

CAPSTONE TURBINE Corp  
Form 10-K  
June 15, 2015

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**FORM 10-K**

(Mark One)

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

For the fiscal year ended March 31, 2015

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 001-15957

**CAPSTONE TURBINE CORPORATION**

(Exact name of registrant as specified in its charter)

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

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

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

**91311**  
(Zip Code)

**(818) 734-5300**

(Registrant's telephone number, including area code)

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

Title of each class	Name of exchange on which registered
Common Stock, par value \$.001 per share	NASDAQ Global Market
Series A Preferred Stock Purchase Rights	

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

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

(Do not check if a  
smaller reporting company)

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

The aggregate market value of the shares of Common Stock of the registrant held by non-affiliates on September 30, 2014 was approximately \$353.3 million.

As of June 8, 2015, there were 330,689,556 shares of the registrant's Common Stock issued and outstanding.

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement relating to the registrant's 2015 annual meeting of stockholders are incorporated by reference into Part III of this report to the extent described therein.

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**PART I**

**Item 1. Business.**

**Overview**

Capstone Turbine Corporation ("Capstone" or 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 and critical power supply. In addition, our microturbines can be used as battery charging generators for hybrid electric vehicle applications. Microturbines allow customers to produce power on-site in parallel with the electric grid or stand alone when no utility grid is available. Several technologies are used to provide "on-site power generation" (also called "distributed generation") such as reciprocating engines, solar power, wind powered systems and fuel cells. For customers who do not have access to the electric utility grid, microturbines provide clean, on-site power with fewer scheduled maintenance intervals and greater fuel flexibility than competing technologies. For customers with access to the electric grid, microturbines provide an additional source of continuous duty power, thereby providing additional reliability and potential cost savings. With our stand-alone feature, customers can produce their own energy in the event of a power outage and can use microturbines as their primary source of power for extended periods. Because our microturbines also produce clean, usable heat energy, they provide economic advantages to customers who can benefit from the use of hot water, chilled water, air conditioning and heating. Our microturbines are sold, installed and serviced primarily through our global distribution network. Together we offer new and remanufactured parts as well as a comprehensive Factory Protection Plan ("FPP"). Successful implementation of microturbines relies on the quality of the microturbine, marketability for appropriate applications, and the quality of the installation and support.

We believe we were the first company to offer a commercially available power source using microturbine technology. Capstone offers microturbines designed for commercial, industrial and utility users with product offerings ranging from 30 kilowatts ("kW") to one megawatt in electric power output. Our 30 kW ("C30") microturbine can produce enough electricity to power a small convenience store. The 65 kW ("C65") microturbine can produce enough heat to provide hot water to a 100-room hotel while also providing about one-third of its electrical requirements. Our 200 kW ("C200") microturbine is well suited for larger hotels, office buildings and wastewater treatment plants, among others. By packaging the C200 microturbine power modules into an International Organization for Standardization ("ISO") sized container, Capstone has created a family of microturbine offerings from 600 kW up to one megawatt in a compact footprint. Our 1000 kW ("C1000 Series") microturbines are well suited for utility substations, larger commercial and industrial facilities and remote oil and gas applications. Our microturbines combine patented air-bearing technology, advanced combustion technology and sophisticated power electronics to form efficient and ultra-low emission electricity and cooling and heat production systems. Because of our air-bearing technology, our microturbines do not require liquid lubricants. This means they do not require routine maintenance to change and dispose of oil or other liquid lubricants, as do the most common competing products. Capstone microturbines can be fueled by various sources, including natural gas, propane, sour gas, renewable fuels such as landfill or digester gas, kerosene, diesel and biodiesel. The C65 and C200 microturbines are available with integrated heat exchangers, making them easy to engineer and install in applications where hot water is used. Our products produce exceptionally clean power. Our natural gas-fueled C65 and C200 microturbines were certified by the California Air Resources Board ("CARB") as meeting its stringent 2007 emissions requirements the same emissions standard used to certify fuel cells and the same emissions levels as a state-of-the-art central power plant. Our C65 Landfill and Digester Gas systems were certified in January 2008 by CARB as meeting 2008 waste gas emissions requirements for landfill and digester gas applications. Our C200 Landfill and Digester Gas systems were certified in

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November 2010 by CARB as meeting 2008 waste gas emissions requirements for landfill and digester gas applications.

On February 1, 2010, we acquired the 100 kW ("TA100") microturbine product line from Calnetix Power Solutions, Inc. ("CPS"). The TA100 microturbine is most similar to the Capstone product design compared to other microturbine products in the industry.

We sell complete microturbine units, subassemblies, components and various accessories. We also remanufacture microturbine engines and provide after-market parts and services. Our microturbines are sold primarily through distributors and Original Equipment Manufacturers ("OEMs"). Distributors purchase our products for sale to end users and also provide application engineering and installation support. Distributors are also required to provide a variety of additional services, including engineering the applications in which the microturbines will be used, installation support of the products at the end users' sites, commissioning the installed applications and providing post-commissioning service. Our distributors perform as value-added resellers. OEMs integrate Capstone's products into their own product solutions.

To assure proper installation of Capstone microturbine systems, we have instituted a Factory Trained Installer ("FTI") training and certification program. Personnel from our distributors and OEMs, as well as design engineering firms, contractors and end users attend this FTI training. We offer to assist all customers by reviewing their installation designs to confirm that the technical requirements for proper operation have been met, such as electrical interconnections, load requirements, fuel type and pressure, cooling air flow and turbine exhaust routing. As part of the microturbine commissioning process, we also receive a checklist to confirm that the final installation adheres to Capstone technical requirements before we accept any warranty obligations. This is aimed at providing the end user with a proper installation that will operate as expected for the life of the equipment.

Through our global distribution network, we offer a comprehensive FPP for a fixed annual fee to perform regularly scheduled and unscheduled maintenance as needed. Capstone provides factory and on-site training to certify all personnel that are allowed to perform service on our microturbines. Individuals who are certified are called Authorized Service Providers ("ASPs"), and must be employed by a distributor in order to perform work pursuant to a Capstone FPP. The majority of our distributors provide these services.

This Annual Report on Form 10-K (this "Form 10-K") refers to Capstone's fiscal years ending March 31 as its "Fiscal" years.

## **Our Products**

We began commercial sales of our C30 products in 1998, targeting the emerging distributed generation industry that was being driven by fundamental changes in power requirements. In September 2000, we shipped the first commercial unit of our 60 kW microturbine ("C60"), which was replaced by the C65 model during the quarter ended March 31, 2006. We began shipping the C60 ICHP solution in 2003. The first commercial C200 microturbine was shipped on August 28, 2008. Our C1000 Series product was developed based on Capstone's C200 microturbine engine. The C1000 Series product can be configured into 1,000 kW, 800 kW and 600 kW solutions in a single ISO-sized container. The first commercial shipment of our C1000 Series product was on December 29, 2008. We began shipping TA100 microturbines in March 2010.

During Fiscal 2015, we booked total orders of \$84.5 million for 587 units, or 86.0 megawatts, compared to \$131.5 million for 675 units, or 135.3 megawatts, during Fiscal 2014. We shipped 620 units with an aggregate of 91.4 megawatts, generating revenue of \$90.4 million compared to 671 units with an aggregate of 109.9 megawatts, generating revenue of \$108.8 million during Fiscal 2014. Total backlog as of March 31, 2015 decreased \$5.9 million, or 3%, to \$165.7 million from \$171.6 million at March 31,

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2014. As of March 31, 2015, we had 787 units, or 182.8 megawatts, in total backlog compared to 820 units, or 188.2 megawatts, at the same date last year. The decrease in backlog was primarily the result of the downturn of the oil markets, a substantially stronger U.S. dollar making our products more expensive overseas and on-going geopolitical tensions in Russia, North Africa and the Middle East. 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 twelve months. The timing of shipments is subject to change based on several variables (including customer deposits, payments, availability of credit and customer delivery schedule changes), most of which are not in our control and can affect the timing of our revenue.

The following table summarizes our backlog:

	As of March 31,			
	2015		2014	
	Megawatts	Units	Megawatts	Units
C30	2.9	97	3.0	101
C65	32.6	502	33.8	520
TA100	1.9	19	1.9	19
C200	2.4	12	3.4	17
C600	7.2	12	9.0	15
C800	9.8	12	8.8	11
C1000	125.0	125	127.0	127
Waste heat recovery generator	1.0	8	1.3	10
<b>Total Backlog</b>	<b>182.8</b>	<b>787</b>	<b>188.2</b>	<b>820</b>

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

Our microturbines incorporate four major design features:

advanced combustion technology;

patented air-bearing technology;

digital power electronics; and

remote monitoring capability.

Our advanced combustion technology allows Capstone microturbines to achieve low emissions with a design geared towards manufacturability. These low emission levels not only provide an environmentally friendly product, but also eliminate permitting requirements in several municipalities for continuously operated onsite power generation. The air-bearing system allows the microturbine's single moving assembly to produce power without the need for typical petroleum-based lubrication. Air-bearings use a high-pressure field of air rather than petroleum lubricants. This improves reliability and reduces maintenance such as oil changes. The electronic controls manage critical functions and monitor operations of the microturbine. For instance, our electronics control the microturbine's speed, temperature and fuel flow and communicate with external networks and building management systems. The power electronics coordinate with the grid when the units are operated in a grid-connect mode and with the onboard battery when equipped for stand-alone mode. All control functions are



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performed digitally. Performance is optimized, resulting in lower emissions, higher reliability and high efficiency over a variable power range.

The electrical output of our units can be paralleled in multiple unit configurations through our Advanced Power Server product and a digital communications cable to serve larger installations requiring electrical loads up to ten megawatts.

Our products can operate:

connected to the electric utility grid as a current source;

on a stand-alone basis as a voltage source;

multipacked to support larger loads as a "virtual single" unit; and

in dual mode, where the microturbine operates connected to the electric utility grid or operates independently.

We also offer C65 and C200 ICHP systems. These systems combine the standard C65 and C200 microturbine unit with a heat recovery module that provides electricity and heats water.

Our family of products is offered in the following configurations:

Fuel Types	C30		C65		TA100		C200		C1000 Series	
	Grid Connect	Dual Mode	Grid Connect	Dual Mode	Grid Connect	Dual Mode	Grid Connect	Dual Mode	Grid Connect	Dual Mode
Low pressure natural gas	X	X	X	X	X	X	X	X	X	X
High pressure natural gas	X	X	X	X	X	X	X	X	X	X
Compressed natural gas	X	X	X	X	X	X	X	X	X	X
Landfill gas	X		X				X		X	
Digester gas	X		X				X		X	
Gaseous propane	X	X	X	X			X	X	X	X
High pressure sour gas	X	X	X	X			X	X	X	X
Diesel	X	X	X	X			X	X	X	X
Kerosene	X	X	X	X						

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

Our electronic controls manage microturbines using Capstone's proprietary software and advanced algorithms. The controls:

start the turbogenerator and manage its load;

coordinate the functioning of the microturbine with the grid;

manage the speed, fuel flow and exhaust temperature of the microturbine;



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convert the variable frequency, up to a maximum of 1,600 Hertz and variable voltage power produced by the generator into a usable output of either 50 or 60 Hertz AC for stationary applications or DC for hybrid electric vehicle applications; and

provide digital communications to externally maintain and control the equipment.

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In addition, our proprietary Capstone Remote Monitoring Software ("CRMS") allows end users to remotely operate and manage the microturbine. Unlike the technology of other power sources that require on-site monitoring and maintenance, the CRMS allows end users to remotely and efficiently monitor their microturbine systems. This remote capability can provide end users with power generation flexibility and cost savings.

The C30 microturbines were initially designed to operate connected to an electric utility grid and to use a high pressure natural gas fuel source. We have expanded our microturbine's functionality to operate with different fuels. The combustor system remains the same for all fuels except for the fuel injectors, which currently vary between liquid and gaseous fuels. The Capstone microturbine's multi-fuel capability provides significant competitive advantages with respect to some of our selected vertical markets.

Our C65 grid-connect and stand-alone microturbine power systems are listed by Underwriters Laboratories ("UL") as meeting the UL 2200 stationary engine generator standards and the UL 1741 utility interconnection requirements. Our products are manufactured by processes that are ISO 9001:2008 and ISO 14001:2004 certified.

In 2002, the California Energy Commission certified our C30 and C60 microturbines as the first products to comply with the requirements of its "Rule 21" grid interconnection standard. This standard streamlines the process for connecting distributed generation systems to the grid in California. The benefits of achieving this standard include avoiding both costly external equipment procurement requirements and extensive site-by-site and utility-by-utility analysis. Our protective relay functionality has also been recognized by the State of New York, which has pre-cleared our microturbines for connection to New York's electric utility grid.

Our C60 microturbine was the first combustion power generation product to be certified by the CARB as meeting its stringent distributed generation emissions standards that went into effect in 2003. Our C65 microturbine now meets the even more stringent CARB 2007 standard for natural gas.

The TA100 microturbine offers a digital communication interface which can be connected to an external controller (not sold by Capstone) to provide multiple unit and dual mode dispatching functionality. An external synchronization board is provided to parallel the electrical output in multiple unit configurations for stand-alone operation.

We are the first microturbine manufacturer to achieve UL Class I, Division 2 certification for operation in hazardous-area oil and gas applications. These specially packaged systems are applied in oil and gas production areas with potentially explosive environments. In September 2009, we received UL certification for our C200 grid-connect and stand-alone microturbine as meeting the UL 2200 stationary engine generator standards and the UL 1741 utility interconnection requirements. In June 2010, we received UL certification for our C1000 Series grid-connect and stand-alone microturbine as meeting the UL 2200 stationary engine generator standards and the UL 1741 utility interconnection requirements.

**Applications**

Worldwide, stationary power generation applications vary from huge central stationary generating facilities up to 1,000 MW to back-up generators as small as 2 kW. Historically, power generation in most developed countries such as the United States has been part of a regulated utility system. A number of developments related primarily to the deregulation of the utility industry as well as significant technology advances have broadened the range of power supply choices available to all types of customers.

Capstone products serve multiple vertical markets worldwide. Within the markets served, we focus on vertical markets that we have identified as having the greatest near-term potential. In the markets

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we are focusing on, which are energy efficiency, renewable energy, natural resources, critical power supply, transportation and marine, we have identified specific targeted vertical market segments.

*Energy Efficiency CHP/CCHP*

Energy efficiency maximizes the use of energy produced by the microturbines, reduces emissions compared with traditional power generation and enhances the economic advantage to customers. Energy efficiency uses both the heat and electric energy produced in the power generation process. Using the heat and electricity created from a single combustion process increases the efficiency of the system from approximately 30% to 75% or more. The increased operating efficiency reduces overall greenhouse gas emissions compared with traditional independent sources such as power generation and local thermal generation and, through displacement of other separate systems, can reduce operating costs. Our microturbines' emissions of commonly found air pollutants ("criteria pollutants"), such as nitrogen oxides ("NOx"), carbon monoxide ("CO") and volatile organic compounds ("VOCs"), are lower than those from the on-site boilers that our CHP system displaces, meaning that local emissions of these pollutants are actually reduced when a Capstone energy efficiency CHP system is installed. This high CHP efficiency also means more efficient use of fuel and can reduce net utility costs for end users. The most common uses of heat energy include space heating and air conditioning, heating and cooling water, as well as drying and other applications. For example, we have used the heat generated by the microturbines to supply hot water solutions for hotels, office buildings and retail, commercial and industrial customers. When our microturbine exhaust drives an absorption chiller, the chiller produces chilled water for air conditioning and other uses.

There are energy efficiency markets for CHP and CCHP applications worldwide. A U.S. Department of Energy ("DOE") report cited the total technical potential for the energy efficiency CHP at commercial, institutional and industrial sites in the United States to be over 130 gigawatts. Many governments have encouraged more efficient use of the power generation process to reduce pollution, lower dependence on fossil fuels and control the cost of locally produced goods. To access these markets, we have entered into agreements with distributors which have engineered energy efficiency CHP packages that utilize the hot exhaust air of the microturbine for heating water and also use the hot exhaust to run an absorption chiller for air conditioning. We also offer our own integrated energy efficiency CHP and CCHP product for the C65, C200 and C1000 Series products.

*Renewable Energy*

Our microturbines can use renewable methane gases from landfills, wastewater treatment facilities and other biogas applications such as food processing and agricultural waste, referred to as green waste, and cow, pig and chicken manure. They can burn these renewable waste gases with minimal emissions, thereby, in some cases, avoiding the imposition of penalties incurred for pollution while simultaneously producing electricity from this "free" renewable fuel for use at the site or in the surrounding areas. The microturbines have demonstrated effectiveness in these applications and outperform conventional combustion engines in a number of situations, including when the gas contains a high amount of sulfur.

Capstone released for sale the C65 stand-alone digester product in the renewable energy market segment in 2007. This product is targeted at remote villages in third-world countries with wastewater treatment facilities that offer a valuable source of fuel which can be converted to electricity. A joint applications and engineering team evaluated the performance of the existing C65 digester gas system to ensure that the combustion system would be stable from 0 to 100% power output. Minor controls changes were implemented to increase stability at low power levels. The ability to convert this low BTU fuel to electricity along with the high reliability and low maintenance features of this product make it well suited for this market.

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

On a worldwide basis, there are thousands of locations where the drilling, production, compression and transportation of natural resources and other extraction and production processes create fuel byproducts, which traditionally have been released or burned into the atmosphere. Our microturbines are installed in the natural resource market to be used in oil and gas exploration, production, compression and transmission sites both onshore and offshore as a highly reliable critical source of power generation. In addition, our microturbines can use flare gas as a fuel to provide prime power. Typically these oil and gas or mining operations have no electric utility grid and rely solely on Capstone's microturbine for reliable low emission power supply.

Many major oil and gas companies are exploring large shale reserves, or plays, in the United States. In mid-2010 Capstone sold its first microturbines into the U.S. shale gas market in the Eagle Ford and Marcellus shale plays. The addressable market for Capstone microturbines in this industry is significant. The shale gas market for microturbines is expected to grow substantially as demand for natural gas continues to rise and the U.S. Environmental Protection Agency ("EPA"), the Department of the Interior and other federal and state agencies work to reduce emissions of methane, volatile organic compounds and hazardous air pollutants associated with natural gas development. Capstone has been invited to participate in numerous Natural Gas STAR workshops in the United States and foreign markets to demonstrate the emissions reductions our technology can provide.

The C200 product is offered for sale configured to meet Class 1 Zone 2 hazardous location requirements for the oil and gas market. Hazardous location requirements are met through package ventilation changes for purging and pressurizing package air to avoid potential flammable mixtures as well as controls for emergency disconnect of fuel and electrical sources. The package is upgraded to stainless steel construction to withstand the corrosive offshore environments where these units are installed. Oil and gas customers prefer the low maintenance and high reliability attributes offered by our turbines to ensure continued production. Capstone also offers C30 and C65 microturbine products in similar configurations.

*Critical Power Supply*

Because of the potentially catastrophic consequences of even momentary system failure, certain power users such as high technology, health care and information systems facilities require particularly high levels of reliability in their power service. To meet these customer requirements, traditional solutions utilize Uninterruptible Power Supplies ("UPS") to protect critical loads from momentary power disturbances along with backup diesel generators for extended outages. Capstone offers an alternative solution that can both meet customer reliability requirements and reduce operating costs.

Capstone has developed the world's only microturbine powered UPS solutions that offer clean, IT-grade power and can completely displace the need for traditional UPS and backup diesel generators. We offer two microturbine-powered UPS solutions. The Capstone UPSource microturbine-powered UPS solution provides prime or emergency power solutions. Capstone's Hybrid UPS microturbine powered solution provides power when dispatched in high efficiency, standard UPS and emergency power solutions. Both critical power supply products offer 99.999999% availability in an n+1 configuration when the product has at least one independent backup. Our microturbine-powered UPS solutions are UL listed. These integrated solutions are ideal for new construction or facility expansion and are typically installed with absorption chillers or other heat recovery systems to obtain high efficiency and reduce operating costs compared with traditional solutions.

Dual mode units operating in a prime power configuration can support a 150% overload for 10 seconds during transient conditions. Dual mode units operating in grid parallel mode can provide customers a back-up power system with an economic return. These systems offer high onsite energy efficiency when combined with a heat exchanger (CHP) to create hot water or with a chiller (CCHP)

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for air conditioning at these facilities. This configuration, when combined with the Capstone Dual Mode Controller, can transition from the grid parallel mode to prime power mode in less than ten seconds. Capstone microturbines can also be installed along with a rotary UPS to provide a complete line-interactive continuous power solution. In this case, the microturbines remain in grid connect mode while the rotary UPS stabilizes the utility voltage and provides a seamless transfer from operation connected to the grid to operation isolated from the grid.

*Transportation*

Our technology is also used in hybrid electric vehicle ("HEV") applications. Our customers have applied our products in hybrid electric vehicles such as transit buses and trucks. In these applications the microturbine acts as an onboard battery charger to recharge the battery system as needed. The benefits of microturbine hybrids include extended range, fuel economy gains, quieter operation, reduced emissions and higher reliability 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 and 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 markets. The most immediate market 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, reducing overall fuel consumption and emissions. The other 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. Our marine customers use both our liquid fueled and natural gas products. Liquefied natural gas ("LNG") is in its early stages as a marine fuel, and the number of vessels powered by LNG is forecasted to double every two years over the next decade. Vessel owners can receive the same benefits as users of stationary Capstone products: low emissions with no aftertreatment, long maintenance intervals, high reliability, low noise and no vibration.

**Sales, Marketing and Distribution**

We primarily sell our microturbine product, parts and service through distributors. Our world-wide distribution network is our most valuable intangible asset that we have proudly developed from the ground up. Each one of our distributors is a strategically placed independent partner of Capstone marketing and selling the Capstone products and services on our behalf. Our typical terms of sale include shipment of the products with title, care, custody and control transferring at our dock, payment due anywhere from in advance of shipment to 90 days from shipment, and warranty periods of approximately 15 to 18 months from shipment. We typically do not have customer acceptance provisions in our agreements.

*North America*

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

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Recent energy reform in Mexico has opened new market opportunities by allowing competition and enabling power generation companies to sell directly to consumers instead of only to the state-owned Federal Electricity Commission. Capstone's strategy in Mexico is to leverage our distribution network in Mexico across various market verticals.

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

*Asia and Australia*

Our sales and marketing strategy in Asia and Australia has been to develop and strengthen distributor relationships throughout these continents.

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

*Middle East and Africa*

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

*Europe and Russia*

To address the European market, including Russia, we are strengthening our relationships with existing and new distributors and have increased Capstone local sales and service support. We have an office in Europe for the purpose of working with our distributors there on a daily basis to realize growth opportunities. We have established a spare parts distribution center in Europe to make parts readily available to our distributors. Europe has a history of extensive use of distributed generation technologies. During Fiscal 2015, the pace of economic recovery in Europe was slow and demand remained soft with a decrease in revenue of 30%, primarily from Russia, compared to Fiscal 2014. Further, the continuation or escalation of the current geopolitical instability in Russia and Ukraine could continue to negatively impact our operations, sales, and future growth prospects in that region. For more information, see "Risk Factors" beginning on Page 14 of this Form 10-K.

*South America*

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

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energy efficiency, renewable energy and natural resources. Our historical sales in South America have primarily been in the natural resources market.

**Revenue**

For geographic and segment revenue information, please see Note 2 Summary of Significant Accounting Policies Segment Reporting in the "Notes to Consolidated Financial Statements."

**Customers**

Sales to Horizon Power Systems ("Horizon"), one of the Company's domestic distributors, accounted for 17%, 12% and 27% of our revenue for the years ended March 31, 2015, 2014 and 2013, respectively. Sales to BPC Engineering ("BPC"), one of the Company's Russian distributors, accounted for 11%, 17% and 11% of our revenue for the years ended March 31, 2015, 2014 and 2013, respectively. Sales to E-Finity Distributed Generation, LLC ("E-Finity"), one of the Company's domestic distributors, accounted for 19% of our revenue for the year ended March 31, 2014. Additionally, Optimal Group Australia Pty Ltd ("Optimal"), one of the Company's Australian distributors, accounted for 17% of net accounts receivable as of March 31, 2015. BPC, Electro Mecanique Industries ("EMI"), one of the Company's distributors in the Middle East and Africa, and E-Finity accounted for 26%, 18% and 16%, respectively, of net accounts receivable as of March 31, 2014.

During the three months ended March 31, 2015, we recorded approximately \$7.1 million with respect to the accounts receivable allowance from BPC. We determined that the collectability of this accounts receivable balance was not reasonably assured based on BPC's recent payment history and because the impact of the steep decline of the Russian ruble could continue to negatively impact its ability to pay its outstanding accounts receivable balance. Also during the three months ended September 30, 2014, we recorded approximately \$2.6 million with respect to the accounts receivable allowance from EMI. We determined that the collectability of this accounts receivable balance was not reasonably assured based on EMI's payment history. The Company recorded bad debt expense of approximately \$10.1 million, \$0.2 million and \$0.3 million for the years ended March 31, 2015, 2014 and 2013, respectively.

