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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**Form 10-Q**

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(Mark One)

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

For the quarterly period ended June 30, 2017

or

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

For the transition period from        to

Commission File Number: 001-15957

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**Capstone Turbine Corporation**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

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

**21211 Nordhoff Street,  
Chatsworth, California**  
(Address of principal executive offices)

**91311**  
(Zip Code)

**818-734-5300**  
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

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

The number of shares outstanding of the registrant's common stock as of August 4, 2017 was 42,615,940.

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**PART I — FINANCIAL INFORMATION****Item 1. Financial Statements****CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(In thousands, except share amounts)**  
**(Unaudited)**

	<b>June 30, 2017</b>	<b>March 31, 2017</b>
<b>Assets</b>		
Current Assets:		
Cash and cash equivalents	\$ 14,139	\$ 14,191
Restricted cash	5,000	5,514
Accounts receivable, net of allowances of \$6,804 at June 30, 2017 and \$6,845 at March 31, 2017	12,231	17,003
Inventories	15,438	14,538
Prepaid expenses and other current assets	2,583	3,073
Total current assets	49,391	54,319
Property, plant and equipment, net	2,007	2,115
Non-current portion of inventories	887	961
Intangible assets, net	583	651
Other assets	302	225
Total assets	<u>\$ 53,170</u>	<u>\$ 58,271</u>
<b>Liabilities and Stockholders' Equity</b>		
Current Liabilities:		
Accounts payable and accrued expenses	\$ 13,590	\$ 14,719
Accrued salaries and wages	1,374	1,819
Accrued warranty reserve	3,073	3,766
Deferred revenue	5,877	5,050
Revolving credit facility	9,484	11,533
Current portion of notes payable and capital lease obligations	128	302
Total current liabilities	33,526	37,189
Long-term portion of notes payable and capital lease obligations	23	26
Other long-term liabilities	147	158
Total liabilities	<u>33,696</u>	<u>37,373</u>
Commitments and contingencies (Note 15)		
Stockholders' Equity:		
Preferred stock, \$.001 par value; 10,000,000 shares authorized; none issued	—	—
Common stock, \$.001 par value; 515,000,000 shares authorized, 42,388,199 shares issued and 42,268,594 shares outstanding at June 30, 2017; 38,920,174 shares issued and 38,803,630 shares outstanding at March 31, 2017	42	39
Additional paid-in capital	877,364	874,697
Accumulated deficit	(856,291)	(852,199)
Treasury stock, at cost; 119,605 shares at June 30, 2017 and 116,544 shares at March 31, 2017	(1,641)	(1,639)
Total stockholders' equity	<u>19,474</u>	<u>20,898</u>
Total liabilities and stockholders' equity	<u>\$ 53,170</u>	<u>\$ 58,271</u>

See accompanying notes to condensed consolidated financial statements.

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(In thousands, except per share data)**  
**(Unaudited)**

	Three Months Ended	
	June 30,	
	2017	2016
Revenue:		
Product, accessories and parts	\$ 15,491	\$ 15,783
Service	3,749	3,282
Total revenue	<u>19,240</u>	<u>19,065</u>
Cost of goods sold:		
Product, accessories and parts	14,037	13,637
Service	2,964	2,429
Total cost of goods sold	<u>17,001</u>	<u>16,066</u>
Gross margin	<u>2,239</u>	<u>2,999</u>
Operating expenses:		
Research and development	1,149	1,621
Selling, general and administrative	4,960	5,746
Total operating expenses	<u>6,109</u>	<u>7,367</u>
Loss from operations	(3,870)	(4,368)
Other expense	(10)	(16)
Interest income	9	5
Interest expense	(221)	(134)
Loss before income taxes	(4,092)	(4,513)
Provision for income taxes	—	3
Net loss	<u>\$ (4,092)</u>	<u>\$ (4,516)</u>
Net loss per common share—basic and diluted	<u>\$ (0.10)</u>	<u>\$ (0.17)</u>
Weighted average shares used to calculate basic and diluted net loss per common share	<u>41,081</u>	<u>27,171</u>

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended June 30,	
	2017	2016
<b>Cash Flows from Operating Activities:</b>		
Net loss	\$ (4,092)	\$ (4,516)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	304	407
Amortization of deferred financing costs	105	44
Reduction in accounts receivable allowances	(13)	(904)
Inventory provision	183	208
Provision for warranty expenses	779	142
Loss on disposal of equipment	23	171
Stock-based compensation	154	238
Changes in operating assets and liabilities:		
Accounts receivable	4,786	(1,254)
Inventories	(1,010)	1,935
Prepaid expenses and other current assets	296	230
Accounts payable and accrued expenses	(1,147)	(32)
Accrued salaries and wages and long term liabilities	(455)	(359)
Accrued warranty reserve	(1,472)	(377)
Deferred revenue	827	1,863
Net cash used in operating activities	<u>(732)</u>	<u>(2,204)</u>
<b>Cash Flows from Investing Activities:</b>		
Expenditures for property and equipment	(178)	(9)
Net cash used in investing activities	<u>(178)</u>	<u>(9)</u>
<b>Cash Flows from Financing Activities:</b>		
Net repayments of revolving credit facility	(2,049)	(3,382)
Repayment of notes payable and capital lease obligations	(122)	(194)
Cash used in employee stock-based transactions	(5)	(2)
Net proceeds from issuance of common stock and warrants	2,520	13,128
Net cash provided by financing activities	<u>344</u>	<u>9,550</u>
Net increase (decrease) in Cash, Cash Equivalents and Restricted Cash	(566)	7,337
Cash, Cash Equivalents and Restricted Cash, Beginning of Period	19,705	16,706
Cash, Cash Equivalents and Restricted Cash, End of Period	<u>\$ 19,139</u>	<u>\$ 24,043</u>
<b>Supplemental Disclosures of Cash Flow Information:</b>		
Cash paid during the period for:		
Interest	\$ 108	\$ 136
Income taxes	\$ —	\$ 3
<b>Supplemental Disclosures of Non-Cash Information:</b>		
Acquisition of property and equipment through accounts payable	\$ 7	\$ 53

See accompanying notes to condensed consolidated financial statements.

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
(Unaudited)

**1. Business and Organization**

Capstone Turbine Corporation (the “Company”) develops, manufactures, markets and services microturbine technology solutions for use in stationary distributed power generation applications, including cogeneration (combined heat and power (“CHP”), integrated combined heat and power (“ICHP”), and combined cooling, heat and power (“CCHP”)), renewable energy, natural resources, critical power supply, transportation and marine. In addition, the Company’s microturbines can be used as battery charging generators for hybrid electric vehicle applications. The Company was organized in 1988 and has been commercially producing its microturbine generators since 1998.

**2. Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“generally accepted accounting principles” or “GAAP”) for interim financial information and the instructions to Form 10-Q and Regulation S-X promulgated under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). They do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The condensed consolidated balance sheet at March 31, 2017 was derived from audited financial statements included in the Company’s Annual Report on Form 10-K for the year ended March 31, 2017. In the opinion of management, the interim condensed consolidated financial statements include all adjustments (including normal recurring adjustments) necessary for a fair presentation of the financial condition, results of operations and cash flows for such periods. Results of operations for any interim period are not necessarily indicative of results for any other interim period or for the full year. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended March 31, 2017. This Quarterly Report on Form 10-Q (this “Form 10-Q”) refers to the Company’s fiscal years ending March 31 as its “Fiscal” years.

***Evaluation of Ability to Maintain Current Level of Operations*** In connection with preparing the consolidated financial statements for the first quarter of Fiscal 2018, management evaluated whether there were conditions and events, considered in the aggregate, that raised substantial doubt about the Company’s ability to meet its obligations as they became due for the next twelve months from the date of issuance of its first quarter of Fiscal 2018 financial statements. Management assessed that there were such conditions and events, including a history of recurring operating losses, negative cash flows from operating activities, the continued negative impact caused by the volatility of the global oil and gas markets, a strong U.S. dollar (making our products more expensive overseas) and ongoing geopolitical tensions in Russia, North Africa and the Middle East. Cash provided by working capital during the first quarter of Fiscal 2018 were higher than planned, primarily because of cash provided by the collection of accounts receivable. However, the Company did not fully achieve its planned number of product shipments during the first quarter of Fiscal 2018, resulting in lower than expected revenue. The Company incurred a net loss of \$4.1 million and used cash in operating activities of \$0.7 million for the first quarter of Fiscal 2018. In addition, as of June 30, 2017, the Company had cash, cash equivalents and restricted cash of \$19.1 million, and outstanding borrowings under its credit facility of \$9.5 million.

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

On June 2, 2017, the Company, entered into two secured credit facilities (the “Bridge Bank Credit Agreements”) with Western Alliance Bank through its Bridge Bank division (“Bridge Bank”), with credit support provided by the Export-Import Bank of the United States through its working capital guarantee program. Under the terms of the Bridge Bank Credit Agreements, the Company may borrow up to \$12.0 million on a revolving basis depending on, among other factors, the amount of its eligible inventory and accounts receivable. The Bridge Bank Credit Agreements are for a two-year period ending June 2, 2019. See Note 11—Revolving Credit Facility, for discussion of the credit facilities with Bridge Bank.

The Company maintained two Credit and Security Agreements, with Wells Fargo Bank, National Association (“Wells Fargo”), which provided the Company with a credit facility up to \$20.0 million in the aggregate. Upon closing with Bridge Bank the Company’s existing credit facilities with Wells Fargo, were paid off in full.

Based on the Company’s current operating plan, management anticipates that, given current working capital levels, current financial projections, the ability to borrow under its credit facility with Bridge Bank and the funds raised by selling additional securities through the at-the-market offering as of the date of issuance of its first quarter of Fiscal 2018 financial statements, the Company will be able to meet its financial obligations as they become due over the next twelve months from the date of issuance of its first quarter of Fiscal 2018 financial statements.

The consolidated financial statements include the accounts of the Company, Capstone Turbine International, Inc., its wholly owned subsidiary that was formed in June 2004 and Capstone Turbine Financial Services, LLC, its wholly owned subsidiary that was formed in October 2015, after elimination of inter-company transactions.

### **3. Recently Issued Accounting Standards**

In July 2017, the Financial Accounting Standards Board (“FASB”) issued a two-part Accounting Standards Update (“ASU”) No. 2017-11, I. Accounting for Certain Financial Instruments With Down Round Features and II. Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests With a Scope Exception (“ASU 2017-11”). ASU 2017-11 amends guidance in FASB ASC 260, Earnings Per Share, FASB ASC 480, Distinguishing Liabilities from Equity, and FASB ASC 815, Derivatives and Hedging. The amendments in Part I of ASU 2017-11 change the classification analysis of certain equity-linked financial instruments (or embedded features) with down round features. The amendments in Part II of ASU 2017-11 re-characterize the indefinite deferral of certain provisions of Topic 480 that now are presented as pending content in the Codification, to a scope exception. Those amendments do not have an accounting effect. ASU 2017-11 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted. The Company adopted ASU 2017-11 for the three months ended June 30, 2017, and retrospectively applied ASU 2017-11 as required. See Note 10—Fair Value Measurements for further discussion on changes as a result of the adoption of ASU 2017-11.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), (“ASU 2016-02”). The purpose of ASU 2016-02 is to provide financial statement users a better understanding of the amount, timing, and uncertainty of cash flows arising from leases. The adoption of ASU 2016-02 will result in the recognition of a right-of-use asset and a lease liability for most operating leases. New disclosure requirements include qualitative and quantitative information about the amounts recorded in the financial statements. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018. ASU 2016-02 requires a modified retrospective transition by means of a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year in which the guidance is effective with the option to elect certain practical expedients. Early adoption is permitted. The Company is currently evaluating the impact of ASU 2016-02 on its consolidated financial position and results of operations.

In July 2015, the FASB issued ASU 2015-11, Simplifying the Measurement of Inventory (“ASU 2015-11”). ASU 2015-11 requires inventory that is recorded using the first-in, first-out method to be measured at the lower of cost or net realizable value. ASU 2015-11 is effective for annual and interim periods beginning after December 15, 2016, and should be applied prospectively with early adoption permitted at the beginning of an interim or annual reporting period. The Company adopted ASU 2015-11 with no impact on its consolidated financial position or results of operations.

#### **Revenue Recognition Related ASUs:**

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”). ASU 2014-09 supersedes nearly all existing revenue recognition guidance under GAAP. The standard’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services.

In August 2015, the FASB issued FASB ASU No. 2015-14, Revenue from Contracts with Customers: Deferral of the Effective Date (“ASU 2014-09”), which deferred the effective date of ASU 2014-09 by one year. ASU 2014-09 is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period, using one of two retrospective application methods. Early application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period.

In March 2016, the FASB issued FASB ASU No. 2016-08, Revenue from Contracts with Customers: Principal versus Agent Considerations (“ASU 2016-08”). ASU 2016-08 clarifies the implementation guidance on principal versus agent considerations.

In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing (“ASU 2016-10”). ASU 2016-10 clarifies the implementation guidance for identifying performance obligations and determining when to recognize revenue on licensing agreements for intellectual property.

In May 2016, the FASB issued ASU No. 2016-11, Revenue Recognition and Derivatives and Hedging: Rescission of SEC Guidance Because of ASU 2014-09 and ASU 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting (“ASU 2016-11”). ASU 2016-11 rescinds certain SEC staff comments previously made in regard to these ASU’s.

In May 2016, the FASB issued ASU No. 2016-12, Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients (“ASU 2016-12”) that provide guidance on assessing collectability, presentation of sales taxes, noncash consideration, and completed contracts and contract modifications at transition.

In December 2016, the FASB issued ASU 2016-20, Technical Corrections and Improvements to ASU 2014-09. The amendments in ASU 2014-09 affect narrow aspects of the guidance in ASU 2014-09, which is not yet effective. The amendments in ASU 2014-09 address loan guarantee fees, impairment testing of contract costs, provisions for losses on construction-type and production-type contracts, and various disclosures.

The Company is evaluating its existing revenue recognition policies and the impact of ASU 2014-09, ASU 2015-14, ASU 2016-08, ASU 2016-10, ASU 2016-11, ASU 2016-12 and ASU 2016-20, if any, on its financial position and results of operations. The effective date and transition requirements for the amendments are the same as the effective date and transition requirements for ASU 2014-09. The Company will be required to adopt the revenue recognition standard in annual reporting periods beginning after December 15, 2017 (fiscal year ending March 31, 2019) and interim periods within those annual periods.

#### **4. Customer Concentrations and Accounts Receivable**

Sales to Horizon Power Systems (“Horizon”) and E-Finity Distributed Generation, LLC (“E-Finity”), two of the Company’s domestic distributors, accounted for 21% and 15%, respectively, of revenue for the first quarter of Fiscal 2018. Sales to Regatta Solutions, Inc. (“Regatta”) and E-Finity, two of the Company’s domestic distributors, accounted for 17% and 10%, respectively, of revenue for the first quarter of Fiscal 2017.

Additionally, E-Finity, Optimal Group Australia Pty Ltd, one of the Company’s Australian distributors and Dtc Soluciones Inmobiliarias S.A. de C.V. (“DTC”), one of the Company’s Mexican distributors accounted for 26%, 13%, and 10%, respectively, of net accounts receivable as of June 30, 2017. E-Finity, DTC and Reliable Secure Power Systems, one of the Company’s domestic distributors (“RSP”), accounted for 29%, 12% and 10%, respectively, of net accounts receivable as of March 31, 2017.

The Company recorded a net bad debt recovery of approximately \$13,000 during the first quarter of Fiscal 2018. As of June 30, 2017, the Company collected approximately \$1.7 million from BPC Engineering (“BPC”), one of its Russian distributors, on their combined balances of previously reserved receivable and deferred revenue totaling

approximately \$8.1 million. The Company recorded a bad debt recovery of \$0.9 million during the first quarter of Fiscal 2017.

## 5. Inventories

Inventories are valued on a first in first out (“FIFO”) basis and lower of cost or net realizable value and consisted of the following as of June 30, 2017 and March 31, 2017 (in thousands):

	<b>June 30, 2017</b>	<b>March 31, 2017</b>
Raw materials	\$ 14,921	\$ 15,035
Work in process	85	—
Finished goods	1,319	464
Total	16,325	15,499
Less non-current portion	(887)	(961)
Current portion	<u>\$ 15,438</u>	<u>\$ 14,538</u>

The non-current portion of inventories represents the portion of the inventories in excess of amounts expected to be sold or used in the next twelve months. The non-current inventories are primarily comprised of repair parts for older generation products that are still in operation but are not technologically compatible with current configurations. The weighted average age of the non-current portion of inventories on hand as of June 30, 2017 is 1.7 years. The Company expects to use the non-current portion of the inventories on hand as of June 30, 2017 over the periods presented in the following table (in thousands):

<b>Expected Period of Use</b>	<b>Non- current Inventory Balance Expected to be Used</b>
13 to 24 months	\$ 455
25 to 36 months	432
Total	<u>\$ 887</u>

## 6. Property, Plant and Equipment

Property, plant and equipment consisted of the following as of June 30, 2017 and March 31, 2017 (in thousands):

	<b>June 30, 2017</b>	<b>March 31, 2017</b>
Machinery, rental equipment, equipment, automobiles and furniture	\$ 15,698	\$ 17,657
Leasehold improvements	9,822	9,870
Molds and tooling	2,856	2,866
	28,376	30,393
Less, accumulated depreciation	<u>(26,369)</u>	<u>(28,278)</u>
Total property, plant and equipment, net	<u>\$ 2,007</u>	<u>\$ 2,115</u>

Depreciation expense for property and equipment was \$0.2 million and \$0.3 million for first quarter of Fiscal 2018 and Fiscal 2017, respectively.

## 7. Intangible Assets

Intangible assets consisted of the following as of June 30, 2017 and March 31, 2017 (in thousands):

	<b>June 30, 2017</b>			
	<b>Weighted Average Amortization Period</b>	<b>Intangible Assets, Gross</b>	<b>Accumulated Amortization</b>	<b>Intangible Assets, Net</b>
Manufacturing license	17 years	\$ 3,700	\$ 3,696	\$ 4
Technology	10 years	2,240	1,661	579
Trade name & parts, service and TA100 customer relationships	1.2 to 5 years	1,766	1,766	—
Total		<u>\$ 7,706</u>	<u>\$ 7,123</u>	<u>\$ 583</u>

  

	<b>March 31, 2017</b>			
	<b>Weighted Average Amortization Period</b>	<b>Intangible Assets, Gross</b>	<b>Accumulated Amortization</b>	<b>Intangible Assets, Net</b>
Manufacturing license	17 years	\$ 3,700	\$ 3,684	\$ 16
Technology	10 years	2,240	1,605	635
Trade name & parts, service and TA100 customer relationships	1.2 to 5 years	1,766	1,766	—
Total		<u>\$ 7,706</u>	<u>\$ 7,055</u>	<u>\$ 651</u>

Amortization expense for the intangible assets was \$0.1 million during the first quarter of each of Fiscal 2018 and Fiscal 2017.

