estimated grant date fair value under the authoritative guidance. Management applies the Black-Scholes option pricing model to value stock options issued to employees and directors, and applies judgment in estimating key assumptions that are important elements of the model in expense recognition. These elements include the expected life of the option, the expected stock-price volatility, and expected forfeiture rates. Compensation expense is generally amortized on a straight-line basis over the requisite service period, which is generally the vesting period. See Note 10, “Stockholders’ Equity,” for additional information. Common stock, stock options, and warrants issued to non-employees that are not part of an equity offering are accounted for under the applicable guidance under ASC 505-50, “Equity-Based Payments to Non-Employees,” and are generally re-measured at each reporting date until the awards vest.

Foreign currency translation

Our product development center in Taiwan uses local currency as its functional currency. Included within “Accumulated other comprehensive income” within the Consolidated Statements of Stockholders’ Equity is the effect of foreign currency translation related to our Taiwan operations.

Until its disposition, our international subsidiary used its local currency as its functional currency. Assets and liabilities were translated at exchange rates in effect at the balance sheet date and income and expense accounts were translated at average exchange rates during the year. Resulting translation adjustments were recorded directly to “Accumulated other comprehensive income” within the Consolidated Statements of Stockholders’ Equity. With the sale of CLL in August 2015, the translation adjustments recorded within the Consolidated Statements of Stockholders’ Equity in 2015 were reclassified and are recorded as a component of the “Loss on disposal of discontinued operations” within the Consolidated Statements of Operations. See Note 4, “Discontinued Operations,” for additional information.

Advertising expenses

Advertising expenses are charged to operations in the period incurred. They consist of costs for the placement of our advertisements in various media and the costs of demos provided to potential distributors of our products. Advertising expenses from continuing operations were $0.5 million, $1.4 million, and $0.7 million for the years ended December 31, 2017, 2016, and 2015, respectively.

Shipping and handling costs

We include shipping and handling revenues in net sales, and shipping and handling costs in cost of sales.

Product warranties

We warrant finished goods against defects in material and workmanship under normal use and service for periods generally between one and ten years. Settlement costs consist of actual amounts expensed for warranty coverage, which are largely a result of the cost of replacement products. A liability for the estimated future costs under product warranties is maintained for products outstanding under warranty and is included in “Accrued liabilities” in our Consolidated Balance Sheets. The warranty activity for the respective years is as follows (in thousands):

	At December 31,	
	2017	2016
Balance at the beginning of the year	$ 331	$ 314
Accruals for warranties issued	196	170
Adjustments to existing warranties	(87)	(95)
Settlements made during the year (in kind)	(266)	(58)
Accrued warranty expense	$ 174	$ 331

Recent accounting standards and pronouncements

In May 2017, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2017-09, *Compensation—Stock Compensation: Scope of Modification Accounting*, which provides guidance about which changes to the terms or conditions of a share-based payment award would require an entity to apply modification accounting. This standard is effective for fiscal years beginning after December 15, 2017. We have evaluated the accounting guidance and determined that there is no material impact to our consolidated financial position or results of operations.

In November 2016, the FASB issued ASU No. 2016-18, *Restricted Cash*, which requires entities to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flow. This standard is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period, but any adjustments must be reflected as of the beginning of the fiscal year that includes that interim period. The new standard must be adopted retrospectively. We have evaluated the accounting guidance and determined that there is no material impact to our consolidated financial position or results of operations.

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230) Classification of Certain Cash Receipts and Cash Payments*, which is intended to reduce diversity in practice by making eight targeted changes to how cash receipts and cash payments are presented and classified in the statement of cash flows. This ASU is effective for fiscal years beginning after December 15, 2017, and will require adoption on a retrospective basis. We have evaluated the accounting guidance and determined that there is no material impact to our consolidated financial position or results of operations.

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

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, which supersedes the current lease accounting requirements. This standard requires a lessee to record on the balance sheet the assets and liabilities for the rights and obligations created by leases with lease terms of more than 12 months. In addition, this standard requires lessees to disclose certain key information about lease transactions. Upon implementation, an entity's lease payment obligations will be recognized at their estimated present value along with a corresponding right-of-use asset. Lease expense recognition will be generally consistent with current practice. This standard will be effective for interim and annual periods beginning after December 15, 2018, and will require adoption on a modified retrospective basis. We are in the process of evaluating the impact of the standard.

In January 2016, the FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*, which amends certain aspects of the recognition, measurement, presentation and disclosure of financial instruments. This amendment requires all equity investments to be measured at fair value with changes in the fair value recognized through net income (other than those accounted for under the equity method of accounting or those that result in the consolidation of the investee). This standard will be effective for interim and annual periods beginning after December 15, 2017, and will require adoption on a prospective basis with a cumulative-effect adjustment to the beginning balance sheet. We have evaluated the accounting guidance and determined that there is no material impact to our consolidated financial position or results of operations.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, as amended by ASU 2015-14, 2016-08, 2016-10, 2016-12, and 2016-20, which is a comprehensive revenue recognition standard which supersedes nearly all of the existing revenue recognition guidance under U.S. GAAP. This standard requires an entity to recognize revenue when it transfers promised goods or services to customers in amounts that reflect the consideration the entity expects for receive in exchange for those goods or services. Entities will need to use more judgments and estimates than under the current guidance, including estimating the amount of variable revenue to recognize for each performance obligation. Additional disclosures regarding the nature, amount, and timing of revenues and cash flows from contracts will also be required. This ASU is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period, using either a full retrospective or a modified retrospective approach. We will adopt the standard on January 1, 2018, as required, using the modified retrospective approach. We have evaluated the accounting guidance and determined that there is no material impact to our consolidated financial position or results of operations, as our revenue arrangements generally consist of a single performance obligation to transfer promised goods. We continue to evaluate the impact the guidance in this ASU will have on our disclosures.

NOTE 3. RESTRUCTURING

In 2016 and 2017, we were not able to sustain the level of sales and profitability recognized in 2015. Due to our financial performance in 2016 and 2017, including net losses of $16.9 million and $11.3 million, respectively, and total cash used of $18.0 million and $5.9 million, respectively, we believe that substantial doubt about our ability to continue as a going concern existed at December 31, 2016 and 2017.

As a result, we evaluated actions to mitigate the substantial doubt about our ability to continue as a going concern. Our evaluation considered both quantitative and qualitative information, including our current financial position and liquid resources, and obligations due or anticipated within the next year. With $16.6 million in cash and no debt obligations as of December 31, 2016, we focused our efforts on reducing our overall operating expenses in an effort to return to profitability. Consequently, in February 2017, we announced a corporate restructuring initiative with a goal of significantly reducing annual operating costs from 2016 levels. The initiative included an organizational consolidation of management and oversight functions in order to streamline and better align the organization into more focused, efficient, and cost-effective reporting relationships, and involved headcount reductions and office closures. This initiative was designed to return the Company to profitability and mitigate the substantial doubt that existed at December 31, 2016 about our ability to continue as a going concern. The restructuring actions taken in 2017 resulted in a net decrease in operating expenses through December 31, 2017 of $8.4 million, including restructuring and asset impairment charges of $1.8 million in 2017 and impairment charges of $0.9 million in 2016.

While the substantial doubt about our ability to continue as a going concern continued to exist at December 31, 2017, we had $10.8 million in cash and no debt obligations at the end of the year. Consequently, considering both quantitative and qualitative information, we continue to believe that the combination of our restructuring actions, current financial position, liquid resources, obligations due or anticipated within the next year, executive reorganization, and implementation of our sales channel strategy will return us to profitability in 2018 and effectively mitigates the substantial doubt about our ability to continue as a going concern.

The actions taken in the first quarter of 2017 included closing our offices in Rochester, Minnesota, New York, New York, and Arlington, Virginia and reduced our staff by 20 employees, primarily located in these offices. During the second quarter of 2017, we fully exited the New York and Arlington facilities and took additional actions to improve our operating efficiencies. These actions reduced our staff by an additional 17 production and administrative employees in our Solon location.

During the year ended December 31, 2017 we recorded net restructuring expenses totaling approximately $1.7 million, consisting of approximately $0.8 million for severance and related benefits, approximately $0.7 million related to the facility closings, and approximately $0.2 million primarily related to fixed asset and prepaid expenses write-offs.

Our restructuring liabilities consist of one-time termination costs for severance and benefits to former employees and estimated ongoing costs related to long-term operating lease obligations. The recorded value of the termination severance and benefits to employees approximates fair value, as the remaining obligation is based on the arrangements made with the former employees, and these obligations will be completely satisfied in less than 12 months. The recorded value of the ongoing lease obligations is based on the remaining lease term and payment amount, net of estimated sublease income, discounted to present value. Changes in subsequent periods resulting from a revision to either the timing or the amount of estimated cash flows over the future period are measured using the credit adjusted, risk-free rate that was used to measure the restructuring liabilities initially. The current portion of the ongoing lease obligations is included within the caption, "Accrued liabilities" and the long term portion of the ongoing lease obligations comprises the caption, "Other liabilities" in the Consolidated Balance Sheets as of December 31, 2017. We estimated that we would receive a total of approximately $1.2 million in sublease payments to offset our remaining lease obligations, which extend until June 2021, of approximately $1.7 million. We expect to incur insignificant additional costs over the remaining life of our lease obligations, but we do not anticipate further major restructuring activities in the near future. The following is a reconciliation of the beginning and ending balances of our restructuring liability:

	Severance and Related Benefits	Facilities	Other	Total
Balance at January 1, 2017	$ —	$ —	$ —	$ —
Additions	$ 770	$ 830	$ 186	$ 1,786
Accretion of lease obligations	$ —	$ 31	$ —	$ 31
Adjustment of lease obligations		$ (155)	$ —	$ (155)
Write-offs		$ 9	$ (95)	$ (86)
Payments	$ (708)	$ (375)	$ (91)	$ (1,174)
Balance at December 31, 2017	$ 62	$ 340	$ —	$ 402

NOTE 4. DISCONTINUED OPERATIONS

EFLS

As part of the strategy to align our resources with developing and selling our energy-efficient LED products into the commercial and military maritime markets, we completed the exit of our turnkey solutions business, operated by EFLS during the third quarter of 2015. During 2014, we shifted our focus away from the turnkey solutions business. We stopped accepting new projects and completed all outstanding solutions-based projects in the first quarter of 2015. As of September 30, 2015, the exit of our turnkey solutions business was complete. Accordingly, the operating results related to EFLS have been included as discontinued operations in the Consolidated Statements of Operations for all periods presented. There were no assets disposed as a result of the disposition, and we did not recognize a gain or loss on disposal or record an income tax expense or benefit. We do not anticipate any significant continuing involvement related to this discontinued operation.

CLL

In August 2015, we sold our wholly-owned United Kingdom subsidiary, CLL. The sale was for nominal consideration under the terms of the agreement. As a result of the transaction and the elimination of this foreign subsidiary consolidated under the equity method of accounting, we recorded a one-time loss of $44 thousand, which included a $469 thousand accumulated other comprehensive income reclassification adjustment for foreign currency translation adjustments. The loss was recorded in the Consolidated Statements of Operations under the caption "Loss on disposal of discontinued operations." We do not anticipate any significant continuing involvement related to this discontinued operation.

Pool Products Business

On November 26, 2013, we announced the sale of our pool products business for a cash purchase price of $5.2 million. Under the terms of the Purchase Agreement, we sold substantially all of the assets associated with the pool products business and the buyer assumed certain related liabilities. In connection with the sale, we and the buyer entered into a transition services agreement that continued until April 30, 2014, under which we provided services to transition the pool products business to the buyer. In addition, the Purchase Agreement contains representations, warranties and covenants of us and the buyer and prohibits us from competing with the buyer in the pool business for a period of five years following the closing. The Purchase Agreement also provided for an escrow of $500 thousand of the purchase price to secure customary indemnification obligations with respect to our representations, warranties, covenants and other obligations under the Purchase Agreement. Under the terms of the Purchase Agreement, the first of five $100 thousand scheduled escrow releases commenced on March 25, 2014, and was to continue on the 25th day of each of the next four subsequent months. As of December 31, 2015 and 2014, $200 thousand of the cash held in escrow had been released to us and $300 thousand remained in escrow subject to the resolution of outstanding buyer claims that were the subject of an arbitration claim filed by the buyer in February 2015. At December 31, 2015, we offset the full escrow amount by the expected costs to settle this claim, as we had reached an agreement in principle with the buyer. On March 18, 2016, a settlement agreement was executed for this claim and the funds in the escrow account, plus the interest earned on the account, were released to the buyer. The legal fees incurred for the arbitration are included in the loss on disposal of discontinued operations for all periods presented. For additional information on the status of the remaining cash in escrow, please refer to Note 14, “Legal Matters.”

As a result of exiting EFLS and selling CLL and the pool products businesses, we have reclassified all net sales and expenses associated with this business from the Consolidated Statements of Operations, and have reported the net (loss) income from those activities as discontinued operations in the Consolidated Statements of Operations for all years presented.

The following table summarizes the components included in loss from discontinued operations in our Consolidated Statements of Operations for the periods presented (in thousands):

	December 31,	
	2016	**2015**
Net sales	$ —	$ 1,078
Cost of sales	—	588
Gross Profit	—	490
Operating expenses of discontinued operations	—	657
Other expenses	—	—
Loss on disposal of discontinued operations	(12)	(534)
Loss from discontinued operations before income taxes	(12)	(701)
Benefit from income taxes	—	(10)
Loss from discontinued operations	$ (12)	$ (691)

The following table shows the components of the loss from discontinued operations by business for the periods presented (in thousands):

	December 31,	
	2016	2015
CLL	—	(138)
EFLS	—	(29)
Pool products business	—	—
Loss from operations of discontinued operations	—	(167)
CLL	—	(44)
Pool products business	(12)	(490)
Loss on disposal of discontinued operations	(12)	(534)
Loss from discontinued operations before income taxes	(12)	(701)
Benefit from income taxes	—	(10)
Loss from discontinued operations	$ (12)	$ (691)

NOTE 5. INVENTORIES

Inventories are stated at the lower of standard cost (which approximates actual cost determined using the first-in, first-out cost method) or net realizable value and consists of the following (in thousands):

	At December 31,	
	2017	2016
Raw materials	$ 3,316	$ 5,049
Finished goods	6,598	10,016
Reserve for excess, obsolete, and slow moving inventories	(4,196)	(5,596)
Inventories, net	**$ 5,718**	**$ 9,469**

During 2017, we implemented a strategic sales initiative to sell certain excess inventory that had previously been written-down in conjunction with our excess inventory reserve analysis in prior years, as required by U.S. GAAP. This initiative resulted in a net reduction of our gross inventory levels and excess inventory reserves of $5.2 million and $1.4 million, respectively, in 2017.

During the first half of 2016 we initiated an aggressive inventory procurement plan in order to meet the expected demand based on the commercial sales growth experienced during the first six months of the year. While we did not achieve this level of demand, we had already committed to inventory purchases into the third quarter due to manufacturing and shipment lead times. As a result, our gross inventory levels increased $5.0 million as of December 31, 2016 compared to December 31, 2015. After evaluation of historical sales, current economic trends, forecasted sales, and product lifecycles, we charged $3.3 million to cost of sales from continuing operations for excess, obsolete, and slow moving inventories in 2016 compared to $1.7 million in 2015.

NOTE 6. PROPERTY AND EQUIPMENT

Property and equipment are stated at cost and depreciated using the straight-line method over the estimated useful lives of the related assets and consist of the following (in thousands):

	At December 31, 2017	At December 31, 2016
Equipment (useful life 3 - 15 years)	$ 1,557	$ 2,231
Tooling (useful life 2 - 5 years)	371	863
Vehicles (useful life 5 years)	47	39
Furniture and fixtures (useful life 5 years)	137	170
Computer software (useful life 3 years)	1,043	977
Leasehold improvements (the shorter of useful life or lease life)	201	256
Construction in progress	55	154
Property and equipment at cost	3,411	4,690
Less: accumulated depreciation	(2,314)	(2,365)
Property and equipment, net	$ 1,097	$ 2,325

Depreciation expense was $0.7 million, $0.8 million, and $0.3 million for the years ended December 31, 2017, 2016 and 2015, respectively.

During 2015, the Company invested in certain equipment to be used to increase our capabilities and reduce the cost of components used in our domestic manufacturing processes, as many of our sales opportunities were with respect to products made in the U.S. or meeting “Buy American” standards. These opportunities included our military maritime product line, as well as products for use in government-funded facilities, such as military bases, which must comply with certain domestic preference standards. As a result of the decline in 2016 sales as well as our expectation of limited sales of our military Intellitube® product going forward due to new competition for retrofit products for the U.S. Navy, coupled with the current cost of procuring components from our suppliers for such products, versus manufacturing them at a low volume, at December 31, 2016, we re-evaluated the economics of manufacturing versus purchasing such components from our suppliers. We concluded that we would no longer use the equipment and software purchased to conduct this manufacturing and evaluated the carrying value of the equipment and software compared to its fair value and determined that the equipment and software were impaired. Accordingly, we recorded an impairment loss of $0.9 million, to adjust the carrying value of the equipment and software to its net realizable value as of December 31, 2016. Due to the specialized nature of this equipment we were not able to find a buyer for this equipment in 2017. As a result, we re-evaluated the carrying of the equipment and software compared to its fair value and recorded an additional impairment loss of $0.2 million as of December 31, 2017. We have classified the net carrying value of this equipment as “Assets held for sale” in the accompanying Consolidated Balance Sheets as of December 31, 2017.