**Competition**

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

Generally, power purchased from the electric utility grid is less costly than power produced by distributed generation technologies. Utilities may also charge fees to interconnect to their power grids. However, we can provide economic benefits to end users in instances where the waste heat from our microturbine has value (CHP and CCHP), where fuel costs are low (renewable energy/renewable fuels), where the costs of connecting to the grid may be high or impractical (such as remote power applications), where reliability and power quality are of critical importance, or in situations where peak shaving could be economically advantageous because of highly variable electricity prices. Because Capstone 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.

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Our reciprocating engine competitors have products and markets that are well developed and technologies that have been proven for some time. A reciprocating engine, also known as an internal combustion engine, is similar to those used in automotive applications. Reciprocating engines are popular for primary and back-up power applications despite higher levels of emissions, noise and maintenance. These technologies, which typically have a lower up-front cost than microturbines, are currently produced by Caterpillar Inc., Cummins Inc., Deutz Corporation, GE Gas Engines (which now includes Waukesha and Jenbacher), MAN SE, Tecogen, Inc. and Wärtsilä Corporation, among others.

Our microturbines may also compete with other distributed generation technologies, including solar power, wind power systems and fuel cells. Solar and wind powered systems produce no emissions. The main drawbacks to solar and wind powered systems are their dependence on weather conditions, the utility grid and high capital costs that can often make these systems uneconomical without government subsidies depending upon geographic locale and application of the technology. Although the market for fuel cells is still developing, a number of companies are focused on markets similar to ours, including FuelCell Energy Inc., Bloom Energy Corporation, LG Fuel Cell Systems, a business unit of LG Electronics, Plug Power Inc. and Ballard Power Systems Inc. Fuel cells have lower levels of NOx, CO, VOCs and other criteria pollutant emissions than our microturbines. Fuel cells, like solar and wind powered systems, have received higher levels of incentives for the same type of applications as microturbines. Management believes that, absent these higher government incentives, microturbines provide a better value to end users in most applications. However, over the medium-to-long term, fuel cell technology companies may introduce products that compete more directly with our microturbines.

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

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

provide power when a utility grid is not available or goes out of service;

reduce total cost of purchasing electricity and fuel;

improve electric power availability and provide high power quality;

operate on multiple fuel types;

reduce emissions (both criteria pollutants and greenhouse gases);

simplify operation; and

control maintenance costs and associated disposal of hazardous materials.

**Governmental and Regulatory Impact**

Our markets can be positively or negatively impacted by the effects of governmental and regulatory matters. We are affected not only by energy policy, laws, regulations and incentives of governments in the markets in which we sell, but also by rules, regulations and costs imposed by utilities. Utility companies or governmental entities may place barriers on the installation or interconnection of our product with the electric grid. Further, utility companies may charge additional fees to customers who install on-site power generation; thereby reducing the electricity they take from the utility, or for having the capacity to use power from the grid for back-up or standby purposes. These types of restrictions, fees or charges could hamper the ability to install or effectively use our product, or increase the cost to our potential customers for using our systems. This could make our systems less desirable, thereby adversely affecting our revenue and profitability. In addition, utility rate reductions can make our products less competitive which would have a material adverse effect on our operations. These costs, incentives and rules are not always the same as those faced by technologies with which we compete.



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However, rules, regulations, laws and incentives could also provide an advantage to our distributed generation solutions as compared with competing technologies if we are able to achieve required compliance in a lower cost, more efficient manner. Additionally, reduced emissions and higher fuel efficiency could help our customers combat the effects of global warming. Accordingly, we may benefit from increased government regulations that impose tighter emission and fuel efficiency standards.

Capstone continues to engage with federal and state policymakers to develop government programs to promote the deployment of Capstone's low emission and energy efficient products. Kevin Mullin, Speaker Pro Tempore and Assembly member for California's 22<sup>nd</sup> Assembly district, recently introduced A.B. 674 in the California legislature. This bill may stimulate the market in California for Capstone products by revising utility charges and standby rates that apply to distributed generation projects. We cannot provide assurance that any such legislation will be enacted, however. In the wake of numerous destructive storms, several state and local governments are putting greater value in resilient distributed generation resources, including CHP and microgrids, and even reassessing the traditional utility model. However, utilities in other states have asked public utility commissioners to revisit incentive programs and exemptions from grid usage charges for distributed generation technologies, arguing that these policies shift costs to other rate payers.

The United States Government is focused on promoting exports of American products with a specific emphasis on clean energy goods. Capstone participates in export promotion activities such as trade missions which help us enter new markets by facilitating interactions with foreign buyers and distributors. Government funding can impact the rate of development of new technologies. While we continue to receive development funding, committed amounts remaining are relatively low. Competing new technologies generally receive larger incentives and development funding than do microturbines. There are certain recent federal funding solicitations that may support microturbine development. We cannot provide any assurance that any proposal Capstone submits will be funded.

**Sourcing and Manufacturing**

We are focused on continuously improving our supply chain effectiveness, strengthening our manufacturing processes and increasing operational efficiencies within our organization. Our microturbines are designed to achieve high volume and low cost production objectives. Our manufacturing designs include the use of conventional technology, which has been proven in high volume automotive and turbocharger production for many years. Many components used in the manufacture of our products are readily fabricated from commonly available raw materials or off-the-shelf items available from multiple supply sources; however, certain items are custom made to meet our specifications. We believe that in most cases, adequate capacity exists at our suppliers and that alternative sources of supply are available or could be developed within a reasonable period of time. We have an on-going program to develop alternative back-up suppliers for sole source parts. We regularly reassess the adequacy and abilities of our suppliers to meet our needs. We continue to evaluate and implement new systems designed to provide improved quality, reliability, service, greater efficiency and lower supply chain costs. We have substantially increased our focus on process controls and validations, supplier controls, distribution controls and providing our operations teams with the training and tools necessary to drive continuous improvement in product quality. In addition, we remain focused on examining our operations and general business activities to identify cost-improvement opportunities in order to enhance our operational effectiveness. Our ability to leverage these capabilities may be affected by the current variability in our demand volumes and forecasting. Our strategy is to identify primary and secondary sources for critical components when available to minimize factory down time due to unavailability of such parts, which could affect our ability to meet manufacturing schedules.

We have a combined total of approximately 102,000 square foot manufacturing footprint running on a single shift in the San Fernando Valley area of Southern California. We assemble and test units as

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well as manufacture air-bearings and certain combustion system components at our facility in Chatsworth, California. Additionally, we assemble and test our C200 and C1000 Series products and manufacture recuperator cores at our facility in Van Nuys, California. Management believes our manufacturing facilities located in Chatsworth and Van Nuys, California have a combined production capacity of approximately 2,000 units per year, depending on product mix. Excluding working capital requirements, management believes we can expand our combined production capacity to approximately 4,000 units per year, depending on product mix, with approximately \$10 to \$15 million of capital expenditures. We have not committed to this expansion nor identified a source for its funding, if available.

Solar Turbines Incorporated ("Solar"), a wholly owned subsidiary of Caterpillar Inc., was our sole supplier of recuperator cores prior to 2001. In 2000, we exercised an option to license Solar's technology, which allows us to manufacture these cores ourselves and we began manufacturing them in June 2001. The cores are subject to a per-unit royalty fee. As of March 31, 2015, cumulative royalties of \$0.6 million have been paid under the terms of the licensing agreement with Solar.

The Company is a party to a Development and License Agreement with Carrier Corporation ("Carrier") regarding the payment of royalties on the sale of each of the Company's 200 kilowatt ("C200") microturbines. During the three months ended September 30, 2013, we reached our repayment threshold level and the fixed rate royalty was reduced by 50% on future sale of each of our C200 microturbines. As of March 31, 2015, cumulative royalties of \$15.2 million have been paid under the terms of the Development Agreement with Carrier.

**Research and Development ("R&D")**

For the fiscal years ended March 31, 2015, 2014 and 2013, R&D expenses were \$9.7 million, \$9.0 million and \$9.0 million, respectively, which amounts are equivalent to 8%, 7% and 7% of total revenue, respectively, for these fiscal years. R&D expenses are reported net of benefits from cost-sharing programs, such as DOE grants and the Development Agreement with Carrier. Benefits from cost-sharing programs were \$0.5 million, \$1.4 million and \$1.7 million for Fiscal 2015, 2014 and 2013, respectively. Our R&D activities enabled us to become one of the first companies to develop a commercially available microturbine that operates in parallel with the grid. We were the first company to successfully demonstrate a commercially available microturbine that operates on a stand-alone basis.

During Fiscal 2015 we made significant development in variants of the C1000 Series product line. A liquid fuel version of the C1000 Series was produced with the use of Capstone's lean premix combustion technology based on the development work done previously with the C200 liquid fuel system. Liquid fuel products are well suited for markets where customers do not have access to gaseous fuels but still demand the low emissions, low maintenance, and high reliability benefits offered by Capstone's microturbine products. Additionally, a dual-mode (grid connect & standalone capability) Digester gas C1000 was produced to run off the Palm Oil Milling Effluent (POME) biogas produced as a byproduct of the palm oil extraction process. Advancement realized in both of these products opens up new markets for Capstone and also allows for further development possibilities in the areas of liquid fuel and biogas.

During Fiscal 2014 we achieved compliance with the German low voltage requirements, which have been adopted throughout much of Europe. During Fiscal 2015 we continued to make improvements to all our microturbine products to be compliant with other widely adopted European low and medium voltage grid inter-connect requirements for decentralized power generation. Compliance with other widely adopted European requirements for both low and medium voltage are planned to be completed during Fiscal 2016. This work will prepare us for the expected expansion of distributed generation grid inter-connect requirements within the US market. In addition, we continue to work both cost reduction and performance enhancement activities to improve the value of our microturbine products for our

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customer base. Cost reduction activities are focused on leveraging the capabilities of our supply base and internal design lean manufacturing improvements. Product enhancements are focused on reducing the already very low maintenance requirements for our products, while at the same time improving operational efficiency; thereby reducing our customers' total cost of ownership.

We are continuing to work on product improvements to our C30 and C65 microturbine products targeted at the hybrid electric bus and truck market. Because of Capstone's single moving assembly, manufacturers believe there is also the opportunity to produce a lower cost product in larger automotive volumes. Our current focus is on a next generation product that would include existing components and a liquid-cooled set of electronics that are consistent with the size, cost and cooling strategies employed on vehicles today.

Capstone is working with the Kenworth Truck Company to demonstrate a Class 7 series hybrid delivery truck with funding support from the South Coast Air Quality Management District and the San Joaquin Valley Air Pollution Control District. This truck will be operated on actual customer delivery routes in both air districts to quantify the performance, emissions, fuel economy, and other benefits of a microturbine-based series hybrid solution. The Kenworth Class 7 hybrid truck is currently being retrofitted with a refrigerated box body and should be ready for track testing at Kenworth facilities later in the year. The truck will then be used in a demonstration phase to a large commercial customer within the San Joaquin Valley, California. Capstone expects to collect and utilize information from the Kenworth Class 7 hybrid truck's road testing and demonstration processes for future product developments and enhancements. A prototype or concept vehicle may take several years to go into commercial production following completion of rigorous testing.

Capstone also worked with Peterbilt Motors to develop a series hybrid drivetrain as part of a concept Class 8 tractor for Walmart. The Walmart Advanced Vehicle Experience ("WAVE") concept truck is the latest in Walmart's fleet efficiency program. The WAVE concept truck has advanced aerodynamics and is powered by a Capstone C30 range-extending microturbine in its hybrid powertrain. This futuristic concept truck was unveiled at the Mid America Trucking Show in March, 2014. Future development efforts will be based on the lessons learned from these programs. As such, Capstone is working with both Peterbilt and Walmart as they continue to showcase the WAVE truck at various expos and hybrid vehicle shows around the country.

Capstone liquid fuel microturbines have demonstrated emissions levels which meet the CARB 2010 standards for Heavy Duty Diesel Engines ("HDDE"). Capstone is able to meet these extremely low emissions requirements using its lean premix combustion technology with no exhaust aftertreatment. Competitive reciprocating engine technologies require aftertreatment components that increase system cost, require frequent maintenance, and impact engine efficiency. Capstone's compressed natural gas ("CNG") fueled microturbines also meet extremely low emission standards, including the U.S. Environmental Protection Agency and CARB 2010 emissions requirements for On-Road HDDE for Urban Bus. Test emissions from our Natural Gas microturbines measured dramatically less than the emissions levels set forth by the CARB standard including NOx at 75% and CO at 96% less than the required levels. These microturbines are now certified by CARB and available for production in Fiscal 2016.

Capstone is expanding into the marine sector through collaboration with vessel owners, shipyards, and its marine OEM partner, Microturbine Marine Energy. Capstone's marine products can be used to provide hybrid electric marine propulsion, "hotel power," CHP, or CCHP. They are especially ideal for small- and mid-size commercial ships that travel inland waterways and emissions controlled areas (ECAs). A notable case study is the Deen Shipping's Argonon, where LNG fuels two C30 microturbines. Both units have been in operation since 2011 and have saved 25 tons of diesel equivalents per year, compared to conventional accommodation heating and chilling. Capstone has also been working with major marine certifying bodies (Lloyd's Register and DNV-GL) on Type Approval

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for its marine products, which is expected in 2015. Type Approval provides independent product verification that the product conforms to recognized industry quality standards, International Conventions and/or Marine Classification Society Rules, through a process of independent design review, sample testing and verification of production controls.

Capstone continues to evolve our C65 Hybrid UPS product line. After having received the 2011 NOVA Award from the Construction Innovation Forum for the C65 Hybrid UPS Microturbine at Syracuse University's data center labeled one of the greenest data centers in the world, Capstone's C65 Hybrid UPS system has continued development and has recent installations at Sempra in Monterey Park, CA and Capstone's own Data Center in Chatsworth, CA. The product utilizes Capstone's inverter electronics and controls technology to provide continuous power quality to meet the customer's critical load. The load inverter is connected through a central power bus to provide power from one of three available power sources including the utility grid, battery storage system, or microturbine generator. Power to the critical load is synchronized to an available utility grid to allow direct bypass of the critical load to the utility grid. This redundant functionality is provided in a single integrated package that can be scaled to a larger seamless power unit through Capstone's multipack feature. These units can also be combined with a heat recovery module or an absorption chiller to provide higher total output efficiency. Unlike current UPS products combined with reciprocating engines for backup, the low emissions Capstone Hybrid UPS product allows for continuous operation year round allowing customers the ability to receive a payback on their capital equipment investment.

Capstone is working with the Department of Energy ("DOE") on two next generation technology roadmap programs, including a High Efficiency Microturbine with integral heat recovery and advanced AFA (Alumina Forming Austenitic) stainless steel material program in partnership with Oak Ridge National Laboratory (ORNL). The High Efficiency Microturbine with integral heat recovery is focused on improving microturbine electrical efficiency and overall system efficiency utilizing heat recovery. We are currently focusing efforts on the development of the C370 Dual Spool High Efficiency Microturbine with integral heat recovery system. In March 2013, Capstone successfully completed proof-of-concept testing of the low pressure spool also known as the C250 that produced >270 kW as part of the first phase of development. This allowed Capstone to successfully achieve Phase Gate 2 requirements of the DOE contract and proceed with high pressure spool development. Capstone also demonstrated and increased capability of the power electronics and electrical system required to support this higher power generator. The final phase of the program, which is expected to be completed during Fiscal 2016, will incorporate further engine efficiency improvements, resulting in a product design with a projected electrical efficiency of 42% and targeted power output of 370 kW. Improvements in efficiency are key to all markets as improved fuel efficiency benefits users through lower operating costs. AFA stainless steel is a material that offers superior oxidation and creep resistance to commercial heat-resistant steel alloys used in Capstone microturbines at a significantly reduced cost. In Fiscal 2015, we successfully completed the first of two long term endurance tests and have engaged industry partners on commercialization viability. In Fiscal 2017, we expect to complete the second endurance test, after which we will be positioned to make a commercialization decision.

**Protecting our Intellectual Property Rights and Patents**

We rely on a combination of patent, trade secret, copyright and trademark law and nondisclosure agreements to establish and protect our intellectual property rights in our products. In this regard, we have obtained 103 U.S. and 34 international patents (in certain cases covering the same technology in multiple jurisdictions). The patents we have obtained will expire between 2015 and 2027.

Management believes that a policy of protecting intellectual property is an important component of our strategy of being the leader in microturbine system technology and will provide us with a long-term competitive advantage. In addition, we implement security procedures at our plants and

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facilities and have confidentiality agreements with our suppliers, distributors, employees and certain visitors to our facilities.

**Organization and Employees**

We were organized in 1988. On June 22, 2000, we reincorporated as a Delaware corporation.

As of March 31, 2015, we had 236 employees. No employees are covered by collective bargaining arrangements. We consider relations with our employees to be good.

**Available Information**

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

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**Item 1A. Risk Factors.**

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

*our results of operations;*

*profits and losses;*

*R&D activities;*

*sales expectations;*

*our ability to develop markets for our products;*

*sources for parts;*

*federal, state and local government regulations;*

*general business;*

*industry and economic conditions applicable to us;*

*the efficiency, reliability and environmental advantages of our products and their need for maintenance;*

*our ability to be cost-competitive and to outperform competition;*

*customer satisfaction;*

*the value of using our products;*

*our ability to achieve economies of scale;*

*market advantage;*

*return on investments;*

*issues with suppliers;*

*anticipation of product supply requirements;*

*listing requirements;*

*our microturbine technology;*

*the utilization of our products;*

*competition;*

*the introduction of new technologies;*

*our production capacity;*

*international markets;*

*protection of intellectual property;*

*the adequacy of our facilities;*

*dividends;*

*business strategy;*

*product development;*

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*capital resources;*

*capital expenditures;*

*liquidity;*

*amortization expense of intangibles;*

*cost of warranties;*

*stock-based compensation;*

*our stockholders rights plan;*

*purchase and lease commitments;*

*current liabilities;*

*recently issued accounting standards;*

*market risk;*

*the strength of the U.S. dollar;*

*interest rate sensitivity; and*

*growth of the shale gas market.*

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

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



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

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

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

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

We maintain two Credit and Security Agreements (the "Agreements"), with Wells Fargo Bank, National Association, ("Wells Fargo"), that provide us with a credit facility up to \$15.0 million in the aggregate. At March 31, 2015, we had \$13.0 million outstanding under this line of credit. Under this credit facility, we are required to satisfy specified financial and restrictive covenants. Failure to comply with these covenants could cause an event of default which, if not cured or waived, could require us to repay substantial indebtedness immediately or allow Wells Fargo to terminate the credit facility. In addition, we have pledged our accounts receivable, inventories, equipment, patents and other assets as collateral under the Agreements which would be subject to seizure by Wells Fargo if we were in default and unable to repay the indebtedness.

Several times since entering into the Agreements, we have not been in compliance with certain covenants under the Agreements. In connection with each event of noncompliance, Wells Fargo waived the event of default and, on several occasions, we amended the Agreements in response to the default. As of March 31, 2015, we were not in compliance with the annual net income financial covenant contained in the Agreements, as amended. On June 10, 2015, we received from Wells Fargo a waiver of such noncompliance. If we had not obtained the default waivers, or if we are ever again in noncompliance, we would not be able to draw additional funds under the credit facility. The Agreement also defines an event of default to include a material adverse effect on our business, as determined by Wells Fargo. An event of default for this or any other reason, if not waived, would have a material adverse effect on the Company.

Our obligations under the credit facility could have important consequences, including the following:

We may have difficulty obtaining additional financing at favorable interest rates to meet our requirements for operations, capital expenditures, general corporate or other purposes.

We will be required to dedicate a substantial portion of our cash flow to the payment of principal and interest on indebtedness, which will reduce the amount of funds available for operations, capital expenditures and future acquisitions.

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

For more information, see the section below entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources."

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***If we are unable to either substantially improve our operating results or obtain additional financing, we may be unable to continue as a going concern.***

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

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

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

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

Our products represent an emerging market, and we do not know whether our targeted customers will accept our technology or will purchase our products in sufficient quantities to allow our business to grow. To succeed, demand for our products must increase significantly in existing markets, and there must be strong demand for products that we introduce in the future. If a sustainable market fails to develop or develops more slowly than we anticipate, we may be unable to recover the losses we have incurred to develop our products, we may have further impairment of assets, and we may be unable to meet our operational expenses. The development of a sustainable market for our systems may be hindered by many factors, including some that are out of our control. Examples include:

consumer reluctance to try a new product;

regulatory requirements;

the cost competitiveness of our microturbines;

costs associated with the installation and commissioning of our microturbines;

maintenance and repair costs associated with our microturbines;

the future costs and availability of fuels used by our microturbines;

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economic downturns and reduction in capital spending;

consumer perceptions of our microturbines' safety and quality;

the emergence of newer, more competitive technologies and products; and

decrease in domestic and international incentives.

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

We cannot be certain that we will deliver ordered products in a timely manner. Any reliability or quality issues that may arise with our products could prevent or delay scheduled deliveries or adversely impact the performance of our products. Any such delays or costs could significantly impact our business, financial condition and operating results.

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

Some of our components are currently available only from a single source or limited sources. We may experience delays in production if we fail to identify alternative suppliers, or if any parts supply is interrupted, each of which could materially adversely affect our business and operations. In order to reduce manufacturing lead times and ensure adequate component supply, we enter into agreements with certain suppliers that allow them to procure inventories based upon criteria defined by us. If we fail to anticipate customer demand properly, an oversupply of parts could result in excess or obsolete inventories, which could adversely affect our business. Additionally, if we fail to correctly anticipate our internal supply requirements, an undersupply of parts could limit our production capacity. Our inability to meet volume commitments with suppliers could affect the availability or pricing of our parts and components. A reduction or interruption in supply, a significant increase in price of one or more components or a decrease in demand of products could materially adversely affect our business and operations and could materially damage our customer relationships. Financial problems of suppliers on whom we rely could limit our supply of components or increase our costs. Also, we cannot guarantee that any of the parts or components that we purchase will be of adequate quality or that the prices we pay for the parts or components will not increase. Inadequate quality of products from suppliers could interrupt our ability to supply quality products to our customers in a timely manner. Additionally, defects in materials or products supplied by our suppliers that are not identified before our products are placed in service by our customers could result in higher warranty costs and damage to our reputation. We also outsource certain of our components internationally. As a result of outsourcing internationally, we may be subject to delays in delivery because of regulations associated with the import/export process, delays in transportation or regional instability.

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

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

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

Adverse economic conditions may prevent our customers from purchasing our products or delay their purchases, which would adversely affect our business, financial condition and results of operations. In addition, our ability to access the capital markets may be severely restricted or made very expensive at a time when we need, or would like, to do so, which could have a material adverse impact on our liquidity and financial resources. Certain industries in which our customers do business and certain geographic areas have been and could continue to be adversely affected by adverse economic conditions.

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

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

We sell our products with warranties. There can be no assurance that the provision for estimated product warranty will be sufficient to cover our warranty expenses in the future. We cannot ensure that our efforts to reduce our risk through warranty disclaimers will effectively limit our liability. Any significant incurrence of warranty expense in excess of estimates could have a material adverse effect on our operating results, financial condition and cash flow. Further, we have at times undertaken programs to enhance the performance of units previously sold. These enhancements have at times been provided at no cost or below our cost. If we choose to offer such programs again in the future, such actions could result in significant costs.

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

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

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

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

name recognition, historical performance and market power of our competitors;

product quality and performance;

operating efficiency;

product price;

availability, price and compatibility of fuel;

development of new products and features; and

emissions levels.

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

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

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

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

As we expand in international markets, customers may have difficulty or be unable to integrate our products into their existing systems or may have difficulty complying with foreign regulatory and commercial requirements. As a result, our products may require redesign. Any redesign of the product may delay sales or cause quality issues. In addition, we may be subject to a variety of other risks associated with international business, including import/export restrictions, fluctuations in currency exchange rates and economic or political instability.

***The current geopolitical instability in Russia and Ukraine and related sanctions by the U.S. government against certain companies and individuals may hinder our ability to conduct business with potential or existing customers and vendors in these countries.***

We derived approximately 11% and 17% of our revenue from Russia during Fiscal 2015 and Fiscal 2014, respectively. The continuation or escalation of the current geopolitical instability in Russia and Ukraine could negatively impact our operations, sales, and future growth prospects in that region. Recently, the U.S. government imposed sanctions through several executive orders restricting U.S. companies from conducting certain oil and gas production related business activities with specified Russian and Ukrainian individuals and companies and requiring export licenses for certain of such activities. While we believe that the executive orders currently do not preclude us from conducting business with our current customers in Russia, the sanctions imposed by the U.S. government could be expanded in the future to restrict us from engaging with them. If we are unable to conduct business with new or existing customers or pursue opportunities in Russia or Ukraine or elsewhere, our

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business, including revenue, profitability and cash flows, could be materially adversely affected. In addition, we are currently evaluating the impact of the executive orders on our relationships with vendors. If we are unable to conduct business with certain vendors, our operations in Russia and Ukraine could be materially adversely affected.