Expected future amortization expense of intangible assets as of June 30, 2017 is as follows (in thousands):

<b>Year Ending March 31,</b>	<b>Amortization Expense</b>
2018 (remainder of fiscal year)	172
2019	224
2020	187
Thereafter	—
Total expected future amortization	<u>\$ 583</u>

The manufacturing license provides the Company with the ability to manufacture recuperator cores previously purchased from Solar Turbines Incorporated (“Solar”). The Company is required to pay a per-unit royalty fee over a seventeen-year period for cores manufactured and sold by the Company using the technology. Royalties of approximately \$6,500 and \$8,300 were earned by Solar for the first quarter of Fiscal 2018 and 2017, respectively. Earned royalties of approximately \$16,500 and \$10,000 were unpaid as of June 30, 2017 and March 31, 2017, respectively, and are included in accounts payable and accrued expenses in the accompanying balance sheets.

## 8. Stock-Based Compensation

The following table summarizes, by statement of operations line item, stock-based compensation expense for the Company’s first quarter of Fiscal 2018 and 2017 (in thousands):

	<b>Three months ended June 30,</b>	
	<b>2017</b>	<b>2016</b>
Cost of goods sold	\$ 20	\$ 15
Research and development	7	3
Selling, general and administrative	127	220
Stock-based compensation expense	<u>\$ 154</u>	<u>\$ 238</u>

**Stock Plans**

**2000 Equity Incentive Plan**

In June 2000, the Company adopted the 2000 Equity Incentive Plan (“2000 Plan”). The 2000 Plan provides for a total maximum aggregate number of shares which may be issued of 1,849,000 shares.

*Stock Options*

The Company issues stock options under the 2000 Plan to employees, non-employee directors and consultants that vest and become exercisable over a four-year period and expire 10 years after the grant date. The Company uses a Black-Scholes valuation model to estimate the fair value of the options at the grant date, and compensation cost is recorded on a straight-line basis over the vesting period. During the year ended March 31, 2017, the Company established an accounting policy election to assume zero forfeiture for stock options and account for forfeitures when they occur. All options are subject to the following vesting provisions: one-fourth vest one year after the issuance date and 1/48th vest on the first day of each full month thereafter, so that all options will be vested on the first day of the 48th month after the grant date. Information relating to stock options for the Company’s first quarter of Fiscal 2018 is as follows:

	<u>Shares</u>	<u>Weighted-Average Exercise Price</u>	<u>Weighted-Average Remaining Contractual Term (in years)</u>	<u>Aggregate Intrinsic Value</u>
Options outstanding at March 31, 2017	314,537	\$ 15.48		
Granted	—	\$ —		
Exercised	—	\$ —		
Forfeited, cancelled or expired	<u>(2,500)</u>	<u>\$ 26.92</u>		
Options outstanding at June 30, 2017	<u>312,037</u>	<u>\$ 15.39</u>	<u>5.2</u>	<u>—</u>
Options fully vested at June 30, 2017 and those expected to vest beyond June 30, 2017	<u>312,037</u>	<u>\$ 15.39</u>	<u>5.2</u>	<u>—</u>
Options exercisable at June 30, 2017	<u>223,107</u>	<u>\$ 20.85</u>	<u>3.6</u>	<u>—</u>

*Black-Scholes Model Valuation Assumptions*

There were no stock options granted during either of the first quarter of Fiscal 2018 or 2017. The Company recorded expense of approximately \$8,000 associated with its stock options during the first quarter of Fiscal 2018. There was no expense associated with stock options during the first quarter of Fiscal 2017. As of June 30, 2017, there was approximately \$0.1 million of total compensation cost related to unvested stock option awards that is expected to be recognized as expense over a weighted average period of 3.2 years.

*Restricted Stock Units and Performance Restricted Stock Units*

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

<b>Restricted Stock and Performance Restricted Stock Units</b>	<b>Shares</b>	<b>Weighted Average Grant Date Fair Value</b>
Nonvested restricted stock units outstanding at March 31, 2017	316,709	\$ 2.85
Granted	29,540	0.67
Vested and issued	(9,191)	20.22
Forfeited	(2,255)	2.97
Nonvested restricted stock units outstanding at June 30, 2017	<u>334,803</u>	<u>2.18</u>
Restricted stock units expected to vest beyond June 30, 2017	<u>334,780</u>	<u>\$ 2.18</u>

The following table provides additional information on restricted stock units for the Company's first quarter of Fiscal 2018 and 2017:

	<b>Three months ended June 30,</b>	
	<b>2017</b>	<b>2016</b>
Restricted stock compensation expense (in thousands)	\$ 139	\$ 188
Aggregate fair value of restricted stock units vested and issued (in thousands)	\$ 7	\$ 22
Weighted average grant date fair value of restricted stock units granted during the period	\$ 0.67	\$ —

As of June 30, 2017, there was approximately \$0.4 million of total compensation cost related to unvested restricted stock units that is expected to be recognized as expense over a weighted average period of 1.2 years.

#### *Restricted Stock Awards*

The Company issues restricted stock awards under the 2000 Plan to employees and non-employee directors. During the first quarter of Fiscal 2018 and 2017 the Company granted stock awards to non-employee directors who elected to take payment of all or any part of the directors' fees in stock in lieu of cash. The following table outlines the restricted stock award activity for the first quarter of Fiscal 2018 and 2017:

	<b>Three Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>
Restricted stock awards compensation expense (in thousands)	\$ 7	\$ 50
Restricted stock awards granted	2,016	32,201
Weighted average grant date fair value of restricted stock awards granted during the period	\$ 0.62	\$ 1.57

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

#### **Grants outside of 2000 Plan**

As of June 30, 2017, the Company had outstanding 88,930 non-qualified common stock options and 14,820 restricted stock units issued outside of the 2000 Plan. The Company granted these stock options and restricted stock units during the three months ended September 30, 2016 as inducement grants to the new Vice President, Manufacturing of the Company, with exercise prices or values, as applicable, based on the fair market value of the Company's common stock on the grant date.

Although the options and restricted stock units were not granted under the 2000 Plan, they are governed by terms and conditions identical to those under the 2000 Plan. All options are subject to the following vesting provisions: one-fourth vest one year after the issuance date and 1/48th vest on the first day of each full month thereafter, so that all

options will be vested on the first day of the 48th month after the grant date. All outstanding options have a contractual term of ten years. The restricted stock units vest in equal installments over a period of four years.

### **Stockholder Rights Plan**

On May 6, 2016, the Company entered into Amendment No. 5 (the “Amendment”) to the Rights Agreement, dated as of July 7, 2005, as amended by Amendment No. 1, dated as of July 3, 2008, Amendment No. 2, dated as of June 9, 2011, Amendment No. 3, dated as of July 1, 2014 and Amendment No. 4, dated as of August 5, 2014, (the “Original Rights Agreement”) between the Company and Computershare Inc.

The Amendment accelerated the expiration of the Company’s preferred share purchase rights (the “Original Rights”) from 5:00 p.m., California time, on the 30th day after the Company’s 2017 annual meeting of stockholders to 5:00 p.m., California time, on May 6, 2016, and had the effect of terminating the Original Rights Agreement on that date. At the time of the termination of the Original Rights Agreement, all of the Original Rights distributed to holders of the Company’s common stock pursuant to the Original Rights Agreement expired.

On May 6, 2016, the Company entered into a rights agreement (the “NOL Rights Agreement”) with Computershare Inc., as rights agent. In connection with the NOL Rights Agreement, the Company’s Board of Directors authorized and declared a dividend distribution of one preferred stock purchase right (a “New Right”) for each share of the Company’s common stock authorized and outstanding. Each New Right entitles the registered holder to purchase from the Company a unit consisting of one one-thousandth of a share of Series B Junior Participating Preferred Stock, par value \$0.001 per share, at a purchase price of \$8.76 per unit, subject to adjustment. The description and terms of the New Rights are set forth in the NOL Rights Agreement.

The purpose of the NOL Rights Agreement is to diminish the risk that the Company’s ability to use its net operating losses and certain other tax assets (collectively, “Tax Benefits”) to reduce potential future federal income tax obligations would become subject to limitations by reason of the Company’s experiencing an “ownership change,” as defined in Section 382 of the Internal Revenue Code of 1986. A company generally experiences such an ownership change if the percentage of its stock owned by its “5-percent shareholders,” as defined in Section 382 of the Internal Revenue Code of 1986, increases by more than 50 percentage points over a rolling three-year period. The NOL Rights Agreement is designed to reduce the likelihood that the Company will experience an ownership change under Section 382 of the Internal Revenue Code of 1986 by (i) discouraging any person or group from becoming a 4.99% shareholder and (ii) discouraging any existing 4.99% shareholder from acquiring additional shares of the Company’s stock.

The New Rights will not be exercisable until the earlier to occur of (i) the close of business on the tenth business day after a public announcement or filing that a person has, or group of affiliated or associated persons or persons acting in concert have, become an “Acquiring Person,” which is defined as a person or group of affiliated or associated persons or persons acting in concert who, at any time after the date of the NOL Rights Agreement, have acquired, or obtained the right to acquire, beneficial ownership of 4.99% or more of the Company’s outstanding shares of common stock, subject to certain exceptions or (ii) the close of business on the tenth business day after the commencement of, or announcement of an intention to commence, a tender offer or exchange offer the consummation of which would result in any person becoming an Acquiring Person (the earlier of such dates being called the “Distribution Date”). Certain synthetic interests in securities created by derivative positions, whether or not such interests are considered to be ownership of the underlying common stock or are reportable for purposes of Regulation 13D of the Exchange Act, are treated as beneficial ownership of the number of shares of common stock equivalent to the economic exposure created by the derivative position, to the extent actual shares of the common stock are directly or indirectly held by counterparties to the derivatives contracts.

The New Rights, which are not exercisable until the Distribution Date, will expire prior to the earliest of (i) May 6, 2019 or such later day as may be established by the Board of Directors prior to the expiration of the New Rights, provided that the extension is submitted to the Company’s stockholders for ratification at the next annual meeting of stockholders of the Company succeeding such extension; (ii) the time at which the New Rights are redeemed pursuant to the NOL Rights Agreement; (iii) the time at which the New Rights are exchanged pursuant to the NOL Rights Agreement; (iv) the time at which the New Rights are terminated upon the occurrence of certain transactions; (v) the close of business on the first day after the Company’s 2017 annual meeting of stockholders, if approval by the stockholders of the Company of the NOL Rights Agreement has not been obtained on or prior to the close of business on the first day after the Company’s 2017 annual meeting of stockholders; (vi) the close of business on the effective date of

the repeal of Section 382 of the Internal Revenue Code of 1986, if the Board of Directors determines that the NOL Rights Agreement is no longer necessary or desirable for the preservation of Tax Benefits; and (vii) the close of business on the first day of a taxable year of the Company to which the Board of Directors determines that no Tax Benefits are available to be carried forward.

Each share of Series B Junior Participating Preferred Stock will be entitled, when, as and if declared, to a preferential per share quarterly dividend payment equal to the greater of (i) \$1.00 per share or (ii) an amount equal to 1,000 times the dividend declared per share of common stock. Each share of Series B Junior Participating Preferred Stock will entitle the holder thereof to 1,000 votes on all matters submitted to a vote of the stockholders of the Company. In the event of any merger, consolidation or other transaction in which shares of common stock are converted or exchanged, each share of Series B Junior Participating Preferred Stock will be entitled to receive 1,000 times the amount received per one share of common stock.

## **9. Offerings of Common Stock and Warrants and At-the-Market Offering Program**

On October 18, 2016, the Company entered into a securities purchase agreement with certain accredited investors, pursuant to which the Company agreed to sell 3.6 million shares of common stock, pre-funded Series B warrants to purchase up to 2.7 million shares of common stock, and Series A warrants to purchase up to 6.3 million shares of common stock. Pursuant to a placement agent agreement, dated as of October 18, 2016, the Company engaged Oppenheimer & Co. Inc. as the lead placement agent for the offering and ROTH Capital Partners, LLC as co-placement agent for the offering. Each share of common stock was sold at a price of \$1.20. Each Series B warrant was issued with an exercise price of \$1.20 per share of common stock, \$1.19 of which was pre-funded at closing and \$0.01 of which is payable upon exercise. Each Series A warrant was issued with an initial exercise price of \$1.34 per share of common stock. These Series A warrants contain anti-dilution provisions that reduce the exercise price of the warrants if certain dilutive issuances occur. The anti-dilution provisions of the Series A warrants are subject to approval by the Company's stockholders. The net proceeds to the Company from this offering, after deducting the placement agent fees and other estimated offering expenses, were approximately \$6.8 million. The offering closed on October 21, 2016.

On April 19, 2016, the Company entered into an underwriting agreement with Oppenheimer & Co. Inc. as the sole book-running manager, and Rodman & Renshaw, a unit of H.C. Wainwright & Co., LLC, as the co-manager, related to the public offering of 2.7 million shares of our common stock and pre-funded Series B warrants to purchase up to 5.5 million shares of common stock, which were offered in lieu of common stock to those purchasers whose purchase of common stock in the offering otherwise would result in the purchaser beneficially owning more than 4.99% of the Company's outstanding common stock following the completion of the offering. Also included in the offering were Series A warrants to purchase 4.1 million shares of common stock. Every two shares of common stock were sold with one Series A warrant to purchase one share of common stock at a collective negotiated price of \$3.50. Every two Series B warrants were sold with one Series A warrant to purchase one share of common stock at a collective negotiated price of \$3.48. The Series A warrants are exercisable, subject to certain limitations, during the period commencing six months after the date of the issuance and expire five years after the first day they are exercisable. The pre-funded Series B warrants were exercisable, subject to certain limitations, upon issuance and expire nine months from the date of issuance, subject to extension under certain circumstances. The net proceeds to the Company from the sale of the common stock and warrants, after deducting fees and other offering expenses, were approximately \$13.1 million. The offering closed on April 22, 2016.

During the three months ended June 30, 2017, there was no Series A warrant activity and 10,407,500 Series A warrants remained outstanding. During the Fiscal year ended March 31, 2017, all Series B warrants were exercised and there are no Series B warrants outstanding.

Effective August 28, 2015, the Company entered into a sales agreement with respect to an at-the-market offering program pursuant to which the Company may offer and sell, from time to time at its sole discretion, shares of its common stock, having an aggregate offering price of up to \$30.0 million. The Company will set the parameters for sales of the shares, including the number to be sold, the time period during which sales are requested to be made, any limitation on the number that may be sold in one trading day and any minimum price below which sales may not be made. During the three months ended June 30, 2017, we issued 3.5 million shares of the Company's common stock under the at-the-market offering program and the net proceeds to the Company from the sale of the Company's common stock were approximately \$2.5 million after deducting commissions paid of approximately \$37,700. As of June 30, 2017, 10.7 million shares of the Company's common stock were sold pursuant to the at-the-market offering program and

the net proceeds to the Company from the sale of the common stock were approximately \$12.8 million after deducting commissions paid of approximately \$0.4 million. As of June 30, 2017, approximately \$13.7 million remained available for issuance with respect to the at-the-market offering program. These available proceeds are subject to Instruction I.B.6(a) to Form S-3 often referred to as the “Baby Shelf Rules.”

## 10. Fair Value Measurements

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

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

*Level 2.* Inputs to the valuation methodology include:

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

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

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

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

The table below presents our assets and liabilities that are measured at fair value on a recurring basis at June 30, 2017 and are categorized using the fair value hierarchy (in thousands):

	Fair Value Measurements at June 30, 2017			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Restricted cash	\$5,000	\$ 5,000	\$ —	\$ —

The table below presents our assets and liabilities that are measured at fair value on a recurring basis during the fiscal year ended March 31, 2017 and are categorized using the fair value hierarchy (in thousands):

**Fair Value Measurements at March 31, 2017**

	<b>Total</b>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>
Cash equivalents	\$ 7,520	\$ 7,520	\$ —	\$ —
Restricted cash	\$ 5,514	\$ 5,514	\$ —	\$ —

Cash equivalents include cash held in money market and U.S. treasury funds at March 31, 2017.

*Basis for Valuation*

The carrying values reported in the consolidated balance sheets for cash and cash equivalents, restricted cash, accounts receivable and accounts payable approximate fair values because of the immediate or short-term maturities of these financial instruments. As the Company's obligations under the Credit Facility are based on adjustable market rates reflective of what would currently be available to the Company, the Company has determined that the carrying value approximates the fair value. The carrying values and estimated fair values of these obligations are as follows (in thousands):

	<b>As of</b>		<b>As of</b>	
	<b>June 30, 2017</b>		<b>March 31, 2017</b>	
	<b>Carrying Value</b>	<b>Estimated Fair Value</b>	<b>Carrying Value</b>	<b>Estimated Fair Value</b>
Obligations under the credit facility	\$ 9,484	\$ 9,484	\$ 11,533	\$ 11,533

*Adoption of ASU 2017-11*

The Company changed its method of method of accounting for warrants through the early adoption of ASU 2017-11 during the three months ended June 30, 2017 on a full retrospective basis. Accordingly, the Company reclassified the warrant liability to additional paid in capital on its March 31, 2017 consolidated balance sheets, which increased additional paid-in capital by \$2.9 million and decreased warrant liability by \$2.9 million. In addition, because of the retrospective adoption, the Company credited change in fair value of warrant liability on its consolidated statements of operations by \$0.5 million and \$1.3 million for the three months and year ended March 31, 2017, respectively. The change in unrealized gain/loss on warrant liability was offset by a \$1.3 million credit to accumulated deficit on the consolidated balance sheets. Adoption of ASU 2017-11 had no impact on the Company's consolidated statement of cash flows in the current or previous interim and annual reporting periods. The adoption of ASU 2017-11 also had no impact on statement of operations during the three months ended June 30, 2016 and no cumulative effect to the accumulated deficit as of the beginning of the prior annual reporting period, as there were no warrants outstanding in those respective periods that were impacted by ASU 2017-11. The following table provides a reconciliation of warrant liability, additional paid-in capital, accumulated deficit and change in fair value of warrant liability on the consolidated balance sheets for the year ended March 31, 2017 (in thousands):

	<b>Consolidated Balance Sheets</b>		
	<b>Warrant Liability</b>	<b>Additional Paid-in Capital</b>	<b>Accumulated deficit</b>
Balance, March 31, 2017 (Prior to adoption of ASU 2017-11)	\$ 2,917	\$ 870,457	\$ (850,876)
Reclassified warrant liability	\$ (4,240)	\$ 4,240	\$ —
Reclassified unrealized gain on warrant liability	\$ 1,323	\$ —	\$ (1,323)
Balance, March 31, 2017 (After adoption of ASU 2017-11)	\$ —	\$ 874,697	\$ (852,199)

**11. Revolving Credit Facility**

**Former Credit Facility** The Company maintained two Credit and Security Agreements, as amended, with Wells Fargo, which provided the Company with a line of credit of up to \$20.0 million in the aggregate. As of June 30, 2016 and March 31, 2017, \$6.1 million and \$11.5 million in borrowings were outstanding, respectively, under the former credit facility. Interest expense related to the former credit facility during the first quarter of Fiscal 2018 was \$0.2 million, which includes \$0.1 million in amortization of deferred financing costs. Interest expense related to the former

credit facility during the first quarter of Fiscal 2017 was \$0.1 million, which includes \$43,750 in amortization of deferred financing costs. The Company's borrowing rate was 4.9% at March 31, 2017.