NOTE 7. ACCRUED LIABILITIES

Accrued current liabilities consisted of the following (in thousands):

	At December 31,	
	2017	2016
Accrued payroll and related benefits	$ 394	$ 522
Accrued sales commissions and incentives	124	325
Accrued warranty expense	174	331
Accrued severance and related benefits	—	328
Accrued restructuring - short-term	170	—
Accrued legal and professional fees	77	63
Accrued other expenses	53	107
Total accrued liabilities	$ 992	$ 1,676

NOTE 8. DEBT

Credit facilities

On December 22, 2011, we entered into a $4.5 million revolving line of credit (“credit facility”) with Rosenthal & Rosenthal. The total loan amount available to us under the line of credit was equal to 85 percent of our net, eligible receivables, plus available inventory (50 percent of the lower of cost or market value of eligible inventory, or $250 thousand, whichever was less). The credit facility was secured by a lien on our domestic assets. The interest rate for borrowing on accounts receivable was 8.5 percent, on inventories 10 percent, and on overdrafts 13 percent. Additionally, there was an annual 1 percent facility fee on the entire $4.5 million amount of the credit facility payable at the beginning of the year. The agreement automatically renewed from year to year after December 31, 2014, unless we provided the requisite notice to Rosenthal. Additionally, Rosenthal had the right to terminate the agreement by providing 60 days written notice to us. We provided the required advance notice to Rosenthal, and as such, the facility was terminated in December 2015.

Borrowings

On June 1, 2009, we entered into a $70 thousand unsecured promissory note with Quercus Trust that bore interest in the amount of 1 percent per year. The principal and accrued interest on the note were due on June 1, 2109. In December 2015, we entered into an agreement with Quercus Trust to cancel the note and the accrued interest for a single payment of $13 thousand in cash. At the time of the cancellation, we had recorded $5 thousand in accrued interest on this note. For the year ended December 31, 2015, we recognized a gain of $62 thousand within “Other income” within the Consolidated Statements of Operations as a result of this cancellation.

NOTE 9. COMMITMENTS AND CONTINGENCIES

We lease certain equipment, manufacturing, warehouse and office space under non-cancellable operating leases expiring through 2022 under which we are responsible for related maintenance, taxes, and insurance. Future minimum non-cancellable lease commitments are as follows (in thousands):

For the year ending December 31,	Minimum Lease Commitments	Sublease Payments (1)	Net Lease Commitments
2018	$ 1,259	$ 428	$ 831
2019	1,127	399	728
2020	960	267	693
2021	789	134	655
2022 & thereafter	309	—	309
Total contractual obligations	$ 4,444	$ 1,228	$ 3,216

(1) Represents the amount of income expected from sublease agreements executed in 2017 for our former New York, New York and Arlington, Virginia offices.

Certain leases included above contain escalation clauses and, as such, rent expense was recorded on a straight-line basis over the term of the lease. Net rent expense from continuing operations was $1.2 million, $1.2 million, and $0.8 million for the years ended December 31, 2017, 2016, and 2015, respectively.

On December 22, 2014, a former employee filed a lawsuit against us in the Superior Court of the State of California, County of San Diego, known as Merl Toyer v. Energy Focus, Inc., et al., alleging wrongful termination and other claims related to his employment with us. We subsequently removed the case to the United States District Court for the Southern District of California. On May 1, 2015, we entered into a settlement agreement with the plaintiff, which assigned no culpability to any party and provided for a payment by us in exchange for full settlement and release of his claims. As of June 30, 2015, the total settlement amount of $0.3 million had been paid to the plaintiff. In September 2015, we received $0.2 million as reimbursement from our insurance company for the settlement claim. For the year ended December 31, 2015, we had income of $0.2 million from the insurance reimbursement and expense of $0.2 million, net of the insurance settlement, respectively, included in the Consolidated Statements of Operations under the caption, "Selling, general, and administrative."

NOTE 10. STOCKHOLDERS' EQUITY

Common stock follow-on offering

On September 11, 2015, we announced the pricing of a registered underwritten follow-on offering of shares of our common stock by us and certain of our stockholders (the "Selling Stockholders"). We sold 1,500,000 shares of our common stock at a purchase price to the public of $17.00 per share and the Selling Stockholders sold an additional 1,500,000 shares of our common stock on the same terms and conditions.

The offering closed on September 16, 2015 and we received $23.6 million in net proceeds from the transaction, after giving effect to underwriting discounts and commissions and estimated expenses. We expect to use the remaining net proceeds from the offering to finance our growth efforts, for working capital, and other general corporate purposes.

Warrants

We have issued warrants in conjunction with various equity issuances, debt financing arrangements, and sales incentives. As part of the underwriting agreement for our August 6, 2014 public offering, we issued a warrant for 47,000 shares to the underwriter representing four percent of the number of shares of common stock sold in the offering at an issue price of $5.40 per share representing 120 percent of the public offering price of the shares of common stock. The warrant was exercised on September 10, 2015. Additionally, there was a warrant issued to a former employee in 2013 as part of the sales of our pool products business, which was exercised in May 2015.

A summary of warrant activity was as follows:

	Warrants Outstanding	Weighted Average Exercise Price During Period
Balance, December 31, 2014	969,549	4.61
Warrants exercised	(638,189)	4.58
Warrants cancelled/forfeited	(112,110)	5.54
Warrants expired	(205,000)	4.20
Balance, December 31, 2015	14,250	4.30
Warrants cancelled/forfeited	(7,500)	4.30
Balance, December 31, 2016	6,750	$ 4.30
Warrants cancelled/forfeited	(6,750)	$ 4.30
Balance, December 31, 2017	—	$ —

Stock-based compensation

On May 6, 2014, our Board of Directors approved the Energy Focus, Inc. 2014 Stock Incentive Plan (the “2014 Plan”). The 2014 Plan was approved by the stockholders at our annual meeting on July 15, 2014, after which no further awards could be issued under the Energy Focus, Inc. 2008 Incentive Stock Plan (the “2008 Plan”). The 2014 Plan initially allowed for awards up to 600,000 shares of common stock and expires on July 15, 2024. On July 22, 2015, the stockholders approved an amendment to the 2014 Plan to increase the shares available for issuance under the 2014 Plan by an additional 600,000 shares. On June 21, 2017, the stockholders approved an amendment to the 2014 Plan to increase the shares available for issuance under the 2014 Plan by an additional 1,300,000. We have two other equity-based compensation plans under which options are currently outstanding; however, no new awards may be granted under these plans. Generally, stock options are granted at fair market value and expire ten years from the grant date. Employee grants generally vest in three or four years, while grants to non-employee directors generally vest in one year. The specific terms of each grant are determined by our Board of Directors. At December 31, 2017, 1,798,693 shares remain available to grant under the 2014 Plan.

Stock-based compensation expense is attributed to the granting of stock options, restricted stock, and restricted stock unit awards. For all stock-based awards, we recognize compensation expense using a straight-line amortization method.

The impact on our results for stock-based compensation was as follows (in thousands):

	For the year ended December 31,		
	2017	**2016**	**2015**
Cost of sales	$ 34	$ 56	$ 38
Product development	59	84	37
Selling, general, and administrative	714	1,220	738
Total stock-based compensation	$ 807	$ 1,360	$ 813

At December 31, 2017 and 2016, we had unearned stock compensation expense of $0.7 million and $1.2 million, respectively. These costs will be charged to expense and amortized on a straight-line basis in subsequent periods. The remaining weighted average period over which the unearned compensation is expected to be amortized was approximately 1.8 years as of both December 31, 2017 and 2016.

Stock options

The fair value of each stock option is estimated on the date of grant using the Black-Scholes option pricing model. Estimates utilized in the calculation include the expected life of the option, risk-free interest rate, and expected volatility, and are further comparatively detailed as follows:

	2017	**2016**	**2015**
Fair value of options issued	$ 2.66	$ 5.27	$ 5.33
Exercise price	$ 3.55	$ 7.46	$ 7.23
Expected life of option (in years)	5.8	5.8	5.8
Risk-free interest rate	2.1%	1.5%	1.7%
Expected volatility	91.9%	93.7%	90.7%
Dividend yield	0.00%	0.00%	0.00%

We utilize the simplified method as provided by ASC 718-10 to calculate the expected stock option life. Under ASC 718-10, the expected stock option life is based on the midpoint between the vesting date and the end of the contractual term of the stock option award. The use of this simplified method in place of using the actual historical exercise data is allowed when a stock option award meets all of the following criteria: the exercise price of the stock option equals the stock price on the date of grant; the exercisability of the stock option is only conditional upon completing the service requirement through the vesting date; employees who terminate their service prior to the vesting date forfeit their stock options; employees who terminate their service after vesting are granted a limited time period to exercise their stock options; and the stock options are nontransferable and nonhedgeable. We believe that our stock option awards meet all of these criteria. The estimated expected life of the option is calculated based on contractual life of the option, the vesting life of the option, and historical exercise patterns of vested options. The risk-free interest rate is based on U.S. treasury zero-coupon yield curve on the grant date for a maturity similar to the expected life of the option. The volatility estimates are calculated using historical volatility of our stock price calculated over a period of time representative of the expected life of the option. We have not paid dividends in the past, and do not expect to pay dividends over the corresponding expected term as of the grant date.

Options outstanding under all plans at December 31, 2017 have a contractual life of ten years, and vesting periods between one and four years. A summary of option activity under all plans was as follows:

	Number of Options	Weighted Average Exercise Price Per Share
Outstanding at December 31, 2014	459,271	$ 8.95
Granted	340,500	8.65
Cancelled	(147,152)	10.10
Exercised	(50,412)	4.69
Outstanding at December 31, 2015	602,207	8.58
Granted	167,819	7.31
Cancelled	(160,126)	12.94
Exercised	(79,166)	4.48
Outstanding at December 31, 2016	530,734	7.48
Granted	192,984	3.55
Cancelled	(377,095)	6.71
Expired	(56,111)	10.65
Exercised	(42,000)	2.30
Outstanding at December 31, 2017	248,512	$ 5.76
Vested and expected to vest at December 31, 2017	228,880	$ 5.97
Exercisable at December 31, 2017	110,476	$ 8.63

The "Expected to Vest" options are the unvested options that remain after applying the pre-vesting forfeiture rate assumption to total unvested options. The total intrinsic value of options exercised during 2017 was $42 thousand. The total intrinsic value of options outstanding and options exercisable at December 31, 2017 was $150.00 each, which was calculated using the closing stock price at the end of the year of $2.45 per share less the option price of the in-the-money grants.

The options outstanding at December 31, 2017 have been segregated into ranges for additional disclosure as follows:

OPTIONS OUTSTANDING					OPTIONS EXERCISABLE		
Range of Exercise Prices	Number of Shares Outstanding	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price		Number of Shares Exercisable	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price
$2.30 — $3.25	59,558	9.1	$	3.04	2,000	4.9	$ 2.45
$3.26 — $4.00	74,165	9.2		3.43	—	9.2	3.43
$4.01 — $5.50	51,919	6.6		4.96	50,461	6.6	4.94
$5.51 — $20.00	62,870	6.0		11.75	58,015	5.8	12.05
	248,512	7.8	$	5.76	110,476	6.1	$ 8.63

Restricted stock and Restricted Stock Units

Prior to 2011, we issued restricted stock to Executive Officers and Directors in lieu of paying a portion of their cash compensation or Directors' fees.

In 2015, we began issuing restricted stock units to employees and non-employee Directors under the 2014 Plan with vesting periods ranging from 1 to 3 years from the grant date.

The following table shows a summary of restricted stock and restricted stock unit activity:

	Restricted Stock Units Outstanding		Weighted Average Grant Date Fair Value
At December 31, 2014	—		—
Granted	73,750		6.92
Forfeited	(16,250)		5.54
At December 31, 2015	57,500	$	7.31
Granted	290,966		6.56
Vested	(11,213)		14.18
Forfeited	(87,138)		6.73
At December 31, 2016	250,115	$	6.34
Granted	375,542	$	3.18
Vested	(115,622)	$	5.78
Forfeited	(203,893)	$	5.30
At December 31, 2017	306,142	$	3.37

Employee stock purchase plans

In September 2013, our stockholders approved the 2013 Employee Stock Purchase Plan (the "2013 Plan") to replace the 1994 prior purchase plan. A total of 500,000 shares of common stock were provided for issuance under the 2013 Plan. The 2013 Plan permits eligible employees to purchase common stock through payroll deductions at a price equal to the lower of 85 percent of the fair market value of our common stock at the beginning or end of the offering period. Employees may end their participation at any time during the offering period, and participation ends automatically upon termination of employment with us. During 2017, 2016 and 2015, employees purchased 16,004, 22,094, and 18,119, respectively. At December 31, 2017, 427,437 shares remained available for purchase under the 2014 Plan.

NOTE 11. INCOME TAXES

We file income tax returns in the U.S. federal jurisdiction, as well as in various state and local jurisdictions. With few exceptions, we are no longer subject to U.S. federal, state, and local, or non-United States income tax examinations by tax authorities for years before 2014. Our practice is to recognize interest and penalties related to income tax matters in income tax expense when and if they become applicable. At December 31, 2017 and 2016, respectively, there were no accrued interest and penalties related to uncertain tax positions.

The following table shows the components of (loss) income from continuing operations before income taxes (in thousands):

	For the year ended December 31,		
	2017	**2016**	**2015**
United States	$ (11,382)	$ (16,848)	$ 9,620
(Loss) income from continuing operations before income taxes	$ (11,382)	$ (16,848)	$ 9,620

The following table shows the components of the provision for income taxes from continuing operations (in thousands):

	For the year ended December 31,		
	2017	**2016**	**2015**
Current:			
U.S. federal	$ —	$ 1	$ 123
State	10	26	26
Total current	$ 10	$ 27	$ 149
Deferred:			
U.S. Federal	$ (125)	$ —	$ —
State	$ —	$ —	$ —
Total deferred	$ (125)	$ —	$ —
Provision for income taxes	$ (115)	$ 27	$ 149

The principal items accounting for the difference between income taxes computed at the U.S. statutory rate and the provision for income taxes from continuing operations reflected in our Consolidated Statements of Operations are as follows:

	For the year ended December 31,		
	2017	**2016**	**2015**
U.S. statutory rate	34.0 %	34.0 %	34.0 %
State taxes (net of federal tax benefit)	2.3	1.7	0.2
Valuation allowance	17.4	(27.5)	(27.9)
Deferred rate change due to changes in tax laws	(51.7)	—	—
Other	(1.0)	(8.4)	(4.8)
	1.0 %	(0.2)%	1.5 %

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets are as follows (in thousands):

	At December 31,		
	2017	2016	2015
Allowance for doubtful accounts	$ —	$ 18	$ 18
Accrued expenses and other reserves	1,749	3,138	2,244
Tax credits, deferred R&D, and other	197	142	122
Net operating loss	8,610	9,239	5,384
Valuation allowance	(10,556)	(12,537)	(7,768)
Net deferred tax assets	$ —	$ —	$ —

In 2017, our effective tax rate was lower than the statutory rate due to the remeasurement of our deferred tax assets resulting from the Tax Cuts and Jobs Act of 2017 (the "Act") and a decrease in the valuation allowance. In 2016, our effective tax rate was lower than the statutory rate due to an increase in the valuation allowance as a result of the $10.6 million additional federal net operating loss we recognized for the year.

On December 22, 2017, the Act was signed into law making significant changes to the Internal Revenue Code ("IRC"). Changes include, but are not limited to, a corporate tax rate decrease from 35 percent to 21 percent effective for tax years beginning after December 31, 2017, repeal of the corporate Alternative Minimum Tax, elimination of certain deductions, and changes to the carryforward period and utilization of Net Operating Losses generated after December 31, 2017. We have calculated our best estimate of the impact of the Act in our year end income tax provision in accordance with our understanding of the Act and guidance available as of the date of this filing. As a result of the Act, we have recorded $0.1 million as additional income tax benefit in the fourth quarter of 2017, the period in which the legislation was enacted. The amount related to the release of the valuation allowance on the Alternative Minimum Tax Credit carry-forward which is expected to be fully refunded by 2021. We remeasured the deferred tax assets and liabilities, based on the rates at which they are expected to reverse in the future. The impact of the remeasurement was $5.9 million of additional tax expense which was offset by a $5.9 million reduction of the valuation allowance resulting in a net zero impact to the financial statements. The U.S. Treasury Department, the Internal Revenue Service, and other standard-setting bodies could interpret or issue guidance on how provisions of the Act will be applied or otherwise administered that is different from our interpretation. As we complete our analysis of the Act, collect and prepare necessary data, and interpret any additional guidance, we may make adjustments to provisional amounts that we have recorded that may materially impact our provision for income taxes in the period in which the adjustments are made.

Since we believe it is more likely than not that the benefit from net operating loss carry-forwards will not be realized, we have provided a full valuation allowance against our deferred tax assets at December 31, 2017 and 2016, respectively. We had no net deferred tax liabilities at December 31, 2017 or 2016, respectively. In 2017, we recognized U.S. federal and various states income tax benefit of $0.1 million as a result of the reduction of the valuation allowance on the portion of Alternative Minimum Tax Credits that are expected to be refunded. In 2016, we recognized U.S. federal and various states income tax expense as a result of the adjustment from the 2015 provision to the actual tax on the 2015 returns that were filed in 2016.

Deferred income tax assets are reduced by a valuation allowance when it is more likely than not that some portion of the deferred income tax assets will not be realized. In considering the need for a valuation allowance, we assess all evidence, both positive and negative, available to determine whether all or some portion of the deferred tax assets will not be realized. Such evidence includes, but is not limited to, recent earnings history, projections of future income or loss, reversal patterns of existing taxable and deductible temporary differences, and tax planning strategies. We will continue to evaluate the need for a valuation allowance on a quarterly basis.

At December 31, 2017, we had net operating loss carry-forwards of approximately $91.8 million for U.S. federal, state, and local income tax purposes. However, due to changes in our capital structure, approximately $37.3 million of this amount is available to offset future taxable income after the application of the limitations found under Section 382 of the IRC. As a result of this limitation, in 2018, we expect to have approximately $37.3 million of the net operating loss carry-forward available for use. If not utilized, these carry-forwards will begin to expire in 2021 for federal purposes and have begun to expire for state and local purposes. Additionally, the changes to our capital structure have subjected, and will continue to subject our net operating loss carry-forward to an annual limitation as discussed further below. This limitation will significantly restrict our ability to utilize the carry-forward to offset taxable income in future periods.