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

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we are required to include in our annual reports on Form 10-K our assessment of the effectiveness of our internal controls over financial reporting. This assessment includes disclosure of any material weaknesses identified by our management in our internal controls over financial reporting, as well as a statement that our independent registered public accounting firm has issued an attestation report on the effectiveness of our internal controls over financial reporting. Our management concluded that our internal controls over financial reporting were ineffective as of March 31, 2014 because a material weakness was detected which related to our risk assessment process. Management determined that this material weakness was remediated during Fiscal 2015. Refer to Item 9A, "Controls and Procedures" for additional information. We may in the future identify further material weaknesses in our internal controls over financial reporting that we have not discovered to date. If we cannot adequately maintain the effectiveness of our internal controls over financial reporting, we might be subject to sanctions or investigation by regulatory authorities, such as the SEC. Any such action could adversely affect our financial results and the market price of our securities.

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

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

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

During Fiscal 2010, we completed the acquisition of certain assets relating to the microturbine business of CPS, and we may acquire other businesses in the future. The success of these transactions will depend on, among other things, our ability to develop productive relationships with the corresponding distributors and to integrate assets and personnel, if any, acquired in these transactions and to apply our internal controls processes to these acquired businesses. The integration of any acquired businesses or significant assets may require significant attention from our management, and the diversion of management's attention and resources could have a material adverse effect on our ability to manage our business. Furthermore, we may not realize the degree or timing of benefits we anticipated when we first enter into these transactions. If actual integration costs are higher than amounts assumed, if we are unable to integrate the assets and personnel acquired in an acquisition as anticipated, or if we are unable to fully benefit from anticipated synergies, our business, financial condition, results of operations, and cash flows could be materially adversely affected.

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

Our accounts receivable balance, net of allowances, was \$13.1million and \$28.0 million as of March 31, 2015 and March 31, 2014, respectively. Days sales outstanding in accounts receivable (DSO) at the end of Fiscal 2015 was 40 days, compared with 70 days at the end of Fiscal 2014. We recorded bad debt expense of \$10.1 million and \$0.2 million during Fiscal 2015 and Fiscal 2014, 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.

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

Horizon and BPC accounted for approximately 17% and 11%, respectively, of our revenue for Fiscal 2015. Additionally, Optimal accounted for 17% of net accounts receivable as of March 31, 2015. The loss of Horizon, BPC or any other significant customers could adversely affect our results of operations.

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

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

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

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



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

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

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

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

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

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

Our operating results depend on our ability to develop and introduce new products, enhance existing products and reduce the costs to produce our products. The success of our products is dependent on several factors, including proper product definition, product cost, timely completion and introduction of the products, differentiation of products from those of our competitors, meeting changing customer requirements, emerging industry standards and market acceptance of these products. The development of new, technologically advanced products and enhancements is a complex and uncertain process requiring high levels of innovation, as well as the accurate anticipation of technological and market trends. There can be no assurance that we will successfully identify new

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product opportunities, develop and bring new or enhanced products to market in a timely manner, successfully lower costs and achieve market acceptance of our products, or that products and technologies developed by others will not render our products or technologies obsolete or noncompetitive.

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

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

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

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

***Commodity market factors impact our costs and availability of materials.***

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

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

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

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***Potential litigation may adversely impact our business.***

We may face litigation relating to labor matters or other matters. Any litigation could be costly, divert management attention or result in increased cost of doing business.

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

We view our intellectual property rights as important assets. We seek to protect our intellectual property rights through a combination of patent, trademark, copyright and trade secret laws, as well as licensing and confidentiality agreements. These protections may not be adequate to prevent third parties from using our intellectual property without our authorization, breaching any confidentiality agreements with us, copying or reverse engineering our products, or developing and marketing products that are substantially equivalent to or superior to our own. The unauthorized use of our intellectual property by others could reduce our competitive advantage and harm our business. If it became necessary for us to litigate to protect these rights, any proceedings could be burdensome and costly and we may not prevail. We cannot guarantee that any patents, issued or pending, will provide us with any competitive advantage or will not be challenged by third parties. Moreover, the expiration of our patents may lead to increased competition with respect to certain products. In addition, we cannot be certain that we do not or will not infringe third parties' intellectual property rights. Any such claim, even if it is without merit, may be expensive and time-consuming to defend, subject us to damages, cause us to cease making, using or selling certain products that incorporate the disputed intellectual property, require us to redesign our products, divert management time and attention and/or require us to enter into costly royalty or licensing arrangements.

***Our results of operations could be materially and adversely affected by risks related to cyber security threats.***

As a manufacturer of high technology commercial products, we face cyber security threats, as well as the potential for business disruptions associated with information technology failures or cyber security attacks. We routinely experience cyber security threats, threats to our information technology infrastructure and attempts to gain access to our sensitive information. Because of the evolving nature of these security threats, the impact of any future incident cannot be predicted. The occurrence of any of these events could adversely affect our results of operations, the services we provide to customers, the competitive advantages derived from our R&D efforts, the usefulness of our products and services, our reputation or our stock price.

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

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

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

At March 31, 2015, we had federal and state net operating loss carryforwards of approximately \$626 million and \$203 million, respectively, which may be utilized to reduce future taxable income,

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subject to limitations under Section 382 of the Internal Revenue Code of 1986. These deferred tax assets have been fully offset by a valuation allowance. Any subsequent accumulations of common stock ownership leading to a change of control under Section 382 of the U.S. Internal Revenue Code of 1986, including through sales of stock by large stockholders, all of which are outside of our control, could limit and defer our ability to utilize our net operating loss carryforwards to offset future federal income tax liabilities.

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

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

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

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

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

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

Our common stock is listed on the Nasdaq Global Market. In order to maintain that listing, we must satisfy minimum financial and other requirements. On December 19, 2014, we received a notice from the Nasdaq Listing Qualifications Department stating that, for 30 consecutive business days preceding the notice date, the closing bid price for our common stock had been below the minimum \$1.00 per share requirement for continued listing on the Nasdaq Global Market as set forth in Nasdaq Listing Rule 5450(a)(1). In accordance with Nasdaq Listing Rule 5810(c)(3)(A), we have been provided 180 calendar days, or until June 17, 2015, to regain compliance with the minimum bid price requirement. In order to regain compliance, the bid price of our common stock must close at \$1.00 per share or more for a minimum of ten consecutive business days, at which time Nasdaq Listing Qualifications Department would provide written confirmation of our compliance. In the event we do not meet the minimum bid price requirement during the initial 180-day grace period, we may be eligible for an additional 180-day grace period under the Nasdaq listing rules if we meet the listing standards for The Nasdaq Capital Market. We may need to implement a reverse stock split to regain compliance with the Nasdaq Listing Rules.

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

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

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

actual or anticipated variations in quarterly operating results;

market sentiment toward alternative energy stocks in general or toward Capstone;

changes in financial estimates or recommendations by securities analysts;

conditions or trends in our industry or the overall economy;

loss of one or more of our significant customers;

errors, omissions or failures by third parties in meeting commitments to us;

changes in the market valuations or earnings of our competitors or other technology companies;

the trading of options on our common stock;

announcements by us or our competitors of significant acquisitions, strategic partnerships, divestitures, joint ventures or other strategic initiatives;

announcements of significant market events, such as power outages, regulatory changes or technology changes;

changes in the estimation of the future size and growth rate of our market;

future equity financings;

the failure to produce our products on a timely basis in accordance with customer expectations;

the inability to obtain necessary components on time and at a reasonable cost;

litigation or disputes with customers or business partners;

capital commitments;

additions or departures of key personnel;

sales or purchases of our common stock;

the trading volume of our common stock;

developments relating to litigation or governmental investigations; and

decreases in oil, natural gas and electricity prices.

In addition, the stock market in general, and the Nasdaq Global Market and the market for technology companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of particular companies affected. The market prices of securities of technology companies and companies servicing the technology industries have been particularly volatile. These broad market and industry factors may

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cause a material decline in the market price of our common stock, regardless of our operating performance. In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted against that company. This type of litigation, regardless of whether we prevail on the underlying claim, could result in substantial costs and a diversion of management's attention and resources, which could materially harm our financial condition, results of operations and cash flow.

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

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

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

Our board of directors has adopted a stockholder rights plan, pursuant to which one preferred stock purchase right has been issued for each share of our common stock authorized and outstanding. Until the occurrence of certain prescribed events, the rights are not exercisable and are transferable along with, and only with, each share of our common stock and are evidenced by the common stock certificates. One preferred stock purchase right will also be issued with each share of our common stock we issue in the future until the rights plan expires or is terminated or we redeem or exchange the rights for other property in accordance with the terms of the rights plan or at such time, if any, as the rights separate from each share of our common stock and become exercisable. Each share of Series A Junior Participating Preferred Stock will be entitled to receive, when, as and if declared by our board of directors out of funds legally available for the purpose, dividends payable in cash in an amount per share (rounded to the nearest cent) equal to 100 times the aggregate per share amount of all dividends or other distributions, including non-cash dividends (payable in kind), declared on our common stock other than a dividend payable in shares of common stock or a subdivision of the outstanding shares of common stock. The rights plan prohibits the issuance of additional rights after the rights separate from our common stock. The rights plan is intended to protect our stockholders in the event of an unfair or coercive offer to acquire us. However, the existence of the rights plan may discourage, delay or prevent a merger or acquisition of us that is not supported by our board of directors.

**Item 1B. Unresolved Staff Comments.**

None.

**Item 2. Properties.**

Our principal corporate offices, administrative, sales and marketing, R&D and support facilities consist of approximately 98,000 square feet of leased office space, warehouse space and assembly and test space located at 21211 Nordhoff Street in Chatsworth, California. Our lease for those premises expires in September 2019, and we have one five-year option to extend the term of this lease. We also lease an approximately 79,000 square foot facility at 16640 Stagg Street in Van Nuys, California as an engineering test and manufacturing facility for our recuperator cores. This lease will expire in December 2017. Management believes our facilities are adequate for our current needs.

Table of Contents**Item 3. Legal Proceedings.**

From time to time, the Company may become subject to certain legal proceedings, claims and litigation arising in the ordinary course of business. In the opinion of management, we are not a party to any other material legal proceedings, nor are we aware of any other pending or threatened litigation that would have a material effect on our business, operating results, cash flows, financial position or results of operations should such litigation be resolved unfavorably.

**Item 4. Mine Safety Disclosures.**

Not applicable.

**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.***Price Range of Common Stock*

Our common stock is publicly traded on the Nasdaq Global Market under the symbol "CPST". The following table sets forth the low and high sales prices for each period indicated.

	High	Low
<b>Year Ended March 31, 2015:</b>		
First Quarter	\$ 2.32	\$ 1.28
Second Quarter	\$ 1.53	\$ 1.03
Third Quarter	\$ 1.08	\$ 0.56
Fourth Quarter	\$ 0.77	\$ 0.59
<b>Year Ended March 31, 2014:</b>		
First Quarter	\$ 1.34	\$ 0.82
Second Quarter	\$ 1.52	\$ 1.07
Third Quarter	\$ 1.45	\$ 1.12
Fourth Quarter	\$ 2.60	\$ 1.26

As of June 8, 2015, the last reported sale price of our common stock on the Nasdaq Global Market was \$0.55 per share.

*Stockholders*

As of June 8, 2015, there were 560 stockholders of record of our common stock. This does not include the number of persons whose stock is held in nominee or "street name" accounts through brokers.

*Dividend Policy*

We currently intend to retain any earnings for use in our business and, therefore, we do not anticipate paying any cash dividends in the foreseeable future. We have never declared or paid any cash dividends on our capital stock. In the future, the decision to pay any cash dividends will depend upon our results of operations, financial condition, cash flow and capital expenditure plans, as well as such other factors as our Board of Directors, in its sole discretion, may consider relevant. Additionally, the consent of Wells Fargo would be necessary in order for the Company to declare and pay a dividend in accordance with the terms of the Credit Agreements.



Table of Contents**Item 6. Selected Financial Data.**

The selected financial data shown below have been derived from the audited financial statements of Capstone. The historical results are not necessarily indicative of the operating results to be expected in the future. The selected financial data should be read in conjunction with "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and related notes included elsewhere in this Annual Report.

(In thousands, except per share data)	Year Ended March 31,				
	2015	2014	2013	2012	2011
<b>Statement of Operations:</b>					
Revenue	\$ 115,461	\$ 133,105	\$ 127,557	\$ 109,371	\$ 81,890
Cost of goods sold	97,174	111,409	113,172	103,944	82,427
Gross margin (loss)	18,287	21,696	14,385	5,427	(537)
Operating costs and expenses:					
Research and development	9,679	9,029	8,979	8,237	6,986
Selling, general and administrative(1)	39,517	27,981	27,364	28,927	26,203
Loss from operations	(30,909)	(15,314)	(21,958)	(31,737)	(33,726)
Net loss	\$ (31,533)	\$ (16,256)	\$ (22,563)	\$ (18,764)	\$ (38,470)
Net loss per share of common stock basic and diluted	\$ (0.10)	\$ (0.05)	\$ (0.07)	\$ (0.07)	\$ (0.16)

	As of March 31,				
	2015	2014	2013	2012	2011
<b>Balance Sheet Data:</b>					
Cash and cash equivalents	\$ 32,221	\$ 27,859	\$ 38,817	\$ 49,952	\$ 33,456
Working capital	27,528	26,443	32,782	49,532	22,274
Total assets	78,927	84,118	87,338	99,792	87,019
Revolving credit facility	12,953	13,228	13,476	10,431	7,080
Capital lease/note payable obligations	496	645	594	433	297
Long-term liabilities	161	70	142	254	309
Stockholders' equity	\$ 34,704	\$ 34,093	\$ 41,886	\$ 58,617	\$ 34,480

- (1) The Company recorded bad debt expense of approximately \$10.1 million, \$0.2 million, \$0.3 million, \$2.3 million and \$0.2 million for the years ended March 31, 2015, 2014, 2013, 2012 and 2011, respectively.

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

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

**Overview**

Capstone is 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 Capstone 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.

During Fiscal 2015 our net loss increased by 93% to \$31.5 million and our net loss per share increased by 100% to \$0.10 compared to the same period last year. The increase in the net loss was primarily the result of lower revenue and accounts receivable allowance for two customers during Fiscal 2015 compared to the same period last year. Please see Results of Operations on page 34 for further discussion on the lower revenue and accounts receivable allowance. We continue to remain focused on improving our gross margin. Our gross margin was 16% for each of Fiscal 2015 and Fiscal 2014. While our year over year revenue decreased 13%, our gross margin rate remained flat compared to Fiscal 2014. During Fiscal 2015 we benefitted from our ongoing efforts in manufacturing cost reductions that were entirely offset by lower volume and lower average selling prices for our microturbines compared to the same period last year. Fiscal 2015 was characterized by lower revenue as our operational progress was eclipsed by challenging macroeconomic headwinds over the last year which included the dramatic downturn of the oil markets, a substantially stronger U.S. dollar making our products more expensive overseas and ongoing geopolitical tensions in Russia, North Africa and the Middle East; all of these factors negatively impacted our business.

Capstone products continue to gain interest in all six of the major vertical markets (energy efficiency, renewable energy, natural resources, critical power supply, marine and transportation). In the energy efficiency market, we continue to expand our market presence in hotels, office buildings, hospitals, retail and industrial applications globally. The renewable energy market is fueled by landfill gas, biodiesel, and biogas from sources such as food processing, agricultural waste and cow, pig and chicken manure. Our success in the oil and gas and other natural resources market, which continues to be a growing market worldwide is driven by our microturbines reliability, emissions profile and ease of installation. We have also seen increased interest in critical power supply solution applications as customers want solutions that can handle both primary and backup power. Capstone's transportation market, which utilizes microturbines for electric vehicle industries, is gaining interest as liquid natural gas becomes more readily available as a transportation fuel and emission regulations continue to be tightened on the diesel engine industry.

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

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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 manages operating expenses and strives to improve manufacturing efficiencies while simultaneously lowering direct material costs and increasing average selling prices. The key drivers to Capstone's success are revenue growth, higher average selling prices, lower direct material costs, positive new order flow and reduced cash usage.

To support our opportunities to grow in our targeted markets, we continue to enhance the reliability and performance of our products by regularly developing new processes and enhancing training to assist those who apply, install and use our products.

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

1)

***Focus on Vertical Markets*** Within the distributed generation markets that we serve, we focus on vertical markets that we identify as having the greatest near-term potential. In our primary products and applications (energy efficiency, renewable energy, natural resources, critical power supply, marine and transportation products), we identify specific targeted vertical market segments. Within each of these segments, we identify what we believe to be the critical factors to success and base our plans on those factors.

During Fiscal 2015, we booked orders for 86.0 megawatts and shipped 91.4 megawatts of products, which combined with our backlog at March 31, 2014, resulted in 182.8 megawatts in backlog at the end of the fiscal year. Our product shipments in Fiscal 2015 were: 49% for use in natural resources applications, 44% for use in energy efficiency applications and 7% for use in renewable energy applications.

*Energy Efficiency CHP/CCHP*

Energy efficiency maximizes the use of energy produced by the microturbines, reduces emissions compared with traditional power generation and enhances the economic advantage to customers. Energy efficiency applications use both the heat and electric energy produced in the power generation process. Using the heat and electricity created from a single combustion process increases the efficiency of the system from approximately 30% to 75% or more. The increased operating efficiency reduces overall greenhouse gas emissions compared with traditional independent sources such as power generation and local thermal generation and, through displacement of other separate systems, can reduce variable production costs.

*Renewable Energy*

Our microturbines can use renewable methane gases from landfills, wastewater treatment facilities and biogas from sources such as food processing, agricultural waste and cow, pig and chicken manure. Capstone's microturbines can burn these renewable waste gases with minimal emissions, thereby, in some cases, avoiding the imposition of penalties incurred for pollution while simultaneously producing electricity from this "free" renewable fuel for use at the site or in the surrounding area. Capstone's microturbines have demonstrated effectiveness in these applications and outperform conventional combustion engines in a number of situations, including when the gas contains a high amount of sulfur.

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

On a worldwide basis, there are thousands of locations where the drilling, production, compression and transportation of natural resources and other extraction and production processes create fuel byproducts, which traditionally have been released or burned into the atmosphere. Our microturbines are installed in the natural resource market to be used in oil

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and gas exploration, production, compression and transmission sites both onshore and offshore as a highly reliable critical source of power generation. In addition, our microturbines can use flare gas as a fuel to provide prime power. Typically these oil and gas or mining operations have no access to an electric utility grid and rely solely on Capstone's microturbines for a reliable low emission power supply.

*Critical Power Supply*

Because of the potentially catastrophic consequences of even momentary system failure, certain power users, such as high technology and information systems companies, require particularly high levels of reliability in their power service. Management believes that Capstone's critical power supply offerings are the world's only microturbine powered Uninterruptible Power Source solutions that can offer clean, IT-grade power produced from microturbines, the utility or a combination of both.

*Transportation*

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

*Marine*

Our technology is also used in marine applications. Our customers have applied our products in the commercial vessel and luxury yacht markets. The most immediate market for our marine products is for use as ship auxiliaries. In this application, the microturbines provide power to the vessel's electrical loads and, in some cases, the vessel is able to utilize the exhaust energy to increase the overall efficiency of the application, reducing overall fuel consumption and emissions. The other 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.

2)

***Sales and Distribution Channels*** We seek out distributors that have business experience and capabilities to support our growth plans in our targeted markets. A significant portion of our revenue is derived from sales to distributors who resell our products to end users. We have a total of 97 distributors and Original Equipment Manufacturers ("OEMs"). In North America, we currently have 31 distributors and OEMs. Outside of North America, we currently have 66 distributors and OEMs. We continue to refine the distribution channels to address our specific targeted markets.

3)

***Service*** We provide service primarily through our global distribution network. Together with our global distribution network we offer new and remanufactured parts as well as a comprehensive Factory Protection Plan ("FPP"). Through our global distribution network, we offer a comprehensive FPP for a fixed annual fee to perform regularly scheduled and unscheduled maintenance as needed. Capstone provides factory and onsite training to certify all personnel that are allowed to perform service on our microturbines. FPPs are generally paid quarterly in advance. Our FPP backlog at the end of Fiscal 2015 and Fiscal 2014 was \$61.2 million and \$47.2 million, respectively, which represents the value of the contractual agreement for FPP services that has not been earned and extends through Fiscal 2029. Service revenue in Fiscal 2015 was approximately 9% of total revenue.

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- 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, TA100, 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. We are currently focusing efforts on enhancing our products to improve reliability, reduce direct material costs, and be compliant with the new European grid interconnect requirements. We are also developing a more efficient microturbine CHP system with the DOE. The first phase of the development program has successfully achieved 270 kW with a prototype C250 engine. Capstone plans to continue development of the engine as well as power electronics and software controls required for successful commercialization. The second phase of the program is expected to incorporate further engine efficiency improvements, resulting in a product with a projected electrical efficiency of 42% and targeted power output of 370 kW. The DOE awarded us a grant of \$5.0 million in support of this development program of which \$3.9 million has been used through March 31, 2015.
- 6) **Cost and Core Competencies** We believe that the core competencies of Capstone 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.

Management believes 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, our financial model indicates that we will achieve positive cash flow when we ship approximately 200 units in a quarter, depending on an assumed product mix. Management believes our manufacturing facilities located in Chatsworth and Van Nuys, California have a combined production capacity of approximately 2,000 units per year, depending on product mix. Excluding working capital requirements, management believes we can expand our combined production capacity to approximately 4,000 units per year, depending on product mix, with approximately \$10 to \$15 million of capital expenditures. We have not committed to this expansion nor identified a source for its funding.

**Critical Accounting Policies**

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses and related disclosures of contingent liabilities. On an on-going basis, we evaluate our estimates, including but not limited to those related to long-lived assets,

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including finite-lived intangible assets and fixed assets, bad debts, inventories, warranty obligations, stock-based compensation, income taxes and contingencies. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

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

We evaluate the carrying value of long-lived assets, including intangible assets with finite lives, for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. Factors that are considered important that could trigger an impairment review include a current-period operating or cash flow loss combined with a history of operating or cash flow losses and a projection or forecast that demonstrates continuing losses or insufficient income associated with the use of a long-lived asset or asset group. Other factors include a significant change in the manner of the use of the asset or a significant negative industry or economic trend. This evaluation is performed based on undiscounted estimated future cash flows compared with the carrying value of the related assets. If the undiscounted estimated future cash flows are less than the carrying value, an impairment loss is recognized and the loss is measured by the difference between the carrying value and the estimated fair value of the asset group. The estimated fair value of the assets are determined using the best information available. On a quarterly basis, we assess whether events or changes in circumstances have occurred that potentially indicate the carrying value of long-lived assets may not be recoverable. Intangible assets include a manufacturing license, technology, backlog and customer relationships. We reevaluate the useful life determinations for these intangible assets each reporting period to determine whether events and circumstances warrant a revision in their remaining useful lives. The Company performed an analysis as of March 31, 2015 and determined that no impairment was necessary. See Note 5 Intangible Assets in the "Notes to Consolidated Financial Statements."

Our inventories are valued on a first in first out ("FIFO") basis and at the lower of cost or market. We routinely evaluate the composition of our inventories and identify slow-moving, excess, obsolete or otherwise impaired inventories. Inventories identified as impaired are evaluated to determine if write-downs are required. Included in this assessment is a review for obsolescence as a result of engineering changes in our product. Future product enhancement and development may render certain inventories obsolete, resulting in additional write-downs of inventories. In addition, inventories are classified as current or long-term based on our sales forecast and also, in part, based on our projected usage for warranty claims and service. A change in forecast could impact the classification of inventories.

We provide for the estimated cost of warranties at the time revenue from sales is recognized. We also accrue the estimated costs to address reliability repairs on products no longer under warranty when, in our judgment, and in accordance with a specific plan developed by us, it is prudent to provide such repairs. We estimate warranty expenses based upon historical and projected product failure rates, estimated costs of parts, labor and shipping to repair or replace a unit and the number of units covered under the warranty period. While we engage in extensive quality programs and processes, our warranty obligation is affected by failure rates and service costs in correcting failures. As we have more units commissioned and longer periods of actual performance, additional data becomes available to assess future warranty costs. When we have sufficient evidence that product changes are altering the historical failure occurrence rates, the impact of such changes is then taken into account in estimating future warranty liabilities. Changes in estimates are recorded in the period that new information, such as design changes,

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cost of repair and product enhancements, becomes available. Should actual failure rates or service costs differ from our estimates, revisions to the warranty liability would be required and could be material to our financial condition, results of operations and cash flow.