**New Credit Facility** On June 2, 2017, the Company, entered into two secured credit facilities (the "Bridge Bank Credit Agreements") with Western Alliance Bank through its Bridge Bank division ("Bridge Bank"), with credit support provided by the Export-Import Bank of the United States through its working capital guarantee program. Under the terms of the Bridge Bank Credit Agreements, the Company may borrow up to \$12.0 million on a revolving basis depending on, among other factors, the amount of its eligible inventory and accounts receivable. The Bridge Bank Credit Agreements are for a two-year period ending June 2, 2019. Upon closing with Bridge Bank the Company's existing credit facilities with Wells Fargo, were paid off in full.

Total borrowings, letter of credit obligations and the then aggregate committed amount of cash management services under the Bridge Bank Credit Agreements may not exceed 85% of the sum of unrestricted cash and the amount of cash collateral held at Bridge Bank. As a condition of the Bridge Bank Credit Agreements, the Company has restricted \$5.0 million of cash equivalents as additional security for the credit facility. Borrowings under the Bridge Bank Credit Agreements will bear per annum interest at the prime rate plus 1.5 percent, subject to increase during the occurrence of an event of default. Obligations under the Bridge Bank Credit Agreements are secured by all of the Company's assets, including intellectual property and general intangibles. The Company has incurred \$0.2 million in origination fees. These fees has been recorded under the caption "Prepaid expenses and other current assets" in the accompanying condensed consolidated balance sheets and amortized to interest expense through June 2019. As of June 30, 2017, \$9.5 million in borrowings were outstanding under the new credit facility. Interest expense related to the new credit facility during the first quarter of Fiscal 2018 was \$58,800, which includes \$18,000 in amortization of deferred financing costs. The Company's borrowing rate was 5.8% at June 30, 2017.

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

The financial covenants of the domestic credit agreement with Bridge Bank (the "Domestic Facility") requires the Company not to exceed specified levels of losses relative to its financial model and the outstanding line of credit advances may not exceed 85% of the sum of unrestricted cash and the amount of cash collateral held at Bridge Bank. The Domestic Facility also defines an event of default to include a material adverse effect on the Company's business. An event of default for this or any other reason, if not waived, could have a material adverse effect on the Company. As of June 30, 2017 we were in compliance with the covenants contained in the Bridge Bank Credit Agreements for Fiscal 2018.

## **12. Accrued Warranty Reserve**

The Company provides for the estimated costs of warranties at the time revenue is recognized. The specific terms and conditions of those warranties vary depending upon the microturbine product sold and geography of sale. The Company's product warranties generally start from the delivery date and continue for up to eighteen months. Factors that affect the Company's warranty obligation include product failure rates, anticipated hours of product operations and costs of repair or replacement in correcting product failures. These factors are estimates that may change based on new information that becomes available each period. Similarly, the Company also accrues the estimated costs to address reliability repairs on products no longer in warranty when, in the Company's judgment, and in accordance with a specific plan developed by the Company, it is prudent to provide such repairs. The Company assesses the adequacy of recorded warranty liabilities quarterly and makes adjustments to the liability as necessary. When the Company has sufficient evidence that product changes are altering the historical failure occurrence rates, the impact of such changes is then taken into account in estimating future warranty liabilities. During the three months ended December 31, 2016, the Company recorded a one-time non-cash warranty provision of approximately \$5.2 million to retrofit proactively select non-Signature Series C200 microturbines with the more robust new Signature Series generator components to improve product performance and reliability. The balance of this reliability repair program as of June 30, 2017 was \$1.3 million. Changes in accrued warranty reserve during the first quarter of Fiscal 2018 are as follows (in thousands):

Balance, beginning of the period	\$ 3,766
Standard warranty provision	878
Accrual related to reliability repair programs	(99)
Deductions for warranty claims	(1,472)
Balance, end of the period	<u>\$ 3,073</u>

### 13. Deferred Revenue

As of March 31, 2017 the balance of deferred revenue was approximately \$5.0 million. The change in deferred revenue attributed to Comprehensive Factory Protection Plan (“FPP”) contracts during the first quarter of Fiscal 2018 was an decrease of \$61,500 and the change in deferred revenue attributed to deposits during the first quarter of Fiscal 2018 was increase of \$0.9 million. Changes in deferred revenue during the first quarter of Fiscal 2018 are as follows (in thousands):

FPP Balance, beginning of the period	\$ 3,414
FPP Billings	3,617
FPP Revenue recognized	(3,678)
Balance attributed to FPP contracts	3,353
Deposits	2,524
Deferred revenue balance, end of the period	<u>\$ 5,877</u>

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

### 14. Other Current Liabilities

The Company is a party to a Development and License Agreement with Carrier Corporation (“Carrier”) regarding the payment of royalties on the sale of each of the Company’s 200 kilowatt (“C200”) microturbines. Carrier earned \$0.2 million in royalties for C200 and C1000 Series system sales during each of the first quarter of Fiscal 2018 and 2017. Earned royalties of approximately \$0.2 million and \$0.3 million were unpaid as of June 30, 2017 and March 31, 2017, respectively, and are included in accrued expenses in the accompanying balance sheets.

### 15. Commitments and Contingencies

#### Purchase Commitments

As of June 30, 2017, the Company had firm commitments to purchase inventories of approximately \$28.4 million through Fiscal 2019. Certain inventory delivery dates and related payments are not firmly scheduled; therefore, amounts under these firm purchase commitments will be payable upon the receipt of the related inventories.

#### Lease Commitments

The Company leases offices and manufacturing facilities under various non-cancelable operating leases expiring at various times through the fiscal year ending March 31, 2020. All of the leases require the Company to pay maintenance, insurance and property taxes. The lease agreements for primary office and manufacturing facilities provide for rent escalation over the lease term and renewal options for five-year periods. Rent expense is recognized on a straight-line basis over the term of the lease. The difference between rent expense recorded and the amount paid is credited or charged to deferred rent, which is included in other long-term liabilities in the accompanying balance sheets. The balance of deferred rent was approximately \$0.1 million and \$0.2 million as of June 30, 2017 and March 31, 2017, respectively. Rent expense was approximately \$0.6 million during the first quarter of each of Fiscal 2018 and Fiscal 2017.

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

### **Other Commitments**

The Company has agreements with certain of its distributors requiring that if the Company renders parts obsolete in inventories the distributors own and hold in support of their obligations to serve fielded microturbines, then the Company is required to replace the affected stock at no cost to the distributors. While the Company has never incurred costs or obligations for these types of replacements, it is possible that future changes in the Company’s product technology could result and yield costs to the Company if significant amounts of inventory are held at distributors. As of June 30, 2017, no significant inventories were held at distributors.

### **Legal Matters**

#### *Federal Securities Class Action*

Two putative securities class action complaints were filed against the Company and certain of its current and former officers in the United States District Court for the Central District of California under the following captions: David Kinney, etc. v. Capstone Turbine, et al., No. 2:15-CV-08914 on November 16, 2015 (the “Kinney Complaint”) and Kevin M. Grooms, etc. v. Capstone Turbine, et al., No. 2:15-CV-09155 on December 18, 2015 (the “Grooms Complaint”).

The putative class in the Kinney Complaint is comprised of all purchasers of the Company’s securities between November 7, 2013 and November 5, 2015. The Kinney Complaint alleges material misrepresentations and omissions in public statements regarding BPC and the likelihood that BPC would not be able to fulfill many legal and financial obligations to the Company. The Kinney Complaint also alleges that the Company’s financial statements were not appropriately adjusted in light of this situation and were not maintained in accordance with GAAP, and that the Company lacked adequate internal controls over accounting. The Kinney Complaint alleges that these public statements and accounting irregularities constituted violations by all named defendants of Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, as well as violations of Section 20(a) of the Exchange Act by the individual defendants. The Grooms Complaint makes allegations and claims that are substantially identical to those in the Kinney Complaint, and both complaints seek compensatory damages of an undisclosed amount. On January 16, 2016, several shareholders filed motions to consolidate the Kinney and Grooms actions and for appointment as lead plaintiff. On February 29, 2016, the Court granted the motions to consolidate, and appointed a lead plaintiff. On May 6, 2016, a Consolidated Amended Complaint with allegations and claims substantially identical to those of the Kinney Complaint was filed in the consolidated action. The putative class period in the Consolidated Amended Complaint is June 12, 2014 to November 5, 2015. Defendants filed a motion to dismiss the Consolidated Amended Complaint on June 17, 2016. On March 10, 2017, the Court issued an order granting Defendants’ motion to dismiss in its entirety with leave to amend. Plaintiffs filed an amended complaint on April 28, 2017. Defendants’ motion to dismiss was filed June 2, 2017. Plaintiffs filed their opposition to the motion to dismiss on July 7, 2017, and Defendants filed their reply in support of the motion to dismiss on July 28, 2017. A hearing is scheduled for August 18, 2017. The Company has not recorded any liability as of March 31, 2017 since any potential loss is not probable or reasonably estimable given the preliminary nature of the proceedings.

#### *State Derivative Lawsuits — California*

On February 18, 2016, a purported shareholder derivative action was filed in Los Angeles Superior Court in the State of California against the Company and certain of its current and former officers and directors under the following

caption: *Stesiak v. Jamison, et al.*, No. BC610782. The lawsuit alleges that certain of the Company's current and former officers and directors knew or should have known that BPC would be unable to fulfill its obligations to the Company, but allowed the Company to make false and misleading statements regarding BPC and the Company's financial condition. The complaint also alleges that the defendants failed to timely adjust the Company's account receivables and backlog to reflect BPC's inability to pay the Company. The complaint asserts causes of action for breach of fiduciary duty and unjust enrichment. It demands damages for the amount of damage sustained by the Company as a result of the individual defendants' alleged breach of fiduciary duties and unjust enrichment, that the Company institute corporate governance reforms, and disgorgement from the individual defendants. On May 5, 2016, the parties filed a stipulation and proposed order seeking to stay this action until such time as the defendants' motion(s) to dismiss the federal securities class action are either granted with prejudice or denied in whole or in part. On May 10, 2016, the Court entered that proposed order. Given that the federal securities class action was dismissed with leave to amend, this case is still stayed. A status conference is scheduled for September 20, 2017.

On June 8, 2016, a purported shareholder derivative action entitled *Velma Kilpatrick v. Simon, et al.*, No. BC623167, was filed in Los Angeles Superior Court in the State of California against the Company and certain of its current and former officers and directors. The complaint alleges that certain of the Company's current and former officers and directors knew or should have known that BPC would be unable to fulfill its obligations to the Company, but allowed the Company to make false and misleading statements regarding BPC and the Company's financial condition. The complaint also alleges that the defendants failed to timely adjust the Company's account receivables and backlog to reflect BPC's inability to pay the Company. The complaint asserts causes of action for breach of fiduciary duty. It demands damages for the amount of damage sustained by the Company as a result of the individual defendants' alleged breach of fiduciary duties, and that the Company institute corporate governance reforms. On August 23, 2016, the parties filed a stipulation and proposed order seeking to stay this action until such time as the defendants' motion(s) to dismiss the federal securities class action are either granted with prejudice or denied in whole or in part. Given that the federal securities class action was dismissed with leave to amend, this case is still stayed. A status conference is scheduled for September 26, 2017.

On December 27, 2016, a purported shareholder derivative action entitled *Andre Rosowsky v. Jamison, et al.*, No. 30-2016-00894859-CU-MC-CJC was filed in Orange County Superior Court in the State of California against the Company and certain of its current and former officers and directors. The complaint alleges that certain of the Company's current and former officers and directors knew or should have known that BPC would be unable to fulfill its obligations to the Company, but allowed the Company to make false and misleading statements regarding BPC and the Company's financial condition. The complaint also alleges that the defendants failed to timely adjust the Company's account receivables and backlog to reflect BPC's inability to pay the Company. The complaint asserts causes of action for breach of fiduciary duty and unjust enrichment. It demands damages for the amount of damage sustained by the Company as a result of the individual defendants' alleged breach of fiduciary duties, that the Company institute corporate governance reforms, and restitution from the individual defendants. On April 14, 2017, the case was removed to the United States District Court for the Central District of California. On May 5, 2017, the plaintiff voluntarily dismissed his complaint without prejudice.

#### *Federal Derivative Lawsuits*

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

On July 12, 2016 and July 18, 2016, respectively, two additional purported shareholder derivative actions were filed in the United States District Court for the Central District of California against the Company and certain of its

current and former officers and directors, under the caption Tuttle v. Atkinson, et al., No. CV16-05127, and Boll v. Jamison, et al., No. CV16-5282, respectively. The lawsuits allege that certain of the Company's current and former officers and directors knew or should have known that BPC would be unable to fulfill its obligations to the Company, but allowed the Company to make false and misleading statements regarding BPC and the Company's financial condition. The Tuttle complaint asserts causes of action for breach of fiduciary duty, gross mismanagement, and unjust enrichment, and the Boll complaint asserts causes of action for breach of fiduciary duty, unjust enrichment, abuse of control, gross mismanagement, and waste of corporate assets. Both complaints demand damages sustained by the Company as a result of the individual defendants' alleged breaches of fiduciary duties, and equitable relief, including that the Company institute appropriate corporate governance reforms. The federal derivative actions have been stayed until such time as the defendants' motion(s) to dismiss the federal securities class action are either granted with prejudice or denied in whole or in part. Given that the federal securities class action was dismissed with leave to amend, these cases are still stayed.

*Shareholder Demand*

Following the dismissal without prejudice of his purported shareholder derivative action discussed above, former plaintiff in Andre Rosowsky v. Jamison, et al. sent us a letter dated July 7, 2017 (the "Shareholder Demand") demanding that the Board of Directors take action to remedy purported breaches of fiduciary duties allegedly related to the claims asserted in the above-discussed securities class action and derivative actions. The Company acknowledged the Shareholder Demand on July 25, 2017. The Company's Board of Directors has formed a committee to evaluate the Shareholder Demand.

**16. Net Loss Per Common Share**

Basic loss per share of common stock is computed using the weighted average number of common shares outstanding for the period. Diluted loss per share is computed without consideration to potentially dilutive instruments because the Company incurred losses in the three months ended June 30, 2017 which would make these instruments anti-dilutive. As of June 30, 2017 and 2016, the number of anti-dilutive stock options and restricted stock units excluded from diluted net loss per common share computations was approximately 0.6 million and 0.7 million, respectively. As of June 30, 2017 and 2016, the number of warrants excluded from diluted net loss per common share computations was approximately 10.4 million and 6.0 million, respectively.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion should be read in conjunction with the condensed consolidated financial statements and notes included in this Form 10-Q and in our Annual Report on Form 10-K for the year ended March 31, 2017. When used in this Form 10-Q, and in the following discussion, the words “believes”, “anticipates”, “intends”, “expects” and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties which could cause actual results to differ materially from those projected. These risks include those under Risk Factors in our Annual Report on Form 10-K for the year ended March 31, 2017 and in other reports we file with the SEC. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date hereof. We assume no obligation to update any of the forward-looking statements contained herein after the filing of this Form 10-Q to conform such statements to actual results or changes in expectations except as may be required by law. All dollar amounts are approximate.

### **Overview**

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

We continue to execute on our three-pronged business profitability plan to reduce operating expenses; diversify and increase revenue; and improve gross margin. During the first quarter of Fiscal 2018 our net loss decreased by 9% to \$4.1 million and our basic and diluted loss per share improved by 41% to \$0.10 compared to \$4.5 million and \$0.17, respectively, in the same period of the previous year. The improvement in the net loss during the first quarter of Fiscal 2018 was primarily the result of a reduction of operating expenses of approximately 18% from the first quarter of Fiscal 2017. The improvement in the net loss per share during the first quarter of Fiscal 2018 was primarily the result of an increase in weighted average shares outstanding to 41.1 million for the first quarter of Fiscal 2018 from 27.2 million for the first quarter of Fiscal 2017. During the first quarter of Fiscal 2018 we continued to see a steady increase of incoming orders from a mix of our geographical and vertical markets and an increase in our service contract business with record level revenue, along with the decrease in our operating expenses as result of our continued initiatives to reduce operating expenses compared to the first quarter of Fiscal 2017. Our revenue from the Middle East and African markets during the first quarter of Fiscal 2018, was approximately 10% of revenue compared to 1% of revenue the same period last year as we continue to investment in key growth initiatives in these new markets. Our revenue continues to be negatively impacted by the volatility of the global oil and gas markets, a strong U.S. dollar (making our products more expensive overseas) and ongoing geopolitical tensions in Russia, North Africa and the Middle East.

Our products continue to gain interest in all six of the major vertical markets (energy efficiency, renewable energy, natural resources, critical power supply, transportation and marine). In the energy efficiency market, we continue to expand our market presence in hotels, office buildings, hospitals, retail and industrial applications globally. The renewable energy market is fueled by landfill gas, biodiesel, and biogas from sources such as food processing, agricultural waste and cow, pig and chicken manure. Our product sales in the oil and gas and other natural resources market is driven by our microturbines' reliability, emissions profile and ease of installation. Given the volatility of the oil and gas market, however, we have refocused our business strategy to target projects within the energy efficiency and renewal energy markets. The actual shift to the energy efficiency market is reflected in the product shipments by vertical markets table on page 23. We have also seen increased interest in critical power supply applications as customers want solutions that can handle both primary and backup power.