The IRC imposes restrictions on the utilization of various carry-forward tax attributes in the event of a change in ownership, as defined by IRC Section 382. During 2015, we completed an IRC Section 382 review and the results of this review indicate ownership changes have occurred which would cause a limitation on the utilization of carry-forward attributes. Our net operating loss carry-forwards and research and development credits are all subject to limitation. Under these tax provisions, the limitation is applied first to any capital losses, next to any net operating losses, and then to any general business credits. The Section 382 limitation is currently estimated to result in the expiration of $54.2 million of net operating loss carry-forwards and $0.3 million of research and development credits. A valuation allowance has been established to reserve for the potential benefits of the remaining net operating loss carry-forwards in the consolidated financial statements to reflect the uncertainty of future taxable income required to utilize available tax loss carry-forwards.

NOTE 12. PRODUCT AND GEOGRAPHIC INFORMATION

During 2013, we sold our pool products business. During 2014, we shifted our focus away from the turnkey solutions business to align our resources with developing and selling our LED products and completed our exit of that business in September 2015. With the exit from EFLS and sale of CLL, we have aligned our resources and focused our efforts on the sale of LED lighting products, in particular our military and commercial tubular LED ("TLED") lines of products, into targeted vertical markets. Our products are sold primarily in the United States through a combination of direct sales employees, independent sales representatives and distributors. We currently operate in a single industry segment, developing and selling our energy-efficient light-emitting diode ("LED") lighting products into the military maritime and commercial markets.

The following table provides a breakdown of product net sales from continuing operations for the years indicated (in thousands):

	Year ended December 31,		
	2017	2016	2015
Commercial	$ 15,217	$ 14,809	$ 14,156
Military maritime	4,629	16,189	50,128
R&D services	—	—	119
Total net sales	$ 19,846	$ 30,998	$ 64,403

A geographic summary of net sales from continuing operations is as follows (in thousands):

	For the year ended December 31,		
	2017	2016	2015
United States	$ 19,446	$ 29,840	$ 64,251
International	400	1,158	152
Total net sales	$ 19,846	$ 30,998	$ 64,403

At December 31, 2017 and 2016, approximately 98 percent and 99 percent of our long-lived assets, respectively, which consist of property and equipment, were located in the United States.

NOTE 13. RELATED PARTY TRANSACTIONS

On December 12, 2012, our Board of Directors appointed James Tu to serve as our non-executive Chairman. On April 30, 2013, Mr. Tu became the Executive Chairman assuming the duties of the Principal Executive Officer. On October 30, 2013 Mr. Tu was appointed Executive Chairman and Chief Executive Officer by the Board of Directors. On May 9, 2016, Mr. Tu also assumed the role of President. On August 11, 2016, our Board of Directors appointed a separate Executive Chairman of the Board, and Mr. Tu continued to serve in the role of Chief Executive Officer and President, until February 19, 2017.

Mr. Tu is also the Founder, Chief Executive Officer and Chief Investment Officer of 5 Elements Global Advisors, an investment advisory and management company managing the holdings of 5 Elements Global Fund LP, which was a beneficial owner of more than 5 percent of our common stock prior to the August 2014 registered offering. As of December 31, 2017, 5

Elements Global Fund LP holds approximately 2.5 percent of our common stock. 5 Elements Global Advisors focuses on investing in clean energy companies with breakthrough, commercialized technologies, and near-term profitability potential. Mr. Tu is also Co-Founder of Communal International Ltd. ("Communal"), a British Virgin Islands company dedicated to assisting clean energy, solutions-based companies, maximizing technology and product potential and gaining them access to global marketing, distribution licensing, manufacturing and financing resources. Communal has a 50 percent ownership interest in 5 Elements Energy Efficiencies (BVI) Ltd., a beneficial owner of approximately 2.4 percent of our common stock. Yeh-Mei Cheng controls 5 Elements Energy Efficiencies (BVI) Ltd. and owns the other 50 percent. She is Co-Founder of Communal International Ltd. with Mr. Tu and the mother of Simon Cheng, a member of our Board of Directors through February 19, 2017 and an employee of the Company.

On February 27, 2012, we entered into an Asian Business Development/Collaboration Agreement with Communal. The agreement had a term of 60 months, under which we paid $523 thousand to Communal in 2012. Effective January 1, 2013, the Asian Business Development/Collaboration Agreement with Communal was amended to reflect the extension of the terms of the Agreement for an additional twelve months, and the addition of certain services and countries in the territory covered by the Agreement. In connection with the amended and restated Agreement, we paid an additional $425 thousand in 2013 and recorded expense of $226 thousand. For the year ended December 31, 2015, nothing was paid under this Agreement and we recorded expense of $226 thousand per year. On December 23, 2015, we terminated the Agreement with Communal without penalty.

NOTE 14. LEGAL MATTERS

We may be the subject of threatened or pending legal actions and contingencies in the normal course of conducting our business. We provide for costs related to these matters when a loss is probable and the amount can be reasonably estimated. The effect of the outcome of these matters on our future results of operations and liquidity cannot be predicted because any such effect depends on future results of operations and the amount or timing of the resolution of such matters. While it is not possible to predict the future outcome of such matters, we believe that the ultimate resolution of such individual or aggregated matters will not have a material adverse effect on our consolidated financial position, results of operations, or cash flows. For certain types of claims, we maintain insurance coverage for personal injury and property damage, product liability and other liability coverages in amounts and with deductibles that we believe are prudent, but there can be no assurance that these coverages will be applicable or adequate to cover adverse outcomes of claims or legal proceedings against us.

On November 26, 2013, we announced the sale of our pool products business for a cash purchase price of $5.2 million. Under the terms of the Purchase Agreement, we sold substantially all of the assets associated with the pool products business and the buyer assumed certain related liabilities. The Purchase Agreement provided for an escrow of $500 thousand of the purchase price to secure customary indemnification obligations with respect to our representations, warranties, covenants and other obligations under the Purchase Agreement. Under the terms of the Purchase Agreement, the first of five $100 thousand scheduled escrow releases commenced on March 25, 2014, and was to continue on the 25th day of each of the next four subsequent months. As of December 31, 2015 and 2014, $200 thousand of the cash held in escrow had been released to us and $300 thousand remained in escrow subject to the resolution of outstanding buyer claims. The Purchase Agreement provides that all disputes related to the sale must be resolved through binding arbitration. On February 18, 2015, the buyer filed a claim with the American Arbitration Association ("AAA") asserting claims for damages of $780 thousand under the Purchase Agreement and relating to product development, which was amended on September 1, 2015 to assert damages of $1.6 million. We believed the claims were without merit and asserted a counterclaim in the arbitration for the $300 thousand that remained in escrow. On March 18, 2016, a settlement agreement was executed for this claim and the funds in the escrow account, plus the interest earned on the account, were released to the buyer.

SUPPLEMENTARY FINANCIAL INFORMATION TO ITEM 8.

The following table sets forth our selected unaudited financial information for the four quarters in the periods ended December 31, 2017 and 2016, respectively. This information has been prepared on the same basis as the audited financial statements and, in the opinion of management, contains all adjustments necessary for a fair presentation thereof.

QUARTERLY FINANCIAL DATA (UNAUDITED)
(*amounts in thousands, except per share amounts*)

2017	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Net sales from continuing operations	$ 4,727	$ 5,002	$ 6,011	$ 4,106
Gross profit from continuing operations	1,622	1,137	1,501	561
Net loss from continuing operations	(1,858)	(1,773)	(3,114)	(4,522)
Net loss from discontinued operations	—	—	—	—
Net loss	$ (1,858)	$ (1,773)	$ (3,114)	$ (4,522)
Net loss per share (basic and diluted):				
Net loss from continuing operations	$ (0.16)	$ (0.15)	$ (0.26)	$ (0.39)
Net loss from discontinued operations	—	—	—	—
Net loss	$ (0.16)	$ (0.15)	$ (0.26)	$ (0.39)

2016	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Net sales from continuing operations	$ 7,186	$ 8,261	$ 7,126	$ 8,425
Gross profit from continuing operations	(1,072)	3,082	2,522	3,145
Net loss from continuing operations	(7,805)	(3,177)	(3,916)	(1,977)
Net loss from discontinued operations	—	—	—	(12)
Net loss	$ (7,805)	$ (3,177)	$ (3,916)	$ (1,989)
Net loss per share (basic and diluted):				
Net loss from continuing operations	$ (0.67)	$ (0.27)	$ (0.34)	$ (0.17)
Net loss from discontinued operations	—	—	—	—
Net loss	$ (0.67)	$ (0.27)	$ (0.34)	$ (0.17)

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNT AND FINANCIAL DISCLOSURES

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures

We maintain "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act"), that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Our disclosure controls and procedures have been designed to meet reasonable assurance standards. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. Any design of disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based on their evaluation as of the end of the period covered by this Report on Form 10-K, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of December 31, 2017.

Management's report on internal controls over financial reporting

The management of Energy Focus, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of internal control over financial reporting based upon criteria established in "Internal Control – Integrated Framework (2013)" issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO Framework").

An effective internal control system, no matter how well designed, has inherent limitations, including the possibility of human error and circumvention or overriding of controls; therefore, it can provide only reasonable assurance with respect to reliable financial reporting. Furthermore, effectiveness of an internal control system in future periods cannot be guaranteed, because the design of any system of internal controls is based in part upon assumptions about the likelihood of future events. There can be no assurance that any control design will succeed in achieving its stated goals under all potential future conditions. Over time, certain controls may become inadequate because of changes in business conditions, or the degree of compliance with policies and procedures may deteriorate. As such, misstatements due to error or fraud may occur and not be detected.

Based upon our evaluation under the COSO framework as of December 31, 2017, management concluded that its internal control over financial reporting was effective as of December 31, 2017.

Changes in internal control over financial reporting

During the fourth quarter of 2017, there were no material changes in our internal controls over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Attestation Report of Independent Registered Public Accounting Firm

This Annual Report does not include an attestation report of our independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our independent public accounting firm pursuant to the rules of the Securities and Exchange Commission that permit us to provide only management's report.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

Directors

The information regarding our directors will be set forth under the caption “Election of Directors” in our Proxy Statement for our 2017 Annual Meeting of Stockholders (the “Proxy Statement”) and is incorporated herein by reference.

Executive officers

The information regarding our executive officers is set forth under the caption entitled “Executive Officers of the Registrant” following Item 4, in Part I, of this report and is incorporated herein by reference.

Section 16(a) beneficial ownership reporting compliance

The information regarding compliance with Section 16 of the Securities Exchange Act of 1934 will be set forth under the caption entitled “Section 16(a) Beneficial Ownership Reporting Compliance” in our Proxy Statement and is incorporated herein by reference.

Audit committee

The information regarding the Audit Committee of our Board of Directors and the information regarding “Audit Committee Financial Experts” will be set forth under the caption entitled “Audit and Finance Committee” in our Proxy Statement and is incorporated herein by reference.

Code of ethics

We have adopted a Code of Ethics and Business Conduct, which applies to all of our directors, officers, and employees. Our Code of Ethics and Business Conduct can be found on our website at www.energyfocus.com. Any person may receive a copy free of charge by writing to us at Energy Focus, Inc., 32000 Aurora Road, Suite B, Solon, Ohio 44139, Attention: Secretary.

We intend to disclose on our website any amendment to, or waiver from, a provision of our Code of Ethics and Business Conduct that applies to our directors and executive officers, including our principal executive officer, principal financial officer, principal accounting officer or controller, or any persons performing similar functions, and that is required to be publicly disclosed pursuant to the rules of the Securities and Exchange Commission.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is incorporated herein by reference from the information provided in the section captioned “Executive Compensation and Other Information” to be included in our Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information about security ownership of certain beneficial owners and management and related stockholder matters required by this item is incorporated herein by reference from the information to be provided in the section captioned “Security Ownership of Principal Shareholders and Management” in our Proxy Statement. Information regarding our equity compensation plans is set forth under Item 5 of this Annual Report under “Shares authorized for issuance under equity compensation plans.”

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information regarding certain relationships and related transactions and director independence required by this item is incorporated herein by reference to the information to be provided in our Proxy Statement under the captions “Certain Relationships and Related Transactions” and **“**Director Independence.”

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information regarding principal accountant fees and services and the pre-approval policies and procedures required by this item is incorporated herein by reference from the information to be contained in our Proxy Statement under the captions “Principal Accountant Fees and Services” and “Pre-Approval Policies and Procedures.”

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) **(1) Financial statements**

The financial statements required by this Item 15(a)(1) are set forth in Item 8.

(2) Financial statement schedules

Schedule II—Valuation and Qualifying Accounts is set forth below. All other schedules are omitted either because they are not applicable or the required information is shown in the financial statements or the notes.

SCHEDULE II
ENERGY FOCUS, INC.
SCHEDULE OF VALUATION AND QUALIFYING ACCOUNTS
(amounts in thousands)

Description	Beginning Balance	Charges to Revenue/ Expense	Deductions	Ending Balance
Year ended December 31, 2017				
Allowance for doubtful accounts and returns	$ 236	$ 23	$ 217	$ 42
Inventory reserves	5,596	1,139	2,539	4,196
Valuation allowance for deferred tax assets	12,537	3,883	5,864	10,556
Year ended December 31, 2016				
Allowance for doubtful accounts and returns	$ 155	$ 156	$ 75	$ 236
Inventory reserves	2,315	6,110	2,829	5,596
Valuation allowance for deferred tax assets	7,768	4,769	—	12,537
Year ended December 31, 2015				
Allowance for doubtful accounts and returns	$ 307	$ 39	$ 191	$ 155
Inventory reserves	576	2,066	327	2,315
Valuation allowance for deferred tax assets	9,008	(1,240)	—	7,768

(3) Exhibits required by Item 601 of Regulation S-K

The information required by this Item is set forth on the Exhibit Index that follows the signature page of this report.

ITEM 16. FORM 10-K SUMMARY

Not applicable.

SIGNATURES

Pursuant to the requirements of Section 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, thereto duly authorized.

ENERGY FOCUS, INC.

By: /s/ Theodore L. Tewksbury III

Theodore L. Tewksbury III

Chairman, Chief Executive Officer and President

Date: February 22, 2018

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 indicated and on the date indicated:

Signature	Title
/s/ Theodore L. Tewksbury III Theodore L. Tewksbury III	Chairman, Chief Executive Officer, President and Director *(Principal Executive Officer)*
/s/ Michael H. Port Michael H. Port	Chief Financial Officer *(Principal Financial and Accounting Officer)*
*Ronald D. Black	Director
*William Cohen	Director
*Glenda Dorchak	Director
*Marc J. Eisenberg	Director
*Michael R. Ramelot	Director

*By: /s/ Theodore L. Tewksbury III

Theodore L. Tewksbury III (Attorney-in-fact)

Date: February 22, 2018

EXHIBIT INDEX

Exhibit Number	Description of Documents
3.1	Certificate of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 to the Registrant’s Quarterly Report on Form 10-Q filed on November 13, 2013).
3.2	Amendment to Certificate of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 to the Registrant’s Current Report on Form 8-K filed on July 16, 2014).
3.3	Amendment to Certificate of Incorporation of the Registration (incorporated by reference to Exhibit 3.1 to the Registrant’s Current Report on Form 8-K filed on July 27, 2015).
3.4	Certificate of Designation of Series A Participating Preferred Stock of the Registrant (incorporated by reference to Exhibit 3.2 to the Registrant’s Current Report on Form 8-K filed on November 27, 2006).
3.5	Bylaws of the Registrant (incorporated by reference to Exhibit 3.5 to the Registrant’s Annual Report on Form 10-K filed on March 10, 2016).
3.6	Certificate of Ownership and Merger, Merging Energy Focus, Inc., a Delaware corporation, into Fiberstars, Inc., a Delaware corporation (incorporated by reference to Exhibit 3.1 to the Registrant’s Quarterly Report on Form 10-Q filed on May 10, 2007).
4.1	Form of Common Stock Certificate (incorporated by reference to Exhibit 4.1 of the Registrant’s Annual Report on Form 10-K filed on March 27, 2014).
10.1*	2013 Employee Stock Purchase Plan (incorporated by reference to Appendix A to the Registrant’s Definitive Proxy Statement on Form DEF14A filed on August 16, 2013).
10.2*	2004 Stock Incentive Plan (incorporated by reference to Exhibit 99.1 to the Registrant’s Registration Statement on Form S-8 (Commission File No. 333-122-686) filed on February 10, 2005).
10.3*	2008 Incentive Stock Plan, as amended (incorporated by reference from Appendix B to the Registrant’s Preliminary Proxy Statement on Form PRER14A filed on June 8, 2012).
10.4*	2014 Stock Incentive Plan, as amended (filed with this report).
10.5*	Form of Nonqualified Stock Option Grant Agreement to Non-Employee Directors (incorporated by reference to Exhibit 10.1 to the Registrant’s Current Report on Form 8-K filed on July 16, 2014).
10.6*	Form of Nonqualified Stock Option Grant Agreement to Employees (incorporated by reference to Exhibit 10.2 to the Registrant’s Current Report on Form 8-K filed on July 16, 2014).
10.7*	Form of Restricted Stock Unit Grant Agreement to Employees (incorporated by reference to Exhibit 10.3 to the Registrant’s Current Report on Form 8-K filed on July 16, 2014).
10.8*	Form of Restricted Stock Unit Grant Agreement to Non-Employee Directors (filed with this Report).
10.9*	Form of Incentive Stock Option Grant Agreement to Employees (incorporated by reference to Exhibit 10.4 to the Registrant’s Current Report on Form 8-K filed on July 16, 2014).
10.10*	Agreement and General Release of Claims dated May 6, 2016 between Eric W. Hilliard and Energy Focus, Inc. (incorporated by reference to Exhibit 99.2 to the Registrant’s Current Report on Form 8-K filed May 11, 2016).
10.11*	Separation Agreement and Release dated June 17, 2016 between Marcia J. Miller and Energy Focus, Inc. (incorporated by reference to Exhibit 10.1 to the Registrant’s Current Report on Form 8-K filed June 21, 2016).
10.12*	Executive Chairman Offer Letter dated November 18, 2016 between Theodore L. Tewksbury III and Energy Focus, Inc. (filed as Exhibit 10.13 to the Registrant’s Annual Report on Form 10-K filed February 23, 2017).
10.13*	Chief Financial Officer Offer Letter dated November 18, 2016 between Bradley B. White and Energy Focus, Inc. (filed as Exhibit 10.14 to the Registrant’s Annual Report on Form 10-K filed February 23, 2017).
10.14*	Separation Agreement and Release dated February 18, 2017 between James Tu and Energy Focus, Inc. (incorporated by reference to Exhibit 10.4 to the Registrant’s Current Report on Form 8-K filed February 21, 2017).
10.15*	Chairman, Chief Executive Officer and President Offer Letter and Change in Control Participation Agreement dated February 19, 2017 between Theodore L. Tewksbury III and Energy Focus, Inc. (incorporated by reference to Exhibit 10.1 to the Registrant’s Current Report on Form 8-K filed February 21, 2017).
10.16*	Change in Control Benefit Plan Participation Agreement dated March 21, 2017 between Michael H. Port and Energy Focus, Inc. (incorporated by reference to Exhibit 10.1 to the Registrant’s Quarterly Report on Form 10-Q filed May 4, 2017).