Our revenue consists of sales of products, parts, accessories and service, which includes FPPs, net of discounts. Our distributors purchase products, parts and FPPs for sale to end users and are also required to provide a variety of additional services, including application engineering, installation, commissioning and post-commissioning service. Our standard terms of sales to distributors and direct end users include transfer of title, care, custody and control at the point of shipment, payment terms ranging from full payment in advance of shipment to payment in 90 days, no right of return or exchange, and no post-shipment performance obligations by us except for warranties provided on the products and parts sold. We recognize revenue when all of the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or service has been rendered, selling price is fixed or determinable and collectability is reasonably assured. Service revenue derived from time and materials contracts is recognized as the service is performed. FPP contracts are agreements to perform certain agreed-upon service to maintain a product for a specified period of time. Service revenue derived from FPP contracts is recognized on a straight-line basis over the contract period. We occasionally enter into agreements that contain multiple elements, such as equipment, installation, engineering and/or service.

Trade accounts receivable are recorded at the invoiced amount and typically non-interest bearing. We maintain allowances for estimated losses resulting from the inability of our customers to make required payments and other accounts receivable allowances. We evaluate all accounts aged over 60 days past payment terms. If the financial condition of our customers deteriorates or if other conditions arise that result in an impairment of their ability or intention to make payments, additional allowances may be required.

We have a history of unprofitable operations. These losses generated significant federal and state net operating loss ("NOL") carryforwards. We record a valuation allowance against the net deferred income tax assets associated with these NOLs if it is "more likely than not" that we will not be able to utilize them to offset future income taxes. Because of the uncertainty surrounding the timing of realizing the benefits of our favorable tax attributes in future income tax returns, a valuation allowance has been provided against all of our net deferred income tax assets. We currently provide for income taxes only to the extent that we expect to pay cash taxes, primarily foreign and state taxes. It is possible, however, that we could be profitable in the future at levels which could cause management to determine that it is more likely than not that we will realize all or a portion of the NOL carryforwards. Upon reaching such a conclusion, we would record the amount of net deferred tax assets that are expected to be realized. Such adjustment would increase income in the period that the determination was made.

We recognize stock-based compensation expense associated with stock options in the statement of operations. Determining the amount of stock-based compensation to be recorded requires us to develop estimates to be used in calculating the grant-date fair value of stock options. We calculate the grant-date fair values using the Black-Scholes valuation model. The use of Black-Scholes model requires us to make estimates of the following assumptions:

*Expected volatility* The estimated stock price volatility was derived based upon the Company's actual historic stock prices over the expected option life, which represents the Company's best estimate of expected volatility.

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*Expected option life* The expected life, or term, of options granted was derived from historical exercise behavior and represents the period of time that stock option awards are expected to be outstanding.

*Risk-free interest rate* We used the yield on zero-coupon U.S. Treasury securities for a period that is commensurate with the expected life assumption as the risk-free interest rate.

The amount of stock-based compensation recognized during a period is based on the value of the portion of the awards that are ultimately expected to vest. We estimate forfeitures at the time of grant and revise, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The term "forfeitures" is distinct from "cancellations" or "expirations" and represents only the unvested portion of the surrendered option. We review historical forfeiture data and determine the appropriate forfeiture rate based on that data. We re-evaluate this analysis periodically and adjust the forfeiture rate as necessary. Ultimately, we recognize the actual expense over the vesting period only for the shares that vest.

**Results of Operations**

***Year Ended March 31, 2015 Compared to Year Ended March 31, 2014***

**Revenue** Revenue for Fiscal 2015 decreased \$17.6 million, or 13%, to \$115.5 million from \$133.1 million for Fiscal 2014. The change in revenue for Fiscal 2015 compared to Fiscal 2014 included decreases in revenue of \$12.3 million from the European market, \$4.3 million from the African market, \$3.9 million from the North American market and \$1.5 million from the Asian market. The decrease in the European market was primarily the result of the continuing geopolitical instability in Russia and Ukraine and the effects of a stronger U.S. dollar making our product more expensive overseas compared to Fiscal 2014. The revenue decline during Fiscal 2015 in the North American market was primarily the result of a drop in the oil and gas market which has affected the timing of customer demand for our products compared to the same period last year. Revenue from the Asian and African markets decreased during Fiscal 2015 because of the impact of a decline in the oil and gas market and stronger U.S. dollar. These overall decreases in revenue were offset by increases in revenue of \$3.6 million from the Australian market and \$0.8 million from the South American market. The increase in the Australian and South American markets was primarily the result of our continued efforts to improve distribution channels.

Megawatts shipped, microturbine units shipped and average revenue per unit decreased primarily as a result of lower sales volume and shift in product mix for our microturbines during Fiscal 2015 compared to the same period last year. Revenue from microturbine products during Fiscal 2015 decreased \$19.4 million, or 18%, to \$89.4 million from \$108.8 million for Fiscal 2014. Microturbine megawatts shipped during Fiscal 2015 decreased 18.5 megawatts to 91.4 megawatts from 109.9 megawatts for Fiscal 2014. Microturbine units shipped during Fiscal 2015 decreased 51 units to 620 units from 671 units shipped during Fiscal 2014. Average revenue per unit shipped decreased for Fiscal 2015 to approximately \$144,000 compared to approximately \$162,000 per unit for Fiscal 2014. The decrease in average revenue per unit was primarily the result of a decrease in shipments of our C1000 Series systems partially offset by an increase in shipments of our C65 microturbines during Fiscal 2015 compared to the same period last year.

For Fiscal 2015, revenue from our accessories, parts and service increased \$1.8 million, or 7%, to \$26.1 million from \$24.3 million for Fiscal 2014. The increase in revenue resulted primarily from higher FPP contract enrollment and sales of microturbine parts, partially offset by lower sales of microturbine service work.

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



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our control and can affect the timing of our revenue. Therefore, we evaluate historical revenue in conjunction with backlog to anticipate the growth trend of our revenue.

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

	Years Ended March 31,					
	2015			2014		
	Revenue	Megawatts	Units	Revenue	Megawatts	Units
C30	\$ 4.8	2.9	97	\$ 5.6	3.7	124
C65	30.1	27.8	427	29.1	26.1	402
TA100	0.3	0.2	2	0.5	0.4	4
C200	7.1	6.6	33	14.8	12.6	63
C600	5.9	6.0	10	10.4	10.8	18
C800	8.3	8.8	11	10.1	11.2	14
C1000	32.7	39.0	39	38.1	45.0	45
Waste heat recovery generator	0.2	0.1	1	0.2	0.1	1
Unit upgrades						
Total from Microturbine Products	\$ 89.4	91.4	620	\$ 108.8	109.9	671
Accessories, Parts and Service	26.1			24.3		
Total	\$ 115.5	91.4	620	\$ 133.1	109.9	671

Sales to Horizon Power Systems ("Horizon"), one of the Company's domestic distributors, accounted for 17%, 12% and 27% of our revenue for the years ended March 31, 2015, 2014 and 2013, respectively. Sales to BPC Engineering ("BPC"), one of the Company's Russian distributors, accounted for 11%, 17% and 11% of our revenue for the years ended March 31, 2015, 2014 and 2013, respectively. Sales to E-Finity Distributed Generation, LLC ("E-Finity"), one of the Company's domestic distributors, accounted for 19% of our revenue for the year ended March 31, 2014.

**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 \$18.3 million, or 16% of revenue, for Fiscal 2015 compared to a gross margin of \$21.7 million, or 16% of revenue, for Fiscal 2014. The change in the gross margin during Fiscal 2015 compared to Fiscal 2014 was driven by multiple factors including lower royalty expense of \$1.2 million, lower production and service center labor and overhead expense of \$1.0 million and lower warranty expense of \$0.4 million. The positive impact of these factors was offset by the adverse impact of lower volume, lower average selling prices and a change in product mix for our microturbines of \$5.0 million and higher inventory charges of \$1.0 million. Management continues to implement initiatives to improve gross margin by further reducing manufacturing overhead fixed and direct material costs as we work to achieve profitability and improving product performance.

Royalty expense decreased \$1.2 million during Fiscal 2015 compared to Fiscal 2014 as a result of a reduction in the predetermined fixed rate royalty. We pay a predetermined fixed rate royalty for each microturbine system covered by our Development and License Agreement with Carrier. The fixed rate royalty was reduced by 50% during the three months ended September 30, 2013 as a result of the contractual reduction.

Production and service center labor and overhead expense decreased approximately \$1.0 million during Fiscal 2015 compared to Fiscal 2014 primarily as the result of decreases in service center travel expense of approximately \$0.3 million, facilities expense of \$0.3 million, salaries expense of \$0.2 million and supplies expense of \$0.2 million.

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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 decrease in warranty expense of \$0.4 million reflects a decrease in the standard warranty provision as a result of sales volume and a decrease in reliability repair programs during Fiscal 2015 compared to the prior year. Management expects warranty claim levels for C200 and C1000 Series systems to decline as reliability repair programs are completed and these products mature.

Inventory charges increased approximately \$1.0 million during Fiscal 2015 compared to Fiscal 2014 primarily as a result of an allowance for slow-moving inventory related to our waste heat recovery generators.

During the three months ended March 31, 2015, we shipped approximately \$0.7 million of product to BPC. Given the uncertainty as to the collectability of the sale, revenue recognition on this shipment was deferred. However, as we do not have title to the product or rights to receive the product back in the event we are not paid, such amounts were expensed through cost of goods sold for Fiscal 2015.

**Research and Development Expenses** R&D expenses include compensation, engineering department expenses, overhead allocations for administration and facilities and materials costs associated with development. R&D expenses for Fiscal 2015 increased \$0.7 million, or 8%, to \$9.7 million from \$9.0 million for Fiscal 2014. R&D expenses are reported net of benefits from cost-sharing programs, such as DOE grants. During Fiscal 2015 cost sharing benefits decreased approximately \$0.9 million offset by a decrease of approximately \$0.2 million in professional services expense. There were approximately \$0.5 million of cost-sharing benefits for Fiscal 2015 and \$1.4 million of such benefits for Fiscal 2014. Cost-sharing programs vary from period to period depending on the phase of the programs. Management expects R&D expenses in Fiscal 2016 to be slightly higher than in Fiscal 2015 as we continue product robustness and direct material cost reduction initiatives.

**Selling, General and Administrative ("SG&A") Expenses** SG&A expenses for Fiscal 2015 increased \$11.5 million, or 41%, to \$39.5 million from \$28.0 million for Fiscal 2014. The net increase in SG&A expenses was comprised of increases of \$9.9 million in bad debt expense, \$0.9 million in salaries expense, \$0.6 million in professional services expense, which includes legal expense, \$0.4 million in marketing expense and \$0.1 million in business travel expense, offset by a decreases of \$0.2 million in facilities expense and \$0.2 million in supplies expense. The increase in the bad debt expense was primarily the result of accounts receivable allowances recorded for BPC and Electro Mecanique Industries ("EMI"), one of the Company's distributors in the Middle East and Africa, during Fiscal 2015. During the three months ended March 31, 2015, we recorded approximately \$7.1 million with respect to the accounts receivable allowance from BPC. We determined that the collectability of this accounts receivable balance was not reasonably assured based on BPC's recent payment history and because the impact of the steep decline of the Russian ruble could continue to negatively impact its ability to pay its outstanding accounts receivable balance. Also during three months ended September 30, 2014, we recorded approximately \$2.6 million with respect to EMI. We determined that the collectability of this accounts receivable balance was not reasonably assured based on EMI's payment history. Excluding bad debt expense, management expects SG&A expenses in Fiscal 2016 to be higher than in Fiscal 2015 primarily as a result of expanding our aftermarket services, which may require paying incentive-based compensation to certain key Capstone employees in the event that Capstone achieves its planned results of operations.

**Interest Expense** Interest expense decreased \$0.2 million, or 29%, to \$0.5 million during Fiscal 2015 from \$0.7 million during Fiscal 2014. Interest expense is primarily from the average balances

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outstanding under the Credit Facility. As of March 31, 2015, we had total debt of \$13.0 million outstanding under the Credit Facility.

**Change in Fair Value of Warrant Liability** Effective September 23, 2013, warrants issued in connection with the September 23, 2008 registered direct placement to purchase 4.0 million shares expired, and the liability associated with the warrants was reversed. The reversal of the warrant liability resulted in a benefit of approximately \$10,000 for Fiscal 2014. This reversal of the warrant liability had no impact on our cash balances.

**Income Tax Provision** Income tax expense decreased \$0.1 million, or 50%, to \$0.1 million during Fiscal 2015 from \$0.2 million during Fiscal 2014. Income tax expense incurred was related to state and foreign taxes. The effective income tax rate of 0.4% differs from the federal and state blended statutory rate of approximately 37% primarily as a result of recording taxable losses. At March 31, 2015, we had federal and state net operating loss carryforwards of approximately \$626 million and \$202 million, respectively, which may be utilized to reduce future taxable income, subject to limitations under Section 382 of the Internal Revenue Code of 1986. We provided a valuation allowance for 100% of our net deferred tax asset of \$246.8 million at March 31, 2015 because the realization of the benefits of these favorable tax attributes in future income tax returns is not deemed more likely than not. Similarly, at March 31, 2014, the net deferred tax asset was fully reserved.

**Year Ended March 31, 2014 Compared to Year Ended March 31, 2013**

**Revenue** Revenue for Fiscal 2014 increased \$5.5 million, or 4%, to \$133.1 million from \$127.6 million for Fiscal 2013. The change in revenue for Fiscal 2014 compared to Fiscal 2013 included increases in revenue of \$15.2 million from the European market, \$6.1 million from the African market and \$2.3 million from the Asian market. The increase in the European market was primarily related to increased sales into the Russian natural resources vertical market. The increase in the African market was primarily the result of further market adoption of our products in this market. The increase in the Asian market was primarily because of an increase in average selling prices of microturbine units shipped in Asia during Fiscal 2014 compared to the same period last year. This overall increase in revenue was offset by decreases in revenue of \$16.4 million from the North American market, \$1.5 million from the South American market and \$0.2 million from the Australian market. The decreases in the North American, South American and Australian markets were primarily the result of a shift in certain customers' project timelines compared to the same period last year.

Megawatts shipped and microturbine units shipped during Fiscal 2014 increased as a result of higher sales volume for our C65 microturbine and a change in product mix of the C1000 Series systems, offset by lower sales volume for our C30, TA100 and C200 microturbines. For Fiscal 2014, revenue from microturbine products increased \$6.1 million, or 6%, to \$108.8 million from \$102.7 million for Fiscal 2013. Microturbine megawatts shipped during Fiscal 2014 increased 6.7 megawatts to 109.9 megawatts from 103.2 megawatts for Fiscal 2013. Microturbine units shipped during Fiscal 2014 increased 43 units to 671 units from 628 units for Fiscal 2013. Average revenue per unit decreased for Fiscal 2014 to approximately \$162,000 compared to approximately \$163,000 per unit for Fiscal 2013. The decrease in average revenue per unit was primarily the result of a change in mix of C1000 Series systems and more C65 microturbines shipped during Fiscal 2014 compared to the same period last year.

For Fiscal 2014, revenue from our accessories, parts and service decreased \$0.6 million, or 2%, to \$24.3 million from \$24.9 million for Fiscal 2013. The decrease in revenue resulted primarily from lower sales of microturbine service work, partially offset by higher FPP contract enrollment, sales of microturbine parts and sales of accessories.

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. Therefore, we evaluate historical revenue in conjunction with backlog to anticipate the growth trend of our revenue.

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

	Years Ended March 31,					
	2014			2013		
	Revenue	Megawatts	Units	Revenue	Megawatts	Units
C30	\$ 5.6	3.7	124	\$ 6.8	4.4	147
C65	29.1	26.1	402	22.9	21.0	323
TA100	0.5	0.4	4	1.5	0.8	8
C200	14.8	12.6	63	18.1	15.6	78
C600	10.4	10.8	18	12.4	12.6	21
C800	10.1	11.2	14	5.3	5.6	7
C1000	38.1	45.0	45	35.6	43.0	43
Waste heat recovery generator	0.2	0.1	1			
Unit upgrades				0.1	0.2	1
Total from Microturbine Products	\$ 108.8	109.9	671	\$ 102.7	103.2	628
Accessories, Parts and Service	24.3			24.9		
Total	\$ 133.1	109.9	671	\$ 127.6	103.2	628

Sales to E-Finity accounted for 19% of our revenue for the year ended March 31, 2014. Sales to BPC accounted for 17%, 11% and 26% of our revenue for the years ended March 31, 2014, 2013 and 2012, respectively. Sales to Horizon accounted for 12%, 27% and 19% of our revenue for the years ended March 31, 2014, 2013 and 2012, respectively.

**Gross Margin** Cost of goods sold includes direct material costs, production and service center labor and overhead, inventory charges and provision for estimated product warranty expenses. The gross margin was \$21.7 million, or 16% of revenue, for Fiscal 2014 compared to a gross margin of \$14.4 million, or 11% of revenue, for Fiscal 2013. The increase of \$7.3 million in gross margin was the result of a \$4.4 million improvement realized from overall higher revenue as a result of higher sales volume of our microturbine products as discussed above, lower direct material costs primarily related to the C1000 Series, decreases in our royalty expense of \$1.5 million, warranty expense of \$1.2 million and production and service center labor and overhead expenses of \$0.2 million during Fiscal 2014 compared to the prior year.

Royalty expense decreased \$1.5 million during Fiscal 2014 compared to Fiscal 2013 as a result of a reduction in the predetermined fixed rate royalty offset by higher volume of covered microturbine systems. We pay a predetermined fixed rate royalty for each microturbine system covered by our Development and License Agreement with Carrier. The fixed rate royalty was reduced by 50% during the three months ended September 30, 2013 as a result of the contractual reduction.

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 decrease in warranty expense of \$1.2 million reflected a decrease in reliability repair programs, offset by an increase in the per unit standard warranty provision as a result of sales mix and higher volume of units under warranty during Fiscal 2014 compared to the prior year.

Production and service center labor and overhead expense decreased approximately \$0.2 million during Fiscal 2014 compared to Fiscal 2013 primarily as the result of a decrease in service center travel expense of approximately \$0.4 million, offset by an increase in facilities expense of approximately \$0.2 million.

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**Research and Development Expenses** R&D expenses include compensation, engineering department expenses, overhead allocations for administration and facilities and materials costs associated with development. We had R&D expenses of approximately \$9.0 million for each of Fiscal 2014 and Fiscal 2013. R&D expenses are reported net of benefits from cost-sharing programs, such as DOE grants. During Fiscal 2014 supplies expense decreased approximately \$0.3 million, offset by a decrease in cost sharing benefits of approximately \$0.3 million. There were approximately \$1.4 million of cost-sharing benefits for Fiscal 2014 and \$1.7 million of such benefits for Fiscal 2013. Cost-sharing programs vary from period to period depending on the phase of the programs.

**Selling, General and Administrative ("SG&A") Expenses** SG&A expenses for Fiscal 2014 increased \$0.6 million, or 2%, to \$28.0 million from \$27.4 million for Fiscal 2013. The net increase in SG&A expenses was comprised of increases of approximately \$0.7 million in salaries expense, \$0.2 million in facilities expense \$0.2 million in consulting expense and \$0.2 million in supplies expense, offset by a decrease of approximately \$0.7 million in marketing expense.

**Interest Expense** Interest expense for each of Fiscal 2014 and Fiscal 2013 was approximately \$0.7 million. Interest expense is primarily from the average balances outstanding under the Credit Facility. As of March 31, 2014, we had total debt of \$13.2 million outstanding under the Credit Facility.

**Change in Fair Value of Warrant Liability** Effective September 23, 2013, warrants to purchase approximately 4.0 million shares of common stock that were issued in connection with the September 23, 2008 registered direct placement expired, and the liability associated with the warrants was reversed. The reversal of the warrant liability resulted in a benefit of approximately \$10,000 for Fiscal 2014. This reversal of the warrant liability had no impact on our cash balances. The change in fair value of the warrant liability resulted in a benefit of approximately \$0.8 million for Fiscal 2013. This change in fair value of warrant liability was a result of warrant exercises and revaluing the warrant liability based on the Monte Carlo simulation valuation model which is based primarily upon the quoted price of the Company's common stock in an active market. This revaluation of the warrant liability had no impact on our cash balances.

**Income Tax Provision** Income tax expense decreased \$0.5 million, or 71%, to \$0.2 million during Fiscal 2014 from \$0.7 million during Fiscal 2013. Income tax expense incurred was primarily related to foreign taxes of \$0.2 million. The effective income tax rate of 1.4% differs from the federal and state blended statutory rate of 35% primarily as a result of recording taxable losses. At March 31, 2014, we had federal and state net operating loss carryforwards of approximately \$606.2 million and \$226.9 million, respectively, which may be utilized to reduce future taxable income, subject to limitations under Section 382 of the Internal Revenue Code of 1986. We provided a valuation allowance for 100% of our net deferred tax asset of \$236.2 million at March 31, 2014 because the realization of the benefits of these favorable tax attributes in future income tax returns is not deemed more likely than not. Similarly, at March 31, 2013, the net deferred tax asset was fully reserved.

**Quarterly Results of Operations**

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

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(In thousands, except per share data)

(Unaudited)	Year Ended March 31, 2015				Year Ended March 31, 2014			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Revenue	\$ 29,869	\$ 30,084	\$ 32,248	\$ 23,260	\$ 36,438	\$ 37,003	\$ 35,291	\$ 24,373
Cost of goods sold	26,347	23,978	27,005	19,844	30,292	29,668	30,399	21,050
Gross margin	3,522	6,106	5,243	3,416	6,146	7,335	4,892	3,323
Operating expenses:								
R&D	2,942	2,355	2,055	2,327	2,471	2,267	1,956	2,335
SG&A	14,702	7,508	9,543	7,764	6,781	6,991	6,641	7,568
Loss from operations	(14,122)	(3,757)	(6,355)	(6,675)	(3,106)	(1,923)	(3,705)	(6,580)
Net loss	\$ (14,298)	\$ (3,935)	\$ (6,529)	\$ (6,771)	\$ (3,381)	\$ (2,189)	\$ (3,888)	\$ (6,798)
Net loss per common share basic and diluted	\$ (0.05)	\$ (0.01)	\$ (0.02)	\$ (0.02)	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.02)

During the three months ended March 31, 2015, we recorded an allowance of approximately \$1.2 million for slow-moving inventory related to our waste heat recovery generators. In addition, we shipped approximately \$0.7 million of product to BPC during the three months ended March 31, 2015. Given the uncertainty as to the collectability of the sale, the revenue for this shipment was not recognized. Both transactions were included in cost of goods sold for the three months ended March 31, 2015.

During the three months ended March 31, 2015, we recorded approximately \$7.1 million with respect to the accounts receivable allowance from BPC. We determined that the collectability of this accounts receivable balance was not reasonably assured based on BPC's recent payment history and because the impact of the recent steep decline of the Russian ruble could continue to negatively impact its ability to pay its outstanding accounts receivable balance. During the three months ended September 30, 2014, we recorded approximately \$2.6 million with respect to the accounts receivable balance from EMI. We determined that the collectability of this accounts receivable balance was not reasonably assured based on EMI's payment history. Both transactions were included in SG&A for the three months ended March 31, 2015 and September 30, 2014, respectively.

## **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 creating the strategic changes summarized herein. Our planned capital expenditures for the year ending March 31, 2016 include approximately \$2.0 million for plant and equipment costs related to manufacturing and operations. We have invested our cash in institutional funds that invest in high quality short-term money market instruments to provide liquidity for operations and for capital preservation.

Our cash and cash equivalent balances increased \$4.4 million during the year ended March 31, 2015, compared to a decrease of \$11.0 million during the year ended March 31, 2014. The overall improvement in cash used during the year ended March 31, 2015 compared to the year ended March 31, 2014 was primarily the result of cash provided by financing activities.

**Operating Activities** During the year ended March 31, 2015, we used \$23.0 million in cash in our operating activities, which consisted of a net loss for the period of \$31.5 million and cash used for working capital of \$11.9 million, offset by non-cash adjustments (primarily accounts receivable allowances, warranty provision, depreciation and amortization, stock-based compensation and inventory provision) of \$20.4 million. During the year ended March 31, 2014, operating cash usage was \$15.4 million, which consisted of a net loss for the period of \$16.3 million and cash used for working capital of \$9.7 million, offset by non-cash adjustments of \$10.6 million.