We continue to focus on improving our products based on customer input, building brand awareness and new channels to market by developing a diversified network of strategic distribution partners. Our focus is on products and solutions that provide near term opportunities to drive repeatable business rather than discrete projects for niche markets. In addition, management closely monitors operating expenses and strives to improve manufacturing efficiencies while

simultaneously lowering direct material costs and increasing average selling prices. The key drivers to our success are revenue growth, higher average selling prices, lower direct material costs, positive new order flow and reduced cash usage.

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

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

	Three Months Ended June 30,	
	2017	2016
Energy efficiency	56%	48%
Natural resources	39%	46%
Renewable energy	5%	6%

*Energy Efficiency—CHP/CCHP*

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

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

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

*Renewable Energy*

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

### *Critical Power Supply*

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

### *Transportation*

Our technology also can be used in HEV applications. Our customers have applied our products in HEV applications such as transit buses and Class 7 and 8 work trucks. In these applications, the microturbine acts as an onboard battery charger to recharge the battery system as needed. The benefits of microturbine-powered HEV hybrids include extended range, fuel economy gains, quieter operation, reduced emissions and higher reliability when compared with traditional internal combustion engines. Internal combustion diesel engine manufacturers have been challenged for the last several years to develop technology improvements, prior to aftertreatment that reduce emissions to levels specified by the EPA and CARB 2007 and 2010 standards. Many manufacturers are incorporating aftertreatment that increases upfront equipment costs, vehicle weight and life cycle costs, which may reduce overall engine efficiency.

### *Marine*

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

### *Backlog*

Net product orders were \$16.9 million and \$10.9 million for the first quarter of Fiscal 2018 and Fiscal 2017, respectively. Ending backlog was \$117.3 million at June 30, 2017 compared to \$108.4 million at June 30, 2016. Book-to-bill ratio was 1.3:1 and 0.9:1 for the first quarter of Fiscal 2018 and Fiscal 2017, respectively. Book-to-bill ratio is the ratio of new orders we received to units shipped and billed during a period.

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

- Sales and Distribution Channels*** We seek out distributors that have business experience and capabilities to support our growth plans in our targeted markets. We have a total of 96 distributors and Original Equipment Manufacturers ("OEMs"). In the United States and Canada, we currently have 23 distributors and OEMs. Outside of the United States and Canada, we currently have 73 distributors and OEMs. We continue to refine the distribution channels to address our specific targeted markets.
- Service*** We provide service primarily through our global distribution network. Together with our global distribution network we offer a comprehensive FPP for a fixed annual fee to perform regularly scheduled and unscheduled maintenance as needed. We provide factory and on-site training to certify all personnel that are allowed to perform service on our microturbines. FPPs are generally paid quarterly in advance. Our FPP



backlog as of June 30, 2017 was \$76.7 million, which represents the value of the contractual agreement for FPP services that has not been earned and extends through Fiscal 2029. Our FPP backlog as of June 30, 2016 was \$71.4 million. Our FPP backlog as of March 31, 2017 was \$77.1 million.

4. **Product Robustness and Life Cycle Maintenance Costs** We continue to invest in enhancements that relate to high performance and high reliability. An important element of our continued innovation and product strategy is to focus on the engineering of our product hardware and electronics to make them work together more effectively and deliver improved microturbine performance, reliability and low maintenance cost to our customers.
5. **New Product Development** Our new product development is targeted specifically to meet the needs of our selected vertical markets. We expect that our existing product platforms, the C30, C65, C200 and C1000 Series microturbines, will be our foundational product lines for the foreseeable future. Our research and development project portfolio is centered on enhancing the features of these base products. More recently, due to our cost reduction efforts, our focus is on expanding the existing products, including the launch of our C1000 Signature Series microturbine in December 2015.

Our product development activities during Fiscal 2017 included new-patented fuel injector and certification of our C65 microturbine to applicable European Union medium voltage grid interconnection standards. In addition, we continued our development in our C200S ICHP microturbine and overall cost reduction for our Signature Series. We developed a new-patented multi-staged lean pre-vaporizing, pre-mixing fuel injector providing ultra-low emissions that meet EPA Tier 4 requirements for power generation. Under this new program, exhaust emissions from these engines will be required to decrease by more than 90%. Our C65, C200 and C1000 Series microturbines became VDE, BDEW and CEI certified during Fiscal 2017. These new standards were attained following the development and implementation of new microturbine system software architecture. The C200S microturbine incorporates numerous system and design upgrades intended to improve overall product quality, reliability, and performance. Our new C200S ICHP product further supports our effort to diversify our business into the CHP and CCHP energy efficiency markets and the new roof mounted integrated CHP heat recovery modules, designed specifically for our Signature Series product, is expected to add additional revenue opportunities.

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

We believe that effective execution in each of these key areas will be necessary to leverage Capstone's promising technology and early market leadership into achieving positive cash flow with growing market presence and improving financial performance. Based on our recent progress and assuming achievement of targeted cost reductions and product mix, pricing and performance, our financial model indicates that we will achieve positive cash flow when we generate \$25 million in quarterly revenue with a 25% gross margin. We are in the process of consolidating our manufacturing processes into our Van Nuys location. We believe that once this is complete we will have a production capacity of approximately 2,000 units per year, depending on product mix. We believe we will be able to support this production capacity level by adding additional shifts, which would increase working capital requirements, and making some additional capital expenditures.

#### **Critical Accounting Policies and Estimates**

The preparation of our condensed consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. Management believes the most complex and sensitive judgments, because of their significance to the condensed consolidated financial statements, result primarily from the need to make estimates about the effects of matters that are inherently uncertain. Actual results



could differ from management's estimates. Management believes the critical accounting policies listed below affect our more significant accounting judgments and estimates used in the preparation of the condensed consolidated financial statements. These policies are described in greater detail in our Annual Report on Form 10-K for Fiscal 2017 and continue to include the following areas:

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

## Results of Operations

### *Three Months Ended June 30, 2017 and 2016*

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

	Three Months Ended	
	June 30,	
	2017	2016
United States and Canada	\$ 10.5	\$ 7.7
Europe and Russia	2.6	5.3
Latin America	1.4	2.2
Asia and Australia	2.8	3.7
Middle East and Africa	1.9	0.2
Total	<u>\$ 19.2</u>	<u>\$ 19.1</u>

**Revenue** Revenue for the first quarter of Fiscal 2018 increased \$0.1 million, or 1%, to \$19.2 million from \$19.1 million for the first quarter of Fiscal 2017. The change in revenue for the first quarter of Fiscal 2018 compared to the first quarter of Fiscal 2017 included increases in revenue of \$2.8 million from the United States and Canadian markets and \$1.7 million from the Middle East and African markets. These overall increases in revenue were offset by decreases in revenue of \$2.7 million from the European and Russian markets, \$0.9 million from the Asian and Australian markets and \$0.8 million from the Latin American market. The increase in revenue in the United States and Canadian markets during the first quarter of Fiscal 2018 compared to the same period the previous year was primarily because we shipped a higher number of our C1000 Series systems in these markets. The increase in revenue in the Middle East and African markets during the first quarter of Fiscal 2018 compared to the same period in the previous year was primarily the result of our continued investment in key growth initiatives in those markets. Despite the increase in revenue in the Middle East and African markets, our revenue continues to be negatively impacted by the volatility of the global oil and gas markets, a strong U.S. dollar (making our products more expensive overseas) and ongoing geopolitical tensions in Russia, North Africa and the Middle East. The decrease in revenue in the European and Russian markets during the first quarter of Fiscal 2018 was primarily because of large non-recurring microturbine product shipments for specific projects that had occurred during the first quarter of Fiscal 2017. In addition, the decrease in European and Russian markets was primarily because there were no microturbine product shipments to Russia during the first quarter of Fiscal 2018 compared to the same period last year. The decrease in revenue in the Asian and Australian markets was primarily the result of large non-recurring microturbine product shipments for specific projects that had occurred during the first quarter of Fiscal 2017. The decrease in revenue in the Latin American market during the first quarter of Fiscal 2018 compared to the same period the previous year was primarily the result of a strong U.S. dollar and reduced capital and operational spending, particularly in the upstream and midstream sectors of the oil and gas markets.

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

	Three Months Ended June 30,					
	2017			2016		
	Revenue	Megawatts	Units	Revenue	Megawatts	Units
Microturbine Product	\$ 12.6	12.1	52	\$ 12.1	11.6	70
Accessories and Parts	2.9			3.7		
Service	3.7			3.3		
Total Accessories, Parts and Service	6.6			7.0		
Total	\$ 19.2			\$ 19.1		

For the first quarter of Fiscal 2018, revenue from microturbine products increased \$0.5 million, or 4%, to \$12.6 million from \$12.1 million for the first quarter of Fiscal 2017. Megawatts shipped during the first quarter of Fiscal 2018 increased 0.5 megawatts, or 4%, to 12.1 megawatts from 11.6 megawatts during the first quarter of Fiscal 2017. The increase in revenue and megawatts shipped was because of a shift in product mix, as we sold a higher number of our C1000 Series systems during the first quarter of Fiscal 2018 compared to the same period last year. The timing of shipments is subject to change based on several variables (including customer deposits, payments, availability of credit and delivery schedule changes), most of which are not within our control and can affect the timing of our revenue. Average revenue per megawatt shipped was approximately \$1.0 million during each of the first quarter of Fiscal 2018 and 2017.

For the first quarter of Fiscal 2018, revenue from our accessories and parts decreased \$0.8 million, or 22%, to \$2.9 million from \$3.7 million for the first quarter of Fiscal 2017. The decrease in revenue from accessories and parts was primarily because of the timing of our parts sales promotions.

Service revenue for the first quarter of Fiscal 2018 increased \$0.4 million, or 12%, to \$3.7 million from \$3.3 million for the first quarter of Fiscal 2017. The increase in service revenue was primarily the result of our growing installed base and an increase in our energy efficiency customers purchasing our FPP service agreements.

Sales to Horizon Power Systems (“Horizon”) and E-Finity Distributed Generation, LLC (“E-Finity”), two of our domestic distributors, accounted for 21% and 15%, respectively, of revenue for the first quarter of Fiscal 2018. Sales to Regatta Solutions, Inc. (“Regatta”) and E-Finity, two of our domestic distributors, accounted for 17% and 10%, respectively, of revenue for the first quarter of Fiscal 2017.

**Gross Margin** Cost of goods sold includes direct material costs, production and service center labor and overhead, inventory charges and provision for estimated product warranty expenses. The gross margin was \$2.2 million, or 11% of revenue, for the first quarter of Fiscal 2018 compared to a gross margin of \$3.0 million, or 16% of revenue, for the first quarter of Fiscal 2017. The decrease in gross margin of \$0.8 million, compared to the first quarter of Fiscal 2017 was primarily because of a shift in product mix of \$0.7 million, incremental warranty expense of \$0.6 million, offset by a decrease in production and service center labor and overhead expense of \$0.5 million. In addition to consolidating our manufacturing processes into our Van Nuys location, management continues to implement initiatives to improve gross margin in Fiscal 2018 by further reducing manufacturing overhead and fixed and direct material costs and improving product performance as we work to achieve profitability.

Warranty expense is a combination of a standard warranty provision recorded at the time revenue is recognized and changes, if any, in estimates for reliability repair programs. Reliability repair programs are based upon estimates that are recorded in the period that new information becomes available, including design changes, cost of repair and product enhancements, which can include both in-warranty and out-of-warranty systems. The increase in warranty expense of \$0.6 million during the first quarter of Fiscal 2018 compared to the first quarter of Fiscal 2017 reflects warranty accommodations and timing of warranty claims in the current period and the result of a benefit in the same period last year related to the decrease in the number of units covered under warranty. Management expects warranty expense in Fiscal 2018 to be lower than in Fiscal 2017 primarily because of a decrease in reliability repair programs

Production and service center labor and overhead expense decreased \$0.5 million during the first quarter of Fiscal 2018 compared to the first quarter of Fiscal 2017 primarily because of decreases of \$0.3 million in salaries

expense and \$0.2 million in loss in fixed asset disposal expense. These decreases were primarily the result of our cost reduction program to lower labor and overhead expenses throughout the organization.

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

	Three Months Ended June 30,	
	2017	2016
<b>Gross Margin</b>		
Product	\$ 0.1	\$ 0.8
As a percentage of product revenue	1 %	7 %
Accessories, parts and service	\$ 2.1	\$ 2.2
As a percentage of accessories, parts and service revenue	32 %	31 %
Total Gross Margin	<u>\$ 2.2</u>	<u>\$ 3.0</u>
As a percentage of total revenue	11 %	16 %

Product gross margin decreased to 1% during the first quarter of Fiscal 2018 compared to the first quarter of Fiscal 2017 primarily because of a shift in product mix, warranty accommodations and timing of warranty claims in the current period. Accessories, parts and service gross margin increased to 32% during the first quarter of Fiscal 2018 compared to the first quarter of Fiscal 2017 primarily because of our growing installed base, increase in energy efficiency customers purchasing our FPP service agreements and timing of FPP services performed.

**Research and Development (“R&D”) Expenses** R&D expenses for the first quarter fiscal 2018 decreased \$0.5 million, or 31%, to \$1.1 million from \$1.6 million in the year-ago first quarter. The reduction in R&D expense resulted primarily from lower salaries expense, which was a result of the reduction of the number of active research projects, because of our initiatives to reduce operating expenses and achieve profitability. Management expects R&D expenses in Fiscal 2018 to be lower than in Fiscal 2017 as a result of the continued cost reduction initiatives.

**Selling, General, and Administrative (“SG&A”) Expenses** SG&A expenses for the first quarter of Fiscal 2018 decreased \$0.7 million, or 12%, to \$5.0 million from \$5.7 million for the first quarter of Fiscal 2017. The net decrease in SG&A expenses was comprised of decreases of approximately \$0.6 million in professional services, including accounting and legal expenses, \$0.4 million in salaries expense, \$0.2 million in facilities expense, \$0.2 million in consulting expense and \$0.2 million in marketing expense. These decreases were offset by lower bad debt recovery of \$0.9 million for the first quarter of Fiscal 2018 compared to same period last year. Excluding bad debt recovery, management expects SG&A expenses in Fiscal 2018 to be lower than in Fiscal 2017 primarily as a result of our continued initiatives to reduce operating expenses and achieve profitability.

**Interest Expense** Interest expense increased \$0.1 million, or 100%, to \$0.2 million during the first quarter of Fiscal 2018 from \$0.1 million for the first quarter of Fiscal 2017. The increase in interest expense was the result of amortization of deferred financing costs related to paying of our former credit facility with Wells Fargo. In addition, the increase in interest expense was because of higher average balances outstanding under our new credit facility with Bridge Bank. As of June 30, 2017, we had total debt of \$9.5 million outstanding under the credit facility.

### Liquidity and Capital Resources

Our cash requirements depend on many factors, including the execution of our plan. We expect to continue to devote substantial capital resources to running our business and implementing the strategic changes summarized herein. Our planned capital expenditures for the year ending March 31, 2018 include approximately \$1.0 million for plant and equipment costs related to manufacturing and operations. Management expects to spend less than planned as a result of a change in timing of capital expenditures for the replacement of older equipment. Our cash is held in depository institution accounts to provide liquidity for operations and for capital preservation.

Our cash, cash equivalents and restricted cash balances decreased \$0.6 million during the first quarter of Fiscal 2018, compared to an increase of \$7.3 million during the first quarter of Fiscal 2017. Cash, cash equivalents and restricted cash decreased during the first quarter of first quarter of Fiscal 2018 primarily because of cash used in

operating activities as described below. Cash, cash equivalents and restricted cash during the first quarter of Fiscal 2017 includes proceeds from the April 2016 underwritten public offering as described below.

**Operating Activities** During the first quarter of Fiscal 2018, we used \$0.7 million in cash in our operating activities, which consisted of a net loss for the period of \$4.1 million, offset by cash provided by working capital of \$1.9 million and non cash adjustments (primarily warranty provision, accounts receivable allowances, depreciation and amortization, stock based compensation and inventory provision) of \$1.5 million. During the first quarter of Fiscal 2017, we used \$2.2 million in cash in our operating activities, which consisted of a net loss for the period of \$4.5 million, offset by cash provided by working capital of \$2.0 million and non cash adjustments of \$0.3 million.

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

	Three Months Ended June 30,	
	2017	2016
Net loss	\$ (4,092)	\$ (4,516)
Non-cash operating activities(1)	1,535	306
Changes in operating assets and liabilities:		
Accounts receivable	4,786	(1,254)
Inventories	(1,010)	1,935
Accounts payable and accrued expenses	(1,147)	(32)
Other changes in operating assets and liabilities	(804)	1,357
Net cash used in operating activities	<u>\$ (732)</u>	<u>\$ (2,204)</u>

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

The change in non-cash operating activities during the first quarter of Fiscal 2018 compared to the same period the previous year was primarily because of bad debt recoveries. The change in accounts receivable was the result of higher collection of accounts receivable during the first quarter of Fiscal 2018 compared to the first quarter of Fiscal 2017. The change in inventory was primarily the result of an increase in finished goods, offset by a decrease in raw materials during the first quarter of Fiscal 2018 compared to the same period the previous year. The change in accounts payable and accrued expenses was primarily the result of the level of inventory receipts and timing of payments made by us during the first quarter of Fiscal 2018 compared to the same period the previous year. The change in other operating assets and liabilities was primarily because of warranty payments for the proactive retrofit of certain non-Signature Series C200 microturbines and microturbine system order deposits during the first quarter of Fiscal 2018 compared to the first quarter of Fiscal 2017.

**Investing Activities** Net cash used in investing activities of \$0.2 million and \$9,000 during the first quarter of Fiscal 2018 and 2017, respectively, relates primarily to the acquisition of fixed assets.

**Financing Activities** During the first quarter of Fiscal 2018, we generated approximately \$0.3 million in financing activities compared to cash generated during the first quarter of Fiscal 2017 of approximately \$9.6 million. The funds generated from financing activities during first quarter of Fiscal 2018 were primarily the result of proceeds from the at-the-market offering program described below, offset by net repayments under the credit facility and the repayment of notes payable and capital lease obligations. The funds generated from financing activities during the first quarter of Fiscal 2017 were primarily the result of proceeds from the April 2016 underwritten public offering described below, offset by net repayments under the credit facility and the repayments of notes payable and capital lease obligations.