10.17*	Energy Focus, Inc. Executive Bonus Plan (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on April 17, 2017).
10.18*	Change in Control Plan and Form of Participation Agreement (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed February 21, 2017).
10.19*	Change in Control Participation Agreement dated February 19, 2017 between Bradley B. White and Energy Focus, Inc. (incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed February 21, 2017).
10.20*	Form of Notice of Stock Option Grant for 2008 Stock Incentive Plan (incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q filed on November 13, 2013).
10.21*	Form of Notice of Stock Option Grant for 2008 Stock Incentive Plan (incorporated by reference to Exhibit 99.2 to the Registrant's Registration Statement on Form S-8 filed on September 8, 2010).
10.22	Lease agreement by and between Aurora Development Center LLC and Energy Focus, Inc. dated April 19, 2016 (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q filed on May 11, 2016).
21.1	Subsidiaries of the Registrant (filed with this Report).
23.1	Consent of Plante & Moran, PLLC, Independent Registered Public Accounting Firm (filed with this Report).
24.1	Powers of Attorney (filed with this Report).
31.1	Rule 13a-14(a) Certification by Chief Executive Officer (filed with this Report).
31.2	Rule 13a-14(a) Certification by Chief Financial Officer (filed with this Report).
32.1	Section 1350 Certification of Chief Executive Officer and Chief Financial Officer (filed with this Report).
101	The following financial information from Energy Focus, Inc. Annual Report on Form 10-K for the year ended December 31, 2014, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Comprehensive Income (Loss), (iv) Consolidated Statements of Shareholders' Equity, (v) Consolidated Statements of Cash Flows, (vi) the Notes to Consolidated Financial Statements.

* Management contract or compensatory plan or arrangement.

Exhibit 10.4

ENERGY FOCUS, INC.
2014 STOCK INCENTIVE PLAN

(As amended on June 21, 2017 and July 22, 2015; and as adjusted to reflect our one-for-ten reverse split effected on July 16, 2014)

1. Purpose of the Plan.

The purpose of this Plan is to enhance stockholder value by linking the compensation of officers, directors and key employees of the Company to increases in the price of Energy Focus, Inc. common stock and the achievement of other performance objectives, and to encourage ownership in the Company by key personnel whose long-term employment is considered essential to the Company's continued progress and success. The Plan is also intended to assist the Company in the recruitment of new employees and to motivate, retain and encourage such employees and directors to act in the stockholders' interest and share in the Company's success.

2. Definitions.

As used herein, the following definitions shall apply:

(a) **"Administrator"** means the Board, any Committee or such delegates as shall be administering the Plan in accordance with Section 4 of the Plan.

(b) **"Affiliate"** means any Subsidiary or other entity that is directly or indirectly controlled by the Company or any entity in which the Company has a significant ownership interest as determined by the Administrator. The Administrator shall, in its sole discretion, determine which entities are classified as Affiliates and designated as eligible to participate in this Plan.

(c) **"Applicable Law"** means the requirements relating to the administration of stock option plans under U.S. federal and state laws, any stock exchange or quotation system on which the Company has listed or submitted for quotation the Common Shares to the extent provided under the terms of the Company's agreement with such exchange or quotation system and, with respect to Awards subject to the laws of any foreign jurisdiction where Awards are, or will be, granted under the Plan, the laws of such jurisdiction.

(d) **"Award"** means a Stock Award, Option, Stock Appreciation Right, or Other Stock-Based Award granted in accordance with the terms of the Plan, or any other property (including cash) granted pursuant to the provisions of the Plan.

(e) **"Awardee"** means an Employee, Director or Consultant who has been granted an Award under the Plan.

(f) **"Award Agreement"** means a Stock Award Agreement, Option Agreement, Stock Appreciation Right Agreement, or Other Stock-Based Award Agreement, which may be in written or electronic format, in such form and with such terms as may be specified by the Administrator, evidencing the terms and conditions of an individual Award. Each Award Agreement is subject to the terms and conditions of the Plan. The effectiveness of an Award shall not be subject to the Award Agreement's being signed by the Company and/or the Participant receiving the Award unless specifically so provided in the Award Agreement.

(g) **"Board"** means the Board of Directors of the Company.

(h) **"Change of Control"** shall mean, except as otherwise provided in an Award Agreement, one of the following shall have taken place after the date of this Plan:

(i) any "person" (as such term is used in Sections 13(d) or 14(d) of the Exchange Act) (other than the Company, any majority controlled subsidiary of the Company, or the fiduciaries of any Company benefit plans) becomes the beneficial owner (as defined in Rules 13d-3 and 13d-5 under the Exchange Act), directly or indirectly, of 50% or more of the total voting power of the voting securities of the Company then outstanding and entitled to vote generally in the election of directors of the Company; provided, however, that no Change of Control shall occur upon the acquisition of securities directly from the Company;

(ii) individuals who, as of the beginning of any 24 month period, constitute the Board (as of the date hereof, the "Incumbent Board") cease for any reason during such 24 month period to constitute at least a majority of the Board, provided that any individual becoming a Director subsequent to the date hereof whose election, or nomination for election by the Company's stockholders, was approved by a vote of at least a majority of the Directors then comprising the Incumbent Board shall be considered as though such individual were a member of the Incumbent Board, but excluding for this purpose any such individual whose initial assumption of office is in connection with an actual or threatened election contest relating to the election of the Directors of the Company; or

(iii) consummation of (A) a merger, consolidation or reorganization of the Company, in each case, with respect to which all or substantially all of the individuals and entities who were the respective beneficial owners of the voting securities of the Company immediately prior to such merger, consolidation or reorganization do not, following such merger, consolidation or reorganization, beneficially own, directly or indirectly, at least 35% of the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors of the entity or entities resulting from such merger, consolidation or reorganization, (B) a complete liquidation or dissolution of the Company, or (C) a sale or other disposition of all or substantially all of the assets of the Company, unless at least 35% of the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors of the entity or entities that acquire such assets are beneficially owned by individuals or entities who or that were beneficial owners of the voting securities of the Company immediately before such sale or other disposition.

Notwithstanding the foregoing, (x) if any payment or distribution event applicable to an Award is subject to the requirements of Section 409A(a)(2)(A) of the Code, the determination of the occurrence of a Change of Control shall be governed by applicable provisions of Section 409A(a)(2)(A) of the Code and regulations and rulings issued thereunder for purposes of determining whether such payment or distribution may then occur, and (y) a transaction shall not constitute a Change of Control if its sole purpose is to change the state of the Company's incorporation or to create a holding company that will be owned in substantially the same proportions by the persons who held the Company's securities immediately before such transaction.

(i) **"Code"** means the United States Internal Revenue Code of 1986, as amended, and any successor thereto, the Treasury Regulations thereunder and other relevant interpretive guidance issued by the Internal Revenue Service or the Treasury Department. Reference to any specific section of the Code shall be deemed to include such regulations and guidance, as well as any successor provision of the Code.

(j) **"Committee"** means a committee of Directors appointed by the Board in accordance with Section 4 of the Plan or, in the absence of any such special appointment, the Compensation Committee of the Board.

(k) **"Common Shares"** means the common shares, no par value, of the Company, or any security of the Company issued in substitution, exchange or lieu thereof.

(l) **"Company"** means Energy Focus, Inc., a Delaware corporation, or, except as utilized in the definition of Change of Control, its successor.

(m) **"Consultant"** means an individual providing services to the Company or any of its Affiliates as an independent contractor, and includes prospective consultants who have accepted offers of consultancy for the Company or any of its Affiliates, so long as such person (i) renders bona fide services that are not in connection with the offer and sale of the Company's securities in a capital-raising transaction, (ii) does not directly or indirectly promote or maintain a market for the Company's securities, and (iii) otherwise qualifies as a consultant under the applicable rules of the SEC for registration of shares of stock on a Form S-8 registration statement

(n) "**Conversion Award**" has the meaning set forth in Section 4(b)(xii) of the Plan.

(o) **"Director"** means a member of the Board. Any Director who does not serve as an employee of the Company is referred to herein as a "**Non-employee Director**."

(p) **"Disability"** means (i) "Disability" as defined in any employment, consulting or similar agreement to which the Participant is a party, or (ii) if there is no such agreement or it does not define "Disability," (A) permanent and total disability as determined under the Company's long-term disability plan applicable to the Participant, or (B) if there is no such plan applicable to the Participant or the Committee determines otherwise in an applicable Award Agreement, "Disability" shall mean the Participant's continuous illness, injury or incapacity for a period of six consecutive months, as determined by the Administrator in its discretion. Notwithstanding the above, with respect to an Incentive Stock Option, Disability shall mean permanent and total disability as defined in Section 22(e)(3) of the Code and, with respect to any Award that constitutes "nonqualified deferred compensation" within the meaning of Section 409A of the Code, the foregoing definition shall apply for purposes of vesting of such Award, provided that such Award shall not be settled until the earliest of: (x) the Participant's "disability" within the meaning of Section 409A of the Code, (y) the Participant's "separation from service" within the meaning of Section 409A of the Code and (z) the date such Award would otherwise be settled pursuant to the terms of the Award Agreement.

(q) **"Disaffiliation"** means a Subsidiary's or Affiliate's ceasing to be a Subsidiary or Affiliate for any reason (including, without limitation, as a result of a public offering, or a spin-off or sale by the Company, of the stock of the Subsidiary or Affiliate) or a sale of a division of the Company and its Affiliates.

(r) **"Employee"** means a regular, active employee of the Company or any Affiliate, including an Officer or Director who is also a regular, active employee of the Company or any Affiliate. The Administrator shall determine whether the Chairman of the Board qualifies as an "Employee." For any and all purposes under the Plan, the term "Employee" shall not include a person hired as an independent contractor, leased employee, consultant or a person otherwise designated by the Administrator, the Company or an Affiliate at the time of hire as not eligible to participate in or receive benefits under the Plan or not on the payroll, even if such ineligible person is subsequently determined to be a common law employee of the Company or an Affiliate or otherwise an employee by any governmental or judicial authority. Unless otherwise determined by the Administrator in its sole discretion, for purposes of the Plan, an Employee shall be considered to have terminated employment and to have ceased to be an Employee if his or her employer ceases to be an Affiliate, even if he or she continues to be employed by such employer.

(s) **"Exchange Act"** means the United States Securities Exchange Act of 1934, as amended, and any successor thereto.

(t) **"Fair Market Value"** with respect to a Share shall mean the market price of such Share, determined by the Committee as follows:

(i) If the Shares are listed on any established stock exchange or a national market system, the per Share Fair Market Value shall be the closing sales price for each share of such stock (or the closing bid, if no sales were reported) on the date of determination (or, if no closing sales price or closing bid was reported on that date, as applicable, on the last trading date such closing sales price or closing bid was reported), as reported in The Wall Street Journal or such other source as the Committee deems reliable;

(ii) If the Shares are regularly quoted on an automated quotation system (including the OTC Bulletin Board and the quotations published by the OTC Markets Group Inc.) or by a recognized securities dealer, the closing sales price for each share of such stock or, if closing sales prices are not reported, the per Share Fair Market Value shall be the mean between the high bid and low asked prices for a Share on the date of determination (or, if no such prices were reported on that date, on the last date such prices were reported), as reported in The Wall Street Journal or such other source as the Committee deems reliable; or

(iii) In the absence of an established market for the Shares of the type described in (a) and (b), above, the per Share Fair Market Value thereof shall be determined by the Committee in good faith and in accordance with the applicable provisions of Section 409A of the Code and the regulations and rulings thereunder.

In all cases, the determination of Fair Market Value by the Committee shall be conclusive and binding on all persons.

(u) **"Grant Date"** means, with respect to each Award, the date upon which the Award is granted to an Awardee pursuant to this Plan, which may be a designated future date as of which such Award will be effective, as determined by the Committee.

(v) **"Incentive Stock Option"** means an Option that is identified in the Option Agreement as intended to qualify as an incentive stock option within the meaning of Section 422 of the Code and the regulations promulgated thereunder, and that actually does so qualify.

(w) **"Nonqualified Stock Option"** means an Option that is not an Incentive Stock Option.

(x) **"Officer"** means a person who is an officer of the Company within the meaning of Section 16 of the Exchange Act and the rules and regulations promulgated thereunder.

(y) **"Option"** means a right granted under Section 8 of the Plan to purchase a number of Shares at such exercise price, at such times, and on such other terms and conditions as are specified in the agreement or other documents evidencing the Award (the "Option Agreement"). Both Incentive Stock Options and Nonqualified Stock Options may be granted under the Plan.

(z) **"Other Stock-Based Award"** means an Award granted pursuant to Section 12 of the Plan on such terms and conditions as are specified in the agreement or other documents evidencing the Award (the "Other Stock-Based Award Agreement").

(aa) **"Participant"** means the Awardee or any person (including any estate) to whom an Award has been assigned or transferred as permitted hereunder.

(bb) **"Plan"** means this 2014 Stock Incentive Plan, as set forth herein and as hereafter amended from time to time.

(cc) **"Qualifying Performance Criteria"** shall have the meaning set forth in Section 13(b) of the Plan.

(dd) **"Retirement"** means, unless the Administrator determines otherwise, Termination of Employment, voluntary or involuntary, by a Participant from the Company and its Affiliates, other than a Termination for Cause, after attaining age fifty-five (55) and having at least ten (10) years of service as an Employee with the Company and its Affiliates, excluding service with an Affiliate of the Company prior to the time that such Affiliate became an Affiliate of the Company. For Plan purposes, a "voluntary" Termination of Employment is a Termination of Employment where the Participant does not qualify for severance benefits, whether under a severance agreement or the Company's or any of its Affiliate's severance policy, plan or other arrangement.

(ee) **"Securities Act"** means the United States Securities Act of 1933, as amended.

(ff) **"Share"** means a Common Share, as adjusted in accordance with Section 15 of the Plan.

(gg) **“Stock Appreciation Right”** means a right granted under Section 10 of the Plan on such terms and conditions as are specified in the agreement or other documents evidencing the Award (the “Stock Appreciation Right Agreement”).

(hh) **“Stock Award”** means an award or issuance of Shares or Stock Units made under Section 11 of the Plan, the grant, issuance, retention, vesting and/or transferability of which is subject during specified periods of time to such conditions (including, without limitation, continued employment or performance conditions) and terms as are expressed in the agreement or other documents evidencing the Award (the “Stock Award Agreement”).

(ii) **“Stock Unit”** means a bookkeeping entry representing an amount equivalent to the Fair Market Value of one Share, payable in cash, property or Shares. Stock Units represent an unfunded and unsecured obligation of the Company, except as otherwise provided for by the Administrator.

(jj) **“Subsidiary”** means any company (other than the Company) in an unbroken chain of companies beginning with the Company, provided each company in the unbroken chain (other than the Company) owns, at the time of determination, stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other companies in such chain.

(kk) **“Ten Percent Stockholder”** means a person who owns (or is deemed to own pursuant to Section 424(d) of the Code) stock possessing more than 10% of the total combined voting power of all classes of stock of the Company or of any of its Affiliates.

(ll) **“Termination for Cause”** means, unless otherwise provided in an Award Agreement, Termination of Employment on account of any act of fraud or intentional misrepresentation or embezzlement, misappropriation or conversion of assets of the Company or any Affiliate, or the intentional and repeated violation of the written policies or procedures of the Company, provided that, for an Employee who is party to an individual severance or employment agreement defining Cause, “Cause” shall have the meaning set forth in such agreement except as may be otherwise provided in such agreement. For purposes of this Plan, a Participant’s Termination of Employment shall be deemed to be a Termination for Cause if, after the Participant’s employment has terminated, facts and circumstances are discovered that would have justified, in the opinion of the Committee, a Termination for Cause.