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

	Year Ended March 31,	
	2015	2014
Net loss	\$ (31,533)	\$ (16,256)
Non-cash operating activities(1)	20,444	10,562
<b>Changes in operating assets and liabilities:</b>		
Accounts receivable	4,761	(10,320)
Inventories	(7,125)	(784)
Accounts payable and accrued expenses	(5,960)	4,475
Other changes in operating assets and liabilities	(3,605)	(3,109)
 Net cash used in operating activities	 \$ (23,018)	 \$ (15,432)

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

The increase in net cash used in operating activities during Fiscal 2015 compared to Fiscal 2014 was primarily related to the increase in net loss, excluding non-cash operating activities, and lower accounts payable and accrued expenses offset by cash provided from accounts receivable and change in inventories. The change of accounts payable and accrued expenses was primarily the result of management's initiatives to reduce aged payables and the timing and level of inventory receipts compared to vendor payments. The change in accounts receivable was primarily the result of timing of cash receipts on lower revenue. The change in inventory was primarily because of higher finished goods as of March 31, 2015. The increase in non-cash operating activities during Fiscal 2015 was primarily the result of an accounts receivable allowance for BPC and EMI during Fiscal 2015 compared to the same period last year.

**Investing Activities** Net cash used in investing activities of \$1.6 million and \$1.2 million during the years ended March 31, 2015 and 2014 relates primarily to the acquisition of fixed assets.

**Financing Activities** During the year ended March 31, 2015, we generated approximately \$29.0 million from financing activities compared to cash generated during the year ended March 31, 2014 of approximately \$5.7 million. The funds generated from financing activities during the year ended March 31, 2015 were primarily from the proceeds related to our underwritten public offering described below. The funds generated from financing activities during the year ended March 31, 2014 were primarily the result of the exercise of warrants, described below which yielded \$6.0 million in cash, offset by repayments under the Credit Facility. Net repayments under the Credit Facility were approximately \$0.3 million during the year ended March 31, 2015 compared to net borrowings of approximately \$0.2 million during the year ended March 31, 2014.

Effective May 6, 2014, the Company completed an underwritten public offering in which it sold 18.8 million shares of the Company's common stock at a price of \$1.70 per share less underwriting discounts and commissions. The shares were allocated to a single institutional investor. The net proceeds to the Company from the sale of the common stock, after deducting fees and other offering expenses, were approximately \$29.8 million.

On October 31, 2013, an unsolicited exercise of warrants to purchase 4.7 million shares resulted in proceeds of approximately \$6.0 million. Effective October 31, 2013, all remaining outstanding warrants expired.

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During the years ended March 31, 2015 and 2014, the amount of cash received from the exercise of stock options was approximately \$0.3 million and \$0.5 million, respectively. Employee stock purchases, net of repurchases of shares of our common stock for employee taxes due on vesting of restricted stock units, resulted in approximately \$0.2 million of net cash used during the year ended March 31, 2015, compared with \$0.1 million of net cash used during the year ended March 31, 2014.

We maintain two Credit and Security Agreements, as amended (the "Agreements"), with Wells Fargo, which provide the Company with a line of credit of up to \$15.0 million in the aggregate. The line of credit can be increased to an amount up to \$20.0 million upon the request of the Company pursuant to the amendment described below (the "Credit Facility"). In addition, Wells Fargo has provided the Company with a non-revolving capital expenditure line of credit up to \$0.5 million to acquire additional eligible equipment for use in the Company's business pursuant to the amendment described below. As of March 31, 2015 the Company had not requested that the maximum line amount be increased to an aggregate of \$20.0 million pursuant to the Agreements. The amount actually available to us may be less and may vary from time to time depending on, among other factors, the amount of eligible inventory and accounts receivable. As security for the payment and performance of the Credit Facility, we granted a security interest in favor of Wells Fargo in substantially all of our assets. One of the Agreements will terminate in accordance with its terms on September 1, 2017, and the other one will terminate on September 30, 2017. As of March 31, 2015 and March 31, 2014, \$13.0 million and \$13.2 million in borrowings were outstanding, respectively, under the Credit Facility.

The Agreements include affirmative covenants as well as negative covenants that prohibit a variety of actions without Wells Fargo'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, (d) pay dividends on, or purchase, acquire, redeem or retire shares of, our capital stock, (e) sell, assign, transfer or otherwise dispose of all or substantially all of our assets, (f) change our accounting method or (g) enter into a different line of business. Furthermore, the Agreements contain financial covenants, including (i) a requirement not to exceed specified levels of losses, (ii) a requirement to maintain a substantial minimum monthly cash balance to outstanding line of credit advances based upon the Company's financial performance, and (iii) limitations on our annual capital expenditures.

Several times since entering into the Agreements we were not in compliance with certain covenants under the Credit Facility. In connection with each event of noncompliance, Wells Fargo waived the event of default and, on several occasions, the Company amended the Agreements in response to the default and waiver. The following summarizes the recent events, amendments and waivers:

On September 16, 2014, the Company entered into a letter agreement (the "Letter Agreement") with Wells Fargo. The Letter Agreement extended the maturity date under the Company's Credit and Security Agreement (Ex-Im Subfacility) from September 30, 2014 to September 1, 2017. The Letter Agreement also, among other things, changed the annual facility fee due to Wells Fargo under the Credit and Security Agreement (Ex-Im Subfacility) and revised the calculation of Capstone's borrowing base under the portion of the Credit Facility established by the Credit and Security Agreement (Ex-Im Subfacility) to increase the borrowing limit related to inventory.

As of September 30, 2014, the Company determined that it was not in compliance with the financial covenant contained in the amended Agreements regarding the Company's annual net income for Fiscal 2015. On November 3, 2014, the Company received from Wells Fargo a waiver of such noncompliance and entered into an amendment to amend the financial covenants regarding net income for Fiscal 2015.



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As of March 31, 2015, the Company determined that it was not in compliance with the financial covenant contained in the amended Agreements regarding the Company's annual net income for Fiscal 2015. On June 10, 2015, the Company received from Wells Fargo a waiver of such noncompliance, and the Company and Wells Fargo entered into an amendment to the Agreements which set the financial covenants for Fiscal 2016. As a condition of the amended Agreements, the Company has restricted \$5.0 million of cash effective June 10, 2015 as additional security for the Credit Facility.

If we had not obtained the waivers and amended the Agreements as described above, we would not be able to draw additional funds under the Credit Facility. In addition, the Company has pledged its accounts receivables, inventories, equipment, patents and other assets as collateral for its Agreements, which would be subject to seizure by Wells Fargo if the Company were in default under the Agreements and unable to repay the indebtedness. Wells Fargo also has the option to terminate the Agreements or accelerate the indebtedness during a period of noncompliance. Based on our current forecasts, management believes we will maintain compliance with the covenants contained in the amended Agreements for at least the next twelve months. If a covenant violation were to occur, management would attempt to negotiate a waiver of compliance from Wells Fargo.

Management has the ability to manage certain operating assets and liabilities, specifically the procurement of inventory and timing of payments of accounts payable, capital expenditures and certain operating expenses depending on the results of its operations to extend its cash and cash equivalents. Management believes that existing cash and cash equivalents are sufficient to meet our anticipated cash needs for at least the next twelve months. In the event that our anticipated cash needs change, it is possible that we may need to raise additional capital in the future. We could seek to raise funds by selling additional securities 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 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, the 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.

Although we believe we have sufficient capital to fund our working capital and capital expenditures for at least the next twelve months, 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 \$13.1 million and \$28.0 million as of March 31, 2015 and March 31, 2014, respectively. Accounts receivable days sales outstanding ("DSO") decreased by 30 days to 40 days as of March 31, 2015 compared to 70 days as of March 31, 2014. The change in DSO was largely the result of an accounts receivable allowance and timing of cash receipts on lower sales during the period. During the three months ended March 31, 2015, we recorded bad debt expense of approximately \$7.1 million with respect to BPC. We determined that the collectability

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of their accounts receivable balance was not reasonably assured based on BPC's recent payment history and because the impact of the steep decline of the Russian ruble could continue to negatively impact its ability to pay its outstanding accounts receivable balance. Also during the three months ended September 30, 2014 we recorded bad debt expense of approximately \$2.6 million with respect to EMI. We determined that the collectability of their accounts receivable balance was not reasonably assured based on EMI's payment history. We recorded bad debt expense of \$10.1 million, \$0.2 million and \$0.3 million for the years ended March 31, 2015, 2014 and 2013, 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 current economic environment.

**Contractual Obligations and Commercial Commitments**

At March 31, 2015, our commitments under notes payable, capital leases and non-cancelable operating leases were as follows (in thousands):

	Total	Payment Due by Period			
		1 Year or Less	1 - 3 Years	3 - 5 Years	More than 5 Years
<b>Contractual Obligations:</b>					
Notes payable and capital lease obligations	\$ 496	\$ 407	\$ 89	\$	\$
Operating lease obligations	7,005	1,988	3,439	1,578	
Revolving credit facility	12,953	12,953			
<b>Total</b>	<b>\$ 20,454</b>	<b>\$ 15,348</b>	<b>\$ 3,528</b>	<b>\$ 1,578</b>	<b>\$</b>

As of March 31, 2015, we had firm commitments to purchase inventories of approximately \$35.2 million through Fiscal 2017. Certain inventory delivery dates and related payments are not firmly scheduled; therefore, amounts under these firm purchase commitments will be payable concurrent with the receipt of the related inventories.

Agreements we have with some of our distributors require that if we render parts obsolete in inventories they own and hold in support of their obligations to serve fielded microturbines, then we are required to replace the affected stock at no cost to the distributors. While we have never incurred costs or obligations for these types of replacements, it is possible that future changes in product technology could result and yield costs if significant amounts of inventory are held at distributors. As of March 31, 2015, no significant inventories were held at distributors.

Pursuant to the terms of our Agreements with Wells Fargo, the minimum interest payable under the Credit Facility is \$66,000 each calendar quarter. One of the Agreements will terminate in accordance with its terms on September 1, 2017 and the other one will terminate on September 30, 2017.

**Off-Balance Sheet Arrangements**

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

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**Inflation**

Inflation did not have a material impact on our results of operations or financial condition for the fiscal years ended March 31, 2015, 2014 and 2013. In an effort to offset the adverse impact of inflation on earnings, we have historically raised selling prices on all products, parts, accessories and services. However, any future adverse impact of inflation on our raw materials and energy costs may not be similarly recoverable through our selling price increases.

**Impact of Recently Issued Accounting Standards**

In April 2015, the Financial Accounting Standards Board (the "FASB") issued Accounting Standard Update ("ASU") 2015-03, Interest Imputation of Interest (Subtopic 835-30). The ASU was issued as part of FASB's current plan to simplify overly complex standards. This ASU requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. The recognition and measurement guidance for debt issuance costs are not affected by this ASU. The update requires retrospective application to all prior period amounts presented. This update is effective for annual and interim periods beginning on or after December 15, 2015, with early application permitted for financial statements that have not been issued. We are currently evaluating the potential impacts the new standard will have on our reporting process.

In August 2014, the FASB issued ASU 2014-15, Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern ("ASU 2014-15"). ASU 2014-15 requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date the financial statements are issued and provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. Certain disclosures will be required if conditions give rise to substantial doubt about an entity's ability to continue as a going concern. ASU 2014-15 applies to all entities and is effective for annual and interim reporting periods ending after December 15, 2016, with early adoption permitted. We are currently evaluating the potential impacts the new standard will have on our reporting process.

In June 2014, the FASB issued ASU 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period ("ASU 2014-12"). ASU 2014-12 requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. ASU 2014-12 is effective for annual reporting periods beginning after December 15, 2015, with early adoption permitted. We are evaluating the potential impacts of the new standard on our existing stock-based compensation plans.

In May 2014, FASB issued ASU 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"). ASU 2014-09 supersedes nearly all existing revenue recognition guidance under U.S. 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. We are evaluating our existing revenue recognition policies to determine whether any contracts in the scope of the guidance will be affected by the new requirements. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods therein.

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

*Foreign Currency*

We currently develop products in the U.S. and market and sell our products predominantly in North America, Europe and Asia. As a result, factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets could affect our financial results. As all of our sales and purchases are currently made in U.S. dollars, we do not utilize foreign exchange contracts to reduce our exposure to foreign currency fluctuations. In the future, as our customers, employees and vendor bases expand, we may enter into transactions that are denominated in foreign currencies.

*Interest*

Our exposure to changes in the interest rates results primarily from our Credit Facility borrowings. As of March 31, 2015 we had \$13.0 million of outstanding indebtedness subject to interest rate fluctuations. Based on these borrowings as of March 31, 2015, a hypothetical 100 basis point increase in the then current LIBOR rate would increase our interest expense by \$0.1 million on an annual basis. The level of outstanding indebtedness fluctuates from period to period and therefore could result in additional interest.

**Item 8. Financial Statements and Supplementary Data.**

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

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

None.

**Item 9A. Controls and Procedures.**

*Disclosure Controls and Procedures*

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

In connection with the preparation of this Form 10-K for the year ended March 31, 2015, an evaluation was performed under the supervision and with the participation of our management, including the CEO and CFO, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). Based on this evaluation, our CEO and CFO have concluded that our disclosure controls and procedures are effective as of March 31, 2015 to ensure that the information required to be disclosed by us in reports we submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the rules and forms prescribed by the SEC. Additionally, such information is accumulated and communicated to management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

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*Management's Annual Report on Internal Control Over Financial Reporting*

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

Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the company's assets;

Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and

Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

We conducted an evaluation of the effectiveness of our internal control over financial reporting based on the 1992 framework in Internal Control Integrated Framework issued by the Committee of Sponsoring Organization of the Treadway Commission. Based on our evaluation under the 1992 framework in Internal Control Integrated Framework, our management concluded that the Company maintained effective internal control over financial reporting as of March 31, 2015.

KPMG LLP, the Company's independent registered public accounting firm, has issued a report on the Company's internal control over financial reporting. The report of KPMG LLP follows. Projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

*Changes in Internal Control Over Financial Reporting*

There was no change in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the Company's most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting, except for the remediation steps to address the material weakness in internal control over financial reporting described below.

*Remediation of Material Weakness*

As previously disclosed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2014, although there were no material errors that resulted from control deficiencies, we identified a material weakness in our risk assessment process, specifically our internal controls related to the design of control activities involving FPP revenue, inventory and cost of goods sold as it relates to inventory. We have remediated all three of the measures related to the material weakness by enhancing the procedures related to (a) the design of control activities with respect to the completeness and accuracy of our FPP revenue calculation, (b) the adequacy of documentation with respect to certain judgmental determinations used in the inventory reserve analysis and (c) the investigation of inventory discrepancies through subcontractor year-end verification. Management is committed to improving the Company's internal control processes and believes the remediation measures have strengthened the design and operating effectiveness of our internal control over financial reporting.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders  
Capstone Turbine Corporation

We have audited Capstone Turbine Corporation's internal control over financial reporting as of March 31, 2015, based on criteria established in Internal Control Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Capstone Turbine Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Capstone Turbine Corporation maintained, in all material respects, effective internal control over financial reporting as of March 31, 2015, based on criteria established in Internal Control Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Capstone Turbine Corporation and subsidiaries as of March 31, 2015 and 2014, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended March 31, 2015, and our report dated June 15, 2015 expressed an unqualified opinion of those consolidated financial statements.

(signed) KPMG LLP

Los Angeles, California  
June 15, 2015

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**Item 9B. Other Information.**

None.

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance.**

**Directors**

Information contained under the caption "Proposal 1: Election of Directors to the Board of Directors" included in our proxy statement relating to our 2015 annual meeting of stockholders is incorporated herein by reference.

**Executive Officers**

Information contained under the caption "Executive Officers of the Company" included in our proxy statement relating to our 2015 annual meeting of stockholders is incorporated herein by reference.

**Compliance with Section 16(a) of the Exchange Act**

Information contained under the caption "Other Information Section 16(a) Beneficial Ownership Reporting Compliance" included in our proxy statement relating to our 2015 annual meeting of stockholders is incorporated herein by reference.

**Code of Ethics**

Information contained under the caption "Other Information Code of Business Conduct and Code of Ethics" included in our proxy statement relating to our 2015 annual meeting of stockholders is incorporated herein by reference.

**Stockholder Nominees**

Information contained under the caption "Governance of the Company and Practices of the Board of Directors Director Recommendation and Nomination Process" included in our proxy statement relating to our 2015 annual meeting of stockholders is incorporated herein by reference.

**Audit and Compliance Committee**

Information contained under the caption "Governance of the Company and Practices of the Board of Directors Board Committees Audit Committee" included in our proxy statement relating to our 2015 annual meeting of stockholders is incorporated herein by reference.

**Item 11. Executive Compensation.**

Information contained under the captions "Compensation Discussion and Analysis," "Executive Compensation," "Compensation of Directors," "Compensation Committee Interlocks and Insider Participation" and "Compensation Committee Report" included in our proxy statement relating to our 2015 annual meeting of stockholders is incorporated herein by reference.

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

**Equity Compensation Plan Information**

Information contained under the caption "Securities Authorized for Issuance under Equity Compensation Plans" included in our proxy statement relating to our 2015 annual meeting of stockholders is incorporated herein by reference.

**Security Ownership of Certain Beneficial Owners and Management**

Information contained under the caption "Security Ownership of Certain Beneficial Owners and Management" included in our proxy statement relating to our 2015 annual meeting of stockholders is incorporated herein by reference.

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

Information contained under the captions "Other Information Related Person Transactions Policies and Procedures" and "Governance of the Company and Practices of the Board of Directors Board of Directors; Leadership Structure" included in our proxy statement relating to our 2015 annual meeting of stockholders is incorporated herein by reference.

**Item 14. Principal Accounting Firm Fees and Services.**

Information contained under the caption "Fees and Services of the Independent Registered Public Accounting Firm" included in our proxy statement relating to our 2015 annual meeting of stockholders is incorporated herein by reference.



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**PART IV**

**Item 15. Exhibits and Financial Statement Schedules.**

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

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

*(a) 3. Index to Exhibits.*

<b>Exhibit Number</b>	<b>Description</b>
2.1	Asset Purchase Agreement between Capstone Turbine Corporation and Calnetix Power Solutions, Inc., dated February 1, 2010(a)
2.2	Amendment to Asset Purchase Agreement between Capstone Turbine Corporation and Calnetix Power Solutions, Inc., dated March 31, 2011(b)
2.3	Second Amendment to Asset Purchase Agreement between Capstone Turbine Corporation and Calnetix Power Solutions, Inc., dated April 28, 2011(b)
3.1	Second Amended and Restated Certificate of Incorporation of Capstone Turbine Corporation(c)
3.2	Certificate of Amendment to the Second Amended and Restated Certificate of Incorporation of Capstone Turbine Corporation(d)
3.3	Amended and Restated Bylaws of Capstone Turbine Corporation(e)
4.1	Specimen stock certificate(f)
4.2	Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock(g)
4.3	Certificate of Amendment of Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock of Capstone Turbine Corporation dated September 16, 2008(h)
4.4	Certificate of Amendment to Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock dated August 30, 2012(i)
4.5	Rights Agreement, dated July 7, 2005, between Capstone Turbine Corporation and Mellon Investor Services LLC(g)
4.6	Amendment No. 1 to Rights Agreement, dated July 3, 2008, between Capstone Turbine Corporation and Mellon Investor Services LLC(j)
4.7	Amendment No. 2 to Rights Agreement, dated June 9, 2011, between Capstone Turbine Corporation and Mellon Investor Services LLC(b)
4.8	Amendment No. 3 to Rights Agreement, dated July 1, 2014, between Capstone Turbine Corporation and Computershare Inc. as successor-in-interest to Mellon Investor Services LLC(k)
4.9	Amendment No. 4 to Rights Agreement, dated August 5, 2014, between Capstone Turbine Corporation and Computershare Inc. as successor-in-interest to Mellon Investor Services LLC(l)

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<b>Exhibit Number</b>	<b>Description</b>
10.1	Amended and Restated License Agreement, dated August 2, 2000, by and between Solar Turbines Incorporated and Capstone Turbine Corporation(m)
10.2	Transition Agreement, dated August 2, 2000, by and between Capstone Turbine Corporation and Solar Turbines Incorporated(m)
10.3	Lease between Capstone Turbine Corporation and Northpark Industrial Leahy Division LLC, dated December 1, 1999, as amended, for leased premises at 21211 Nordhoff Street, Chatsworth, California(n)
10.4	Third Amendment to Lease, dated July 31, 2014, between Capstone Turbine Corporation and Northpark Industrial, for leased premises at 21211 Nordhoff Street, Chatsworth, California(l)
10.5	Fourth Amendment to Lease, dated September 30, 2014, between Capstone Turbine Corporation and Northpark Industrial, for leased premises at 21211 Nordhoff Street, Chatsworth, California(o)
10.6	Lease between Capstone Turbine Corporation and Prologis, L.P., formerly known as AMB Property, L.P., dated September 25, 2000, as amended, for leased premises at 16640 Stag Street, Van Nuys, California(p)
10.7*	Capstone Turbine Corporation Amended and Restated 2000 Equity Incentive Plan as amended and restated effective August 30, 2012(q)
10.8*	Form of Stock Option Agreement for Amended and Restated 2000 Equity Incentive Plan(r)
10.9*	Form of Stock Bonus Agreement for Capstone Turbine Corporation 2000 Equity Incentive Plan(s)
10.10*	Amended and Restated Capstone Turbine Corporation Change of Control Severance Plan(t)
10.11	Development and License Agreement between Capstone Turbine Corporation and Carrier Corporation, successor in interest to UTC Power Corporation, dated September 4, 2007(u)
10.12	First Amendment to the Development and License Agreement between Capstone Turbine Corporation and Carrier Corporation, successor in interest to UTC Power Corporation, dated January 14, 2011(b)
10.13	Form of Investor Agreement, dated September 18, 2012, between Capstone Turbine Corporation and an investor in the 2012 registered direct offering(v)
10.14	Form of Investor Letter Agreement, dated February 21, 2013, between Capstone Turbine Corporation and investors in the 2012 registered direct offering(w)
10.15	Credit and Security Agreement between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated February 9, 2009 (Domestic Facility)(x)
10.16	Credit and Security Agreement between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated February 9, 2009 (Ex-Im Subfacility)(x)
10.17	First Amendment to Credit and Security Agreement between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 9, 2009(x)
10.18	Second Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated November 5, 2009(y)

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<b>Exhibit Number</b>	<b>Description</b>
10.19	Third Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 11, 2010(s)
10.20	Fourth Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 29, 2010(z)
10.21	Fifth Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated November 9, 2010(aa)
10.22	Sixth Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated March 23, 2011(bb)
10.23	Seventh Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 9, 2011(b)
10.24	Eighth Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated September 27, 2011(cc)
10.25	Ninth Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated February 8, 2012(dd)
10.26	Tenth Amendment to the Credit and Security Agreements between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 12, 2012(ee)
10.27	Eleventh Amendment to the Credit and Security Agreements between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 7, 2013(p)
10.28	Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated April 25, 2014(ff)
10.29	Twelfth Amendment to the Credit and Security Agreements between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 9, 2014(gg)
10.30	Letter Agreement, dated September 16, 2014, between by and between Capstone Turbine Corporation and Wells Fargo Bank, NA(hh)
10.31	Thirteenth Amendment to the Credit and Security Agreements and Waiver of Default between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated November 3, 2014(ii)
10.32	Fourteenth Amendment to the Credit and Security Agreements, Waiver of Default and Consent between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 10, 2015
10.33*	Capstone Turbine Corporation Amended and Restated Executive Performance Incentive Plan as amended and restated effective August 29, 2013(jj)
10.34*	Amendment to the Capstone Turbine Corporation Amended and Restated Executive Performance Incentive Plan, dated June 9, 2014(kk)
10.35*	Inducement Stock Option Agreement with Darren R. Jamison, dated December 18, 2006(ll)
10.36*	Restricted Stock Agreement with Darren R. Jamison, dated December 18, 2006(ll)
10.37*	Letter Agreement between Capstone Turbine Corporation and Darren R. Jamison, dated December 1, 2006(ll)
10.38*	Amendment to Letter Agreement between Capstone Turbine Corporation and Darren R. Jamison, effective April 8, 2009(x)



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<b>Exhibit Number</b>	<b>Description</b>
10.39*	Letter Agreement between Capstone Turbine Corporation and James D. Crouse, dated January 31, 2007(mm)
10.40*	Inducement Stock Option Agreement with James D. Crouse, dated February 5, 2007(mm)
10.41*	Restricted Stock Agreement with James D. Crouse, dated February 5, 2007(mm)
10.42*	Form of Inducement Stock Option Agreement(nn)
10.43*	Form of Inducement Restricted Stock Unit Agreement(nn)
10.44*	Amended and Restated Change in Control Severance Agreement with Darren R. Jamison, dated June 14, 2012(ee)
10.45*	First Amendment to Amended and Restated Change in Control Severance Agreement with Darren R. Jamison, effective June 14, 2015
10.46*	Consulting Agreement with Mark Gilbreth, dated April 1, 2013(p)
10.47	Underwriting Agreement dated May 1, 2014 by and between the Company and Cowen and Company, LLC, as representative of the several underwriters(oo)
10.48*	Capstone Turbine Corporation Severance Pay Plan as amended and restated effective February 1, 2010
14.1	Code of Business Conduct(ff)
14.2	Code of Ethics for Senior Financial Officers and Chief Executive Officer(ff)
21	Subsidiary List(b)
23	Consent of KPMG LLP
24	Power of Attorney (included on the signature page of this Form 10-K)
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Schema Document
101.CAL	XBRL Calculation Linkbase Document
101.LAB	XBRL Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document
101.DEF	XBRL Definition Linkbase Document

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Management contract or compensatory plan or arrangement

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

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- (b) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended March 31, 2011 (File No. 001-15957).
- (c) Incorporated by reference to Capstone Turbine Corporation's Registration Statement on Form S-1/A, dated May 8, 2000 (File No. 333-33024).
- (d) Incorporated by reference to Appendix B to Capstone Turbine Corporation's Definitive Proxy Statement, filed on July 17, 2012 (File No. 001-15957).
- (e) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2005 (File No. 001-15957).
- (f) Incorporated by reference to Capstone Turbine Corporation's Registration Statement on Form S-1/A, dated June 21, 2000 (File No. 333-33024).
- (g) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on July 8, 2005 (File No. 001-15957).
- (h) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2009 (File No. 001-15957).
- (i) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on September 6, 2012 (File No. 001-15957).
- (j) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on July 10, 2008 (File No. 001-15957).
- (k) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on July 2, 2014 (File No. 001-15957).
- (l) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on August 5, 2014 (File No. 001-15957).
- (m) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on October 16, 2000 (File No. 001-15957).
- (n) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on September 2, 2009 (File No. 001-15957).
- (o) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on October 6, 2014 (File No. 001-15957).
- (p) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended March 31, 2013 (File No. 001-15957).
- (q)

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

- (r) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2005 (File No. 001-15957).
- (s) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended March 31, 2010 (File No. 001-15957).
- (t) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2004 (File No. 001-15957).
- (u) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2007 (File No. 001-15957).