On October 18, 2016, we entered into a securities purchase agreement with certain accredited investors, pursuant to which we agreed to sell 3,600,000 shares of common stock, pre-funded Series B warrants to purchase up to 2,700,000 shares of common stock (“the October 2016 Offering”), and Series A warrants to purchase up to 6,300,000 shares of common stock. Pursuant to a placement agent agreement, dated as of October 18, 2016, we engaged Oppenheimer & Co. Inc. as the lead placement agent for the offering and ROTH Capital Partners, LLC as co-placement agent for the offering. Each share of common stock was sold at a price of \$1.20. Each Series B warrant was issued with an exercise price of \$1.20 per share of common stock, \$1.19 of which was pre-funded at closing and \$0.01 of which is

payable upon exercise. Each Series A warrant was issued with an initial exercise price of \$1.34 per share of common stock. These Series A warrants contain anti-dilution provisions that reduce the exercise price of the warrants if certain dilutive issuances occur. The anti-dilution provisions of the Series A warrants are subject to approval by our stockholders. The net proceeds to us from this offering, after deducting the placement agent fees and other estimated offering expenses, were approximately \$6.8 million. The offering closed on October 21, 2016.

On April 19, 2016, we entered into an underwriting agreement with Oppenheimer & Co. Inc. as the sole book-running manager, and Rodman & Renshaw, a unit of H.C. Wainwright & Co., LLC, as the co-manager, related to public offering of 2.7 million shares of our common stock and pre-funded Series B warrants to purchase up to 5.5 million shares of common stock, which were offered in lieu of common stock to those purchasers whose purchase of common stock in the offering otherwise would result in the purchaser beneficially owning more than 4.99% of our outstanding common stock following the completion of the offering (the “April 2016 Offering”). Also included in the offering were Series A warrants to purchase 4.1 million shares of common stock. Every two shares of common stock were sold with one Series A warrant to purchase one share of common stock at a collective negotiated price of \$3.50. Every two Series B warrants were sold with one Series A warrant to purchase one share of common stock at a collective negotiated price of \$3.48. The net proceeds to us from the sale of the common stock and warrants, after deducting fees and other offering expenses, were approximately \$13.1 million. The offering closed on April 22, 2016.

Effective August 28, 2015, we entered into a sales agreement with respect to an at-the-market offering program pursuant to which we may offer and sell, from time to time at its sole discretion, shares of our common stock, having an aggregate offering price of up to \$30.0 million. We will set the parameters for sales of the shares, including the number to be sold, the time period during which sales are requested to be made, any limitation on the number that may be sold in one trading day and any minimum price below which sales may not be made. During the first quarter of Fiscal 2018, we issued 3.5 million shares of our common stock under the at-the-market offering program and the net proceeds to us from the sale of our common stock were approximately \$2.5 million after deducting commissions paid of approximately \$37,700. As of June 30, 2017, 10.7 million shares of our common stock were sold pursuant to the at-the-market offering program and the net proceeds to us from the sale of the common stock were approximately \$12.8 million after deducting commissions paid of approximately \$0.4 million. As of June 30, 2017, \$13.7 million remained available for issuance with respect to the at-the-market offering program. These available proceeds are subject to Instruction I.B.6(a) to Form S-3 often referred to as the “Baby Shelf Rules.”

There were no stock options exercised during the first quarter of Fiscal 2018 and 2017, respectively. Employee stock purchases, net of repurchases of shares of our common stock for employee taxes due on vesting of restricted stock units, resulted in approximately \$5,000 and \$2,000 of net cash used during the first quarter of Fiscal 2018 and 2017, respectively.

**Former Credit Facility** We maintained two Credit Agreements, with Wells Fargo, which provided us with a line of credit of up to \$20.0 million in the aggregate. As of March 31, 2017, \$11.5 million in borrowings were outstanding under the former credit facility. Upon closing with Bridge Bank, our existing credit facilities with Wells Fargo were paid off in full.

**New Credit Facility** On June 2, 2017, we entered into two secured credit facilities (the “Bridge Bank Credit Agreements”) with Western Alliance Bank through its Bridge Bank division (“Bridge Bank”), with credit support provided by the Export-Import Bank of the United States through its working capital guarantee program. Under the terms of the Bridge Bank Credit Agreements, we may borrow up to \$12.0 million on a revolving basis depending on, among other factors, the amount of our eligible inventory and accounts receivable. The Bridge Bank Credit Agreements are for a two-year period ending June 2, 2019. As of June 30, 2017, \$9.5 million in borrowings were outstanding under the new credit facility.

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

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

The financial covenants of the domestic credit agreement with Bridge Bank (the “Domestic Facility”) requires us not to exceed specified levels of losses relative to our financial model and the outstanding line of credit advances may not exceed 85% of the sum of unrestricted cash and the amount of cash collateral held at Bridge Bank. The Domestic Facility also defines an event of default to include a material adverse effect on our business. An event of default for this or any other reason, if not waived, could have a material adverse effect on us. As of June 30, 2017 we were in compliance with the covenants contained in the Bridge Bank Credit Agreements for Fiscal 2018.

**Working Capital** Cash provided by working capital was \$1.9 million during the first quarter of Fiscal 2018, a decrease of \$0.1 million from the \$2.0 million cash provided by working capital during the first quarter of Fiscal 2017. We attribute the decrease in our working capital primarily because of higher warranty payments and accounts payable payments made by us, offset by higher collection of accounts receivable. Additionally, we didn’t fully achieve our planned number of product shipments during the first quarter of Fiscal 2018, resulting in lower than expected revenue primarily in the oil and gas markets.

**Evaluation of Ability to Maintain Current Level of Operations** In connection with preparing the consolidated financial statements for the first quarter of Fiscal 2018, management evaluated whether there were conditions and events, considered in the aggregate, that raised substantial doubt about our ability to meet our obligations as they became due for the next twelve months from the date of issuance of our first quarter of Fiscal 2018 financial statements. Management assessed that there were such conditions and events, including a history of recurring operating losses, negative cash flows from operating activities, the continued negative impact by the volatility of the global oil and gas markets, a strong U.S. dollar (making our products more expensive overseas) and ongoing geopolitical tensions in Russia, North Africa and Middle East. Cash provided by working capital during the first quarter of Fiscal 2018 were higher than planned, primarily because of cash provided by accounts receivable. However, we did not fully achieve our planned number of product shipments during the first quarter of Fiscal 2018, resulting in lower than expected revenue. We incurred a net loss of \$4.1 million and used cash in operating activities of \$0.7 million for the first quarter of Fiscal 2018. In addition, at June 30, 2017, we had cash, cash equivalents and restricted cash of \$19.1 million, and outstanding borrowings under our credit facility of \$9.5 million.

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

Based on our current operating plan, management anticipates that, given current working capital levels, current financial projections, the ability to borrow under our new credit facility and the funds raised by selling additional securities through the at-the-market offering as of the date of issuance of our first quarter of Fiscal 2018 financial statements, we will be able to meet our financial obligations as they become due over the next twelve months from the date of issuance of its first quarter of Fiscal 2018 financial statements.

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

- the market acceptance of our products and services;

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

Our accounts receivable balance, net of allowances, was \$12.2 million and \$17.0 million as of June 30, 2017 and March 31, 2017, respectively. Days sales outstanding in accounts receivable, ("DSO"), decreased by 17 days to 58 days as of June 30, 2017 compared to 75 days as of June 30, 2016. The change in DSO was largely the result of higher collection of accounts receivable during the first quarter of Fiscal 2018 compared to the first quarter of Fiscal 2017. We recorded net bad debt recoveries of approximately \$13,000 and \$0.9 million for the first quarter of Fiscal 2018 and 2017, respectively. During Fiscal 2015, we recorded approximately \$7.1 million and \$2.6 million with respect to the accounts receivable allowances from BPC and EMI, respectively.

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

#### **New Accounting Pronouncements**

In July 2017, the Financial Accounting Standards Board ("FASB") issued a two-part Accounting Standards Update ("ASU") No. 2017-11, I. Accounting for Certain Financial Instruments With Down Round Features and II. Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests With a Scope Exception ("ASU 2017-11"). ASU 2017-11 amends guidance in FASB ASC 260, Earnings Per Share, FASB ASC 480, Distinguishing Liabilities from Equity, and FASB ASC 815, Derivatives and Hedging. The amendments in Part I of ASU 2017-11 change the classification analysis of certain equity-linked financial instruments (or embedded features) with down round features. The amendments in Part II of ASU 2017-11 re-characterize the indefinite deferral of certain provisions of Topic 480 that now are presented as pending content in the Codification, to a scope exception. Those amendments do not have an accounting effect. ASU 2017-11 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted. We adopted ASU 2017-11 for the three months ended June 30, 2017, and retrospectively applied ASU 2017-11 as required. See Note 10—Fair Value Measurements for further discussion on changes as a result of the adoption of ASU 2017-11.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), ("ASU 2016-02"). The purpose of ASU 2016-02 is to provide financial statement users a better understanding of the amount, timing, and uncertainty of cash flows arising from leases. The adoption of ASU 2016-02 will result in the recognition of a right-of-use asset and a lease liability for most operating leases. New disclosure requirements include qualitative and quantitative information about the amounts recorded in the financial statements. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018. ASU 2016-02 requires a modified retrospective transition by means of a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year in which the guidance is effective with the option to elect certain practical expedients. Early adoption is permitted. We are currently evaluating the impact of ASU 2016-02 on our consolidated financial position and results of operations.

In July 2015, the FASB issued ASU 2015-11, Simplifying the Measurement of Inventory ("ASU 2015-11"). ASU 2015-11 requires inventory that is recorded using the first-in, first-out method to be measured at the lower of cost or net realizable value. ASU 2015-11 is effective for annual and interim periods beginning after December 15, 2016, and should be applied prospectively with early adoption permitted at the beginning of an interim or annual reporting period. We adopted ASU 2015-11 with no impact on our consolidated financial position or results of operations.

### **Revenue Recognition Related ASUs:**

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”). ASU 2014-09 supersedes nearly all existing revenue recognition guidance under GAAP. The standard’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which we expect to be entitled in exchange for those goods or services.

In August 2015, the FASB issued FASB ASU No. 2015-14, Revenue from Contracts with Customers: Deferral of the Effective Date (“ASU 2014-09”), which deferred the effective date of ASU 2014-09 by one year. ASU 2014-09 is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period, using one of two retrospective application methods. Early application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period.

In March 2016, the FASB issued FASB ASU No. 2016-08, Revenue from Contracts with Customers: Principal versus Agent Considerations (“ASU 2016-08”). ASU 2016-08 clarifies the implementation guidance on principal versus agent considerations.

In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing (“ASU 2016-10”). ASU 2016-10 clarifies the implementation guidance for identifying performance obligations and determining when to recognize revenue on licensing agreements for intellectual property.

In May 2016, the FASB issued ASU No. 2016-11, Revenue Recognition and Derivatives and Hedging: Rescission of SEC Guidance Because of ASU 2014-09 and ASU 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting (“ASU 2016-11”). ASU 2016-11 rescinds certain SEC staff comments previously made in regard to these ASU’s.

In May 2016, the FASB issued ASU No. 2016-12, Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients (“ASU 2016-12”) that provide guidance on assessing collectability, presentation of sales taxes, noncash consideration, and completed contracts and contract modifications at transition.

In December 2016, the FASB issued ASU 2016-20, Technical Corrections and Improvements to ASU 2014-09. The amendments in ASU 2014-09 affect narrow aspects of the guidance in ASU 2014-09, which is not yet effective. The amendments in ASU 2014-09 address loan guarantee fees, impairment testing of contract costs, provisions for losses on construction-type and production-type contracts, and various disclosures.

We are evaluating our existing revenue recognition policies and the impact of ASU 2014-09, ASU 2015-14, ASU 2016-08, ASU 2016-10, ASU 2016-11, ASU 2016-12 and ASU 2016-20, if any, on our financial position and results of operations. The effective date and transition requirements for the amendments are the same as the effective date and transition requirements for ASU 2014-09. We will be required to adopt the revenue recognition standard in annual reporting periods beginning after December 15, 2017 (fiscal year ending March 31, 2019) and interim periods within those annual periods.

### **Off-Balance Sheet Arrangements**

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

### **Item 3. *Quantitative and Qualitative Disclosures About Market Risk***

No material changes have occurred in our quantitative and qualitative market risk disclosure as presented in our Annual Report on Form 10-K for Fiscal 2017.

## **Item 4. Controls and Procedures**

### ***Evaluation of Disclosure Controls and Procedures***

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), as of the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are effective. The term “disclosure controls and procedures” means controls and other procedures of ours that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within required time periods. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

### ***Changes in Internal Control Over Financial Reporting***

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

## **PART II — OTHER INFORMATION**

### **Item 1. Legal Proceedings**

#### ***Federal Securities Class Action***

Two putative securities class action complaints were filed against us and certain of our current and former officers in the United States District Court for the Central District of California under the following captions: David Kinney, etc. v. Capstone Turbine, et al., No. 2:15-CV-08914 on November 16, 2015 (the “Kinney Complaint”) and Kevin M. Grooms, etc. v. Capstone Turbine, et al., No. 2:15-CV-09155 on December 18, 2015 (the “Grooms Complaint”).

The putative class in the Kinney Complaint is comprised of all purchasers of our securities between November 7, 2013 and November 5, 2015. The Kinney Complaint alleges material misrepresentations and omissions in public statements regarding BPC and the likelihood that BPC would not be able to fulfill many legal and financial obligations to us. The Kinney Complaint also alleges that our financial statements were not appropriately adjusted in light of this situation and were not maintained in accordance with GAAP, and that we lacked adequate internal controls over accounting. The Kinney Complaint alleges that these public statements and accounting irregularities constituted violations by all named defendants of Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, as well as violations of Section 20(a) of the Exchange Act by the individual defendants. The Grooms Complaint makes allegations and claims that are substantially identical to those in the Kinney Complaint, and both complaints seek compensatory damages of an undisclosed amount. On January 16, 2016, several shareholders filed motions to consolidate the Kinney and Grooms actions and for appointment as lead plaintiff. On February 29, 2016, the Court granted the motions to consolidate, and appointed a lead plaintiff. On May 6, 2016, a Consolidated Amended Complaint with allegations and claims substantially identical to those of the Kinney Complaint was filed in the consolidated action. The putative class period in the Consolidated Amended Complaint is June 12, 2014 to November 5, 2015. Defendants filed a motion to dismiss the Consolidated Amended Complaint on June 17, 2016. On March 10, 2017, the Court issued an order granting Defendants’ motion to dismiss in its entirety with leave to amend. Plaintiffs filed an amended complaint on April 28, 2017. Defendants’ motion to dismiss was filed June 2, 2017. Plaintiffs filed their opposition to the motion to dismiss on July 7, 2017, and Defendants filed their reply in support of the motion to dismiss on July 28, 2017. A hearing is scheduled for August 18, 2017. We have not recorded any liability as of March 31, 2017 since any potential loss is not probable or reasonably estimable given the preliminary nature of the proceedings.

#### ***State Derivative Lawsuits — California***

On February 18, 2016, a purported shareholder derivative action was filed in Los Angeles Superior Court in the State of California against us and certain of our current and former officers and directors under the following caption: *Stesiak v. Jamison, et al.*, No. BC610782. The lawsuit alleges that certain of our current and former officers and directors knew or should have known that BPC would be unable to fulfill its obligations to us, but allowed us to make false and misleading statements regarding BPC and our financial condition. The complaint also alleges that the defendants failed to timely adjust our account receivables and backlog to reflect BPC's inability to pay us. The complaint asserts causes of action for breach of fiduciary duty and unjust enrichment. It demands damages for the amount of damage sustained by us as a result of the individual defendants' alleged breach of fiduciary duties and unjust enrichment, that we institute corporate governance reforms, and disgorgement from the individual defendants. On May 5, 2016, the parties filed a stipulation and proposed order seeking to stay this action until such time as the defendants' motion(s) to dismiss the federal securities class action are either granted with prejudice or denied in whole or in part. On May 10, 2016, the Court entered that proposed order. Given that the federal securities class action was dismissed with leave to amend, this case is still stayed. A status conference is scheduled for September 20, 2017.

On June 8, 2016, a purported shareholder derivative action entitled *Velma Kilpatrick v. Simon, et al.*, No. BC623167, was filed in Los Angeles Superior Court in the State of California against us and certain of our current and former officers and directors. The complaint alleges that certain of our current and former officers and directors knew or should have known that BPC would be unable to fulfill its obligations to us, but allowed us to make false and misleading statements regarding BPC and our financial condition. The complaint also alleges that the defendants failed to timely adjust our account receivables and backlog to reflect BPC's inability to pay us. The complaint asserts causes of action for breach of fiduciary duty. It demands damages for the amount of damage sustained by us as a result of the individual defendants' alleged breach of fiduciary duties, and that we institute corporate governance reforms. On August 23, 2016, the parties filed a stipulation and proposed order seeking to stay this action until such time as the defendants' motion(s) to dismiss the federal securities class action are either granted with prejudice or denied in whole or in part. Given that the federal securities class action was dismissed with leave to amend, this case is still stayed. A status conference is scheduled for September 26, 2017.

On December 27, 2016, a purported shareholder derivative action entitled *Andre Rosowsky v. Jamison, et al.*, No. 30-2016-00894859-CU-MC-CJC was filed in Orange County Superior Court in the State of California against us and certain of our current and former officers and directors. The complaint alleges that certain of our current and former officers and directors knew or should have known that BPC would be unable to fulfill its obligations to us, but allowed us to make false and misleading statements regarding BPC and our financial condition. The complaint also alleges that the defendants failed to timely adjust our account receivables and backlog to reflect BPC's inability to pay us. The complaint asserts causes of action for breach of fiduciary duty and unjust enrichment. It demands damages for the amount of damage sustained by us as a result of the individual defendants' alleged breach of fiduciary duties, that we institute corporate governance reforms, and restitution from the individual defendants. On April 14, 2017, the case was removed to the United States District Court for the Central District of California. On May 5, 2017, the plaintiff voluntarily dismissed his complaint without prejudice.