(mm) **“Termination of Employment”** means for purposes of this Plan, unless otherwise determined by the Administrator, ceasing to be an Employee (as determined in accordance with Section 3401(c) of the Code and the regulations promulgated thereunder) of the Company or one of its Subsidiaries or Affiliates. Unless otherwise determined by the Committee in the terms of an Award Agreement or otherwise, if a Participant’s employment with the Company and its Affiliates terminates but such Participant continues to provide services to the Company and its Affiliates in a Non-employee Director capacity, such change in status shall be deemed a Termination of Employment. A Participant employed by, or performing services for, a Subsidiary or an Affiliate or a division of the Company and its Affiliates shall be deemed to incur a Termination of Employment if, as a result of a Disaffiliation, such Subsidiary, Affiliate, or division ceases to be a Subsidiary, Affiliate or division, as the case may be, and the Participant does not immediately thereafter become an Employee of (or service provider for), or member of the board of directors of, the Company or another Subsidiary or Affiliate. Temporary absences from employment because of illness, vacation or leave of absence and transfers among the Company and its Subsidiaries and Affiliates shall not be considered Terminations of Employment. In addition, Termination of Employment shall mean a “separation from service” as defined in regulations issued under Code Section 409A whenever necessary to ensure compliance therewith for any payment or settlement of a benefit conferred under this Plan that is subject to such Code section, and, for such purposes, shall be determined based upon a reduction in the bona fide level of services performed to a level equal to twenty percent (20%) or less of the average level of services performed by the Employee during the immediately preceding 36-month period.

3. Stock Subject to the Plan.

(a) *Aggregate Limit.* Subject to the provisions of Section 15(a) of the Plan, the maximum aggregate number of Shares which may be subject to Awards granted under the Plan is 2,500,000 Shares. The Shares issued under the Plan may be either Shares reacquired by the Company, including Shares purchased in the open market, or authorized but unissued Shares. As of the date the Plan is approved by the Company’s stockholders, no further awards will be made under the 2008 Stock Incentive Plan, as amended, (the “Prior Plan”).

(b) *Code Section 162(m) and 422 Limits; Other Share Limitations.* Subject to the provisions of Section 15(a) of the Plan, no Employee may be granted under this Plan (i) Options or Stock Appreciation Rights during any calendar year with respect to more than 150,000 Shares, and (ii) Stock Awards and Other Stock-Based Awards that are intended to comply with the performance-based exception under Code Section 162(m) and are denominated in Shares under which more than 80,000 Shares may be earned for each calendar year (or other 12 month period) in the vesting or performance period. During any calendar year, no Participant may be granted an Award that is intended to comply with the performance-based exception under Code Section 162(m) and is denominated in cash under which more than seven hundred fifty thousand dollars ($750,000) may be earned for each calendar year (or other 12 month period) in the performance period. The foregoing limitations in this section shall be calculated for 2014 to include all awards issued under a Prior Plan since December 31, 2013. In addition, the foregoing limitations in this section shall be multiplied by two with respect to Awards granted to a Participant during the first calendar year in which the Participant commences employment with the Company and its Affiliates. Subject to the provisions of Section 15(a) of the Plan, the aggregate number of Shares that may be subject to all Incentive Stock Options granted under the Plan shall not exceed 100,000 Shares. Notwithstanding anything to the contrary in the Plan, the limitations set forth in this Section 3(b) shall be subject to adjustment under Section 15(a) of the Plan only to the extent that such adjustment will not affect the status of any Award intended to qualify as "performance-based compensation" under Section 162(m) of the Code.

(c) *Share Counting Rules*.

(i) For purposes of this Section 3 of the Plan, Shares subject to Awards that have been canceled, expired, settled in cash, or forfeited for any reason (in whole or in part) shall not reduce the aggregate number of Shares which may be subject to Awards granted under this Plan and shall be available for future Awards granted under this Plan. If Shares subject to an award under any Prior Plan are canceled, expired, settled in cash, or forfeited for any reason (in whole or in part), the Shares subject to an award under the Prior Plan, to the extent of such cancellation, expiration, settlement in cash, or forfeiture, shall not be available for grant under this Plan. Notwithstanding the foregoing, Shares added back under the provisions of this subsection (c) shall not be counted when determining the limit on Shares that may be granted as Incentive Stock Options under subsection (b), above.

(ii) Notwithstanding anything to the contrary contained herein, the following Shares shall not be added to the Shares authorized for grant under paragraph (i) of this Section: (a) Shares tendered by the Participant or withheld by the Company in payment of the purchase price of an Option, (b) Shares tendered by the Participant or withheld by the Company to satisfy any tax withholding obligation with respect to Options or Stock Appreciation Rights, (c) Shares subject to a Stock Appreciation Right that are not issued in connection with its stock settlement on exercise thereof, and (d) Shares reacquired by the Company on the open market or otherwise using cash proceeds from the exercise of Options. Shares subject to Awards that have been retained by the Company in payment or satisfaction of the tax withholding obligation of an Awardee, other than for an Option or Stock Appreciation Right as described above, and Shares that have been delivered (either actually or constructively by attestation) to the Company in payment or satisfaction of the tax withholding obligation of an Awardee, other than for an Option or Stock Appreciation Right as described above, shall again be available for grant under the Plan.

(iii) Conversion Awards shall not reduce the Shares authorized for grant under the Plan or the limitations on Awards to a Participant under subsection (b) above, and Shares subject to a Conversion Award shall not again be available for an Award under the Plan as provided in subsection (c)(i) above.

4. Administration of the Plan.

(a) *Procedure*.

(i) *Multiple Administrative Bodies.* The Plan shall be administered by the Board, a Committee designated by the Board to so administer this Plan and/or their respective delegates.

(ii) *Section 162(m)*. To the extent that the Administrator determines it to be desirable to qualify Awards granted hereunder as "performance-based compensation" within the meaning of Code Section 162(m), Awards to "covered employees" (within the meaning of Code Section 162(m)) or to Employees that the Committee determines may be "covered employees" in the future shall be made by a Committee of two or more "outside directors" within the meaning of Section 162(m) of the Code. References herein to the Administrator in connection with Awards intended to qualify as "performance-based compensation" shall mean a Committee meeting the "outside director" requirements of Code Section 162(m). Notwithstanding any other provision of the Plan, the Administrator shall not have any discretion or authority to make changes to any Award that is intended to qualify as "performance-based compensation" to the extent that the existence of such discretion or authority would cause such Award not to so qualify.

(iii) *Rule 16b-3*. To the extent desirable to qualify transactions hereunder as exempt under Rule 16b-3 promulgated under the Exchange Act ("Rule 16b-3"), Awards to Officers and Directors shall be made by the entire Board or a Committee of two or more "non-employee directors" within the meaning of Rule 16b-3.

(iv) *Other Administration.* To the extent required by the rules of the principal U.S. national securities exchange on which the Shares are traded, the members of the Committee shall also qualify as "independent directors" as set forth in such rules. Except to the extent prohibited by Applicable Law, the Board or a Committee may delegate to a Committee of one or more Directors or to authorized officers of the Company the power to approve Awards to persons eligible to receive Awards under the Plan who are not (A) subject to Section 16 of the Exchange Act or (B) at the time of such approval, "covered employees" under Section 162(m) of the Code.

(v) *Awards to Directors*. The Board shall have the power and authority to grant Awards to Non-employee Directors, including the authority to determine the number and type of awards to be granted; determine the terms and conditions, not inconsistent with the terms of this Plan, of any award; and to take any other actions the Board considers appropriate in connection with the administration of the Plan.

(vi) *Delegation of Authority for the Day-to-Day Administration of the Plan.* Except to the extent prohibited by Applicable Law, the Administrator may delegate to one or more individuals the day-to-day administration of the Plan and any of the functions assigned to it in this Plan. Such delegation may be revoked at any time.

(b) *Powers of the Administrator.* Subject to the provisions of the Plan and, in the case of a Committee or delegates acting as the Administrator, subject to the specific duties delegated to such Committee or delegates, the Administrator shall have the authority, in its discretion:

(i) to select the Non-employee Directors, Consultants and Employees of the Company or its Affiliates to whom Awards are to be granted hereunder;

(ii) to determine the number of Common Shares to be covered by each Award granted hereunder;

(iii) to determine the type of Award to be granted to the selected Employees and Non-employee Directors;

(iv) to approve forms of Award Agreements;

(v) to determine the terms and conditions, not inconsistent with the terms of the Plan, of any Award granted hereunder. Such terms and conditions include, but are not limited to, the exercise and/or purchase price, the time or times when an Award may be exercised (which may or may not be based on performance criteria), the vesting schedule, any vesting and/or exercisability provisions, terms regarding acceleration of Awards or waiver of forfeiture restrictions, the acceptable forms of consideration for payment for an Award, the term, and any restriction or limitation regarding any Award or the Shares relating thereto, based in each case on such factors as the Administrator, in its sole discretion, shall determine and may be established at the time an Award is granted or thereafter;

(vi) to correct administrative errors;

(vii) to construe and interpret the terms of the Plan (including sub-plans and Plan addenda) and Awards granted pursuant to the Plan;

(viii) to adopt rules and procedures relating to the operation and administration of the Plan to accommodate the specific requirements of local laws and procedures. Without limiting the generality of the foregoing, the Administrator is specifically authorized (A) to adopt rules and procedures regarding the conversion of local currency, the shift of tax liability from employer to employee (where legally permitted) and withholding procedures and handling of stock certificates which vary with local requirements, and (B) to adopt sub-plans and Plan addenda as the Administrator deems desirable, to accommodate foreign laws, regulations and practice;

(ix) to prescribe, amend and rescind rules and regulations relating to the Plan, including rules and regulations relating to sub-plans and Plan addenda;

(x) to modify or amend each Award, including, but not limited to, the acceleration of vesting and/or exercisability, provided, however, that any such modification or amendment (A) is subject to the plan amendment provisions set forth in Section 16 of the Plan, and (B) may not materially impair any outstanding Award unless agreed to in writing by the Participant, except that such agreement shall not be required if the Administrator determines in its sole discretion that such modification or amendment either (Y) is required or advisable in order for the Company, the Plan or the Award to satisfy any Applicable Law or to meet the requirements of any accounting standard, or (Z) is not reasonably likely to significantly diminish the benefits provided under such Award, or that adequate compensation has been provided for any such diminishment, except following a Change of Control;

(xi) to allow or require Participants to satisfy withholding tax amounts by electing to have the Company withhold from the Shares to be issued upon exercise of a Nonqualified Stock Option or vesting of a Stock Award that number of Shares having a Fair Market Value equal to the amount required to be withheld. The Fair Market Value of the Shares to be withheld shall be determined in such manner and on such date that the Administrator shall determine or, in the absence of provision otherwise, on the date that the amount of tax to be withheld is to be determined. All elections by a Participant to have Shares withheld for this purpose shall be made in such form and under such conditions as the Administrator may provide;

(xii) to authorize conversion or substitution under the Plan of any or all stock options, stock appreciation rights or other stock awards held by awardees of an entity acquired by the Company (the “Conversion Awards”). Any conversion or substitution shall be effective as of the close of the merger or acquisition. The Conversion Awards may be Nonqualified Stock Options or Incentive Stock Options, as determined by the Administrator, with respect to options granted by the acquired entity;

(xiii) to authorize any person to execute on behalf of the Company any instrument required to effect the grant of an Award previously granted by the Administrator;

(xiv) to impose such restrictions, conditions or limitations as it determines appropriate as to the timing and manner of any resale by a Participant or of other subsequent transfers by the Participant of any Shares issued as a result of or under an Award or upon the exercise of an Award, including, without limitation, (A) restrictions under an insider trading policy, (B) restrictions as to the use of a specified brokerage firm for such resale or other transfers, and (C) institution of "blackout" periods on exercises of Awards;

(xv) to provide, either at the time an Award is granted or by subsequent action, that an Award shall contain as a term thereof, a right, either in tandem with the other rights under the Award or as an alternative thereto, of the Participant to receive, without payment to the Company, a number of Shares, cash or a combination thereof, the amount of which is determined by reference to the value of the Award; and

(xvi) to make all other determinations deemed necessary or advisable for administering the Plan and any Award granted hereunder.

(c) *Effect of Administrator's Decision.* All questions arising under the Plan or under any Award shall be decided by the Administrator in its total and absolute discretion. All decisions, determinations and interpretations by the Administrator regarding the Plan, any rules and regulations under the Plan and the terms and conditions of any Award granted hereunder, shall be final and binding on all Participants. The Administrator shall consider such factors as it deems relevant, in its sole and absolute discretion, to making such decisions, determinations and interpretations, including, without limitation, the recommendations or advice of any officer or other employee of the Company and such attorneys, consultants and accountants as it may select.

(d) *Indemnity*. To the extent allowable under Applicable Law, each member of the Committee or of the Board and any person to whom the Board or Committee has delegated any of its authority under the Plan shall be indemnified and held harmless by the Company from any loss, cost, liability, or expense that may be imposed upon or reasonably incurred by such person in connection with or resulting from any claim, action, suit, or proceeding to which he or she may be a party or in which he or she may be involved by reason of any action or failure to act pursuant to the Plan, and against and from any and all amounts paid by him or her in satisfaction of judgment in such action, suit, or proceeding against him or her; provided he or she gives the Company an opportunity, at its own expense, to handle and defend the same before he or she undertakes to handle and defend it on his or her own behalf. The foregoing right of indemnification shall not be exclusive of any other rights of indemnification to which such persons may be entitled pursuant to the Company's Articles of Incorporation or By-laws, as a matter of law, or otherwise, or any power that the Company may have to indemnify them or hold them harmless.

5. Eligibility.

Awards may be granted only to Directors, Employees and Consultants of the Company or any of its Affiliates; provided, however, that Incentive Stock Options may be granted only to Employees of the Company and its Subsidiaries (within the meaning of Section 424(f) of the Code).

6. Term of Plan.

The Plan shall become effective upon its approval by stockholders of the Company. It shall continue in effect for a term of ten (10) years from the date the Plan is approved by the stockholders of the Company (the "Effective Date") unless terminated earlier under Section 16 of the Plan.

7. Term of Award.

Subject to the provisions of the Plan, the term of each Award shall be determined by the Administrator and stated in the Award Agreement, and may extend beyond the termination of the Plan. In the case of an Option or a Stock Appreciation Right, the term shall be ten (10) years from the Grant Date or such shorter term as may be provided in the Award Agreement.

8. Options.

The Administrator may grant an Option or provide for the grant of an Option, either from time to time in the discretion of the Administrator or automatically upon the occurrence of specified events, including, without limitation, the achievement of performance goals.

(a) *Option Agreement.* Each Option Agreement shall contain provisions regarding (i) the number of Shares that may be issued upon exercise of the Option, (ii) the type of Option, (iii) the exercise price of the Option and the means of payment of such exercise price, (iv) the term of the Option, (v) such terms and conditions regarding the vesting and/or exercisability of an Option as may be determined from time to time by the Administrator, (vi) restrictions on the transfer of the Option and forfeiture provisions, and (vii) such further terms and conditions, in each case not inconsistent with this Plan, as may be determined from time to time by the Administrator.

(b) *Exercise Price*. The per share exercise price for the Shares to be issued upon exercise of an Option shall be determined by the Administrator, except that the per Share exercise price shall be no less than 100% of the Fair Market Value per Share on the Grant Date, except with respect to Conversion Awards. A Ten Percent Stockholder shall not be granted an Incentive Stock Option unless the Option Exercise Price is at least 110% of the Fair Market Value of the Common Stock at the Grant Date and the Option is not exercisable after the expiration of five years from the Grant Date.

(c) *No Option Repricings.* Subject to Section 15 of the Plan, the exercise price of an Option may not be reduced without stockholder approval, nor may outstanding Options be cancelled in exchange for cash, other Awards or Options with an exercise price that is less than the exercise price of the original Option without stockholder approval.

(d) *No Reload Grants.* Options shall not be granted under the Plan in consideration for and shall not be conditioned upon the delivery of Shares to the Company in payment of the exercise price and/or tax withholding obligation under any other employee stock option.

(e) *Vesting Period and Exercise Dates.* Options granted under this Plan shall vest and/or be exercisable at such time and in such installments during the period prior to the expiration of the Option's term as determined by the Administrator and as specified in the Option Agreement. The Administrator shall have the right to make the timing of the ability to exercise any Option granted under this Plan subject to continued active employment, the passage of time and/or such performance requirements as deemed appropriate by the Administrator. At any time after the grant of an Option, the Administrator may reduce or eliminate any restrictions surrounding any Participant's right to exercise all or part of the Option.

(f) *Form of Consideration.* The Administrator shall determine the acceptable form of consideration for exercising an Option, including the method of payment, either through the terms of the Option Agreement or at the time of exercise of an Option. Acceptable forms of consideration may include:

(i) cash;

(ii) check or wire transfer (denominated in U.S. Dollars);

(iii) subject to any conditions or limitations established by the Administrator, other Shares which were held for a period of more than six (6) months on the date of surrender and which have a Fair Market Value on the date of surrender equal to or greater than the aggregate exercise price of the Shares as to which said Option shall be exercised (it being agreed that the excess of the Fair Market Value over the aggregate exercise price, if any, shall be refunded to the Awardee in cash);

(iv) subject to any conditions or limitations established by the Administrator, the Company withholding Shares otherwise issuable upon exercise of an Option;

(v) consideration received by the Company under a broker-assisted sale and remittance program acceptable to the Administrator and in compliance with Applicable Law;

(vi) such other consideration and method of payment for the issuance of Shares to the extent permitted by Applicable Law; or

(vii) any combination of the foregoing methods of payment.

(g) *Procedure for Exercise; Rights as a Stockholder*.

(i) Any Option granted hereunder shall be exercisable according to the terms of the Plan and at such times and under such conditions as determined by the Administrator and set forth in the applicable Option Agreement.

(ii) An Option shall be deemed exercised when (A) the Company receives (1) written or electronic notice of exercise (in accordance with the Option Agreement or procedures established by the Administrator) from the person entitled to exercise the Option and (2) full payment for the Shares with respect to which the related Option is exercised, and (B) with respect to Nonqualified Stock Options, provisions acceptable to the Administrator have been made for payment of all applicable withholding taxes.

(iii) Unless provided otherwise by the Administrator or pursuant to this Plan, until the Shares are issued (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company), no right to vote or receive dividends or any other rights as a stockholder shall exist with respect to the Shares subject to an Option, notwithstanding the exercise of the Option.