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- (v) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on September 19, 2012 (File No. 001-15957).
- (w) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on February 26, 2013 (File No. 001-15957).
- (x) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended March 31, 2009 (File No. 001-15957).
- (y) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for quarterly period ended September 30, 2009 (File No. 001-15957).
- (z) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on July 1, 2010 (File No. 001-15957).
- (aa) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on November 12, 2010 (File No. 001-15957).
- (bb) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on March 25, 2011 (File No. 001-15957).
- (cc) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on October 3, 2011 (File No. 001-15957).
- (dd) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2011 (File No. 001-15957).
- (ee) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended on March 31, 2012 (File No. 001-15957).
- (ff) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended March 31, 2014 (File No. 001-15957).
- (gg) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on June 10, 2014 (File No. 001-15957).
- (hh) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on September 19, 2014 (File No. 001-15957).
- (ii) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2014 (File No. 001-15957).
- (jj) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2013 (File No. 001-15957).
- (kk)

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

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

(mm) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended on March 31, 2007 (File No. 001-15957).

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

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

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**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES  
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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders  
Capstone Turbine Corporation:

We have audited the accompanying consolidated balance sheets of Capstone Turbine Corporation and subsidiaries as of March 31, 2015 and 2014, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended March 31, 2015. In connection with our audits of the consolidated financial statements, we also have audited financial statement schedule II. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Capstone Turbine Corporation and subsidiaries as of March 31, 2015 and 2014, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2015, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Capstone Turbine Corporation's internal control over financial reporting as of March 31, 2015, based on criteria established in Internal Control Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated June 15, 2015 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

(signed) KPMG LLP

Los Angeles, California  
June 15, 2015

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## CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

	March 31, 2015	March 31, 2014
<b>Assets</b>		
Current Assets:		
Cash and cash equivalents	\$ 32,221	\$ 27,859
Accounts receivable, net of allowances of \$11,041 at March 31, 2015 and \$2,246 at March 31, 2014	13,120	28,019
Inventories	23,097	18,102
Prepaid expenses and other current assets	3,063	2,217
<b>Total current assets</b>	<b>71,501</b>	<b>76,197</b>
Property, plant and equipment, net	3,523	2,891
Non-current portion of inventories	2,258	2,938
Intangible assets, net	1,337	1,790
Other assets	308	302
<b>Total</b>	<b>\$ 78,927</b>	<b>\$ 84,118</b>

**Liabilities and Stockholders' Equity**

Current Liabilities:		
Accounts payable and accrued expenses	\$ 22,266	\$ 28,577
Accrued salaries and wages	2,113	1,883
Accrued warranty reserve	3,183	2,965
Deferred revenue	3,051	2,657
Revolving credit facility	12,953	13,228
Current portion of notes payable and capital lease obligations	407	444
<b>Total current liabilities</b>	<b>43,973</b>	<b>49,754</b>
Long-term portion of notes payable and capital lease obligations	89	201
Other long-term liabilities	161	70
Commitments and contingencies (Note 12)		
Stockholders' Equity:		
Preferred stock, \$.001 par value; 10,000,000 shares authorized; none issued		
Common stock, \$.001 par value; 515,000,000 shares authorized, 331,635,840 shares issued and 330,379,962 shares outstanding at March 31, 2015; 311,520,567 shares issued and 310,377,293 shares outstanding at March 31, 2014	332	312
Additional paid-in capital	837,650	805,342
Accumulated deficit	(801,764)	(770,231)
Treasury stock, at cost; 1,255,878 shares at March 31, 2015 and 1,143,274 shares at March 31, 2014	(1,514)	(1,330)
<b>Total stockholders' equity</b>	<b>34,704</b>	<b>34,093</b>
<b>Total</b>	<b>\$ 78,927</b>	<b>\$ 84,118</b>

See accompanying notes to consolidated financial statements.

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## CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

	Years Ended March 31,		
	2015	2014	2013
Revenue	\$ 115,461	\$ 133,105	\$ 127,557
Cost of goods sold	97,174	111,409	113,172
Gross margin	18,287	21,696	14,385
Operating expenses:			
Research and development	9,679	9,029	8,979
Selling, general and administrative	39,517	27,981	27,364
Total operating expenses	49,196	37,010	36,343
Loss from operations	(30,909)	(15,314)	(21,958)
Other (expense) income	41	(20)	25
Interest expense	(548)	(712)	(717)
Change in fair value of warrant liability		10	781
Loss before income taxes	(31,416)	(16,036)	(21,869)
Provision for income taxes	117	220	694
Net loss	\$ (31,533)	\$ (16,256)	\$ (22,563)
Net loss per common share basic and diluted	\$ (0.10)	\$ (0.05)	\$ (0.07)
Weighted average shares used to calculate basic and diluted net loss per common share	328,012	307,060	302,168

See accompanying notes to consolidated financial statements.

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**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

(In thousands, except share amounts)

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Treasury Stock		Total Stockholders' Equity
	Shares	Amount			Shares	Amount	
Balance, March 31, 2012	300,315,313	\$ 300	\$ 790,901	\$ (731,412)	997,820	\$ (1,172)	\$ 58,617
Purchase of treasury stock					40,883	(40)	(40)
Vested restricted stock awards	469,911						
Stock-based compensation			1,500				1,500
Employee stock purchases	22,478	1	20				21
Stock awards to Board of Directors	103,574		101				101
Issuance of common stock upon exercise of put option	4,750,000	5	4,245				4,250
Net loss				(22,563)			(22,563)
Balance, March 31, 2013	305,661,276	\$ 306	\$ 796,767	\$ (753,975)	1,038,703	\$ (1,212)	\$ 41,886
Purchase of treasury stock					104,571	(118)	(118)
Vested restricted stock awards	407,845						
Stock-based compensation			2,031				2,031
Exercise of stock options and employee stock purchases	357,619	1	479				480
Stock awards to Board of Directors	368,827		116				116
Warrants exercised	4,725,000	5	5,949				5,954
Net loss				(16,256)			(16,256)
Balance, March 31, 2014	311,520,567	\$ 312	\$ 805,342	\$ (770,231)	1,143,274	\$ (1,330)	\$ 34,093
Purchase of treasury stock					112,604	(184)	(184)
Vested restricted stock awards	582,528						
Stock-based compensation			2,119				2,119
Exercise of stock options and employee stock purchases	342,860	1	319				320
Stock awards to Board of Directors	364,885		117				117
Issuance of common stock, net of issuance costs	18,825,000	19	29,753				29,772
Net loss				(31,533)			(31,533)
Balance, March 31, 2015	331,635,840	\$ 332	\$ 837,650	\$ (801,764)	1,255,878	\$ (1,514)	\$ 34,704

See accompanying notes to consolidated financial statements.



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## CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Year Ended March 31,		
	2015	2014	2013
<b>Cash Flows from Operating Activities:</b>			
Net loss	\$ (31,533)	\$ (16,256)	\$ (22,563)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	1,697	2,323	2,820
Amortization of deferred financing costs	196	223	148
Accounts receivable allowances	10,138	242	276
Inventory provision	2,810	1,509	1,307
Provision for warranty expenses	3,463	3,903	5,129
Net (gain) loss on disposal of equipment	(96)	225	41
Stock-based compensation	2,236	2,147	1,601
Change in fair value of warrant liability		(10)	(781)
Changes in operating assets and liabilities:			
Accounts receivable	4,761	(10,320)	359
Inventories	(7,125)	(784)	(2,878)
Prepaid expenses and other current assets	(1,075)	470	587
Accounts payable and accrued expenses	(5,960)	4,475	1,221
Accrued salaries and wages and long term liabilities	321	90	(107)
Accrued warranty reserve	(3,245)	(3,237)	(4,324)
Deferred revenue	394	(432)	94
Net cash used in operating activities	(23,018)	(15,432)	(17,070)
<b>Cash Flows from Investing Activities:</b>			
Expenditures for property and equipment	(1,606)	(1,179)	(1,213)
Net cash used in investing activities	(1,606)	(1,179)	(1,213)
<b>Cash Flows from Financing Activities:</b>			
Net (repayments of) proceeds from revolving credit facility	(275)	(248)	3,045
Repayment of notes payable and capital lease obligations	(647)	(415)	(128)
Net proceeds from (cash used in) employee stock-based transactions	136	362	(19)
Proceeds from exercise of common stock warrants and put options	29,772	5,954	4,250
Net cash provided by financing activities	28,986	5,653	7,148
Net increase (decrease) in Cash and Cash Equivalents	4,362	(10,958)	(11,135)
Cash and Cash Equivalents, Beginning of Year	27,859	38,817	49,952
Cash and Cash Equivalents, End of Year	\$ 32,221	\$ 27,859	\$ 38,817
<b>Supplemental Disclosures of Cash Flow Information:</b>			
Cash paid during the year for:			
Interest	\$ 354	\$ 506	\$ 588
Income taxes	\$ 129	\$ 246	\$ 635
<b>Supplemental Disclosures of Non-Cash Information::</b>			
Acquisition of property and equipment through accounts payable	\$ 154	\$ 7	\$ 26

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Renewal of insurance contracts which was financed by notes payable	\$	447	\$	491	\$	476
Acquisition of property and equipment in consideration for the issuance of a note payable	\$	418	\$	158	\$	306

See accompanying notes to consolidated financial statements.

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**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Description of the Company and Basis of Presentation**

Capstone Turbine Corporation (the "Company") develops, manufactures, markets and services microturbine technology solutions for use in stationary distributed power generation applications, including cogeneration (combined heat and power ("CHP")), integrated combined heat and power ("ICHP"), and combined cooling, heat and power ("CCHP")), renewable energy, natural resources and critical power supply. 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.

The Company has incurred significant operating losses since its inception. Management anticipates incurring additional losses until the Company can produce sufficient revenue to cover its operating costs. To date, the Company has funded its activities primarily through private and public equity offerings. This Annual Report on Form 10-K (this "Form 10-K") refers to the Company's fiscal years ending March 31 as its "Fiscal" years.

The consolidated financial statements have been prepared assuming the Company will continue as a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. The Company's net loss from operations for the Fiscal years ended 2015, 2014 and 2013 was \$30.9 million, \$15.3 million and \$22.0 million, respectively. The lower than expected revenue during Fiscal 2015 and an increase in accounts receivable allowance provided for two customers was the primary cause of the increase in the net loss from operations. The Company's cash and cash equivalents as of March 31, 2015 and 2014 were \$32.2 million and \$27.9 million, respectively. The Company's working capital requirements during Fiscal 2015 were higher than planned primarily as a result of lower than anticipated inventory turns and reductions to accounts payable as a result of payments made by the Company. Additionally, the Company did not fully achieve its planned number of product shipments primarily as a result of continuing geopolitical instability in Russia and Ukraine, the dramatic downturn of the oil and gas markets and a substantially stronger U.S. dollar making our products more expensive overseas.

Management has the ability to manage certain operating assets and liabilities, specifically the procurement of inventory and timing of payments of accounts payable, capital expenditures and certain operating expenses depending on the results of its operations to extend its cash and cash equivalents. Management believes that existing cash and cash equivalents are sufficient to meet the Company's anticipated cash needs for at least the next twelve months. In the event that our anticipated cash needs change, it is possible that the Company may need to raise additional capital in the future. The Company may seek to raise funds by selling additional securities 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.

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 Singapore Pte., Ltd., its wholly owned subsidiary that was formed in February 2011, after elimination of inter-company transactions.

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**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. Summary of Significant Accounting Policies**

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

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

**Accounts Receivable** Trade accounts receivable are recorded at the invoiced amount and are typically non-interest bearing. The Company maintains allowances for estimated losses resulting from the inability of customers to make required payments and other accounts receivable allowances.

**Inventories** The Company values inventories at first in first out ("FIFO") basis and lower of cost or market. The composition of inventory is routinely evaluated to identify slow-moving, excess, obsolete or otherwise impaired inventories. Inventories identified as impaired are evaluated to determine if write-downs are required. Included in the assessment is a review for obsolescence as a result of engineering changes in the Company's products. All inventories expected to be used in more than one year are classified as long-term. Inventory charges increased approximately \$1.0 million during Fiscal 2015 compared to Fiscal 2014 primarily as a result of an allowance for slow-moving inventory related to the waste heat recovery generators.

**Depreciation and Amortization** Depreciation and amortization are provided for using the straight-line method over the estimated useful lives of the related assets, ranging from two to ten years. Leasehold improvements are amortized over the lease term or the estimated useful lives of the assets, whichever is shorter. Intangible assets that have finite useful lives are amortized over their estimated useful lives using the straight-line method with the exception of the backlog of 100 kW microturbines ("TA100") acquired from Calnetix Power Solutions, Inc. ("CPS"). Purchased backlog is amortized based on unit sales and presented as a component of cost of goods sold.

**Long-Lived Assets** The Company reviews the recoverability of long-lived assets, including intangible assets with finite lives, whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. If the expected future cash flows from the use of such assets (undiscounted and without interest charges) are less than the carrying value, the Company may be required to record a write-down, which is determined based on the difference between the carrying value of the assets and their estimated fair value. The Company performed an analysis as of March 31, 2015 and determined that no impairment was necessary. Intangible assets include a manufacturing license, trade name, technology, backlog and customer relationships. See Note 5 Intangible Assets.

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

**Revenue** The Company's revenue consists of sales of products, parts, accessories and service, which includes a comprehensive Factory Protection Plan ("FPP"), net of discounts. Capstone's

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**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. Summary of Significant Accounting Policies (Continued)**

distributors purchase products, parts and FPPs for sale to end users and are also required to provide a variety of additional services, including application engineering, installation, commissioning and post-commissioning repair and maintenance service. The Company's standard terms of sales to distributors and direct end-users include transfer of title, care, custody and control at the point of shipment, payment terms ranging from full payment in advance of shipment to payment in 90 days, no right of return or exchange, and no post-shipment performance obligations by Capstone except for warranties provided on the products and parts sold.

Revenue from the sale of products, parts and accessories is generally recognized and earned when all of the following criteria are satisfied: (a) persuasive evidence of a sales arrangement exists; (b) price is fixed or determinable; (c) collectability is reasonably assured; and (d) delivery has occurred. Delivery generally occurs when the title and the risks and rewards of ownership have substantially transferred to the customer. Assuming all other revenue recognition criteria have been met, if it is determined that collection is not reasonably assured, revenue will not be recognized until collectability is reasonably assured, which is generally upon receipt of payment. Management's estimates regarding the collectability of a particular sale may impact the timing of actual revenue recognized each period.

Service performed by the Company has consisted primarily of time and materials based contracts. The time and materials contracts are usually related to out-of-warranty units. Service revenue derived from time and materials contracts is recognized as the service is performed.

The Company also provides maintenance service contracts to customers of its existing installed base. The maintenance service contracts are agreements to perform certain services to maintain a product for a specified period of time. Service revenue derived from maintenance service contracts is recognized on a straight-line basis over the contract period.

**Warranty** The Company provides for the estimated costs of warranties at the time revenue is recognized. The specific terms and conditions of those warranties vary depending upon the product sold and geography of sale. The Company's product warranties generally start from the delivery date and continue for up to 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.

**Research and Development ("R&D")** The Company accounts for grant distributions and development funding as offsets to R&D expenses and both are recorded as the related costs are incurred. Total offsets to R&D expenses amounted to \$0.5 million, \$1.4 million and \$1.7 million for the years ended March 31, 2015, 2014 and 2013, respectively.

**Income Taxes** Deferred income tax assets and liabilities are computed for differences between the consolidated financial statement and income tax basis of assets and liabilities. Such deferred income tax asset and liability computations are based on enacted tax laws and rates applicable to periods in which

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**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. Summary of Significant Accounting Policies (Continued)**

the differences are expected to reverse. Valuation allowances are established, when necessary, to reduce deferred income tax assets to the amounts expected to be realized.

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

**Risk Concentrations** Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. At March 31, 2015, the majority of our cash balances were held at financial institutions located in California. The accounts at these institutions are insured by the Federal Deposit Insurance Corporation up to certain limits. Balances that exceed the insurance coverage aggregate to approximately \$32.0 million as of March 31, 2015. The Company places its cash and cash equivalents with high credit quality institutions. The Company performs ongoing credit evaluations of its customers and maintains an allowance for potential credit losses.

Sales to Horizon Power Systems ("Horizon"), one of the Company's domestic distributors, accounted for 17%, 12% and 27% of our revenue for the years ended March 31, 2015, 2014 and 2013, respectively. Sales to BPC Engineering ("BPC"), one of the Company's Russian distributors, accounted for 11%, 17% and 11% of our revenue for the years ended March 31, 2015, 2014 and 2013, respectively. Sales to E-Finity Distributed Generation, LLC ("E-Finity"), one of the Company's domestic distributors, accounted for 19% of our revenue for the year ended March 31, 2014. Additionally, Optimal Group Australia Pty Ltd, one of the Company's Australian distributors, accounted for 17% of net accounts receivable as of March 31, 2015. BPC, Electro Mecanique Industries ("EMI"), one of the Company's distributors in the Middle East and Africa, and E-Finity accounted for 26%, 18% and 16%, respectively, of net accounts receivable as of March 31, 2014.

During the three months ended March 31, 2015, the Company recorded approximately \$7.1 million with respect to the accounts receivable allowance from BPC. The Company determined that the collectability of this accounts receivable balance was not reasonably assured based on BPC's payment history and because the impact of the recent steep decline of the Russian ruble could continue to negatively impact its ability to pay its outstanding accounts receivable balance. During the three months ended September 30, 2014, the Company recorded approximately \$2.6 million with respect to the accounts receivable balance from EMI. The Company determined that the collectability of this accounts receivable balance was not reasonably assured based on EMI's payment history. The Company recorded bad debt expense of approximately \$10.1 million, \$0.2 million and \$0.3 million for the years ended March 31, 2015, 2014 and 2013, respectively.

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

**Estimates and Assumptions** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Significant estimates include accounting for accounts receivable allowances, stock-based compensation, inventory write-downs, valuation of long-lived assets including intangible assets

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## CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**2. Summary of Significant Accounting Policies (Continued)**

with finite lives, product warranties, income taxes and other contingencies. Actual results could differ from those estimates.

**Net Loss Per Common Share** Basic loss per common share is computed using the weighted-average number of common shares outstanding for the period. Diluted loss per share is also computed without consideration to potentially dilutive instruments because the Company incurred losses which would make such instruments antidilutive. Outstanding stock options at March 31, 2015, 2014 and 2013 were 13.2 million, 12.9 million and 11.8 million, respectively. Outstanding restricted stock units at March 31, 2015, 2014 and 2013 were 1.9 million, 2.1 million and 1.5 million, respectively. As of March 31, 2015 and 2014, the Company did not have any warrants outstanding. As of March 31, 2013, the number of warrants excluded from diluted net loss per common share computations was approximately 26.5 million.

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

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

	Year Ended March 31,		
	2015	2014	2013
United States	\$ 48,890	\$ 58,432	\$ 57,001
Mexico	14,468	8,956	22,581
All other North America	331	196	4,370
<b>Total North America</b>	<b>63,689</b>	<b>67,584</b>	<b>83,952</b>
Russia	12,978	23,216	13,827
All other Europe	15,707	17,820	12,036
<b>Total Europe</b>	<b>28,685</b>	<b>41,036</b>	<b>25,863</b>
Asia	9,257	10,728	8,473
Australia	8,832	5,275	5,461
All other	4,998	8,482	3,808
<b>Total Revenue</b>	<b>\$ 115,461</b>	<b>\$ 133,105</b>	<b>\$ 127,557</b>

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## CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 2. Summary of Significant Accounting Policies (Continued)

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

	Year Ended March 31,		
	2015	2014	2013
C30	\$ 4,804	\$ 5,623	\$ 6,756
C65	30,118	29,107	22,899
TA100	318	460	1,485
C200	7,120	14,754	18,099
C600	5,848	10,374	12,384
C800	8,319	10,127	5,324
C1000	32,685	38,141	35,571
Waste heat recovery generator	155	180	
Unit upgrades			129
Total from Microturbine Products	89,367	108,766	102,647
Accessories, Parts and Service	26,094	24,339	24,910
Total	\$ 115,461	\$ 133,105	\$ 127,557

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

**Recent Accounting Pronouncements** In April 2015, the Financial Accounting Standards Board (the "FASB") issued Accounting Standard Update ("ASU") 2015-03, Interest Imputation of Interest (Subtopic 835-30). The ASU was issued as part of FASB's current plan to simplify overly complex standards. This ASU requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. The recognition and measurement guidance for debt issuance costs are not affected by this ASU. The update requires retrospective application to all prior period amounts presented. This update is effective for annual and interim periods beginning on or after December 15, 2015, with early application permitted for financial statements that have not been issued. We are currently evaluating the potential impacts the new standard will have on our reporting process.

In August 2014, the FASB issued ASU 2014-15, Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern ("ASU 2014-15"). ASU 2014-15 requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date the financial statements are issued and provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. Certain disclosures will be required if conditions give rise to substantial doubt about an entity's ability to continue as a going concern. ASU 2014-15 applies to all entities and is effective for annual and interim reporting periods ending after December 15, 2016, with early adoption permitted. The Company is evaluating the potential impacts the new standard will have on its reporting process.

In June 2014, the FASB issued ASU 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period ("ASU 2014-12"). ASU 2014-12 requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. ASU 2014-12 is effective for annual reporting periods beginning after December 15, 2015, with early



Table of Contents**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****2. Summary of Significant Accounting Policies (Continued)**

adoption permitted. The Company is evaluating the potential impacts of the new standard on its existing stock-based compensation plans.

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 U.S. 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. The Company is evaluating its existing revenue recognition policies to determine whether any contracts in the scope of the guidance will be affected by the new requirements. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods therein.

**3. Inventories**

Inventories are valued on a FIFO basis and lower of cost or market and consisted of the following as of March 31, 2015 and 2014 (in thousands):

	2015	2014
Raw materials	\$ 19,955	\$ 19,080
Work in process		5
Finished goods	5,400	1,955
Total	25,355	21,040
Less non-current portion	(2,258)	(2,938)
Current portion	\$ 23,097	\$ 18,102

The non-current portion of inventories represents that portion of the inventories in excess of amounts expected to be used in the next twelve months. The non-current inventories are primarily comprised of repair parts for older generation products that are still in operation, but are not technologically compatible with current configurations. The weighted average age of the non-current portion of inventories on hand as of March 31, 2015 is 2.0 years. The Company expects to use the non-current portion of the inventories on hand as of March 31, 2015 over the periods presented in the following table (in thousands):

Expected Period of Use	Non-current Inventory Balance Expected to be Used	
13 to 24 months	\$	1,544
25 to 36 months		557
37 to 48 months		157
Total	\$	2,258

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## CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**4. Property, Plant and Equipment**

Property, plant and equipment as of March 31, 2015 and 2014 consisted of the following (in thousands):

	2015	2014	Estimated Useful Life
Machinery, rental equipment, equipment, automobiles and furniture	\$ 20,873	\$ 20,665	2 - 10 years
Leasehold improvements	9,760	9,731	10 years
Molds and tooling	3,722	5,138	2 - 5 years
	34,355	35,534	
Less, accumulated depreciation	(30,832)	(32,643)	
Total property, plant and equipment, net	\$ 3,523	\$ 2,891	

Depreciation expense for property, plant and equipment was \$1.2 million, \$1.8 million and \$2.3 million for the years ended March 31, 2015, 2014 and 2013, respectively.