#### *Federal Derivative Lawsuits*

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

On July 12, 2016 and July 18, 2016, respectively, two additional purported shareholder derivative actions were filed in the United States District Court for the Central District of California against us and certain of our current and former officers and directors, under the caption *Tuttle v. Atkinson, et al.*, No. CV16-05127, and *Boll v. Jamison, et al.*, No. CV16-5282, respectively. The lawsuits allege that certain of our current and former officers and directors knew or

should have known that BPC would be unable to fulfill its obligations to us, but allowed us to make false and misleading statements regarding BPC and our financial condition. The Tuttle complaint asserts causes of action for breach of fiduciary duty, gross mismanagement, and unjust enrichment, and the Boll complaint asserts causes of action for breach of fiduciary duty, unjust enrichment, abuse of control, gross mismanagement, and waste of corporate assets. Both complaints demand damages sustained by us as a result of the individual defendants' alleged breaches of fiduciary duties, and equitable relief, including that we institute appropriate corporate governance reforms. The federal derivative actions have been stayed until such time as the defendants' motion(s) to dismiss the federal securities class action are either granted with prejudice or denied in whole or in part. Given that the federal securities class action was dismissed with leave to amend, these cases are still stayed.

*Shareholder Demand*

Following the dismissal without prejudice of his purported shareholder derivative action discussed above, former plaintiff in *Andre Rosowsky v. Jamison, et al.* sent us a letter dated July 7, 2017 (the "Shareholder Demand") demanding that the Board of Directors take action to remedy purported breaches of fiduciary duties allegedly related to the claims asserted in the above-discussed securities class action and derivative actions. We acknowledged the Shareholder Demand on July 25, 2017. Our Board of Directors has formed a committee to evaluate the Shareholder Demand.

**Item 1A. Risk Factors**

There have been no material changes to the risk factors disclosed in our Annual Report on Form 10-K for Fiscal 2017

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None

**Item 3. Defaults Upon Senior Securities**

None

**Item 4. Mine Safety Disclosures**

Not applicable

**Item 5. Other Information**

**Third Amended and Restated Bylaws**

Effective August 2, 2017, our Board of Directors approved the Third Amended and Restated Bylaws (the "Amended and Restated Bylaws"). The Amended and Restated Bylaws state that unless we consent in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware shall be the sole and exclusive forum for any stockholder (including a beneficial owner of stock) to bring (i) any derivative action or proceeding on behalf of the corporation, (ii) any action asserting a claim of, or a claim based on, breach of a fiduciary duty owed by any current or former director, officer, employee or stockholder (including a beneficial owner of stock) of the corporation to the corporation or the corporation's stockholders (including beneficial owners of stock), (iii) any action asserting a claim against the corporation or any current or former director, officer, employee or stockholder (including a beneficial owner of stock) of the corporation arising pursuant to any provision of the DGCL or the certificate of incorporation or by-laws (as either may be amended from time to time), or (iv) any action asserting a claim against the corporation or any current or former director, officer, employee or stockholder (including a beneficial owner of stock) of the corporation governed by the internal affairs doctrine (or, if the Court of Chancery of the State of Delaware does not have jurisdiction, the federal district court for the District of Delaware).

**Item 6. Exhibits**

The exhibits filed as part of this Quarterly Report on Form 10-Q are set forth on the Exhibit Index, which is incorporated herein by reference.



## Exhibit Index

<u>Exhibit Number</u>	<u>Description</u>
3.1	<a href="#">Second Amended and Restated Certificate of Incorporation of Capstone Turbine Corporation</a> (a)
3.2	<a href="#">Certificate of Amendment to the Second Amended and Restated Certificate of Incorporation of Capstone Turbine Corporation, filed August 30, 2012</a> (b)
3.3	<a href="#">Certificate of Amendment to the Second Amended and Restated Certificate of Incorporation of Capstone Turbine Corporation, filed November 6, 2015</a> (c)
3.4	<a href="#">Third Amended and Restated Bylaws of Capstone Turbine Corporation</a>
10.1	<a href="#">Business Financing Agreement between Capstone Turbine Corporation and Western Alliance Bank, dated June 2, 2017</a> (d)
10.2	<a href="#">Export-Import Bank of the United States Working Capital Guarantee Program—Borrower Agreement between Capstone Turbine Corporation and Western Alliance Bank, dated June 2, 2017</a> (d)
10.3	<a href="#">Intellectual Property Security Agreement between Capstone Turbine Corporation and Western Alliance Bank, dated June 2, 2017</a> (d)
10.4	<a href="#">Fourth Amendment to Lease, dated June 7, 2017, between Capstone Turbine Corporation and Prologis, L.P., for leased premises at 16640 Stagg Street, Van Nuys, California</a> (e)
31.1	<a href="#">Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes—Oxley Act of 2002</a>
31.2	<a href="#">Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes—Oxley Act of 2002</a>
32	<a href="#">Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes—Oxley Act of 2002</a>
101.INS	XBRL Instance Document
101.SCH	XBRL Schema Document
101.CAL	XBRL Calculation Linkbase Document
101.LAB	XBRL Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document
101.DEF	XBRL Definition Linkbase Document

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

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

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

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

(e) Incorporated by reference to Capstone Turbine Corporation’s Current Report on Form 10-K, filed on June 13, 2017 (File No. 001-15957)

**THIRD AMENDED AND RESTATED BYLAWS OF  
CAPSTONE TURBINE CORPORATION**

**Exhibit 3.4**



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# THIRD AMENDED AND RESTATED BYLAWS

## OF

### CAPSTONE TURBINE CORPORATION

#### ARTICLE I – OFFICES

Section 1. *Registered Office.* The registered office of Capstone Turbine Corporation (hereinafter, called the “corporation”) shall be in the City of Dover, County of Kent, State of Delaware.

Section 2. *Other Offices.* The corporation may also have offices at such other places both within and without the State of Delaware as the Board of Directors may from time to time determine or the business of the corporation may require.

#### ARTICLE II – STOCKHOLDERS

Section 1. *Place of Meetings.*

(A) Meetings of stockholders shall be held at any place within or outside the State of Delaware designated by the board of directors. In the absence of any such designation, stockholders’ meetings shall be held at the principal executive office of the corporation.

(B) Notwithstanding the foregoing, the board of directors may, in its sole discretion, determine that stockholder meetings shall not be held at any place, but may instead be held solely by means of remote communication in accordance with Section 211 of the Delaware General Corporation Law (the “DGCL”). If authorized by the board of directors in its sole discretion, and subject to such guidelines and procedures as the board of directors may adopt, stockholders and proxy holders not physically present at a meeting of stockholders may, by means of remote communication (1) participate in a meeting of stockholders; and (2) be deemed present in person and vote at a meeting of stockholders whether such meeting is to be held at a designated place or solely by means of remote communication, provided that (a) the corporation shall implement reasonable measures to verify that each person deemed present and permitted to vote at the meeting by means of remote communication is a stockholder or proxy holder; (b) the corporation shall implement reasonable measures to provide such stockholders and proxy holders a reasonable opportunity to participate in the meeting and to vote on matters submitted to the stockholders, including an opportunity to read or hear the proceedings of the meeting substantially concurrently with such proceedings; and (iii) if any stockholder or proxy holder votes or takes other action at the meeting by means of remote communication, a record of such vote or other action shall be maintained by the corporation.

Section 2. *Annual Meetings of Stockholders.* The annual meeting of stockholders shall be held each year on a date and time designated by the board of directors. Any previously scheduled annual meeting of the stockholders may be postponed by resolution of the board of directors upon public notice given prior to the date previously scheduled for such annual meeting of the stockholders.

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Section 3. *Special Meetings.* A special meeting of the stockholders may be called at any time by the chairman of the board of directors, or by a majority of the directors or by a committee of the board of directors which has been duly designated by the board of directors and whose powers and authority, as provided in a resolution of the board of directors, include the power to call such meetings, but such special meetings may not be called by any other person or persons. Any previously scheduled special meeting of the stockholders may be postponed by resolution of the board of directors upon public notice given prior to the date previously scheduled for such special meeting of the stockholders.

Section 4. *Notice of Stockholders' Meetings.* All notices of meetings of stockholders shall be sent or otherwise given in accordance with Section 5 of this Article II not less than ten (10) nor more than sixty (60) days before the date of the meeting being noticed. The notice shall specify the place, if any, date and hour of the meeting, the means of remote communications, if any, by which stockholders and proxy holders may be deemed to be present in person and vote at such meeting, and in the case of a special meeting, the general nature of the business to be transacted.

Section 5. *Manner of Giving Notice; Affidavit of Notice.* Notice of any meeting of stockholders shall be deemed to have been given:

(A) when deposited in the mail, postage prepaid, directed to the stockholder at his address appearing on the books of the corporation or given by the stockholder to the corporation for the purpose of notice; or

(B) if electronically transmitted as provided in Article VIII, Section 1 of these bylaws.

An affidavit of the mailing, electronic transmission or other means of giving any notice of any stockholders' meeting shall be executed by the secretary, assistant secretary or any transfer agent of the corporation giving such notice, and shall be filed and maintained in the minute book of the corporation.

Section 6. *Quorum.* The presence in person or by proxy of the holders of a majority of the shares entitled to vote at any meeting of stockholders shall constitute a quorum for the transaction of business. The stockholders present at a duly called or held meeting at which a quorum is present may continue to do business until adjournment, notwithstanding the withdrawal of enough stockholders to leave less than a quorum, if any action taken (other than adjournment) is approved by at least a majority of the shares required to constitute a quorum.

Section 7. *Adjourned Meeting and Notice Thereof.* Any stockholders' meeting, annual or special, whether or not a quorum is present, may be adjourned from time to time by the chairman of the meeting, but in the absence of a quorum, no other business may be transacted at such meeting, except as provided in Section 6 of this Article II.

When any meeting of stockholders, either annual or special, is adjourned to another time or place, notice need not be given of the adjourned meeting if the time and place thereof, and the means of remote communications, if any, by which stockholders and proxy holders may be deemed to be present in person and vote at such adjourned meeting are announced at a meeting at which the adjournment is taken, unless a new record date for the adjourned meeting is fixed, or unless the adjournment is for more than thirty (30) days from the

date set for the original meeting. Notice of any such adjourned meeting, if required, shall be given to each stockholder of record entitled to vote at the adjourned meeting in accordance with the provisions of Sections 4 and 5 of this Article II. At any adjourned meeting the corporation may transact any business which might have been transacted at the original meeting.

Section 8. *Voting.* The stockholders entitled to vote at any meeting of stockholders shall be determined in accordance with the provisions of Section 11 of this Article II. Such vote may be by voice vote or by ballot, at the discretion of the chairman of the meeting. Any stockholder entitled to vote on any matter (other than the election of directors) may vote part of the shares in favor of the proposal and refrain from voting the remaining shares or vote them against the proposal; but, if the stockholder fails to specify the number of shares such stockholder is voting affirmatively, it will be conclusively presumed that the stockholder's approving vote is with respect to all shares such stockholder is entitled to vote. If a quorum is present, the affirmative vote of the majority of the shares represented at the meeting and entitled to vote on any matter shall be the act of the stockholders, unless the vote of a greater number or voting by classes is required by the DGCL or the certificate of incorporation or the certificate of determination of preferences as to any preferred stock.

At a stockholders' meeting involving the election of directors, no stockholder shall be entitled to cumulate (i.e., cast for any one or more candidates a number of votes greater than the number of the stockholders shares). The candidates receiving the highest number of votes, up to the number of directors to be elected, shall be elected.

Section 9. *Waiver of Notice or Consent by Absent Stockholders.* The transactions of any meeting of stockholders, either annual or special, however called and noticed, and wherever held, shall be as valid as though had at a meeting duly held after regular call and notice, if a quorum be present either in person or by proxy, and if, either before or after the meeting, each person entitled to vote, not present in person or by proxy, delivers a written waiver signed by such person (or a waiver by electronic transmission by such person) of notice or a consent (manually signed or submitted by electronic transmission) to the holding of the meeting, or an approval of the minutes thereof. The waiver of notice or consent need not specify either the business to be transacted or the purpose of any annual or special meeting of stockholders. All such waivers, consents or approvals shall be filed with the corporate records or made part of the minutes of the meeting.

Attendance of a person at a meeting shall also constitute a waiver of notice of such meeting, except when the person objects, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened, and except that attendance at a meeting is not a waiver of any right to object to the consideration of matters not included in the notice of the meeting if such objection is expressly made at the meeting.

Section 10. *No Stockholder Action by Written Consent Without a Meeting.* Stockholders may take action only at a regular or special meeting of stockholders.

Section 11. *Record Date for Stockholder Notice and Voting.* For purposes of determining the holders entitled to notice of any meeting or to vote, the board of directors may fix, in advance, a record date, which shall not be more than sixty (60) days nor less than ten (10) days prior to the

date of any such meeting, and in such case only stockholders of record on the date so fixed are entitled to notice and to vote, notwithstanding any transfer of any shares on the books of the corporation after the record date fixed as aforesaid, except as otherwise provided in the Delaware General Corporation Law.

If the board of directors does not so fix a record date, the record date for determining stockholders entitled to notice of or to vote at a meeting of stockholders shall be at the close of business on the business day next preceding the day on which notice is given or, if notice is waived, at the close of business on the business day next preceding the day on which the meeting is held.

Section 12. *Proxies.* Every person entitled to vote for directors or on any other matter shall have the right to do so either in person or by one or more agents authorized (a) by a written proxy signed by the person and filed with the secretary of the corporation or (b) by an electronic transmission permitted by law filed in accordance with the procedure established for the meeting. A validly executed proxy which does not state that it is irrevocable shall continue in full force and effect unless (i) revoked by the person executing it, prior to the vote pursuant thereto, by a writing delivered to the corporation (whether manually signed or electronically transmitted) stating that the proxy is revoked or by a subsequent proxy executed or electronically transmitted by, or attendance at the meeting and voting in person by, the person executing or electronically transmitting the proxy, or (ii) written notice of the death or incapacity of the maker of such proxy is received by the corporation before the vote pursuant thereto is counted; provided, however, that no such proxy shall be valid after the expiration of one (1) year from the date of such proxy, unless otherwise provided in the proxy.

Section 13. *Inspectors of Election; Opening and Closing the Polls .* The board of directors by resolution shall appoint one or more inspectors, which inspector or inspectors may include individuals who serve the corporation in other capacities, including, without limitation, as officers, employees, agents or representatives, to act at the meetings of stockholders and make a written report thereof. One or more persons may be designated as alternate inspectors to replace any inspector who fails to act. If no inspector or alternate has been appointed to act or is able to act at a meeting of stockholders, the chairman of the meeting shall appoint one or more inspectors to act at the meeting. Each inspector, before discharging his or her duties, shall take and sign an oath faithfully to execute the duties of inspector with strict impartiality and according to the best of his or her ability. The inspectors shall have the duties prescribed by law.

The chairman of the meeting shall fix and announce at the meeting the date and time of the opening and the closing of the polls for each matter upon which the stockholders will vote at a meeting.

Section 14. *Nomination and Stockholder Business Bylaw .*

(A) *Annual Meetings of Stockholders.*

(1) Nominations of persons for election to the board of directors of the corporation and the proposal of business to be considered by the stockholders may be made at an annual meeting of stockholders (a) pursuant to the corporation's notice of meeting, (b) by or at the direction of the

board of directors or (c) by any stockholder of the corporation who (i) was a stockholder of record at the time of giving of notice provided for in this bylaw and at the time of the annual meeting, (ii) is entitled to vote and present in person at the meeting at the meeting and (iii) complies with the notice procedures set forth in this bylaw as to such business or nomination. The foregoing clause (c) shall be the exclusive means for a stockholder to make nominations or submit other business (other than matters properly brought under Rule 14a-8 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”) and included in the corporation’s notice of meeting) before an annual meeting of stockholders.

(2) Without qualification, for nominations or any other business to be properly brought before an annual meeting by a stockholder pursuant to clause (c) of paragraph (A)(1) of this bylaw, the stockholder must have given timely notice thereof in writing to the secretary of the corporation and such other business must otherwise be a proper matter for stockholder action. To be timely, a stockholder’s notice shall be delivered to the secretary at the principal executive offices of the corporation not earlier than the close of business on the 150<sup>th</sup> calendar day and not later than the close of business on the 120<sup>th</sup> calendar prior to the first anniversary of the date of the corporation’s proxy statement released to security holders in connection with the preceding year’s annual meeting; provided, however, that if no annual meeting was held in the previous year or the date of the annual meeting has been changed by more than thirty (30) calendar days from the date contemplated at the time of the previous year’s proxy statement, a proposal shall be received by the corporation no later than the close of business on the tenth day following the day on which notice of the date of the meeting was mailed or public announcement of the date of the meeting was made, whichever comes first. In no event shall the public announcement of an adjournment of an annual meeting commence a new time period for the giving of a stockholder’s notice as described above.