(iv) The Company shall issue (or cause to be issued) such Shares as soon as administratively practicable after the Option is exercised. An Option may not be exercised for a fraction of a Share.

(h) *Termination of Employment or Board Membership.*

(i) The Administrator shall determine as of the Grant Date (subject to modification subsequent to the Grant Date) the effect a termination from membership on the Board by a Non-employee Director for any reason or a Termination of

Employment due to (A) Disability, (B) Retirement, (C) death, or (D) otherwise (including Termination for Cause) shall have on any Option.

(ii) Unless otherwise provided in the Award Agreement:

(A) Upon termination from membership on the Board by a Non-employee Director, any Option held by such Director that (1) has not vested and is not exercisable as of the effective date of such termination from membership on the Board shall be subject to immediate cancellation and forfeiture, or (2) is vested and exercisable as of the effective date of such termination shall remain exercisable for one year thereafter, or the remaining term of the Option, if less;

(B) Upon Termination of Employment or termination from membership on the Board by a Non-employee Director due to death or Disability, any Option held by such Employee or Non-employee Director that (1) is vested and exercisable as of the effective date of such Termination of Employment or termination from membership on the Board shall remain exercisable for one year after such termination or the remaining term of the Option, if less, and (2) is not yet vested shall vest in full as of the date of death or Disability, and any such vested Options shall remain exercisable for one year after such Termination of Employment or termination from membership on the Board by a Non-employee Director due to death or Disability or the remaining term of the Option, if less;

(C) Upon Termination of Employment due to Retirement, any Option held by an Awardee at Retirement, to the extent vested and exercisable as of the effective date of such Retirement, will remain outstanding for the lesser of one year or the remaining term of the Option; and

(D) Any other Termination of Employment shall result in immediate cancellation and forfeiture of all outstanding Options that have not vested as of the effective date of such Termination of Employment, and any vested and exercisable Options held at the time of such Termination of Employment shall remain exercisable for ninety (90) days thereafter, or the remaining term of the Option, if less. Notwithstanding the foregoing, all outstanding and unexercised Options shall be immediately cancelled in the event of a Termination for Cause.

9. Incentive Stock Option Limitations/Terms.

(a) *Eligibility.* Only employees (as determined in accordance with Section 3401(c) of the Code and the regulations promulgated thereunder) of the Company or any of its Subsidiaries may be granted Incentive Stock Options.

(b) *$100,000 Limitation.* Notwithstanding the designation “Incentive Stock Option” in an Option Agreement, if and to the extent that the aggregate Fair Market Value of the Shares with respect to which Incentive Stock Options are exercisable for the first time by the Awardee during any calendar year (under all plans of the Company and any of its Subsidiaries) exceeds U.S. $100,000, such Options shall be treated as Nonqualified Stock Options. For purposes of this Section 9(b) of the Plan, Incentive Stock Options shall be taken into account in the order in which they were granted. The Fair Market Value of the Shares shall be determined as of the Grant Date.

(c) *Transferability.* The Option Agreement must provide that an Incentive Stock Option is not transferable by the Awardee otherwise than by will or the laws of descent and distribution, and, during the lifetime of such Awardee, must not be exercisable by any other person. If the terms of an Incentive Stock Option are amended to permit transferability, the Option will be treated for tax purposes as a Nonqualified Stock Option.

(d) *Exercise Price.* The per Share exercise price of an Incentive Stock Option shall in no event be inconsistent with the requirements for qualification of the Incentive Stock Option under Section 422 of the Code.

(e) *Other Terms.* Option Agreements evidencing Incentive Stock Options shall contain such other terms and conditions as may be necessary to qualify, to the extent determined desirable by the Administrator, with the applicable provisions of Section 422 of the Code. If any such terms and conditions, as of the Grant Date or any later date, do not so comply, the Option will be treated thereafter for tax purposes as a Nonqualified Stock Option.

10. Stock Appreciation Rights.

A “Stock Appreciation Right” is a right that entitles the Awardee to receive, in cash or Shares (as determined by the Administrator), value equal to or otherwise based on the excess of (i) the Fair Market Value of a specified number of Shares at the time of exercise over (ii) the aggregate exercise price of the right, as established by the Administrator on the Grant Date. Stock Appreciation Rights may be granted to Awardees either alone (“freestanding”) or in addition to or in tandem with other Awards granted under the Plan and may, but need not, relate to a specific Option granted under Section 8 of the Plan. Any Stock Appreciation Right granted in tandem with an Option may be granted at the same time such Option is granted or at any time thereafter before exercise or expiration of such Option, and shall be based on the Fair Market Value of one Share on the Grant Date or, if applicable, on the Grant Date of the Option with respect to a Stock Appreciation Right granted in exchange for or in tandem with, but subsequent to, the Option (subject to the requirements of Section 409A of the Code). All Stock Appreciation Rights under the Plan, other than Conversion Awards, shall be granted subject to the same terms and conditions applicable to Options as set forth in Section 8 of the Plan. Subject to the provisions of Section 8 of the Plan, the Administrator may impose such other conditions or restrictions on any Stock Appreciation Right as it shall deem appropriate.

11. Stock Awards.

(a) *Stock Award Agreement.* Each Stock Award Agreement shall contain provisions regarding (i) the number of Shares subject to such Stock Award or a formula for determining such number, (ii) the purchase price of the Shares, if any, and the means of payment for the Shares, (iii) the performance criteria, if any, and level of achievement versus these criteria that shall determine the number of Shares granted, issued, retainable and/or vested, (iv) such terms and conditions on the grant, issuance, vesting and/or forfeiture of the Shares as may be determined from time to time by the Administrator, (v) restrictions on the transferability of the Stock Award, and (vi) such further terms and conditions, in each case not inconsistent with this Plan, as may be determined from time to time by the Administrator. The Committee may, in its sole discretion, waive the vesting restrictions and any other conditions set forth in any Award Agreement under such terms and conditions as the Committee shall deem appropriate, subject to the limitations imposed under Code Section 162(m) and the regulations thereunder in the case of an Award intended to comply with the performance-based exception under Code Section 162(m), unless determined otherwise under the circumstances by the Committee.

(b) *Restrictions and Performance Criteria.* The grant, issuance, retention and/or vesting of Stock Awards issued to Employees may be subject to such performance criteria and level of achievement versus these criteria as the Administrator shall determine, which criteria may be based on financial performance, personal performance evaluations and/or completion of service by the Awardee. Notwithstanding anything to the contrary herein, the performance criteria for any Stock Award that is intended to satisfy the requirements for “performance-based compensation” under Section 162(m) of the Code (a “Performance Stock Award”) shall be established by the Administrator based on one or more Qualifying Performance Criteria selected by the Administrator and specified in writing not later than ninety (90) days after the commencement of the period of service (or, if earlier, the elapse of 25% of such period) to which the performance goals relate or otherwise within the time period required by the Code or the applicable Treasury Regulations, provided that the outcome is substantially uncertain at that time. Stock Awards for which vesting is not based on the attainment of performance criteria are referred to as “Restricted Stock Awards.”

(c) *Termination of Employment or Board Membership.*

(i) The Administrator shall determine as of the Grant Date (subject to modification subsequent to the Grant Date) the effect a termination from membership on the Board by a Non-employee Director for any reason or a Termination of Employment due to (A) Disability, (B) Retirement (C) death, or (D) otherwise (including Termination for Cause) shall have on any Stock Award.

(ii) Unless otherwise provided in the Award Agreement:

(A) A Termination of Employment or termination from membership on the Board by a Non-employee Director due to Disability or death shall result in immediate full vesting of any as yet unvested Stock Award, and in the case of a Stock Award that vests upon the achievement of performance goals, the vested amount shall be based upon the target award amount;

(B) Any other Termination of Employment or termination from membership on the Board by a Non-employee Director shall result in immediate cancellation and forfeiture of all outstanding, unvested Stock Awards.

In the event that the Administrator shall provide for vesting as to a ratable portion of a performance period in an Award Agreement for a Stock Award under which vesting is based on the attainment of performance criteria over such performance period, the ratable vesting percentage determined by the portion of the performance period during which the Awardee was an Employee of the Company or an Affiliate shall be applied to determine the portion of the Stock Award that is vested based upon actual performance results after the completion of the performance period.

(d) *Rights as a Stockholder.* Unless otherwise provided for by the Administrator, the Participant shall have the rights equivalent to those of a stockholder and shall be a stockholder only after Shares are issued (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company) to the Participant.

12. Other Stock-Based Awards.

(a) *Other Stock-Based Awards*. An “Other Stock-Based Award” means any other type of equity-based or equity-related Award not otherwise described by the terms of this Plan (including the grant or offer for sale of unrestricted Shares), as well as any cash based bonus based on the attainment of Qualifying Performance Criteria as described in Section 13(b), in such amount and subject to such terms and conditions as the Administrator shall determine. Such Awards may involve the transfer of actual Shares to Participants, or payment in cash or otherwise of amounts based on the value of Shares or pursuant to attainment of a performance goal. Each Other Stock-Based Award will be evidenced by an Award Agreement containing such terms and conditions as may be determined by the Administrator.

(b) *Value of Other Stock-Based Awards*. Each Other Stock-Based Award shall be expressed in terms of Shares or units based on Shares or a target amount of cash, as determined by the Administrator. The Administrator may establish performance goals in its discretion. If the Administrator exercises its discretion to establish performance goals, the number and/or value of Other Stock-Based Awards that will be paid out to the Participant will depend on the extent to which the performance goals are met. Notwithstanding anything to the contrary herein, the performance criteria for any Other Stock-Based Award that is intended to satisfy the requirements for "performance-based compensation" under Section 162(m) of the Code shall be established by the Administrator based on one or more Qualifying Performance Criteria selected by the Administrator and specified in writing not later than ninety (90) days after the commencement of the period of service (or, if earlier, the elapse of 25% of such period) to which the performance goals relate and otherwise within the time period required by the Code and the applicable Treasury Regulations, provided that the outcome is substantially uncertain at that time.

(c) *Payment of Other Stock-Based Awards*. Payment, if any, with respect to Other Stock-Based Awards shall be made in accordance with the terms of the Award, in cash or Shares or a combination thereof, as the Administrator determines.

(d) *Termination of Employment or Board Membership.*

(i) The Administrator shall determine as of the Grant Date (subject to modification subsequent to the Grant Date) the effect a termination from membership on the Board by a Non-employee Director for any reason or a Termination of Employment due to (A) Disability, (B) Retirement, (C) death, or (D) otherwise (including Termination for Cause) shall have on any Other Stock-Based Award.

(ii) Unless otherwise provided in the Award Agreement:

(A) A Termination of Employment or termination from membership on the Board by a Non-employee Director due to Disability or death shall result in immediate full vesting of any as yet unvested Other Stock-Based Award, and in the case of an Other Stock-Based Award which vests on the basis of attainment of a performance goal, the vested amount shall be based upon the target award amount;

(B) Any other Termination of Employment or termination from membership on the Board by a Non-employee Director shall result in immediate cancellation and forfeiture of all outstanding, unvested Other Stock-Based Awards.

In the event that the Administrator shall provide for vesting as to a ratable portion of a performance period in an Award Agreement for an Other Stock-Based Award under which vesting is based on the attainment of performance criteria over such performance period, the ratable vesting percentage determined by the portion of the performance period during which the Awardee was an Employee of the Company or an Affiliate shall be applied to determine the portion of the Other Stock-Based Award that is vested based upon actual performance results after the completion of the performance period.

13. Other Provisions Applicable to Awards.

(a) *Non-Transferability of Awards.* Unless determined otherwise by the Administrator, an Award may not be sold, pledged, assigned, hypothecated, transferred or disposed of in any manner other than by beneficiary designation, will or by the laws of descent or distribution, including but not limited to any attempted assignment or transfer in connection with the settlement of marital property or other rights incident to a divorce or dissolution, and any such attempted sale, assignment or transfer shall be of no effect prior to the date an Award is vested and settled. The Administrator may only make an Award transferable to an Awardee's family member or any other person or entity provided the Awardee does not receive consideration for such transfer. If the Administrator makes an Award transferable, either as of the Grant Date or thereafter, such Award shall contain such additional terms and conditions as the Administrator deems appropriate, and any transferee shall be deemed to be bound by such terms upon acceptance of such transfer.

(b) *Qualifying Performance Criteria.* For purposes of this Plan, the term "Qualifying Performance Criteria" shall mean any one or more of the following performance criteria, either individually, alternatively or in any combination, on a basis consistent with U.S. Generally Accepted Accounting Principles ("GAAP") or on a non-GAAP or adjusted GAAP basis, applied to either the Company as a whole or to a Subsidiary, business unit, Affiliate or business segment, either individually, alternatively or in any combination, and measured either annually or cumulatively over a period of years, on an absolute basis or relative to a pre-established target, to previous years' results or to a designated comparison group, in each case as specified by the Committee in the Award or by duly adopted resolution: (i) sales or cash return on sales; (ii) cash flow or free cash flow or net cash from operating activity; (iii) earnings (including gross margin, earnings before or after interest and taxes, earnings before taxes, and net earnings); (iv) basic or diluted earnings per share; (v) growth in earnings or earnings per share; (vi) stock price; (vii) return on equity or average shareholders' equity; (viii) total shareholder return; (ix) return on capital; (x) return on assets or net assets; (xi) return on investments; (xii) revenue or gross profits; (xiii) income before or after interest, taxes, depreciation and amortization, or net income; (xiv) pretax income before allocation of corporate overhead and bonus; (xv) operating income or net operating income; (xvi) operating profit or net operating profit (whether before or after taxes); (xvii) operating margin; (xviii) return on operating revenue; (xix) working capital or net working capital; (xx) market share; (xxi) asset velocity index; (xxii) contract awards or backlog; (xxiii) overhead or other expense or cost reduction; (xxiv) growth in shareholder value relative to the moving average of the S&P 500 Index or a peer group index; (xxv) credit rating; (xxvi) strategic plan development and implementation; (xxvii) improvement in workforce diversity; (xxviii) customer satisfaction; (xxvix) employee satisfaction; (xxx) management succession plan development and implementation; and (xxxi) employee or customer retention. With respect to any Award that is intended to satisfy the requirements for "performance-based compensation" under Section 162(m) of the Code, the performance criteria must be Qualifying Performance Criteria, and the Administrator will (within the first quarter of the performance period, but in no event more than ninety (90) days into that period) establish the specific performance targets (including thresholds and whether to exclude certain extraordinary, non-recurring, or similar items) and Award amounts (subject to the right of the Administrator to exercise discretion to reduce payment amounts following the conclusion of the performance period). Extraordinary, non-recurring items that may be the basis of adjustment include acquisitions or divestitures, restructurings, discontinued operations, extraordinary items, and other unusual or non-recurring charges, an event either not directly related to the operations of the Company, Subsidiary, division, business segment or business unit or not within the reasonable control of management, the cumulative effects of tax or accounting changes in accordance with U.S. GAAP, and foreign exchange gains or losses.

(c) *Certification.* Prior to the payment of any compensation under an Award intended to qualify as "performance-based compensation" under Section 162(m) of the Code, the Administrator shall certify in writing the extent to which any Qualifying Performance Criteria and any other material terms under such Award have been satisfied (other than in cases where such criteria relate solely to the increase in the value of the Common Shares).

(d) *Discretionary Adjustments Pursuant to Section 162(m).* Notwithstanding satisfaction or completion of any Qualifying Performance Criteria, to the extent specified as of the Grant Date, the number of Shares, Options or other benefits granted, issued, retainable and/or vested under an Award on account of satisfaction of such Qualifying Performance Criteria may be reduced (but not increased) by the Administrator on the basis of such further considerations as the Administrator in its sole discretion shall determine.

14. Dividends and Dividend Equivalents.

Awards other than Options and Stock Appreciation Rights may provide the Awardee with the right to receive dividend payments or dividend equivalent payments on the Shares subject to the Award, whether or not such Award is vested. Notwithstanding the foregoing, dividends or dividend equivalents shall not be paid with respect to Stock Awards or Other Stock-Based Awards that, in either case, vest based on the achievement of performance goals prior to the date the performance goals are satisfied and the Award is earned, and then shall be payable only with respect to the number of Shares or Stock Units actually earned under the Award. Such payments may be made in cash, Shares or Stock Units or may be credited as cash or Stock Units to an Awardee's account and later settled in cash or Shares or a combination thereof, as determined by the Administrator. Such payments and credits may be subject to such conditions and contingencies as the Administrator may establish.

15. Adjustments upon Changes in Capitalization, Organic Change or Change of Control.

(a) *Adjustment Clause.* In the event of (i) a stock dividend, extraordinary cash dividend, stock split, reverse stock split, share combination, or recapitalization or similar event affecting the capital structure of the Company (each, a "Share Change"), or (ii) a merger, consolidation, acquisition of property or shares, separation, spin-off, reorganization, liquidation, Disaffiliation, or similar event affecting the Company or any of its Subsidiaries (each, an "Organic Change"), the Administrator or the Board may in its discretion make such substitutions or adjustments as it deems appropriate and equitable to (i) the Share limitations set forth in Section 3 of the Plan, (ii) the number and kind of Shares covered by each outstanding Award, and (iii) the price per Share subject to each such outstanding Award. In the case of Organic Changes, such adjustments may include, without limitation, (x) the cancellation of outstanding Awards in exchange for payments of cash, property or a combination thereof having an aggregate value equal to the value of such Awards, as determined by the Administrator or the Board in its sole discretion (it being understood that in the case of an Organic Change with respect to which stockholders receive consideration other than publicly traded equity securities of the ultimate surviving entity, any such determination by the Administrator that the value of an Option or Stock Appreciation Right shall for this purpose be deemed to equal the excess, if any, of the value of the consideration being paid for each Share pursuant to such Organic Change over the exercise price of such Option or Stock Appreciation Right shall conclusively be deemed valid); (y) the substitution of other property (including, without limitation, cash or other securities of the Company and securities of entities other than the Company) for the Shares subject to outstanding Awards; and (z) in connection with any Disaffiliation, arranging for the assumption of Awards, or replacement of Awards with new awards based on other property or other securities (including, without limitation, other securities of the Company and securities of entities other than the Company), by the affected Subsidiary, Affiliate, or division or by the entity that controls such Subsidiary, Affiliate, or division following such Disaffiliation (as well as any corresponding adjustments to Awards that remain based upon Company securities). The Committee may adjust in its sole discretion the Qualifying Performance Criteria applicable to any Awards to reflect any Share Change and any Organic Change and any unusual or non-recurring events and other extraordinary items, impact of charges for restructurings, discontinued operations, and the cumulative effects of accounting or tax changes, each as defined by GAAP or as identified in the Company's financial statements, notes to the financial statements, management's discussion and analysis or the Company's other SEC filings, provided that in the case of Qualifying Performance Criteria applicable to any performance-based Awards intended to qualify under Code Section 162(m), such adjustment does not violate Section 162(m) of the Code. Any adjustment under this Section 15(a) need not be the same for all Participants.