**5. Intangible Assets**

Intangible assets consisted of the following (in thousands):

	Weighted Average Amortization Period	March 31, 2015		
		Intangible Assets, Gross	Accumulated Amortization	Intangible Assets, Net
Manufacturing license	17 years	\$ 3,700	\$ 3,585	\$ 115
Technology	10 years	2,240	1,157	1,083
Parts and service customer relationships	5 years	1,080	1,080	
TA100 customer relationships	2 years	617	617	
Backlog	Various	490	351	139
Trade name	1.2 years	69	69	
Total		\$ 8,196	\$ 6,859	\$ 1,337

	Weighted Average Amortization Period	March 31, 2014		
		Intangible Assets, Gross	Accumulated Amortization	Intangible Assets, Net
Manufacturing license	17 years	\$ 3,700	\$ 3,536	\$ 164
Technology	10 years	2,240	933	1,307
Parts and service customer relationships	5 years	1,080	900	180
TA100 customer relationships	2 years	617	617	

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Backlog	Various	490	351	139
Trade name	1.2 years	69	69	
Total		\$ 8,196	\$ 6,406	\$ 1,790

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Table of Contents**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****5. Intangible Assets (Continued)**

Amortization expense for the intangible assets was \$0.5 million for each of the years ended March 31, 2015, 2014 and 2013.

Expected future amortization expense of intangible assets as of March 31, 2015 is as follows (in thousands):

Year Ending March 31,	Amortization Expense
2016	\$ 332
2017	352
2018	242
2019	224
2020	187
Thereafter	
<b>Total expected future amortization</b>	<b>\$ 1,337</b>

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 \$71,100, \$83,000, and \$76,700 were earned by Solar for the years ended March 31, 2015, 2014 and 2013, respectively. Earned royalties of approximately \$19,300 and \$20,700 were unpaid as of March 31, 2015 and 2014, respectively, and are included in accrued expenses in the accompanying balance sheets.

**6. Accrued Warranty Reserve**

Changes in the accrued warranty reserve are as follows as of March 31, 2015, 2014 and 2013 (in thousands):

	2015	2014	2013
Balance, beginning of the period	\$ 2,965	\$ 2,299	\$ 1,494
Standard warranty provision	3,516	2,857	3,874
Changes for accrual related to reliability repair programs	(53)	1,046	1,255
Deductions for warranty claims	(3,245)	(3,237)	(4,324)
<b>Balance, end of the period</b>	<b>\$ 3,183</b>	<b>\$ 2,965</b>	<b>\$ 2,299</b>

Table of Contents**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****7. Deferred Revenue**

Changes in deferred revenue are as follows as of March 31, 2015, 2014 and 2013 (in thousands):

	2015	2014	2013
FPP Balance, beginning of the period	\$ 2,061	\$ 1,412	\$ 1,167
FPP Billings	9,773	7,689	5,884
FPP Revenue recognized	(9,343)	(7,040)	(5,639)
Balance attributed to FPP contracts	2,491	2,061	1,412
Deposits	560	596	1,677
Deferred revenue balance, end of the period	\$ 3,051	\$ 2,657	\$ 3,089

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

**8. Income Taxes**

Current income tax provision is the amount of income taxes reported or expected to be reported on our income tax return. The provision for current income taxes for the year ended March 31, 2015 was \$0.1 million, which was related to state income and foreign taxes. The Company did not have current federal income taxes for the year ended March 31, 2015.

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

	Year Ended March 31,		
	2015	2014	2013
Federal income tax at the statutory rate	\$ (10,681)	\$ (5,452)	\$ (7,436)
State taxes, net of federal effect	(671)	(93)	(661)
Foreign taxes	33	134	675
R&D tax credit	(392)	37	(1,157)
Impact of state rate change	(2,627)	492	838
Warrant liability		(3)	(299)
Expiring NOL	3,865	1,543	
Valuation allowance	10,583	3,614	(1,877)
Excess tax benefit stock compensation			10,383
Other	7	(52)	228
Income tax expense (benefit)	\$ 117	\$ 220	\$ 694

Table of Contents**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****8. Income Taxes (Continued)**

The Company's deferred tax assets and liabilities consisted of the following at March 31, 2015 and 2014 (in thousands):

	2015	2014
Deferred tax assets:		
Inventories	\$ 3,323	\$ 2,152
Warranty reserve	1,217	1,051
Bad debt reserve	4,223	803
Deferred revenue	953	731
Net operating loss ("NOL") carryforwards	218,826	214,071
Tax credit carryforwards	18,860	18,369
Depreciation, amortization and impairment loss	3,231	3,631
Other	5,154	4,477
Deferred tax assets	255,787	245,285
Valuation allowance for deferred tax assets	(246,753)	(236,169)
Deferred tax assets, net of valuation allowance	9,034	9,116
Deferred tax liabilities:		
Federal benefit of state taxes	(9,034)	(9,116)
Net deferred tax assets	\$	\$

Because of the uncertainty surrounding the timing of realizing the benefits of favorable tax attributes in future income tax returns, the Company has placed a valuation allowance against its net deferred income tax assets. The change in valuation allowance for Fiscal 2015, 2014 and 2013 was \$10.6 million, \$3.6 million and \$1.9 million, respectively.

The Company's NOL and tax credit carryforwards for federal and state income tax purposes at March 31, 2015 were as follows (in thousands):

	Amount	Expiration Period
Federal NOL	\$ 625,918	2018 - 2035
State NOL	\$ 202,275	2014 - 2035
Federal tax credit carryforwards	\$ 9,684	2018 - 2035
State tax credit carryforwards	\$ 9,176	Indefinite

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

Tax benefits arising from the disposition of certain shares issued upon exercise of stock options within two years of the date of grant or within one year of the date of exercise by the option holder ("Disqualifying Dispositions") provide the Company with a tax deduction equal to the difference between the exercise price and the fair market value of the stock on the date of exercise.

Table of Contents**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****8. Income Taxes (Continued)**

Approximately \$27.7 million of the Company's federal and state NOL carryforwards as of March 31, 2015 were generated by Disqualifying Dispositions of stock options and exercises of nonqualified stock options. In accordance with the reporting requirements under ASC 718, we did not include approximately \$10.0 million of excess windfall tax benefits resulting from stock option exercises as components of our gross deferred tax assets and corresponding valuation allowance disclosures, as tax attributes related to those windfall tax benefits should not be recognized until they result in a reduction of taxes payable. The tax effected amount of gross unrealized net operating loss carry forwards excluded under ASC 718 was approximately \$10.0 million at March 31, 2015. When realized, those excess windfall tax benefits are credited to additional paid-in capital.

Accounting Standards Codification ("ASC") 740, Income Taxes clarifies the accounting for income taxes by prescribing a minimum recognition threshold that a tax position is required to meet before being recognized in the financial statements. ASC 740 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. Based on management's evaluation, the total amount of unrecognized tax benefits related to research and development credits as of March 31, 2015 and 2014 was \$2.6 million and \$2.4 million, respectively. There were no interest or penalties related to unrecognized tax benefits as of March 31, 2015 or March 31, 2014. The amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate as of March 31, 2015 and March 31, 2014 was \$2.6 million and \$2.4 million, respectively. However, this impact would be offset by an equal increase in the deferred tax valuation allowance as the Company has recorded a full valuation allowance against its deferred tax assets because of uncertainty as to future realization. The fully reserved recognized federal and state deferred tax assets related to research and development credits balance as of March 31, 2015 and 2014 was \$9.7 million and \$9.2 million, and \$9.5 million and \$9.6 million, respectively.

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

Balance at March 31, 2012	\$ 2,148
Gross decrease related to prior year tax positions	(100)
Gross increase related to prior year tax positions	222
Gross increase related to current year tax positions	148
Lapse of statute of limitations	
Balance at March 31, 2013	\$ 2,418
Gross decrease related to prior year tax positions	(93)
Gross increase related to prior year tax positions	1
Gross increase related to current year tax positions	115
Lapse of statute of limitations	
Balance at March 31, 2014	\$ 2,441
Gross increase related to prior year tax positions	11
Gross increase related to current year tax positions	112
Lapse of statute of limitations	
Balance at March 31, 2015	\$ 2,564

Table of Contents**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****8. Income Taxes (Continued)**

The Company files income tax returns in the U.S. federal jurisdiction and various state, local and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state, local or non-U.S. income tax examinations by tax authorities for the years before 2010. However, net operating loss carryforwards remain subject to examination to the extent they are carried forward and impact a year that is open to examination by tax authorities. The Company's evaluation was performed for the tax years which remain subject to examination by major tax jurisdictions as of March 31, 2015. When applicable, the Company accounts for interest and penalties generated by tax contingencies as interest and other expense, net in the statements of operations.

**9. Stockholders' Equity**

The following table summarizes, by statement of operations line item, stock-based compensation expense for the years ended March 31, 2015, 2014 and 2013 (in thousands):

	Fiscal Year Ended March 31,		
	2015	2014	2013
Cost of goods sold	\$ 113	\$ 43	\$ 92
Research and development	328	562	319
Selling, general and administrative	1,795	1,542	1,190
Stock-based compensation expense	\$ 2,236	\$ 2,147	\$ 1,601

**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 27,980,000 shares. The 2000 Plan is administered by the Compensation Committee designated by the Board of Directors. The Compensation Committee's authority includes determining the number of incentive awards and vesting provisions. As of March 31, 2015, there were 3,206,800 shares available for future grant.

*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. Stock-based compensation expense is based on awards that are ultimately expected to vest and accordingly, stock-based compensation recognized is reduced by estimated forfeitures. Management's estimate of forfeitures is based on historical forfeitures. 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



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## CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 9. Stockholders' Equity (Continued)

month thereafter, so that all options will be vested on the first day of the 48th month after the grant date. Information relating to stock options for fiscal year ended March 31, 2015, is as follows:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Options outstanding at March 31, 2014	12,851,688	\$ 1.27		
Granted	1,085,800	\$ 1.43		
Exercised	(322,241)	\$ 0.94		
Forfeited, cancelled or expired	(451,884)	\$ 1.66		
Options outstanding at March 31, 2015	13,163,363	\$ 1.28	3.9	
Options fully vested at March 31, 2015 and those expected to vest beyond March 31, 2015	13,163,363	\$ 1.28	3.9	
Options exercisable at March 31, 2015	10,568,511	\$ 1.30	3.3	

*Black-Scholes Model Valuation Assumptions*

The Company calculated the estimated fair value of each stock option on the date of grant using the Black-Scholes valuation method and the following weighted-average assumptions:

	Fiscal Year Ended March 31,		
	2015	2014	2013
Risk-free interest rates	1.8%	0.9%	0.8%
Expected lives (in years)	5.7	5.7	5.7
Dividend yield	%	%	%
Expected volatility	77.0%	77.3%	79.8%
Weighted average grant date fair value of options granted during the period	\$ 0.94	\$ 0.60	\$ 0.67

The Company's computation of expected volatility for the fiscal years ended March 31, 2015, 2014 and 2013 was based on historical volatility. The expected life, or term, of options granted is derived from historical exercise behavior and represents the period of time that stock option awards are expected to be outstanding. Management has selected a risk-free rate based on the implied yield available on U.S. Treasury Securities with a maturity equivalent to the options' expected term.

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## CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**9. Stockholders' Equity (Continued)**

The following table provides additional information on stock options for the Company's fiscal years ended March 31, 2015, 2014 and 2013:

	Fiscal Year Ended March 31,		
	2015	2014	2013
Stock option compensation expense (in thousands)	\$ 1,071	\$ 1,117	\$ 942
Cash received for exercise price (in thousands)	\$ 302	\$ 464	
Intrinsic value (in thousands)	\$ 129	\$ 225	
Weighted average grant date fair value of options exercised during the period	\$ 1.34	\$ 1.35	

As of March 31, 2015, there was approximately \$1.6 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 2.3 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. The related compensation expense recognized is reduced by estimated forfeitures. The Company's estimate of forfeitures is based on historical forfeitures. 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 and performance restricted stock unit ("PRSU") activity:

Restricted Stock and Performance Restricted Stock Units	Shares	Weighted Average Grant Date Fair Value
Nonvested restricted stock units outstanding at March 31, 2014	2,061,224	\$ 1.11
Granted	974,236	\$ 1.37
Vested and issued	(828,136)	\$ 1.13
PRSU adjustments	(200,000)	\$ 1.56
Forfeited	(138,750)	\$ 1.14
Nonvested restricted stock units outstanding at March 31, 2015	1,868,574	\$ 1.19
Restricted stock units expected to vest beyond March 31, 2015	1,760,706	\$ 1.19

Table of Contents**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****9. Stockholders' Equity (Continued)**

The following table provides additional information on restricted stock units for the Company's fiscal years ended March 31, 2015, 2014 and 2013:

	Fiscal Year Ended March 31,		
	2015	2014	2013
Restricted stock compensation expense (in thousands)	\$ 1,048	\$ 914	\$ 558
Aggregate fair value of restricted stock units vested and issued (in thousands)	\$ 1,206	\$ 806	\$ 560
Weighted average grant date fair value of restricted stock units granted during the period	\$ 1.33	\$ 1.09	\$ 1.00

As of March 31, 2015, there was approximately \$1.4 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 2.1 years.

PRSU activity is included in the above restricted stock units tables. In May 2014, the Compensation Committee of the Company's Board of Directors approved the new Performance Restricted Stock Unit Program, which is applicable to certain senior employees. The Compensation Committee granted 200,000 PRSUs to the Chief Executive Officer under the 2000 Plan. The Chief Executive Officer is the only participant for Fiscal 2015. For the first year of the program, the PRSU grant for the Chief Executive Officer is broken out into two performance measurement periods. The first performance measurement period began on April 1, 2014 and will end on March 31, 2016; the second performance measurement period has a three-year term that began on April 1, 2014 and will end on March 31, 2017. Any earned PRSU awards will vest 50% after the end of the applicable performance measurement period and 50% one year thereafter.

The weighted average per share grant date fair value of PRSUs granted during the fiscal year ended March 31, 2015 was \$1.56. Based on our assessment as of March 31, 2015, the PRSU threshold for the first performance measurement likely will not be met and, as a result, the Chief Executive Officer PRSU awards were adjusted and no compensation expense was recorded or recognized during Fiscal 2015. Any compensation expense will be recognized over the corresponding requisite service period and will be adjusted in subsequent reporting periods if the Company's assessment of the probable level of achievement of the performance goals changes. The Company will continue to periodically assess the likelihood of the PRSU threshold being met until the end of the applicable performance period.

Table of Contents**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****9. Stockholders' Equity (Continued)***Non-employee Directors Stock Awards*

The Company issues stock awards under the 2000 Plan 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 non-employee directors stock activity for the Company's fiscal years ended March 31, 2015, 2014 and 2013:

	Fiscal Year Ended March 31,		
	2015	2014	2013
Non-employee directors stock awards compensation expense (in thousands)	\$ 117	\$ 116	\$ 101
Non-employee director deferred stock awards granted	119,277	91,603	103,574
Weighted average grant date fair value of restricted stock awards granted during the period	\$ 0.99	\$ 1.26	\$ 0.98

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.

*2000 Employee Stock Purchase Plan*

In June 2000, the Company adopted the 2000 Employee Stock Purchase Plan (the "Purchase Plan"), which provides for the granting of rights to purchase common stock to regular full and part-time employees or officers of the Company and its subsidiaries. Under the Purchase Plan, shares of common stock will be issued upon exercise of the purchase rights. Under the Purchase Plan, an aggregate of 900,000 shares may be issued pursuant to the exercise of purchase rights. In August 2010, the Board of Directors adopted and the stockholders approved an amendment and restatement of the Purchase Plan. The amendment and restatement includes an increase of 500,000 shares of common stock that will be available under the Purchase Plan and extends the term of the Purchase Plan for a period of ten years. As amended, the Purchase Plan will continue by its terms through June 30, 2020, unless terminated sooner, and will reserve for issuance a total of 1,400,000 shares of common stock. The maximum amount that an employee can contribute during a purchase right period is \$25,000 or 15% of the employee's regular compensation. Under the Purchase Plan, the exercise price of a purchase right is 95% of the fair market value of such shares on the last day of the purchase right period. The fair market value of the stock is its closing price as reported on the Nasdaq Global Market on the day in question. During the fiscal years ended March 31, 2015, 2014 and 2013, the Company issued a total of 20,619 shares, 12,302 shares and 22,478 shares of stock, respectively, to regular full and part-time employees or officers of the Company who elected to participate in the Purchase Plan. As of March 31, 2015, there were 409,569 shares available for future grant under the Purchase Plan.

**Grants outside of the 2000 Plan**

As of March 31, 2015, the Company had outstanding 3,800,000 non-qualified common stock options and 93,750 restricted stock units issued outside of the 2000 Plan. The Company granted 250,000

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## CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**9. Stockholders' Equity (Continued)**

of these stock options during Fiscal 2015, 250,000 of these stock options during Fiscal 2013, 3,300,000 of these stock options prior to Fiscal 2013, 62,500 of these restricted stock units during Fiscal 2015 and 31,250 of these restricted stock units during Fiscal 2013 as inducement grants to new officers and employees of the Company, with exercise prices equal to the fair market value of the Company's common stock on the grant date.

Outside of 2000 Plan	Options	RSUs
Executive Vice President and Chief Executive Officer	2,000,000	
Executive Vice President of Sales and Marketing	850,000	
Vice President of Operations	250,000	62,500
Former Senior Vice President of Customer Service	250,000	31,250
Former Senior Vice President of Program Management	250,000	
Former Senior Vice President of Human Resources	200,000	
<b>Outstanding stock outside of 2000 Plan</b>	<b>3,800,000</b>	<b>93,750</b>

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  $\frac{1}{4}$ th 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**

The Company has entered into a rights agreement (as amended, the "Rights Agreement") with Computershare Inc., successor-in-interest to Mellon Investor Services LLC, as rights agent. In connection with the rights agreement, the Company's board of directors authorized and declared a dividend distribution of one preferred stock purchase right for each share of the Company's common stock authorized and outstanding. Each right entitles the registered holder to purchase from the Company a unit consisting of one one-hundredth of a share of Series A Junior Participating Preferred Stock, par value \$0.001 per share, at a purchase price of \$10.00 per unit, subject to adjustment. The description and terms of the rights are set forth in the rights agreement. Initially, the rights are attached to all common stock certificates representing shares then outstanding, and no separate rights certificates are distributed. Subject to certain exceptions specified in the Rights Agreement, the rights will separate from the common stock and will be exercisable upon the earlier of (i) 10 days following a public announcement that a person or group of affiliated or associated persons has acquired, or obtained the right to acquire, beneficial ownership of 20% or more of the outstanding shares of common stock, other than as a result of repurchases of stock by the Company or certain inadvertent actions by institutional or certain other stockholders, or (ii) 10 days (or such later date as the Company's Board of Directors shall determine) following the commencement of a tender offer or exchange offer (other than certain permitted offers described in the rights agreement) that would result in a person or group beneficially owning 20% or more of the outstanding shares of the Company's common stock.

On July 1, 2014, the Company's Board of Directors unanimously approved a third amendment to the Rights Agreement pursuant to a "sunset provision," which was approved by the stockholders at the

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**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**9. Stockholders' Equity (Continued)**

2014 annual meeting. The third amendment amends the Rights Agreement to provide that the rights will expire on the 30th day after the 2017 annual meeting of stockholders unless continuation of the Rights Agreement is approved by the stockholders at that meeting. On August 5, 2014, the Company entered into a fourth amendment to the Rights Agreement. The fourth amendment amends the Rights Agreement to clarify that the term of the Rights Agreement may not be continued or extended unless and until such amendment has received the approval of the stockholders of the Company at an annual or special meeting of the stockholders held prior to the termination of the Rights Agreement without taking into account such amendment.

The Rights Agreement is intended to protect the Company's stockholders in the event of an unfair or coercive offer to acquire the Company. Management believes the Rights Agreement, however, should not affect any prospective offeror willing to make an offer at a fair price and otherwise in the best interests of the Company and its stockholders, as determined by the Board of Directors. Also, management believes the Rights Agreement should not interfere with any merger or other business combination approved by the Board of Directors.

**Underwritten and Registered Direct Placement of Common Stock**

Effective May 6, 2014, the Company completed an underwritten public offering in which it sold 18.8 million shares of the Company's common stock at a price of \$1.70 per share less underwriting discounts and commissions. The shares were allocated to a single institutional investor. The net proceeds to the Company from the sale of the Common Stock, after deducting fees and other offering expenses, were approximately \$29.8 million.

Effective March 5, 2012, the Company completed a registered direct placement in which it sold 22.6 million shares of the Company's common stock, par value \$.001 per share, and warrants to purchase 22.6 million shares of common stock with an initial exercise price of \$1.55 per share, at a price of \$1.11 per unit (the "2012 Warrants"). Each unit consisted of one share of common stock and a warrant to purchase one share of common stock. The 2012 Warrants expired on October 31, 2013. In addition, the Company obtained the right to require investors in the offering to purchase up to an aggregate maximum of 19.0 million additional shares of common stock from the Company (the "Put Options") during two option exercise periods, the first such option exercise period beginning September 10, 2012 and the second such option exercise period beginning March 4, 2013. Each Put Option was subject to certain conditions which reduced the number of shares that could be sold or eliminate the Put Option. These conditions included a minimum volume-weighted average price (VWAP) and a minimum average trading volume of the Company's common shares during the 30 trading days prior to the exercise of the Put Option. The March 2012 sale resulted in net proceeds of approximately \$23.1 million net of direct incremental costs of approximately \$1.9 million.

On September 18, 2012, the Company entered into an Investor Agreement with one of the investors in the 2012 registered direct offering pursuant to which the investor agreed to (i) waive the condition precedent to the Company's exercise of the Put Option requiring the arithmetic average of the average daily trading volumes during the measurement period set forth in the subscription agreement between the Company and the investor and on the exercise date be not less than 1.75 million shares and (ii) amend the subscription agreement to provide that the purchase price of the additional shares during the first exercise period would be discounted pursuant to a formula that resulted in a purchase price for the first exercise period of \$0.94 per share. Additionally, pursuant to

Table of Contents**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****9. Stockholders' Equity (Continued)**

the Investor Agreement, the Company agreed to amend the exercise price of the 2012 Warrants originally issued to the Investor to \$1.26. The exercise of the first Put Option resulted in net proceeds of \$4.2 million. The 2012 Warrants still outstanding as of March 31, 2013 provided for the purchase of 22.6 million shares at a weighted average exercise price of \$1.41 per share. On February 21, 2013, the Company entered into a letter agreement (each a "Letter Agreement" and, collectively, the "Letter Agreements") with each of the investors in the March 5, 2012 registered direct offering. Pursuant to the Letter Agreements, the parties evidenced their mutual agreement that the Company would not exercise any portion of the second Put Option. The Company chose not to exercise the second of the two Put Options because of its improved cash position and its desire to avoid stockholder dilution. On October 31, 2013, an unsolicited exercise of 2012 Warrants to purchase 4.7 million shares resulted in proceeds of approximately \$6.0 million. Effective October 31, 2013, all remaining outstanding 2012 Warrants expired.

The following table outlines the warrant activity:

	March 2012	September 2008
	Shares	Shares
Balance, March 31, 2012	22,550,000	3,910,034
Anti-dilution provision		51,437
Balance, March 31, 2013	22,550,000	3,961,471
Warrants exercised	(4,725,000)	
Warrants expired	(17,825,000)	(3,961,471)

Balance, March 31, 2014

**10. Fair Value Measurements**

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

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

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

Quoted prices for similar assets or liabilities in active markets

Quoted prices for identical or similar assets or liabilities in inactive markets

Inputs other than quoted prices that are observable for the asset or liability

Inputs that are derived principally from or corroborated by observable market data by correlation or other means





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## CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**10. Fair Value Measurements (Continued)**

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

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

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

The table below presents our assets and liabilities that are measured at fair value on a recurring basis during Fiscal 2015 and are categorized using the fair value hierarchy (in thousands):

	Fair Value Measurements at March 31, 2015			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents	\$ 13,737	\$ 13,737	\$	\$

Cash equivalents includes cash held in money market and U.S. Treasury Funds at March 31, 2014.