To be in proper form, a stockholder’s notice (whether given pursuant to this paragraph (A)(2) or paragraph (B) of this Section 14) to the secretary must:

(a) disclose, as to the stockholder giving the notice and the beneficial owner, if any, on whose behalf the nomination or proposal is made or any person acting in concert therewith (each a “party”) (i) the name and address of each such party, (ii) (A) the class or series and number of shares of the corporation which are, directly or indirectly, owned beneficially and of record by each such party, (B) any option, warrant, convertible security, stock appreciation right, or similar right with an exercise or conversion privilege or a settlement payment or mechanism at a price related to any class or series of shares of the corporation or with a value derived in whole or in part from the value of any class or series of shares of the corporation, whether or not such instrument or right shall be subject to settlement in the underlying class or series of capital stock of the corporation or otherwise (a “Derivative Instrument”) directly or indirectly owned beneficially by each such party and any other direct or indirect opportunity to profit or share in any profit derived from any increase or decrease in the value of shares of the corporation, (C) any proxy, contract, arrangement, understanding, or relationship pursuant to which each such party has a right to vote or transfer any shares of any security of the corporation, or pursuant to which any shares held directly or indirectly by each such party may be voted or transferred by another party, (D) any short interest in any security of the corporation (for purposes of this bylaw a person shall be deemed to have a short interest in a security if such person directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, has the

opportunity to profit or share in any profit derived from any decrease in the value of the subject security), (E) any rights to dividends on the shares of the corporation owned beneficially by each such party that are separated or separable from the underlying shares of the corporation, (F) any proportionate interest in shares of the corporation or Derivative Instruments held, directly or indirectly, by a general or limited partnership in which such party is a general partner or, directly or indirectly, beneficially owns an interest in a general partner, (G) any performance-related fees (other than an asset-based fee) that such stockholder is or may be entitled to based on any increase or decrease in the value of shares of the corporation or Derivative Instruments, if any, as of the date of such notice, including without limitation any such interests held by members of such party's immediate family sharing the same household (which information shall be supplemented by such stockholder and beneficial owner, if any, not later than ten (10) days after the record date for the meeting to disclose such ownership as of the record date) and (H) any direct or indirect equity interest, short interest, or Derivative Instrument, or any material contract or agreement of such party in or with any principal competitor of the corporation, (iii) any other information relating to such party that would be required to be disclosed in a proxy statement or other filings required to be made in connection with solicitations of proxies for, as applicable, the proposal and/or for the election of directors in a contested election pursuant to Section 14 of the Exchange Act and the rules and regulations promulgated thereunder (whether or not such party intends to deliver a proxy statement or conduct its own proxy solicitation), (iv) a statement as to whether or not each such party will deliver a proxy statement and form of proxy to holders of, in the case of a proposal, at least the percentage of voting power of all of the shares of the capital stock of the corporation required under applicable law to carry the proposal, or, in the case of a nomination or nominations for election of directors, at least the percentage of voting power of all of the shares of capital stock of the corporation reasonably believed by the such stockholder of record or beneficial owner or owners, as the case may be, to be sufficient to elect the persons proposed to be nominated by the stockholder of record; (v) the written consent of each such party to the public disclosure of information provided pursuant to this bylaw; (vi) the investment strategy or objective, if any, of the stockholder and each such party; and (vii) an undertaking that each such stockholder agrees to indemnify and hold harmless the corporation against any liability, loss or damages incurred as a result of false or misleading information submitted by the stockholder pursuant to this Section 14;

(b) if the notice relates to any business other than a nomination of a director or directors that the stockholder proposes to bring before the meeting, set forth (i) a brief description of the business desired to be brought before the meeting, the reasons for conducting such business at the meeting and any material interest of such stockholder and beneficial owner, if any, or other persons on whose behalf the proposal is made or persons that are acting in concert therewith with respect to such business and (ii) a description of all agreements, arrangements and understandings between such stockholder and beneficial owner, if any, and any other person or persons (including their names) in connection with the proposal of such business by such stockholder;

(c) set forth, as to each person, if any, whom the stockholder proposes to nominate for election or reelection to the board of directors (i) all information relating to such person that would be required to be disclosed in a proxy statement or other filings required to be made in connection with solicitations of proxies for election of directors in a contested election pursuant to Section 14 of the Exchange Act and the rules and regulations promulgated thereunder

(including such person's written consent to being named in the proxy statement as a nominee and to serving as a director if elected) and (ii) a description of all direct and indirect compensation and other material monetary agreements, arrangements and understandings during the past three years, and any other material relationships, between or among such stockholder and beneficial owner, if any, and their respective affiliates and associates, or others acting in concert therewith, on the one hand, and each proposed nominee, and his or her respective affiliates and associates, or others acting in concert therewith, on the other hand, including, without limitation all information that would be required to be disclosed pursuant to Rule 404 promulgated under Regulation S-K if the stockholder making the nomination and any beneficial owner on whose behalf the nomination is made, if any, or any affiliate or associate thereof or person acting in concert therewith, were the "registrant" for purposes of such rule and the nominee were a director or executive officer of such registrant; and

(d) with respect to each nominee for election or reelection to the board of directors, include a completed and signed questionnaire, representation and agreement required by paragraph (D) of this Section 14.

The corporation may require any proposed nominee to furnish such other information as may reasonably be required by the corporation to determine the eligibility of such proposed nominee to serve as an independent director of the corporation or that could be material to a reasonable stockholder's understanding of the independence, or lack thereof, of such nominee.

Further, a stockholder of record providing notice of a nomination of director(s) or other business proposed to be brought before a meeting shall further update and supplement such notice, if necessary, so that the information provided or required to be provided in such notice pursuant to this bylaw shall be true and correct as of the record date for the meeting and as of the date that is ten (10) business days prior to the meeting or any adjournment or postponement thereof, and such update and supplement shall be delivered to, or mailed and received by, the secretary at the principal executive offices of the corporation not later than five (5) business days after the record date for the meeting (in the case of the update and supplement required to be made as of the record date), and not later than five (5) business days prior to the date of the meeting, if practicable (or, if not practicable, on the first practicable date prior to) any adjournment or postponement thereof (in the case of the update and supplement required to be made as of ten (10) business days prior to the meeting or any adjournment or postponement thereof).

For purposes of this bylaw, a person shall be deemed to be "acting in concert" with another person if such person knowingly acts (whether or not pursuant to an express agreement) in concert with, or towards a common goal relating to the corporation in parallel with, such other person where at least one of the following factors suggests that such persons intend to act in concert or in parallel: exchanging information (whether publicly or privately), attending meetings, conducting discussions or making or soliciting invitations to act in concert or in parallel; provided, that a person shall not be deemed to be acting in concert with any other person solely as a result of the solicitation of proxies after the filing of an effective Schedule 14A under Section 14(a) of the Exchange Act. A person acting in concert with another person shall be deemed to be acting in concert with any third party who is also acting in concert with such other person.

(3) Notwithstanding anything in the second sentence of paragraph (A)(2) of this Section 14 to the contrary, in the event that the number of directors to be elected to the board of directors of the corporation is increased and there is no public announcement by the corporation naming all of the nominees for director or specifying the size of the increased board of directors at least 70 days prior to the first anniversary of the date of the preceding year's annual meeting, a stockholders notice required by this bylaw shall also be considered timely, but only with respect to nominees for any new positions created by such increase, if it shall be delivered to the secretary at the principal executive offices of the corporation not later than the close of business on the tenth (10<sup>th</sup>) day following the day on which such public announcement is first made by the corporation.

( B ) *Special Meetings of Stockholders.* Only such business shall be conducted at a special meeting of stockholders as shall have been brought before the meeting pursuant to the corporation's notice of meeting. Nominations of persons for election to the board of directors shall only be permitted to be made at a special meeting of stockholders at which directors are to be elected pursuant to the corporation's notice of meeting (a) by or at the direction of the board of directors or (b) provided that the board of directors has determined that directors shall be elected at such meeting, by any stockholder of the corporation who (i) is a stockholder of record at the time of giving of notice provided for in this bylaw and at the time of the special meeting, (ii) is entitled to vote and present in person at the meeting, and (iii) complies with the notice procedures set forth in this bylaw as to such nomination. In the event the corporation calls a special meeting of stockholders for the purpose of electing one or more directors to the board of directors, any such stockholder may nominate a person or persons (as the case may be) for election to such position(s) as specified in the corporation's notice of meeting, if the stockholder's notice in the form required by paragraph (A)(2) of this Section 14 with respect to any nomination (including the completed and signed questionnaire, representation and agreement required by paragraph (D) of this Section 14) shall be delivered to the secretary at the principal executive offices of the corporation not earlier than the close of business on the 150<sup>th</sup> calendar day prior to the date of such special meeting and not later than the close of business on the later of the 120<sup>th</sup> calendar day prior to the date of such special meeting or, if the first public announcement of the date of such special meeting is less than one hundred (100) days prior to the date of such special meeting, the tenth (10<sup>th</sup>) day following the day on which public announcement is first made of the date of the special meeting and of the nominees proposed by the board of directors to be elected at such meeting. In no event shall any adjournment or postponement of a special meeting or the announcement thereof commence a new time period for the giving of a stockholder's notice as described above.

(C) *General.*

(1) Only such persons who are nominated in accordance with the procedures set forth in this bylaw shall be eligible to serve as directors and only such business shall be conducted at a meeting of stockholders as shall have been brought before the meeting in accordance with the procedures set forth in this bylaw.

(2) For purposes of this bylaw, "public announcement" shall mean disclosure in a press release reported by a national news service or in a document publicly filed by the corporation

with the Securities and Exchange Commission pursuant to Section 13, 14 or 15(d) of the Exchange Act and the rules promulgated thereunder.

(3) Notwithstanding the foregoing provisions of this bylaw, a stockholder shall also comply with all applicable requirements of the Exchange Act and the rules and regulations thereunder with respect to the matters set forth in this bylaw; provided, however, that any references in these bylaws to the Exchange Act or the rules promulgated thereunder are not intended to and shall not limit the requirements applicable to nominations or proposals as to any other business to be considered pursuant to paragraph (A)(1)(c) or paragraph (B) of this Section 14. Nothing in this bylaw shall be deemed to affect any rights (i) of stockholders to request inclusion of proposals in the corporation's proxy statement pursuant to Rule 14a-8 under the Exchange Act or (ii) of the holders of any series of preferred stock, if any, to elect directors under certain circumstances if and to the extent provided for under law, the certificate of incorporation or these bylaws.

(4) Notwithstanding the foregoing provisions of this bylaw, if a stockholder (or a qualified representative of the stockholder) is not present at the meeting of stockholders to make a nomination or propose other business, such nomination shall be disregarded and such proposed business shall not be transacted, notwithstanding that proxies in respect of such vote have been received by the corporation. "Present in person" shall mean that the stockholder proposing that the business be brought before the meeting of the corporation, or, if the proposing stockholder is not an individual, a qualified representative of such stockholder, appears at such meeting; provided, however if the board of directors authorizes pursuant to Section 1 of Article II of these bylaws a meeting solely by means of remote communication, the board of directors shall adopt, in its sole discretion, such guidelines and procedures for stockholders to be deemed present in person at such virtual meeting. A "qualified representative" of such proposing stockholder shall be, if such proposing stockholder is (x) a general or limited partnership, any general partner or person who functions as a general partner of the general or limited partnership or who controls the general or limited partnership, (y) a corporation or a limited liability company, any officer or person who functions as an officer of the corporation or limited liability company or any officer, director, general partner or person who functions as an officer, director or general partner of any entity ultimately in control of the corporation or limited liability company or (z) a trust, any trustee of such trust.

(D) *Submission of Questionnaire, Representation and Agreement* . To be eligible to be a nominee for election [or reelection] as a director of the corporation, a person must deliver (in accordance with the time periods prescribed for delivery of notice under Section 14 of this Article II) to the secretary at the principal executive offices of the corporation a written questionnaire with respect to the background and qualification of such person and the background of any other person or entity on whose behalf the nomination is being made (which questionnaire shall be provided by the secretary upon written request) and a written representation and agreement (in the form provided by the secretary upon written request) that such person (1) is not and will not become a party to (i) any agreement, arrangement or understanding with, and has not given any commitment or assurance to, any person or entity as to how such person, if elected as a director of the corporation, will act or vote on any issue or question (a "Voting Commitment") that has not been disclosed to the secretary of the corporation or (ii) any Voting Commitment that could limit or interfere with such person's ability to comply, if elected as a director of the corporation, with such person's fiduciary duties under applicable

law, (2) is not and will not become a party to any agreement, arrangement or understanding with any person or entity other than the corporation with respect to any direct or indirect compensation, reimbursement or indemnification in connection with service or action as a director that has not been disclosed in such questionnaire or representation, and (3) in such person's individual capacity and on behalf of any person or entity on whose behalf the nomination is being made, would be in compliance, if elected as a director of the corporation, and will comply with all applicable publicly disclosed corporate governance, conflict of interest, confidentiality and stock ownership and trading policies and guidelines of the corporation.

Section 15. *Conduct of Business.*

(A) *Duties of Chair of Meeting.* Except as otherwise provided by law, the certificate of incorporation or these bylaws, the chair of any meeting of the stockholders shall have the power and authority to determine the order of business and the procedure at the meeting, including, without limitation, the duty to determine whether a nomination or any other business proposed to be brought before the meeting was made or proposed, as the case may be, in accordance with the procedures set forth in these bylaws and, if any proposed nomination or business is not in compliance with these bylaws, to declare that such defective proposal or nomination shall be disregarded, and the manner of voting and the conduct of discussion as seem to him or her in order. The chair shall also have the power to adjourn the meeting to another place, if any, date and time. The date and time of the opening and closing of the polls for each matter upon which the stockholders will vote at the meeting shall be announced at the meeting. No ballots, proxies or votes, nor any revocations thereof or changes thereto, shall be accepted by the inspectors or the chair of the meeting after the closing of the polls unless the Delaware Court of Chancery upon application by a stockholder shall determine otherwise.

(B) *Chair of Meeting.* The Chairman of the Board or, in his or her absence, the Chief Executive Officer of the corporation or, in his or her absence, such person as may be chosen by the board of directors, or if there are not remaining directors serving, such person as may be chosen by the holders of a majority of the voting power of the shares entitled to vote who are present, in person or by proxy, at such meeting shall call to order any meeting of the stockholders and act as chair of the meeting. In the absence of the secretary of the corporation, the secretary of the meeting shall be such person as the chair of the meeting or the board of directors appoints.

### **ARTICLE III – DIRECTORS**

Section 1. *Powers.* Subject to the provisions of the Delaware General Corporation Law and any limitations in the certificate of incorporation and these bylaws relating to action required to be approved by the stockholders or by the outstanding shares, the business and affairs of the corporation shall be managed and all corporate powers shall be exercised by or under the direction of the board of directors.

Section 2. *Number and Qualification of Directors.* Until otherwise determined by resolution of the Board of Directors, the number of directors of the corporation shall be eight (8).

Section 3. *Election and Term of Office of Directors* . Directors shall be elected at the annual meeting of the stockholders. Each director, including a director elected to fill a vacancy, shall serve for a term ending on the next annual meeting following the annual meeting at which such director was elected and until a successor has been elected and qualified or the earlier of his resignation or removal.

Section 4. *Vacancies*. Vacancies in the board of directors may be filled by a majority of the remaining directors, though less than a quorum, or by a sole remaining director. Each director elected to fill a vacancy shall hold office for the remainder of the term of the person whom he succeeds, and until a successor has been elected and qualified.

A vacancy or vacancies in the board of directors shall be deemed to exist in the case of the death, retirement, resignation or removal of any director, or if the board of directors by resolution declares vacant the office of a director who has been declared of unsound mind by an order of court or convicted of a felony, or if the authorized number of directors be increased, or if the stockholders fail at any meeting of stockholders at which any director or directors are elected, to elect the full authorized number of directors to be voted for at that meeting.

Any director may resign or voluntarily retire upon giving notice in writing or by electronic transmission to the chairman of the board, the president, the secretary or the board of directors. Such retirement or resignation shall be effective upon the giving of the notice, unless the notice specifies a later time for its effectiveness. If such retirement or resignation is effective at a future time, the board of directors may elect a successor to take office when the retirement or resignation becomes effective.

No reduction of the authorized number of directors shall have the effect of removing any director prior to the expiration of his term of office.

Section 5. *Place of Meetings and Telephonic Meetings* . Regular meetings of the board of directors may be held at any place within or without the State of Delaware that has been designated from time to time by resolution of the board. In the absence of such designation, regular meetings shall be held at the principal executive office of the corporation. Special meetings of the board shall be held at any place within or without the State of Delaware that has been designated in the notice of the meeting or, if not stated in the notice or there is no notice, at the principal executive office of the corporation. Any meeting, regular or special, may be held by conference telephone or similar communication equipment, so long as all directors participating in such meeting can hear one another, and all such directors shall be deemed to be present in person at such meeting.

Section 6. *Annual Meetings*. Immediately following each annual meeting of stockholders, the board of directors shall hold a regular meeting for the purpose of organization, any desired election of officers and transaction of other business. Notice of this meeting shall not be required.

Section 7. *Other Regular Meetings*. Other regular meetings of the board of directors shall be held at such time as shall from time to time be determined by the board of directors. Such regular meetings may be held without notice provided that notice of any change in the determination of

time of such meeting shall be sent to all of the directors. Notice of a change in the determination of the time shall be given to each director in the same manner as for special meetings of the board of directors.

Section 8. *Special Meetings.* Special meetings of the board of directors for any purpose or purposes may be called at any time by the chairman of the board or the president or any vice president or the secretary or any two directors.

Notice of the time and place of special meetings shall be delivered personally or by telephone to each director, sent by facsimile, first class mail or telegram, charges prepaid, addressed to each director at his or her address as it is shown upon the records of the corporation, or sent by electronic mail addressed to each director at his or her electronic mail address as it is shown upon the records of the corporation. In case such notice is mailed, it shall be deposited in the United States mail at least four (4) days prior to the time of the holding of the meeting. In case such notice is delivered personally, by telephone, facsimile, telegram or electronic mail, it shall be delivered personally, or by telephone, by facsimile, to the telegraph company or by electronic mail at least twenty four (24) hours prior to the time of the holding of the meeting. Any oral notice given personally or by telephone may be communicated to either the director or to a person at the office of the director who the person giving the notice has reason to believe will promptly communicate it to the director. The notice need not specify the purpose of the meeting nor the place if the meeting is to be held at the principal executive office of the corporation.

Section 9. *Quorum.* A majority of the authorized number of directors shall constitute a quorum for the transaction of business, except to adjourn as hereinafter provided. Every act or decision done or made by a majority of the directors present at a meeting duly held at which a quorum is present shall be regarded as the act of the board of directors. A meeting at which a quorum is initially present may continue to transact business notwithstanding the withdrawal of directors, if any action taken is approved by at least a majority of the required quorum for such meeting.

Section 10. *Waiver of Notice.* The transactions of any meeting of the board of directors, however called and noticed or wherever held, shall be as valid as though had at a meeting duly held after regular call and notice if a quorum be present and if, either before or after the meeting, each of the directors not present delivers a written waiver signed by such director (or a waiver by electronic transmission by such director) of notice or a consent (manually signed or submitted by electronic transmission) to the holding of the meeting, or an approval of the minutes thereof. The waiver of notice or consent need not specify the purpose of the meeting. All such waivers, consents and approvals shall be filed with the corporate records or made a part of the minutes of the meeting. Notice of a meeting shall also be deemed given to any director who attends the meeting without protesting, prior thereto or at its commencement, the lack of notice to such director.

Section 11. *Adjournment.* A majority of the directors present, whether or not constituting a quorum, may adjourn any meeting to another time and place.

Section 12. *Notice of Adjournment*. Notice of the time and place of an adjourned meeting need not be given, unless the meeting is adjourned for more than twenty four (24) hours, in which case notice of such time and place shall be given prior to the time of the adjourned meeting, in the manner specified in Section 8 of this Article III, to the directors who were not present at the time of the adjournment.

Section 13. *Action Without Meeting*. Any action required or permitted to be taken by the board of directors may be taken without a meeting, if all members of the board shall individually or collectively consent in writing or by electronic transmission to such action. Such action by written consent or electronic transmission shall have the same force and effect as a unanimous vote of the board of directors. Such written consent or consents or electronic transmission or transmissions shall be filed with the minutes of the proceedings of the board.

Section 14. *Fees and Compensation of Directors*. Directors and members of committees may receive such compensation, if any, for their services and such reimbursement of expenses, as may be fixed or determined by resolution of the board of directors. Nothing herein contained shall be construed to preclude any director from serving the corporation in any other capacity as an officer, agent, employee, or otherwise, and receiving compensation for such services.