(b) *Change of Control*. In the event of a Change of Control, unless otherwise determined by the Administrator as of the Grant Date of a particular Award (or subsequent to the Grant Date), the following acceleration, exercisability and valuation provisions shall apply:

(i) On the date that such Change of Control occurs, any or all Options and Stock Appreciation Rights awarded under this Plan not previously exercisable and vested shall, if not assumed, or substituted with a new award, by the successor to the Company, become fully exercisable and vested, and if the successor to the Company assumes such Options or Stock Appreciation Rights or substitutes other awards for such Awards, such Awards (or their substitutes) shall become fully exercisable and vested if the Participant's employment is terminated (other than a Termination for Cause) within two years following the Change of Control.

(ii) Except as may be provided in an individual severance or employment agreement (or severance plan) to which an Awardee is a party, in the event of an Awardee's Termination of Employment within two years after a Change of Control for any reason other than because of the Awardee's death, Retirement, Disability or Termination for Cause, each Option and Stock Appreciation Right held by the Awardee (or a transferee) that is vested following such Termination of Employment shall remain exercisable until the earlier of the third anniversary of such Termination of Employment (or any later date until which it would remain exercisable under such circumstances by its terms) or the expiration of its original term. In the event of an Awardee's Termination of Employment more than two years after a Change of Control, or within two years after a Change of Control because of the Awardee's death, Retirement, Disability or Termination for Cause, the provisions of Sections 8(i) and 10 of the Plan shall govern (as applicable).

(iii) On the date that such Change of Control occurs, the restrictions and conditions applicable to any or all Stock Awards, Stock Unit Awards and Other Stock-Based Awards that are not assumed, or substituted with a new award, by the successor to the Company shall lapse and such Awards shall be fully vested. Unless otherwise provided in an Award Agreement at the Grant Date, upon the occurrence of a Change of Control without assumption or substitution of the Awards by the successor, any performance based Award shall be deemed fully earned at the target amount as of the date on which the Change of Control occurs. All Stock Awards, Stock Unit Awards and Other Stock-Based Awards shall be settled or paid within thirty (30) days of vesting hereunder. Notwithstanding the foregoing, if the Change of Control would not qualify as a permissible date of distribution under Section 409A(a)(2)(A) of the Code, and the regulations thereunder, the Awardee shall be entitled to receive the Award from the Company on the date that would have applied absent this provision. If the successor to the Company does assume (or substitute with a new award) any Stock Awards, Stock Unit Awards and Other Stock-Based Awards, all such Awards shall become fully vested if the Participant's employment is terminated (other than a Termination for Cause) within two years following the Change of Control, and any performance based Award shall be deemed fully earned at the target amount effective as of such Termination of Employment.

(iv) The Committee, in its discretion, may determine that, upon the occurrence of a Change of Control of the Company, each Option and Stock Appreciation Right outstanding shall terminate within a specified number of days after notice to the Participant, and/or that each Participant shall receive, with respect to each Share subject to such Option or Stock Appreciation Right, an amount equal to the excess of the Fair Market Value of such Share immediately prior to the occurrence of such Change of Control over the exercise price per Share of such Option and/or Stock Appreciation Right; such amount to be payable in cash, in one or more kinds of stock or property (including the stock or property, if any, payable in the transaction) or in a combination thereof, as the Committee, in its discretion, shall determine, and if there is no excess value, the Committee may, in its discretion, cancel such Awards.

(v) An Option, Stock Appreciation Right, Stock Award, Stock Unit Award or Other Stock-Based Award shall be considered assumed or substituted for if following the Change of Control the Award confers the right to purchase or receive, for each Share subject to the Option, Stock Appreciation Right, Stock Award, Stock Unit Award or Other Stock-Based Award immediately prior to the Change of Control, the consideration (whether stock, cash or other securities or property) received in the transaction constituting a Change of Control by holders of Shares for each Share held on the effective date of such transaction (and if holders were offered a choice of consideration, the type of consideration chosen by the holders of a majority of the outstanding Shares); provided, however, that if such consideration received in the transaction constituting a Change of Control is not solely common stock of the successor company, the Committee may, with the consent of the successor company, provide that the consideration to be received upon the exercise or vesting of an Option, Stock Appreciation Right, Stock Award, Stock Unit Award or Other Stock-Based Award, for each Share subject thereto, will be solely common stock of the successor company with a fair market value substantially equal to the per Share consideration received by holders of Shares in the transaction constituting a Change of Control. The determination of whether fair market value is substantially equal shall be made by the Committee in its sole discretion and its determination shall be conclusive and binding.

(c) *Section 409A*. Notwithstanding the foregoing: (i) any adjustments made pursuant to Section 15(a) of the Plan to Awards that are considered "deferred compensation" within the meaning of Section 409A of the Code shall be made in compliance with the requirements of Section 409A of the Code; (ii) any adjustments made pursuant to Section 15(a) of the Plan to Awards that are not considered "deferred compensation" subject to Section 409A of the Code shall be made in such a manner as to ensure that after such adjustment, the Awards either continue not to be subject to Section 409A of the Code or comply with the requirements of

Section 409A of the Code; (iii) the Administrator shall not have the authority to make any adjustments pursuant to Section 15(a) of the Plan to the extent that the existence of such authority would cause an Award that is not intended to be subject to Section 409A of the Code to be subject thereto; and (iv) if any Award is subject to Section 409A of the Code, Section 15(b) of the Plan shall be applicable only to the extent specifically provided in the Award Agreement and permitted pursuant to Section 24 of the Plan in order to ensure that such Award complies with Code Section 409A.

16. Amendment and Termination of the Plan.

(a) *Amendment and Termination.* The Administrator may amend, alter or discontinue the Plan or any Award Agreement, but any such amendment shall be subject to approval of the stockholders of the Company in the manner and to the extent required by Applicable Law. In addition, without limiting the foregoing, unless approved by the stockholders of the Company and subject to Section 16(b), no such amendment shall be made that would:

(i) increase the maximum aggregate number of Shares which may be subject to Awards granted under the Plan;

(ii) reduce the minimum exercise price for Options or Stock Appreciation Rights granted under the Plan; or

(iii) reduce the exercise price of outstanding Options or Stock Appreciation Rights, as prohibited by Section 8(c) without stockholder approval.

(b) *Effect of Amendment or Termination.* No amendment, suspension or termination of the Plan shall materially impair the rights of any Participant with respect to an outstanding Award, unless mutually agreed otherwise between the Participant and the Administrator, which agreement must be in writing and signed by the Participant and the Company, except that no such agreement shall be required if the Administrator determines in its sole discretion that such amendment either (i) is required or advisable in order for the Company, the Plan or the Award to satisfy any Applicable Law or to meet the requirements of any accounting standard, or (ii) is not reasonably likely to significantly diminish the benefits provided under such Award, or that any such diminishment has been adequately compensated, except that this exception shall not apply following a Change of Control. Termination of the Plan shall not affect the Administrator's ability to exercise the powers granted to it hereunder with respect to Awards granted under the Plan prior to the date of such termination.

(c) *Effect of the Plan on Other Arrangements.* Neither the adoption of the Plan by the Board or a Committee nor the submission of the Plan to the stockholders of the Company for approval shall be construed as creating any limitations on the power of the Board or any Committee to adopt such other incentive arrangements as it or they may deem desirable, including without limitation, the granting of restricted shares or restricted share units or stock options otherwise than under the Plan, and such arrangements may be either generally applicable or applicable only in specific cases.

17. Designation of Beneficiary.

(a) An Awardee may file a written designation of a beneficiary who is to receive the Awardee's rights pursuant to Awardee's Award or the Awardee may include his or her Awards in an omnibus beneficiary designation for all benefits under the Plan. To the extent that Awardee has completed a designation of beneficiary while employed with the Company, such beneficiary designation shall remain in effect with respect to any Award hereunder until changed by the Awardee to the extent enforceable under Applicable Law.

(b) Such designation of beneficiary may be changed by the Awardee at any time by written notice. In the event of the death of an Awardee and in the absence of a beneficiary validly designated under the Plan who is living at the time of such Awardee's death, the Company shall allow the legal representative of the Awardee's estate to exercise the Award.

18. No Right to Awards or to Employment.

No person shall have any claim or right to be granted an Award and the grant of any Award shall not be construed as giving an Awardee the right to continue in the employ of the Company or its Affiliates. Further, the Company and its Affiliates expressly reserve the right, at any time, to dismiss any Employee or Awardee at any time without liability or any claim under the Plan, except as provided herein or in any Award Agreement entered into hereunder.

19. Legal Compliance.

Shares shall not be issued pursuant to an Option, Stock Appreciation Right, Stock Award or Other Stock-Based Award unless such Option, Stock Appreciation Right, Stock Award or Other Stock-Based Award and the issuance and delivery of such Shares shall comply with Applicable Law and shall be further subject to the approval of counsel for the Company with respect to such compliance. Unless the Awards and Shares covered by this Plan have been registered under the Securities Act or the Company has determined that such registration is unnecessary, each person receiving an Award and/or Shares pursuant to any Award may be required by the Company to give a representation in writing that such person is acquiring such Shares for his or her own account for investment and not with a view to, or for sale in connection with, the distribution of any part thereof.

20. Inability to Obtain Authority.

To the extent the Company is unable to or the Administrator deems it unfeasible to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be advisable or necessary to the lawful issuance and sale of any Shares hereunder, the Company shall be relieved of any liability with respect to the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained.

21. Reservation of Shares.

The Company, during the term of this Plan, will at all times reserve and keep available such number of Shares as shall be sufficient to satisfy the requirements of the Plan.

22. Notice.

Any written notice to the Company required by any provisions of this Plan shall be addressed to the Secretary of the Company and shall be effective when received. Any notice to a Participant hereunder shall be addressed to the last address of record with the Company and shall be effective when sent via first class mail, courier service, or electronic mail to such last address of record.

23. Governing Law; Interpretation of Plan and Awards.

(a) This Plan and all determinations made and actions taken pursuant hereto shall be governed by the substantive laws, but not the choice of law rules, of the state of Delaware, except as to matters governed by U.S. federal law.

(b) In the event that any provision of the Plan or any Award granted under the Plan is declared to be illegal, invalid or otherwise unenforceable by a court of competent jurisdiction, such provision shall be reformed, if possible, to the extent necessary to render it legal, valid and enforceable, or otherwise deleted, and the remainder of the terms of the Plan and/or Award shall not be affected except to the extent necessary to reform or delete such illegal, invalid or unenforceable provision.

(c) The headings preceding the text of the sections hereof are inserted solely for convenience of reference, and shall not constitute a part of the Plan, nor shall they affect its meaning, construction or effect.

(d) The terms of the Plan and any Award shall inure to the benefit of and be binding upon the parties hereto and their respective permitted heirs, beneficiaries, successors and assigns.

24. Section 409A.

It is the intention of the Company that no Award shall be "deferred compensation" subject to Section 409A of the Code, unless and to the extent that the Administrator specifically determines otherwise, and the Plan and the terms and conditions of all Awards shall be interpreted accordingly. The terms and conditions governing any Awards that the Administrator determines will be subject to Section 409A of the Code, including any rules for elective or mandatory deferral of the delivery of cash or Shares pursuant thereto and any rules regarding treatment of such Awards in the event of a Change of Control, shall be set forth in the applicable Award Agreement, deferral election forms and procedures, and rules established by the Administrator, and shall comply in all respects with Section 409A of the Code. The following rules will apply to Awards intended to be subject to Section 409A of the Code ("409A Awards"):

(a) If a Participant is permitted to elect to defer an Award or any payment under an Award, such election will be permitted only at times in compliance with Code Section 409A.

(b) The Company shall have no authority to accelerate distributions relating to 409A Awards in excess of the authority permitted under Section 409A.

(c) Any distribution of a 409A Award following a Termination of Employment that would be subject to Code Section 409A(a)(2)(A)(i) as a distribution following a separation from service of a "specified employee" as defined under Code Section 409A(a)(2)(B)(i), shall occur no earlier than the expiration of the six-month period following such Termination of Employment.

(d) In the case of any distribution of a 409A Award, if the timing of such distribution is not otherwise specified in the Plan or an Award Agreement or other governing document, the distribution shall be made not later than the end of the calendar year during which the settlement of the 409A Award is specified to occur.

(e) In the case of an Award providing for distribution or settlement upon vesting or the lapse of a risk of forfeiture, if the time of such distribution or settlement is not otherwise specified in the Plan or an Award Agreement or other governing document, the distribution or settlement shall be made not later than March 15 of the year following the year in which the Award vested or the risk of forfeiture lapsed.

(f) Notwithstanding anything herein to the contrary, in no event shall the Company or the Administrator be liable for the payment of, or any gross up payment in connection with, any taxes or penalties owed by the Participant pursuant to Code Section

25. Limitation on Liability.

The Company and any Affiliate which is in existence or hereafter comes into existence shall not be liable to a Participant, an Employee, an Awardee or any other persons as to:

(a) *The Non-Issuance of Shares.* The non-issuance or sale of Shares as to which the Company has been unable to obtain from any regulatory body having jurisdiction the authority deemed by the Company’s counsel to be necessary to the lawful issuance and sale of any shares hereunder; and

(b) *Tax or Exchange Control Consequences.* Any tax consequence or any exchange control obligation owed, by any Participant, Employee, Awardee or other person due to the receipt, exercise or settlement of any Option or other Award granted hereunder.

26. Unfunded Plan.

Insofar as it provides for Awards, the Plan shall be unfunded. Although bookkeeping accounts may be established with respect to Awardees who are granted Stock Awards or Other Stock-Based Awards under this Plan, any such accounts will be used merely as a bookkeeping convenience. The Company shall not be required to segregate any assets which may at any time be represented by Awards, nor shall this Plan be construed as providing for such segregation. Neither the Company nor the Administrator shall be deemed to be a trustee of stock or cash to be awarded under the Plan. Any liability of the Company to any Participant with respect to an Award shall be based solely upon any contractual obligations which may be created by the Plan; no such obligation of the Company shall be deemed to be secured by any pledge or other encumbrance on any property of the Company. Neither the Company nor the Administrator shall be required to give any security or bond for the performance of any obligation which may be created by this Plan.

27. Foreign Employees.

Awards may be granted hereunder to Employees and Consultants who are foreign nationals, who are located outside the United States or who are not compensated from a payroll maintained in the United States, or who are otherwise subject to (or could cause the Company to be subject to) legal or regulatory provisions of countries or jurisdictions outside the United States, on such terms and conditions different from those specified in the Plan as may, in the judgment of the Administrator, be necessary or desirable to foster and promote achievement of the purposes of the Plan, and, in furtherance of such purposes, the Administrator may make such modifications, amendments, procedures, or subplans as may be necessary or advisable to comply with such legal or regulatory provisions.

28. Tax Withholding.

Each Participant shall pay to the Company, or make arrangements satisfactory to the Company regarding the payment of, any federal, state, local or foreign taxes of any kind required by law to be withheld with respect to any Award under the Plan no later than the date as of which any amount under such Award first becomes includible in the gross income of the Participant for any tax purposes with respect to which the Company has a tax withholding obligation. Unless otherwise determined by the Company, withholding obligations may be settled with Shares, including Shares that are part of the Award that gives rise to the withholding requirement; provided, however, that not more than the legally required minimum withholding may be settled with Shares that are part of the Award. The obligations of the Company under the Plan shall be conditional on such payment or arrangements, and the Company and its Affiliates shall, to the extent permitted by law, have the right to deduct any such taxes from any vested Shares or any other payment due to the participant at that time or at any future time. The Administrator may establish such procedures as it deems appropriate, including making irrevocable elections, for the settlement of withholding obligations with Shares.

29. Cancellation of Award; Forfeiture of Gain.

Notwithstanding anything to the contrary contained herein, an Award Agreement may provide that the Award will be cancelled and the Participant will forfeit the Shares or cash received or payable on the vesting or exercise of the Award, and that the amount of any proceeds of the sale or gain realized on the vesting or exercise of the Award must be repaid to the Company, under such conditions as may be required by Applicable Law or established by the Committee in its sole discretion.