The table below presents our assets and liabilities that are measured at fair value on a recurring basis during Fiscal 2014 and are categorized using the fair value hierarchy (in thousands):

	Fair Value Measurements at March 31, 2014			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Quoted Prices in Active Markets for Identical Assets (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents	\$ 13,737	\$ 13,737	\$	\$

*Basis for Valuation*

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

	As of March 31, 2015		As of March 31, 2014	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Obligations under the credit facility	\$ 12,953	\$ 12,953	\$ 13,228	\$ 13,228

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## CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**10. Fair Value Measurements (Continued)**

The Company calculated the estimated fair value of warrants on the date of issuance and at each subsequent reporting date using the following assumptions:

	<b>Fiscal Year Ended March 31, 2013</b>
Risk-free interest rates range	0.1% to 0.2%
Contractual term (in years)	0.5 years to 1.2 years
Expected volatility range	37.2% to 65.8%

The Company has issued common stock warrants at times in the past; however, no warrants are currently outstanding. The Company does not enter into speculative derivative agreements and does not enter into derivative agreements for the purpose of hedging risks.

As discussed above, the Company adopted authoritative guidance issued by the FASB on contracts in an entity's own equity that requires the common stock warrants to be classified as liabilities at their estimated fair value with changes in fair value at each reporting date recognized in the statement of operations. The table below provides a reconciliation of the beginning and ending balances for the warrant liability which is measured at fair value using significant unobservable inputs (Level 3) (in thousands):

<b>Warrant liability:</b>	
Balance as of March 31, 2012	\$ 791
<b>Total realized and unrealized (gains) losses:</b>	
Income included in change in fair value of warrant liability	(781)
<b>Balance at March 31, 2013</b>	<b>\$ 10</b>
<b>Total realized and unrealized (gains) losses:</b>	
Income included in change in fair value of warrant liability	(10)
<b>Balance at March 31, 2014</b>	<b>\$</b>

**11. Revolving Credit Facility**

The Company maintains two Credit and Security Agreements, as amended (the "Agreements"), with Wells Fargo Bank, National Association ("Wells Fargo"), which provide the Company with a line of credit of up to \$15.0 million in the aggregate. The line of credit can be increased to an amount up to \$20.0 million upon the request of the Company pursuant to the amendment described below (the "Credit Facility"). In addition, Wells Fargo has provided the Company with a non-revolving capital expenditure line of credit up to \$0.5 million to acquire additional eligible equipment for use in the Company's business pursuant to the amendment described below. As of March 31, 2015, the Company had not requested that the maximum line amount be increased to an aggregate of \$20.0 million pursuant to the Agreements. The amount actually available to the Company may be less and may vary from time to time depending on, among other factors, the amount of its eligible inventory and accounts receivable. As security for the payment and performance of the Credit Facility, the Company granted a security interest in favor of Wells Fargo in substantially all of the assets of the Company. One of the Agreements will terminate in accordance with its terms on September 1, 2017 and the other one will terminate on September 30, 2017.

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**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**11. Revolving Credit Facility (Continued)**

The Agreements include affirmative covenants as well as negative covenants that prohibit a variety of actions without Wells Fargo'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, (d) pay dividends on, or purchase, acquire, redeem or retire shares of, the Company's capital stock, (e) sell, assign, transfer or otherwise dispose of all or substantially all of the Company's assets, (f) change the Company's accounting method or (g) enter into a different line of business. Furthermore, the Agreements contain financial covenants, including (i) a requirement not to exceed specified levels of losses, (ii) a requirement to maintain a substantial minimum cash balance relative to the outstanding line of credit advances, which was \$11.8 million as of March 31, 2015, and (iii) limitations on the Company's annual capital expenditures. The Agreements also define an event of default to include a material adverse effect on the Company's business, as determined by Wells Fargo. An event of default for this or any other reason, if not waived, would have a material adverse effect on the Company.

Several times since entering into the Agreements the Company was not in compliance with certain covenants under the Credit Facility. In connection with each event of noncompliance, Wells Fargo waived the event of default and, on several occasions, the Company amended the Agreements in response to the default and waiver. The following summarizes the recent events, amendments and waivers:

On September 16, 2014, the Company entered into a letter agreement (the "Letter Agreement") with Wells Fargo. The Letter Agreement extended the maturity date under the Company's Credit and Security Agreement (Ex-Im Subfacility) from September 30, 2014 to September 1, 2017. The Letter Agreement also, among other things, changed the annual facility fee due to Wells Fargo under the Credit and Security Agreement (Ex-Im Subfacility) and revised the calculation of Capstone's borrowing base under the portion of the Credit Facility established by the Credit and Security Agreement (Ex-Im Subfacility) to increase the borrowing limit related to inventory.

As of September 30, 2014, the Company determined that it was not in compliance with the financial covenant contained in the amended Agreements regarding the Company's annual net income for Fiscal 2015. On November 3, 2014, the Company received from Wells Fargo a waiver of such noncompliance and entered into an amendment to amend the financial covenants regarding net income for Fiscal 2015.

As of March 31, 2015, the Company determined that it was not in compliance with the financial covenant contained in the amended Agreements regarding the Company's annual net income for Fiscal 2015. On June 10, 2015, the Company received from Wells Fargo a waiver of such noncompliance, and the Company and Wells Fargo entered into an amendment to the Agreements which set the financial covenants for Fiscal 2016. As a condition of the amended Agreements, the Company has restricted \$5.0 million of cash effective June 10, 2015 as additional security for the Credit Facility.

If the Company had not obtained the waivers and amended the Agreements as described above, the Company would not have been able to draw additional funds under the Credit Facility. In addition, the Company has pledged its accounts receivables, inventories, equipment, patents and other assets as collateral for its Agreements, which would be subject to seizure by Wells Fargo if the Company were in default under the Agreements and unable to repay the indebtedness. Wells Fargo also has the option to

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**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**11. Revolving Credit Facility (Continued)**

terminate the Agreements or accelerate the indebtedness during a period of noncompliance. Based on the Company's current forecasts, the Company believes it will maintain compliance with the covenants contained in the amended Agreements for at least the next twelve months. If a covenant violation were to occur, the Company would attempt to negotiate a waiver of compliance from Wells Fargo.

The Company is required to maintain a Wells Fargo collection account for cash receipts on all of its accounts receivable. These amounts are immediately applied to reduce the outstanding amount on the Credit Facility. The floating rate for line of credit advances is the sum of daily three month London Inter Bank Offer Rate ("LIBOR"), which interest rate shall change whenever daily three month LIBOR changes, plus applicable margin. Based on the revolving nature of the Company's borrowings and payments, the Company classifies all outstanding amounts as current liabilities. The applicable margin varies based on net income and the minimum interest floor is set at \$66,000 each calendar quarter. The Company's borrowing rate was 4.0% at each of March 31, 2015 and March 31, 2014.

The Company is also required to pay an annual unused line fee of one-quarter of one percent of the daily average of the maximum line amount and 1.5% interest with respect to each letter of credit issued by Wells Fargo. These amounts, if any, are also recorded as interest expense by the Company. As of March 31, 2015 and March 31, 2014, \$13.0 million and \$13.2 million in borrowings were outstanding, respectively, under the Credit Facility. As of March 31, 2015, approximately \$1.4 million was available for additional borrowing. Interest expense related to the Credit Facility during the year ended March 31, 2015 was \$0.5 million, which includes \$0.2 million in amortization of deferred financing costs. Interest expense related to the Credit Facility during the year ended March 31, 2014 was \$0.7 million, which includes \$0.2 million in amortization of deferred financing costs. Interest expense related to the Credit Facility during the year ended March 31, 2013 was \$0.7 million, which includes \$0.1 million in amortization of deferred financing costs.

**12. Commitments and Contingencies**

**Purchase Commitments**

As of March 31, 2015, the Company had firm commitments to purchase inventories of approximately \$35.2 million through Fiscal 2018. Certain inventory delivery dates and related payments are not scheduled; therefore amounts under these firm purchase commitments will be payable upon the receipt of the related inventories.

**Lease Commitments**

The Company leases offices and manufacturing facilities under various non-cancelable operating leases expiring at various times through the fiscal year ending 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 consolidated balance sheets. The balance of deferred rent was approximately \$0.2 million and \$0.1 million as of March 31, 2015 and 2014. Rent expense was approximately \$2.4 million, \$2.3 million and \$2.1 million for the years ended March 31, 2015, 2014 and 2013, respectively.

Table of Contents**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****12. Commitments and Contingencies (Continued)**

On July 31, 2014, the Company and Northpark Industrial ("Northpark") entered into a Third Amendment to Lease (the "Third Amendment") to amend the Standard Industrial/Commercial Single-Tenant Lease Net, dated December 1, 1999, as amended (the "Lease"), pursuant to which the Company leases the premises located at 21211 Nordhoff Street, Chatsworth, California for use as primary office space, engineering testing and manufacturing. The Third Amendment extended the term of the Lease for a period of two months commencing on August 1, 2014 and ending on September 30, 2014 and set the monthly base rent payable by the Company under the Lease at \$81,001 per month.

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

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

At March 31, 2015, the Company's minimum commitments under non-cancelable operating leases were as follows (in thousands):

Year Ending March 31,	Operating Leases
2016	\$ 1,988
2017	1,837
2018	1,602
2019	1,047
2020	531
Thereafter	
<b>Total minimum lease payments</b>	<b>\$ 7,005</b>

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**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**12. Commitments and Contingencies (Continued)**

**Other Commitments**

In September 2010, the Company was awarded a grant from the DOE for the research, development and testing of a more efficient microturbine Combined Heat and Power (CHP) system. Part of the improved efficiency will come from an improved microturbine design, with a projected electrical efficiency of 42% and power output of 370 kW. The project is estimated to cost approximately \$15.0 million. The DOE will contribute \$5.0 million toward the project, and the Company will incur approximately \$10.0 million in research and development expense. The contract is over a five-year period and will be completed by September 2015. The Company billed the DOE under the contract for this project a cumulative amount of \$3.9 million through March 31, 2015.

In May 2014, the Company began working with the DOE through Oak Ridge National Laboratory ("ORNL") on an advanced Alumina Forming Austenitic stainless steel material program. ORNL will contribute 100% of the project cost of \$0.2 million toward the project. The contract has a term of 19 months and is expected to be completed by December 30, 2015. The Company billed ORNL a cumulative amount of \$0.1 million under the contract for this project through March 31, 2015.

Agreements the Company has with some of its distributors require that if the Company renders parts obsolete in inventories they own and hold in support of their obligations to serve fielded microturbines, then the Company is required to replace the affected stock at no cost to the distributors. While the Company has never incurred costs or obligations for these types of replacements, it is possible that future changes in the Company's product technology could result and yield costs to the Company if significant amounts of inventory are held at distributors. As of March 31, 2015, no significant inventories were held at distributors.

**Legal Matters**

From time to time, the Company may become subject to certain legal proceedings, claims and litigation arising in the ordinary course of business. In the opinion of management, the Company is not currently a party to any material legal proceedings, nor is the Company aware of any pending or threatened litigation that would have a material effect on the Company's operating results, cash flows, financial position or results of operations should such litigation be resolved unfavorably.

**13. Employee Benefit Plans**

The Company maintains a defined contribution 401(k) profit-sharing plan in which all employees are eligible to participate. Employees may contribute up to Internal Revenue Service annual limits or, if less, 90% of their eligible compensation. Employees are fully vested in their contributions to the plan. The plan also provides for both Company matching and discretionary contributions, which are determined by the Board of Directors. The Company began matching 50 cents on the dollar up to 4% of the employee's contributions in October 2006. Prior to that date, no Company contributions had been made since the inception of the plan. The Company's match vests 25% a year over four years starting from the employee's hire date. The expense recorded by the Company for the years ended March 31, 2015, 2014 and 2013 was approximately \$0.3 million, \$0.3 million and \$0.2 million, respectively.

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**CAPSTONE TURBINE CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**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. During the three months ended September 30, 2013, we reached our repayment threshold level and the fixed rate royalty was reduced by 50%. Carrier earned \$1.6 million, \$2.8 million and \$4.3 million in royalties for C200 and C1000 Series system sales during the year ended March 31, 2015, 2014 and 2013, respectively. Earned royalties of \$0.4 million and \$0.6 million were unpaid as of March 31, 2015 and March 31, 2014, respectively, and are included in accrued expenses in the accompanying balance sheets.

**15. Subsequent Events**

On April 10, 2015, the Company announced that Edward I. Reich, the Executive Vice President and Chief Financial Officer of the Company, would be leaving the Company to pursue other opportunities, effective immediately. Mr. Reich will continue to serve the Company in a consulting capacity until May 10, 2016. On April 11, 2015, Mr. Reich and the Company entered into a General Release and Separation Agreement (the "Separation Agreement"), which provides for, among other things, severance payments to Mr. Reich equal to 12 months of Mr. Reich's salary immediately prior to the termination of his employment, payable in accordance with the Company's regular payroll practices. The Separation Agreement also includes a general release of the Company and its affiliates by Mr. Reich.

Effective June 14, 2015 the Company entered into a first amendment to the Amended and Restated Change of Control Severance Agreement with Darren R. Jamison, the Company's President and Chief Executive Officer. The first amendment extended the term of the Amended and Restated Change of Control Severance Agreement to June 14, 2018.

**CAPSTONE TURBINE CORPORATION**  
**VALUATION AND QUALIFYING ACCOUNTS**  
**FOR THE YEARS ENDED MARCH 31, 2015, 2014 and 2013**

(In thousands)

**Accounts Receivable Allowances:**

<b>Balance, March 31, 2012</b>	\$ 2,228
Additions charged to costs and expenses	276
Deductions	(362)
<b>Balance, March 31, 2013</b>	\$ 2,142
Additions charged to costs and expenses	242
Deductions	(138)
<b>Balance, March 31, 2014</b>	\$ 2,246
Additions charged to costs and expenses	10,138
Deductions	(1,343)
<b>Balance, March 31, 2015</b>	\$ 11,041

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<b>Signature</b>	<b>Title</b>	<b>Date</b>
<hr/> <i>/s/ NOAM LOTAN</i> Noam Lotan	Director	June 15, 2015
<hr/> <i>/s/ GARY J. MAYO</i> Gary J. Mayo	Director	June 15, 2015
<hr/> <i>/s/ ELIOT G. PROTSCH</i> Eliot G. Protsch	Director	June 15, 2015
<hr/> <i>/s/ HOLLY A. VAN DEURSEN</i> Holly A. Van Deursen	Director	June 15, 2015
<hr/> <i>/s/ DARRELL J. WILK</i> Darrell J. Wilk	Director	June 15, 2015

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**Exhibit Index**

<b>Exhibit Number</b>	<b>Description</b>
2.1	Asset Purchase Agreement between Capstone Turbine Corporation and Calnetix Power Solutions, Inc., dated February 1, 2010(a)
2.2	Amendment to Asset Purchase Agreement between Capstone Turbine Corporation and Calnetix Power Solutions, Inc., dated March 31, 2011(b)
2.3	Second Amendment to Asset Purchase Agreement between Capstone Turbine Corporation and Calnetix Power Solutions, Inc., dated April 28, 2011(b)
3.1	Second Amended and Restated Certificate of Incorporation of Capstone Turbine Corporation(c)
3.2	Certificate of Amendment to the Second Amended and Restated Certificate of Incorporation of Capstone Turbine Corporation(d)
3.3	Amended and Restated Bylaws of Capstone Turbine Corporation(e)
4.1	Specimen stock certificate(f)
4.2	Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock(g)
4.3	Certificate of Amendment of Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock of Capstone Turbine Corporation dated September 16, 2008(h)
4.4	Certificate of Amendment to Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock dated August 30, 2012(i)
4.5	Rights Agreement, dated July 7, 2005, between Capstone Turbine Corporation and Mellon Investor Services LLC(g)
4.6	Amendment No. 1 to Rights Agreement, dated July 3, 2008, between Capstone Turbine Corporation and Mellon Investor Services LLC(j)
4.7	Amendment No. 2 to Rights Agreement, dated June 9, 2011, between Capstone Turbine Corporation and Mellon Investor Services LLC(b)
4.8	Amendment No. 3 to Rights Agreement, dated July 1, 2014, between Capstone Turbine Corporation and Computershare Inc. as successor-in-interest to Mellon Investor Services LLC(k)
4.9	Amendment No. 4 to Rights Agreement, dated August 5, 2014, between Capstone Turbine Corporation and Computershare Inc. as successor-in-interest to Mellon Investor Services LLC(l)
10.1	Amended and Restated License Agreement, dated August 2, 2000, by and between Solar Turbines Incorporated and Capstone Turbine Corporation(m)
10.2	Transition Agreement, dated August 2, 2000, by and between Capstone Turbine Corporation and Solar Turbines Incorporated(m)
10.3	Lease between Capstone Turbine Corporation and Northpark Industrial Leahy Division LLC, dated December 1, 1999, as amended, for leased premises at 21211 Nordhoff Street, Chatsworth, California(n)
10.4	Third Amendment to Lease, dated July 31, 2014, between Capstone Turbine Corporation and Northpark Industrial, for leased premises at 21211 Nordhoff Street, Chatsworth, California(l)

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<b>Exhibit Number</b>	<b>Description</b>
10.5	Fourth Amendment to Lease, dated September 30, 2014, between Capstone Turbine Corporation and Northpark Industrial, for leased premises at 21211 Nordhoff Street, Chatsworth, California(o)
10.6	Lease between Capstone Turbine Corporation and Prologis, L.P., formerly known as AMB Property, L.P., dated September 25, 2000, as amended, for leased premises at 16640 Stagg Street, Van Nuys, California(p)
10.7*	Capstone Turbine Corporation Amended and Restated 2000 Equity Incentive Plan as amended and restated effective August 30, 2012(q)
10.8*	Form of Stock Option Agreement for Amended and Restated 2000 Equity Incentive Plan(r)
10.9*	Form of Stock Bonus Agreement for Capstone Turbine Corporation 2000 Equity Incentive Plan(s)
10.10*	Amended and Restated Capstone Turbine Corporation Change of Control Severance Plan(t)
10.11	Development and License Agreement between Capstone Turbine Corporation and Carrier Corporation, successor in interest to UTC Power Corporation, dated September 4, 2007(u)
10.12	First Amendment to the Development and License Agreement between Capstone Turbine Corporation and Carrier Corporation, successor in interest to UTC Power Corporation, dated January 14, 2011(b)
10.13	Form of Investor Agreement, dated September 18, 2012, between Capstone Turbine Corporation and an investor in the 2012 registered direct offering(v)
10.14	Form of Investor Letter Agreement, dated February 21, 2013, between Capstone Turbine Corporation and investors in the 2012 registered direct offering(w)
10.15	Credit and Security Agreement between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated February 9, 2009 (Domestic Facility)(x)
10.16	Credit and Security Agreement between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated February 9, 2009 (Ex-Im Subfacility)(x)
10.17	First Amendment to Credit and Security Agreement between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 9, 2009(x)
10.18	Second Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated November 5, 2009(y)
10.19	Third Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 11, 2010(s)
10.20	Fourth Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 29, 2010(z)
10.21	Fifth Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated November 9, 2010(aa)
10.22	Sixth Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated March 23, 2011(bb)
10.23	Seventh Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 9, 2011(b)
10.24	Eighth Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated September 27, 2011(cc)

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<b>Exhibit Number</b>	<b>Description</b>
10.25	Ninth Amendment to the Credit and Security Agreements and Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated February 8, 2012(dd)
10.26	Tenth Amendment to the Credit and Security Agreements between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 12, 2012(ee)
10.27	Eleventh Amendment to the Credit and Security Agreements between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 7, 2013(p)
10.28	Waiver of Defaults between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated April 25, 2014(ff)
10.29	Twelfth Amendment to the Credit and Security Agreements between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 9, 2014(gg)
10.30	Letter Agreement, dated September 16, 2014, between by and between Capstone Turbine Corporation and Wells Fargo Bank, NA(hh)
10.31	Thirteenth Amendment to the Credit and Security Agreements and Waiver of Default between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated November 3, 2014(ii)
10.32	Fourteenth Amendment to the Credit and Security Agreements, Waiver of Default and Consent between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated November 3, 2014
10.33*	Capstone Turbine Corporation Amended and Restated Executive Performance Incentive Plan as amended and restated effective August 29, 2013(jj)
10.34*	Amendment to the Capstone Turbine Corporation Amended and Restated Executive Performance Incentive Plan, dated June 9, 2014(kk)
10.35*	Inducement Stock Option Agreement with Darren R. Jamison, dated December 18, 2006(ll)
10.36*	Restricted Stock Agreement with Darren R. Jamison, dated December 18, 2006(ll)
10.37*	Letter Agreement between Capstone Turbine Corporation and Darren R. Jamison, dated December 1, 2006(ll)
10.38*	Amendment to Letter Agreement between Capstone Turbine Corporation and Darren R. Jamison, effective April 8, 2009(x)
10.39*	Letter Agreement between Capstone Turbine Corporation and James D. Crouse, dated January 31, 2007(mm)
10.40*	Inducement Stock Option Agreement with James D. Crouse, dated February 5, 2007(mm)
10.41*	Restricted Stock Agreement with James D. Crouse, dated February 5, 2007(mm)
10.42*	Form of Inducement Stock Option Agreement(nn)
10.43*	Form of Inducement Restricted Stock Unit Agreement(nn)
10.44*	Amended and Restated Change in Control Severance Agreement with Darren R. Jamison, dated June 14, 2012(ee)
10.45*	First Amendment to Amended and Restated Change in Control Severance Agreement with Darren R. Jamison, effective June 14, 2015
10.46*	Consulting Agreement with Mark Gilbreth, dated April 1, 2013(p)
10.47	Underwriting Agreement dated May 1, 2014 by and between the Company and Cowen and Company, LLC, as representative of the several underwriters(oo)

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<b>Exhibit Number</b>	<b>Description</b>
10.48*	Capstone Turbine Corporation Severance Pay Plan as amended and restated effective February 1, 2010
14.1	Code of Business Conduct(ff)
14.2	Code of Ethics for Senior Financial Officers and Chief Executive Officer(ff)
21	Subsidiary List(b)
23	Consent of KPMG LLP
24	Power of Attorney (included on the signature page of this Form 10-K)
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Schema Document
101.CAL	XBRL Calculation Linkbase Document
101.LAB	XBRL Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document
101.DEF	XBRL Definition Linkbase Document

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Management contract or compensatory plan or arrangement

- (a) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on February 5, 2010 (File No. 001-15957).
- (b) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended March 31, 2011 (File No. 001-15957).
- (c) Incorporated by reference to Capstone Turbine Corporation's Registration Statement on Form S-1/A, dated May 8, 2000 (File No. 333-33024).
- (d) Incorporated by reference to Appendix B to Capstone Turbine Corporation's Definitive Proxy Statement, filed on July 17, 2012 (File No. 001-15957).
- (e) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2005 (File No. 001-15957).
- (f) Incorporated by reference to Capstone Turbine Corporation's Registration Statement on Form S-1/A, dated June 21, 2000 (File No. 333-33024).

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- (g) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on July 8, 2005 (File No. 001-15957).
  - (h) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2009 (File No. 001-15957).
  - (i) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on September 6, 2012 (File No. 001-15957).
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- (j) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on July 10, 2008 (File No. 001-15957).
- (k) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on July 2, 2014 (File No. 001-15957).
- (l) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on August 5, 2014 (File No. 001-15957).
- (m) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on October 16, 2000 (File No. 001-15957).
- (n) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on September 2, 2009 (File No. 001-15957).
- (o) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on October 6, 2014 (File No. 001-15957).
- (p) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended March 31, 2013 (File No. 001-15957).
- (q) Incorporated by reference to Appendix A to Capstone Turbine Corporation's Definitive Proxy Statement, filed on July 17, 2012 (File No. 001-15957).
- (r) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2005 (File No. 001-15957).
- (s) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended March 31, 2010 (File No. 001-15957).
- (t) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2004 (File No. 001-15957).
- (u) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2007 (File No. 001-15957).
- (v) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on September 19, 2012 (File No. 001-15957).
- (w) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on February 26, 2013 (File No. 001-15957).
- (x) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended March 31, 2009 (File No. 001-15957).
- (y)



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

- (z) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on July 1, 2010 (File No. 001-15957).
  - (aa) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on November 12, 2010 (File No. 001-15957).
  - (bb) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on March 25, 2011 (File No. 001-15957).
  - (cc) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on October 3, 2011 (File No. 001-15957).
  - (dd) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2011 (File No. 001-15957).
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- (ee) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended on March 31, 2012 (File No. 001-15957).
- (ff) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended March 31, 2014 (File No. 001-15957).
- (gg) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on June 10, 2014 (File No. 001-15957).
- (hh) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on September 19, 2014 (File No. 001-15957).
- (ii) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2014 (File No. 001-15957).
- (jj) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2013 (File No. 001-15957).
- (kk) Incorporated by reference to Appendix B to Capstone Turbine Corporation's Definitive Proxy Statement, filed on July 16, 2014 (File No. 001-15957).
- (ll) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2006 (File No. 001-15957).
- (mm) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K for the fiscal year ended on March 31, 2007 (File No. 001-15957).
- (nn) Incorporated by reference to Capstone Turbine Corporation's Registration Statement on Form S-8, dated June 17, 2009 (File No. 333-160049).
- (oo) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on May 1, 2014 (File No. 001-15957).
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