#### ARTICLE IV – COMMITTEES

Section 1. *Committees of Directors*. The board of directors may, by resolution adopted by a majority of the authorized number of directors, designate one or more committees, including an executive committee, each consisting of two or more directors, to serve at the pleasure of the board. The board may designate one or more directors as alternate members of any committee, who may replace any absent member at any meeting of the committee. Any such committee, to the extent provided in the resolution of the board, shall have all the authority of the board, except with respect to:

- (a) the approval of any action which, under the General Corporation Law of Delaware, also requires the approval of the full board of directors, or the stockholders of the outstanding shares;
- (b) the filling of vacancies on the board of directors or in any committee;
- (c) the fixing of compensation of the directors for serving on the board or on any committee;
- (d) the amendment or repeal of bylaws or the adoption of new bylaws;
- (e) the amendment or repeal of any resolution of the board of directors which by its express terms is not so amendable or repealable;
- (f) a distribution to the stockholders of the corporation, except at a rate or in a periodic amount or within a price range determined by the board of directors; or
- (g) the appointment of any other committees of the board of directors or the members thereof.

Section 2. *Meetings and Action of Committees*. Meetings and action of committees shall be governed by, and held and taken in accordance with, the provisions of Article III of these bylaws, Sections 5 (place of meetings), 7 (regular meetings), 8 (special meetings and notice), 9 (quorum), 10 (waiver of notice), 11 (adjournment), 12 (notice of adjournment) and 13 (action without meetings), with such changes in the context of those bylaws as are necessary to substitute the committee and its members for the board of directors and its members, except that the time of regular meetings of committees may be determined by resolution of the board of directors as well as the committee, special meetings of committees may also be called by resolution of the board of directors, and notice of special meetings of committees shall also be given to all alternate members, who shall have the right to attend all meetings of the committee. The board of directors may adopt rules for the government of any committee not inconsistent with the provisions of these bylaws.

## ARTICLE V – OFFICERS

Section 1. *Officers*. The officers of the corporation shall be chosen by the board of directors and shall include a chairman of the board or president, or both, a vice president, a secretary and a chief financial officer. The corporation may also have, at the discretion of the board of directors, a president, one or more additional vice presidents, one or more assistant secretaries, one or more assistant treasurers, and such other officers as may be held by the same person.

Section 2. *Election of Officers*. The officers of the corporation, except such officers as may be appointed in accordance with the provisions of Section 3 or Section 5 of this Article V, shall be chosen annually by the board of directors, and each shall hold his office until he shall resign or be removed or otherwise disqualified to serve or his successor shall be appointed in accordance with the provisions of Section 3 of this Article V. Any number of officers may be elected and qualified.

Section 3. *Subordinate Officers, etc.* The board of directors may appoint, and may empower the chairman of the board to appoint, such other officers as the business of the corporation may require, each of whom shall hold office for such period, have such authority and perform such duties as are provided in the bylaws or as the board of directors may from time to time determine.

Section 4. *Removal and Resignation of Officers*. Any officer may be removed, either with or without cause, by the board of directors, at any regular or special meeting thereof, or, except in case of an officer chosen by the board of directors, by any officer upon whom such power of removal may be conferred by the board of directors.

Any officer may resign at any time by giving written notice to the corporation. Any such resignation shall take effect at the date of the receipt of such notice or at any later time specified therein; and, unless otherwise specified therein, the acceptance of such resignation shall not be necessary to make it effective.

Section 5. *Vacancies in Office*. A vacancy in any office because of death, resignation, removal, disqualification, or any other cause shall be filled in the manner prescribed in these bylaws for regular appointments to such office.

Section 6. *Chairman of the Board*. The chairman of the board shall preside at all meetings of the stockholders and of the board of directors. The chairman of the Board shall be responsible for the general management of the affairs of the corporation and shall perform all duties incidental to his office which may be required by law and all such other duties as are properly required of him by the board of directors. Except where by law the signature of the president is required, the chairman of the board shall possess the same power as the president to sign all certificates, contracts, and other instruments of the corporation which may be authorized by the board of directors. He shall make reports to the board of directors and the stockholders, and shall perform all such other duties as are properly required of him by the board of directors. He shall see that all orders and resolutions of the board of directors and of any committee thereof are carried into effect.

Section 7. *President*. The president shall act in a general executive capacity and shall assist the chairman of the board in the administration and operation of the corporation's business and general supervision of its policies and affairs. The president shall, in the absence of or because of the inability to act of the chairman of the board, perform all duties of the chairman of the board and preside at all meetings of stockholders and of the board of directors. The president may sign, alone or with the secretary, or an assistant secretary, or any other proper officer of the corporation authorized by the board of directors, certificates, contracts, and other instruments of the corporation as authorized by the board of directors.

Section 8. *Vice Presidents*. In the absence or disability of the president, a vice president designated by the board of directors shall perform all the duties of the president, and when so acting shall have all the powers of, and be subject to all the restrictions upon, the president. The vice presidents shall have such other powers and perform such other duties as from time to time may be prescribed for them respectively by the board of directors or the bylaws.

Section 9. *Secretary*. The secretary shall keep or cause to be kept, at the principal executive office or such other place as the board of directors may order, a book of minutes of all meetings and actions of directors, committees of directors and stockholders, with the time and place of holding, whether regular or special, and, if special, how authorized, the notice thereof given, the names of those present at directors' and committee meetings, the number of shares present or represented at stockholders' meetings, and the proceedings thereof.

The secretary shall keep, or cause to be kept, at the principal executive office or at the office of the corporation's transfer agent or registrar, as determined by resolution of the board of directors, a stock register, or a duplicate register, showing the names of all stockholders and their addresses, the number and classes of shares held by each, the number and date of certificates issued for the same, and the number and date of cancellation of every certificate surrendered for cancellation.

The secretary shall give, or cause to be given, notice of all meetings of the stockholders and of the board of directors required by the bylaws or by law to be given and shall have such other powers and perform such other duties as may be prescribed by the board of directors or by the bylaws.

Section 10. *Chief Financial Officer.* The chief financial officer shall keep and maintain, or cause to be kept and maintained, adequate and correct books and records of accounts of the properties and business transactions of the corporation, including accounts of its assets, liabilities, receipts, disbursements, gains, losses, capital, retained earnings and shares. The books of account shall be open at all reasonable times to inspection by any director.

The chief financial officer shall deposit all monies and other valuables in the name and to the credit of the corporation with such depositories as may be designated by the board of directors. The chief financial officer shall disburse the funds of the corporation as may be ordered by the board of directors, shall render to the chairman of the board and directors, whenever they request it, an account of all of his transactions as chief financial officer and of the financial condition of the corporation, and shall have other powers and perform such other duties as may be prescribed by the board of directors or the bylaws.

Section 11. *Assistant Secretaries and Assistant Treasurers.* Any assistant secretary may perform any act within the power of the secretary, and any assistant treasurer may perform any act within the power of the chief financial officer, subject to any limitations which may be imposed in these bylaws or in board resolutions.

## **ARTICLE VI – INDEMNIFICATION OF DIRECTORS, OFFICERS, EMPLOYEES AND OTHER AGENTS**

Section 1. *Indemnification.* The corporation shall indemnify, in the manner and to the full extent permitted by law, any person (or the estate of any person) who was or is a party to, or is threatened to be made a party to, any threatened, pending or completed action, suit or proceeding, whether or not by or in the right of the corporation, and whether civil, criminal, administrative, investigative or otherwise, by reason of the fact that such person is a director or officer of the corporation, and at the discretion of the board of directors may indemnify any person (or the estate of any person) who is such a party or threatened to be made such a party by reason of the fact that such person is or was an employee or agent of the corporation or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise. The corporation may, to the full extent permitted by law, purchase and maintain insurance on behalf of any such person against any liability which may be asserted against him and may enter into contracts providing for the indemnification of such person to the full extent permitted by law. To the full extent permitted by law, the indemnification provided herein shall include expenses (including attorneys' fees), judgments, fines and amounts paid in settlement, and, in the manner provided by law, any such expenses may be paid by the corporation in advance of the final disposition of such action, suit or proceeding. The indemnification provided herein shall not be deemed to limit the right of the corporation to indemnify any other person for any such expenses to the full extent permitted by law, nor shall it be deemed exclusive of any other rights to which any person seeking indemnification from the corporation may be entitled under any agreement, vote of stockholders or disinterested directors or otherwise, both as to action in his official capacity and as to action in another capacity while holding such office.

For the purposes of this Article VI, references to "the corporation" shall include, in addition to the resulting corporation, any constituent corporation (including any constituent of

a constituent) absorbed in a consolidation or merger which, if its separate existence had continued, would have had power and authority to indemnify its directors or officers so that any person who is or was a director or officer of such constituent corporation, or is or was serving at the request of such constituent corporation as a director or officer of another corporation, partnership, joint venture, trust or other enterprise, shall stand in the same position under the provisions of this Article VI with respect to the resulting or surviving corporation as he would have with respect to such constituent corporation if its separate existence had continued.

For purposes of this Article VI, references to “other enterprises” shall include employee benefit plans; references to “fines” shall include any excise taxes assessed on a person with respect to an employee benefit plan; and references to “serving at the request of the corporation” shall include service as a director or officer of the corporation which imposes duties on, or involves services by, such director or officer with respect to an employee benefit plan, its participants or beneficiaries; and a person who acted in good faith and in a manner he reasonably believed to be in the interest of the participants and beneficiaries of an employee benefit plan shall be deemed to have acted in a manner “not opposed to the best interests of the corporation” as referred to in this section.

## **ARTICLE VII – GENERAL CORPORATE MATTERS**

Section 1. *Record Date for Purposes Other Than Notice and Voting*. For purposes of determining the stockholders entitled to receive payment of any dividend or other distribution or allotment of any rights or entitled to exercise any rights in respect of any other lawful action, the board of directors may fix, in advance, a record date, which date shall not precede the date upon which the resolution fixing the record date is adopted by the board of directors, and which shall not be more than sixty (60) nor less than ten (10) days prior to any such action, and in such case only stockholders of record on the date so fixed are entitled to receive the dividend, distribution or allotment of rights or to exercise the rights, as the case may be, notwithstanding any transfer of any shares on the books of the corporation after the record date fixed as aforesaid, except as otherwise provided in the Delaware General Corporation Law.

A determination of stockholders of record entitled to notice of or to vote at a meeting of stockholders shall apply to any adjournment of the meeting; provided, however, that the board of directors may fix a new record date for the adjourned meeting. In order that the corporation may determine the stockholders entitled to consent to corporate action in writing or by electronic transmission without a meeting, the board of directors may fix a record date which shall not be more than ten days after the date upon which the resolution fixing the record date is adopted by the board of directors.

Section 2. *Checks, Drafts, Evidences of Indebtedness*. All checks, drafts or other orders for payment of money, notes or other evidences of indebtedness, issued in the name of or payable to the corporation shall be signed or endorsed by such person or persons and in such manner as, from time to time, shall be determined by resolution of the board of directors.

Section 3. *Corporate Contracts and Instruments, How Executed*. The board of directors, except as otherwise provided in these bylaws, may authorize any officer or officers, agent or agents, to enter into any contract or execute any instrument in the name of and on behalf of the

corporation, and such authority may be general or confined to specific instances; and, unless so authorized or ratified by the board of directors or within the agency power of an officer, no officer, agent or employee shall have any power or authority to bind the corporation by any contract or engagement or to pledge its credit or to render it liable for any purpose or to any amount.

Section 4. *Stock Certificates.* A certificate or certificates for shares of the capital stock of the corporation shall be issued to each stockholder when any such shares are fully paid. All certificates shall be signed in the name of the corporation by the chairman of the board or the president or vice president and by the chief financial officer, the treasurer or an assistant treasurer or the secretary or any assistant secretary, certifying the number of shares and the class or series of shares owned by the stockholder. Any or all of the signatures on the certificate may be facsimile. In case any officer, transfer agent or registrar who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer, transfer agent or registrar before such certificate is issued, it may be issued by the corporation with the same effect as if such person were an officer, transfer agent or registrar at the date of issue.

Section 5. *Lost Certificates.* Except as hereinafter in this Section 5 provided, no new stock certificate shall be issued in lieu of an old certificate unless the latter is surrendered to the corporation and canceled at the same time. The board of directors may in case any stock certificate or certificate for any other security is lost, stolen or destroyed, authorize the issuance of a new certificate in lieu thereof, upon such terms and conditions as the board of directors may require, including provision for indemnification of the corporation secured by a bond or other adequate security sufficient to protect the corporation against any claim that may be made against it, including any expense or liability, on account of the alleged loss, theft or destruction of such certificate or the issuance of such new certificate.

Section 6. *Representation of Stock of Other Corporations.* The chairman of the board, the president, or any vice president, or any other person authorized by resolution of the board of directors by any of the foregoing designated officers, is authorized to vote on behalf of the corporation any and all stock of any other corporation or corporations, foreign or domestic, standing in the name of the corporation. The authority herein granted to said officers to vote or represent on behalf of the corporation any and all stock by the corporation in any other corporation or corporations may be exercised by any such officer in person or by any person authorized to do so by proxy duly executed by said officer.

Section 7. *Construction and Definitions.* Unless the context requires otherwise, the general provisions, rules of construction, and definitions in the Delaware General Corporation Law shall govern the construction of the bylaws. Without limiting the generality of the foregoing, the singular number includes the plural, the plural number includes the singular, and the term "person" includes both a corporation and a natural person.

Section 8. *Fiscal Year.* The fiscal year of the corporation shall be fixed by resolution of the board of directors.

Section 9. *Exclusive Jurisdiction of Delaware Courts.* Unless the corporation consents in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware

shall be the sole and exclusive forum for any stockholder (including a beneficial owner of stock) to bring (i) any derivative action or proceeding on behalf of the corporation, (ii) any action asserting a claim of, or a claim based on, breach of a fiduciary duty owed by any current or former director, officer, employee or stockholder (including a beneficial owner of stock) of the corporation to the corporation or the corporation's stockholders (including beneficial owners of stock), (iii) any action asserting a claim against the corporation or any current or former director, officer, employee or stockholder (including a beneficial owner of stock) of the corporation arising pursuant to any provision of the DGCL or the certificate of incorporation or by-laws (as either may be amended from time to time), or (iv) any action asserting a claim against the corporation or any current or former director, officer, employee or stockholder (including a beneficial owner of stock) of the corporation governed by the internal affairs doctrine (or, if the Court of Chancery of the State of Delaware does not have jurisdiction, the federal district court for the District of Delaware).

#### **ARTICLE VIII – NOTICE BY ELECTRONIC TRANSMISSION**

Section 1. *Notice by Electronic Transmission.* Without limiting the manner by which notice otherwise may be given effectively to stockholders pursuant to the DGCL, the certificate of incorporation or these bylaws, any notice to stockholders given by the Company under any provision of the DGCL, the certificate of incorporation or these bylaws shall be effective if given by a form of electronic transmission consented to by the stockholder to whom the notice is given. Any such consent shall be revocable by the stockholder by written notice to the Company. Any such consent shall be deemed revoked if:

(A) the Company is unable to deliver by electronic transmission two consecutive notices given by the Company in accordance with such consent; and

(B) such inability becomes known to the secretary or an assistant secretary of the Company or to the transfer agent, or other person responsible for the giving of notice.

However, the inadvertent failure to treat such inability as a revocation shall not invalidate any meeting or other action.

Any notice given pursuant to the preceding paragraph shall be deemed given:

(A) if by facsimile telecommunication, when directed to a number at which the stockholder has consented to receive notice;

(B) if by electronic mail, when directed to an electronic mail address at which the stockholder has consented to receive notice;

(C) if by a posting on an electronic network together with separate notice to the stockholder of such specific posting, upon the later of (i) such posting and (ii) the giving of such separate notice; and

(D) if by any other form of electronic transmission, when directed to the stockholder.

An affidavit of the secretary or an assistant secretary or of the transfer agent or other agent of the Company that the notice has been given by a form of electronic transmission shall, in the absence of fraud, be prima facie evidence of the facts stated therein.

Section 2. *Definition of Electronic Transmission*. An “electronic transmission” means any form of communication, not directly involving the physical transmission of paper, that creates a record that may be retained, retrieved, and reviewed by a recipient thereof, and that may be directly reproduced in paper form by such a recipient through an automated process.

Section 3. *Inapplicability*. Notice by a form of electronic transmission shall not apply to Sections 164, 296, 311, 312 or 324 of the DGCL.

#### **ARTICLE IX – AMENDMENTS**

Section 1. *Amendment*. The bylaws, or any of them, may be rescinded, altered, amended or repealed, and new bylaws may be made (i) by the board of directors, by vote of a majority of the number of directors then in office as directors, acting at any meeting of the board of directors, or (ii) by the stockholders, by the vote of the holders of sixty six and two thirds percent (66 2/3%) of the outstanding voting stock of the corporation, at any annual or special meeting of stockholders, provided that notice of such proposed amendment, modification, repeal or adoption is given in the notice of the annual or special meeting; provided, however, that the bylaws can only be amended if such amendment would not conflict with the certificate of incorporation. Any bylaw made or altered by the requisite number of stockholders may be altered or repealed by the board of directors or may be altered or repealed by the requisite number of stockholders.

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**CERTIFICATE OF SECRETARY**

I, the undersigned, do hereby certify:

- (a) That I am the duly elected and acting Secretary of Capstone Turbine Corporation, a Delaware corporation (the "Corporation"); and
- (b) That the foregoing Third Amended and Restated Bylaws constitute the Amended and Restated Bylaws of the Corporation, as duly adopted by the Board of Directors of the Corporation, effective as of August 2, 2017.

IN WITNESS WHEREOF, I have hereunto subscribed my name as of this 2nd day of August, 2017.



Clarice Hovsepian,  
Secretary

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**CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER AND THE CHIEF FINANCIAL OFFICER**

In connection with the quarterly report of Capstone Turbine Corporation (the "Company") on Form 10-Q for the quarter ended June 30, 2017, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Darren R. Jamison, as Chief Executive Officer of the Company, and Jayme L. Brooks, as Chief Financial Officer of the Company, each hereby certifies, pursuant to 18 U.S.C. Sec. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By:                   /s/ DARREN R. JAMISON                    
                  Darren R. Jamison  
                  President and Chief Executive Officer

By:                   /s/ JAYME L. BROOKS                    
                  Jayme L. Brooks  
                  Chief Financial Officer

Date: August 9, 2017