30. Data Privacy and Transfer

As a condition of acceptance of an Award, the Participant explicitly thereby consents to the collection, use and transfer, in electronic or other form, of personal data by and among, as applicable, the Company and its Affiliates for the exclusive purpose of implementing, administering and managing the Participant’s participation in the Plan. The Participant understands that the Company and its Affiliates hold certain personal information about the Participant, including the Participant’s name, home address and telephone number, date of birth, social security or other identification number, salary, nationality, job title, Shares held in the Company or any Subsidiary, details of all Awards or any other entitlement to Shares awarded, canceled, exercised, vested, unvested or outstanding in the Participant’s favor, for the purpose of implementing, managing and administering the Plan (the “Data”). The

Participant further understands that the Company and its Affiliates may transfer the Data among themselves as necessary for the purpose of implementation, management and administration of the Plan, and that the Company and its Affiliates may each further transfer the Data to any third parties assisting the Company in the implementation, management, and administration of the Plan. The Participant understands that these recipients may be located in the Participant's country, or elsewhere, and that the recipient's country may have different data privacy laws and protections than the Participant's country. The Participant understands that he or she may request a list with the names and addresses of any potential recipients of the Data by contacting his or her local human resources representative. The Participant, through participation in the Plan and acceptance of an Award under the Plan, authorizes such recipients to receive, possess, use, retain and transfer the Data, in electronic or other form, for the purposes of implementing, administering and managing the Plan, including any requisite transfer of such Data as may be required to a broker or other third party with whom the Participant may elect to deposit any Shares. In addition, by accepting an Award under the Plan, each Participant agrees and acknowledges (i) that the Data will be held only as long as is necessary to implement, manage, and administer the Plan; (ii) that the Participant may, at any time, view the Data, request additional information about the storage and processing of the Data, require any necessary amendments to the Data, or refuse or withdraw consent to the use and transfer of the Data, without cost, by delivering such revocation or withdrawal of consent in writing to a designated human resources representative; and (iii) that refusal or withdrawal of consent may affect the Participant's ability to participate in the Plan thereafter.

Adopted by the Board of the Directors of the Company on May 6, 2014.

Approved by the Company's stockholders and effective on July 15, 2014.

Exhibit 10.8

ENERGY FOCUS, INC.
2014 Stock Incentive Plan

<u>RESTRICTED STOCK UNIT AWARD AGREEMENT</u>
<u>FOR NON-EMPLOYEE DIRECTORS</u>

THIS RESTRICTED STOCK UNIT AWARD AGREEMENT FOR NON-EMPLOYEE DIRECTORS (this "**Agreement**") is made as of **[INSERT DATE]** (the "**Grant Date**") between ENERGY FOCUS, INC. (the "**Company**") and **[INSERT NAME]** (referred to herein as "**Participant**"). Terms used in this Agreement with initial capital letters without definition are defined in the Energy Focus, Inc. 2014 Stock Incentive Plan (the "**Plan**") and have the same meaning in this Agreement.

1. <u>Restricted Stock Unit Award</u>. On the Grant Date, the Company hereby grants to Participant a Stock Unit Award of **[INSERT NO. OF UNITS]** Units or Shares of the Company's common stock, par value $0.0001 per share (the "**Shares**"), pursuant and subject to the terms of this Agreement and the Plan, a copy of which has been delivered or made available to Participant and is incorporated herein by reference. The Stock Award is hereinafter referred to as the "**Restricted Stock Unit Award**." The number of Shares and the rights granted under this Agreement are subject to adjustment and modification as provided in the Plan. Accordingly, the total number of Shares referred to in this Section means, at any relevant time, the number of Shares stated above as such number shall then have been adjusted pursuant to the Plan.

2. <u>Vesting</u>. Subject to the terms of the Plan, the Restricted Stock Unit Award shall vest as described herein. Provided that Participant continues to be a Director of the Company, the Restricted Stock Unit Award shall vest in full on **[INSERT VEST DATE]** (the "**Vesting Date**")].

3. <u>Termination from Board Membership</u>. Except as otherwise set forth in the Plan or this Agreement:

(a) <u>In General</u>. If Participant's termination from Board membership occurs prior to the Vesting Date for a reason other than Participant's death or Disability, then the Restricted Stock Unit Award will automatically be canceled and forfeited and Participant shall not be entitled to any further rights in respect thereof and the Company's obligation with respect to the Restricted Stock Unit Award shall terminate and be of no further force or effect.

(b) <u>Death or Disability</u>. If Participant's termination from Board membership occurs prior to the Vesting Date due to Participant's death or Disability, the Restricted Stock Unit Award shall become vested in full effective as of the date of such death or Disability.

4. <u>No Stockholder Rights</u>. Notwithstanding anything set forth herein or in the Plan to the contrary, Participant (and Participant's designated beneficiary) shall have no rights as a stockholder of the Company with respect to the Shares until the date the Restricted Stock Unit Award is issued and, therefore, among other things, shall not be entitled to receive any cash dividends paid on the Shares or to any voting rights in respect of the Shares until the Restricted Stock Unit Award is issued and then only to the extent the Restricted Stock Unit Award is earned.

5. <u>Issuance of Shares</u>. Participant (or Participant's designated beneficiary in the event of Participant's death) shall be issued Shares equal to the number of Shares stated in Section 1 hereof with appropriate vesting and/or restriction requirements. The Company may elect to have such Shares issued pursuant to an electronic transfer to Participant's (or Participant's designated beneficiary's in the event of Participant's death) brokerage account or pursuant to a stock certificate or certificates registered in Participant's (or Participant's designated beneficiary's in the event of Participant's death) name representing such Shares.

6. <u>Transfer</u>. The Restricted Stock Unit Award shall be transferable only at Participant's death, by Participant's will or pursuant to the laws of descent and distribution.

7. <u>Governing Law/Venue</u>. This Agreement shall be governed by the laws of the State of Delaware, without regard to principles of conflicts of law, except to the extent superseded by the laws of the United States of America. The parties agree and acknowledge that the laws of the State of Delaware bear a substantial relationship to the parties and/or this Agreement and that the Restricted Stock Unit Award and benefits granted herein would not be granted without the governance of this Agreement by the laws of the State of Delaware. In addition, all legal actions or proceedings relating to this Agreement shall be brought exclusively in state or federal courts located in the State of Ohio and the parties executing this Agreement hereby consent to the personal jurisdiction of such courts. In the event that it becomes necessary for the Company to institute legal proceedings under this Agreement, Participant shall be responsible to the Company for all costs and reasonable legal fees incurred by the Company with regard to such proceedings. Any provision of this Agreement which is determined by a court of competent jurisdiction to be invalid or unenforceable should be construed or limited in a manner that is valid and enforceable and that comes closest to the business objectives intended by such provision, without invalidating or rendering unenforceable the remaining provisions of this Agreement.

8. Interpretation and Administration. The parties agree that the interpretation of this Agreement shall rest exclusively and completely within the sole discretion of the Administrator. The parties agree to be bound by the decisions of the Administrator with regard to the interpretation of this Agreement and with regard to any and all matters set forth in this Agreement. The Administrator may delegate its functions under this Agreement to an officer of the Company designated by the Administrator (hereinafter the "**designee**"). In fulfilling its responsibilities hereunder, the Administrator or its designee may rely upon documents, written statements of the parties or such other material as the Administrator or its designee deems appropriate. The parties agree that there is no right to be heard or to appear before the Administrator or its designee and that any decision of the Administrator or its designee relating to this Agreement shall be final and binding unless such decision is arbitrary and capricious.

9. Electronic Delivery and Consent to Electronic Participation. The Company may, in its sole discretion, decide to deliver any documents related to the Restricted Stock Unit Award grant hereunder and participation in the Plan or future Stock Awards that may be granted under the Plan by electronic means. Participant hereby consents to receive such documents by electronic delivery and to participate in the Plan through an on-line or electronic system established and maintained by the Company or another third party designated by the Company, including the acceptance of Stock Award grants and the execution of Stock Award grant agreements through electronic signature.

10. Notices. All notices requests, consents and other communications required or provided hereunder shall be in writing and, if to the Company, shall be delivered or mailed to its principal office, and, if to Participant, shall be delivered either personally or mailed to the address of Participant appearing on the books and records of the Company.

11. Prompt Acceptance of Agreement. The Restricted Stock Unit Award evidenced by this Agreement shall, at the discretion of the Administrator, be forfeited if this Agreement is not manually executed and returned to the Company, or electronically executed by Participant by indicating Participant's acceptance of this Agreement in accordance with the acceptance procedures set forth on the Company's third-party equity plan administrator's web site, within 90 days of the Grant Date.

12. Entire Agreement. This Agreement, together with the Plan, contains the entire agreement between the parties with respect to the subject matter hereof and supersedes all prior agreements, written or oral, with respect thereto. In the event of any conflict between the provisions of this Agreement and the Plan, the provisions of the Plan shall control.

13. Amendment. This Agreement may not be modified, supplemented or otherwise amended other than pursuant to a written agreement between Company and Participant.

14. No Third-Party Beneficiary. This Agreement is made for the benefit of the Company and any Subsidiary employing Participant during the term hereof.

15. Board Membership. Nothing in the Plan or this Agreement confers upon Participant any right to continue in any relationship with the Company or any Subsidiary, or limit or interfere in any with the right of the Company or Subsidiary to terminate Participant's Board membership at any time.

16. Counterparts. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

17. Right of Set-Off. By accepting this Restricted Stock Unit Award, Participant consents to a deduction from, and set-off against, any amounts owed to Participant by the Company or any Subsidiary from time to time (including, but not limited to, amounts owed to Participant as Board fees) to the extent of the amounts owed to the Company or Subsidiary under this Agreement.

18. Withholding Tax.

(a) Generally. Participant is liable and responsible for all taxes owed in connection with the Restricted Stock Unit Award, regardless of any action the Company takes with respect to any tax withholding obligations that arise in connection with the Restricted Stock Unit Award. The Company does not make any representation or undertaking regarding the tax treatment or the treatment of any tax withholding in connection with the vesting of the Restricted Stock Unit Award. The Company does not commit and is under no obligation to structure the Restricted Stock Unit Award or the vesting of the Restricted Stock Unit Award to reduce or eliminate Participant's tax liability.

(b) Payment of Withholding Taxes. Prior to any event in connection with the Restricted Stock Unit Award (e.g., vesting) that the Company determines may result in any domestic or foreign tax withholding obligation, whether national, federal, state or local, including any employment tax obligation (the "**Tax Withholding Obligation**"), Participant is required to arrange for the satisfaction of the minimum amount of such Tax Withholding Obligation in a manner acceptable to the Company. Unless Participant elects to satisfy the Tax Withholding Obligation by an alternative means that is then permitted by the Company, Participant's acceptance of this Agreement constitutes Participant's instruction and authorization to the Company to withhold on Participant's behalf the number of Shares from those Shares issuable to Participant under this Restricted Stock Unit Award as the Company determines to be sufficient to satisfy the Tax Withholding Obligation as and when any such Tax Withholding Obligation becomes due. In the case of any amounts withheld for taxes pursuant to this provision in the form of Shares, the amount withheld shall not exceed the minimum required by applicable law and regulations.

19. No Representations Regarding Tax Consequences. Participant acknowledges and agrees that the Company has made no warranties or representations to Participant with respect to the tax consequences (including, but not limited to, income tax consequences) related to the Restricted Stock Unit Award granted under this Agreement, and Participant is in no manner relying on the Company or its representatives for an assessment of such tax consequences. Participant acknowledges that the Company has no responsibility to take or refrain from taking any actions in order to achieve a certain tax result for Participant.

20. Headings. Section and subsection headings contained in this Agreement are inserted for the convenience of reference only. Section and subsection headings shall not be deemed to be a part of this Agreement for any purpose, and they shall not in any way define or affect the meaning, construction or scope of any of the provisions hereof.

[signatures on the next page]

Restricted Stock Unit Award Agreement
For Non-Employee Directors
(signature page)

ENERGY FOCUS, INC.

By: ____________

Name: __________

Title:____________

Attest:

____

Name:
Title:

Accepted by:

X____________ Participant Name:

EXHIBIT 21.1

SUBSIDIARIES

Name	Location	Doing Business as
Energy Focus LED Solutions, LLC	Solon, Ohio	Energy Focus LED Solutions, LLC
Energy Focus Europe, LTD	Thatcham, Berkshire, United Kingdom	Energy Focus Europe, LTD

EXHIBIT 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (333-208624) and Form S-8 (333-219805, 333-206088, 333-197422, 333-193024, 333-184028, 333-169274, 333-138963, and 333-122686) of Energy Focus, Inc. of our report dated February 21, 2018 with respect to the consolidated financial statements which appears in this Form 10-K.

/s/ Plante & Moran, PLLC

Cleveland, Ohio
February 21, 2018

Exhibit 24.1

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS THAT the undersigned, a director of Energy Focus, Inc., a Delaware corporation (the "Company"), does hereby constitute and appoint Theodore L. Tewksbury III and Michael H. Port, or any one or more of them, his or her true and lawful attorney, for him or her and in his or her name, place and stead, to execute, by manual or facsimile signature, electronic transmission or otherwise, the Annual Report on Form 10-K of the Company for the year ended December 31, 2017, and any amendments or supplements to said Annual Report and to cause the same to be filed with the Securities and Exchange Commission, together with any exhibits, financial statements and schedules included or to be incorporated by reference therein, hereby granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite or desirable to be done in and about the premises as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all acts and things which said attorneys may do or cause to be done by virtue of these presents.

IN WITNESS WHEREOF, the undersigned has hereunto set his or her hand and seal as of the 21 day of February, 2018.

/s/ Ronald D. Black

Ronald D. Black

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS THAT the undersigned, a director of Energy Focus, Inc., a Delaware corporation (the “Company”), does hereby constitute and appoint Theodore L. Tewksbury III and Michael H. Port, or any one or more of them, his or her true and lawful attorney, for him or her and in his or her name, place and stead, to execute, by manual or facsimile signature, electronic transmission or otherwise, the Annual Report on Form 10-K of the Company for the year ended December 31, 2017, and any amendments or supplements to said Annual Report and to cause the same to be filed with the Securities and Exchange Commission, together with any exhibits, financial statements and schedules included or to be incorporated by reference therein, hereby granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite or desirable to be done in and about the premises as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all acts and things which said attorneys may do or cause to be done by virtue of these presents.

IN WITNESS WHEREOF, the undersigned has hereunto set his or her hand and seal as of the 20 day of February, 2018.

/s/ William Cohen

William Cohen

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS THAT the undersigned, a director of Energy Focus, Inc., a Delaware corporation (the “Company”), does hereby constitute and appoint Theodore L. Tewksbury III and Michael H. Port, or any one or more of them, his or her true and lawful attorney, for him or her and in his or her name, place and stead, to execute, by manual or facsimile signature, electronic transmission or otherwise, the Annual Report on Form 10-K of the Company for the year ended December 31, 2017, and any amendments or supplements to said Annual Report and to cause the same to be filed with the Securities and Exchange Commission, together with any exhibits, financial statements and schedules included or to be incorporated by reference therein, hereby granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite or desirable to be done in and about the premises as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all acts and things which said attorneys may do or cause to be done by virtue of these presents.

IN WITNESS WHEREOF, the undersigned has hereunto set his or her hand and seal as of the 19 day of February, 2018.

/s/ Glenda Dorchak

Glenda Dorchak

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS THAT the undersigned, a director of Energy Focus, Inc., a Delaware corporation (the “Company”), does hereby constitute and appoint Theodore L. Tewksbury III and Michael H. Port, or any one or more of them, his or her true and lawful attorney, for him or her and in his or her name, place and stead, to execute, by manual or facsimile signature, electronic transmission or otherwise, the Annual Report on Form 10-K of the Company for the year ended December 31, 2017, and any amendments or supplements to said Annual Report and to cause the same to be filed with the Securities and Exchange Commission, together with any exhibits, financial statements and schedules included or to be incorporated by reference therein, hereby granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite or desirable to be done in and about the premises as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all acts and things which said attorneys may do or cause to be done by virtue of these presents.

IN WITNESS WHEREOF, the undersigned has hereunto set his or her hand and seal as of the 20 day of February, 2018.

/s/ Marc J. Eisenberg

Marc J. Eisenberg

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS THAT the undersigned, a director of Energy Focus, Inc., a Delaware corporation (the "Company"), does hereby constitute and appoint Theodore L. Tewksbury III and Michael H. Port, or any one or more of them, his or her true and lawful attorney, for him or her and in his or her name, place and stead, to execute, by manual or facsimile signature, electronic transmission or otherwise, the Annual Report on Form 10-K of the Company for the year ended December 31, 2017, and any amendments or supplements to said Annual Report and to cause the same to be filed with the Securities and Exchange Commission, together with any exhibits, financial statements and schedules included or to be incorporated by reference therein, hereby granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite or desirable to be done in and about the premises as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all acts and things which said attorneys may do or cause to be done by virtue of these presents.

IN WITNESS WHEREOF, the undersigned has hereunto set his or her hand and seal as of the 19 day of February, 2018.

/s/ Michael R. Ramelot

Michael R. Ramelot

EXHIBIT 31.1

CERTIFICATION

I, Theodore L. Tewksbury III, certify that:

1. I have reviewed this Annual Report on Form 10-K of Energy Focus, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have;

    (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

    (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Theodore L. Tewksbury III
Theodore L. Tewksbury III
Chairman, Chief Executive Officer and President

Date: February 22, 2018

EXHIBIT 31.2

CERTIFICATION

I, Michael H. Port, certify that:

1. I have reviewed this Annual Report on Form 10-K of Energy Focus, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have;

    (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    (d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

    (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Michael H. Port
Michael H. Port
Chief Financial Officer
Date: February 22, 2018

EXHIBIT 32.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Energy Focus, Inc. (the “Company”) on Form 10-K for the year ended December 31, 2017 (the “Report”), I, Theodore L. Tewksbury III, Chairman, Chief Executive Officer and President of the Company and I, Michael H. Port, Chief Financial Officer of the Company, each certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002, that to the best of my knowledge:

(i) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Theodore L. Tewksbury III

Theodore L. Tewksbury III
Chairman, Chief Executive Officer and President
Date: February 22, 2018

/s/ Michael H. Port

Michael H. Port
Chief Financial Officer
Date: February 22, 2018

A signed original of this written statement required by Section 906 has been provided to Energy Focus, Inc. and will be retained by Energy Focus, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.