

ENERGY FOCUS INC.

**Moderator: Nick Berchtold
March 31, 2010
3:30 pm CT**

Operator: Ladies and gentlemen thank you very much for holding and welcome to the Energy Focus Inc. Fourth Quarter and 2009 earnings call. Today's conference is being recorded

And at this time, I'd like to turn things over to Brion Tanous; please go ahead.

Brion Tanous: Thank you very much, Kevin and welcome again to Energy Focus's Fourth Quarter and Fiscal 2009 Earnings call.

Before we begin, I would like to remind you that forward looking statements made in this release pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995.

Such forward looking statements include statements regarding the business outlook for 2010 and thereafter, the potential growth of Energy Focus's sales based upon its energy savings over alternative lighting technology.

Investors are cautioned that all forward looking statements involve risk and uncertainties. Actual results may differ materially and results are unpredicted. Risk factors that could affect the company's future include but are not limited to a slowing of the US and world economy and its effect on Energy Focus markets; failure to develop marketable products from new technologies;

failure of EFO or other new products to meet performance expectations; higher than anticipated expenses; unanticipated costs of integrating acquisitions into Energy Focus operations; delays in the manufacturing of products; increased competition; other adverse sales and distribution factors and greater than anticipated costs and/or warranty expenses.

For further information about potential factors which could affect Energy Focus's financial results please refer to the company's SEC reports including its annual reports on Form 10-K and its quarterly reports on Form 10-Q.

These forward looking statements speak only as to the date hereof. Energy Focus disclaims any intention or obligation to update or revise any forward looking statements.

With that, I would like to now turn the call over to Chief Executive Officer Joe Kaveski. Joe?

Joe Kaveski: Thank you, Brion and thank everyone again for participating in Energy Focus's fourth quarter and year end earnings call for 2009.

Today, I'd like to make a few brief comments concerning our 2009 results and then provide you with some insight into our 2010 anticipated financial performance. Before I begin, I'd like to thank our many shareholders for their overwhelming participation in our successful 2009 rights offering.

As you will hear during this call, your help has provided the much needed financial support that is successfully transforming our company towards significant growth and profitability.

To begin, and as we discussed with our shareholders during our 2009 rights offering, 2009 was a very difficult year for the company.

Our sales ended down nearly 38% compared to 2008 levels, and the company's net cash outflow was approximately \$9.5 million which included significant one time expenses related to our rights offerings, acquisition and divestiture efforts.

In a nutshell, the company's overall financial performance reflected the overall depressed market conditions that exist across the world. However, 2009 was a pivotal year in the transitioning of our company into a fully integrated lighting energy solutions provider.

Our new focus on providing comprehensive lighting solutions for existing buildings specifically in the public sector is right for the times and it's clearly the foundation for sustainable growth and profitability.

During 2009, the company significantly reduced its fixed SG&A costs by over 18%. We successfully completed the rights offering. The company secured an adequate construction bonding facility which is a pre-requisite to contract with public sector customers. The company rationalized its manufacturing facility, we focused our lighting technologies towards energy efficient general illumination lighting products for existing buildings rather than specialty lighting products for pools and the new construction marketplace. We secured \$6.5 million in new military LED lighting and solar R&D contracts. The company sold our German decorative lighting business and of course we acquired the Stones River Companies thereby establishing a sales and delivery (B chest) into the existing building public sector market.

With our transition and the integration of SRC nearing completion I'm delighted to report to you that our strategy is working and our 2010 overall results will demonstrate this.

In the first quarter of 2010, the company has already announced \$14.4 million in new lighting contracts for work that is expected to complete in 2010 and that we secured \$1.5 million in new cost recovery R&D contract.

Better yet today, I'm delighted to announce the company has secured three new additional orders totaling \$2.1 million that we expect to complete in 2010.

One of these contracts is to upgrade the lighting and install controls in a large Fortune 500 manufacturing facility. The other two contracts are with large national energy services companies to upgrade the lighting in numerous public buildings in the southeast.

In all three of these contracts, our company audited the existing facilities, inventoried their lighting systems, proposed an improved lighting system design and now that we have the contracts we'll procure the materials and oversee the turnkey installations of the improved lighting systems.

And what's really exciting is that more contracts are coming. Our engineer's sales proposal pipeline continues to grow. The American Reinvestment and Recovery Act stimulus money is beginning to trickle into the market and finding its way into lighting upgrade projects.

As a result the company is receiving more requests for lighting upgrade proposals, most of which are coming from the public sector. Furthermore, the company has recently shored up its balance sheet by securing funding to replace our Silicon Valley Bank line of credit which expired at the end of 2009.

So to recap in just the first quarter of 2010 the company has secured lighting energy solutions and R&D contracts totaling \$16.5 million which we expect to complete in 2010. These contracts in just the first quarter of this year represents more business than we secured during all of last year.

Clearly the company's strategy is working. So as we look forward I would like to offer some guidance as to our expected 2010 financial performance.

For the first quarter of 2010, the company expects revenues to exceed \$7.5 million in sales, which is roughly three times our sales recorded in the first quarter of 2009, and our net cash outflow from operations will be less in \$1 million, which represents at least a 74% reduction from our net cash outflow during the first quarter of 2009.

Furthermore, the company expects total revenues generated during 2010 to exceed \$35 million, to further reduce our non-value added operating costs and to be net cash flow positive from operations in 2010.

So in conclusion, the company is off to a great start. It's clear that our strategy to reposition the company is working and I remain excited and bullish about the current and future success of Energy Focus.

So with that, I'd now like to turn the call over to Nick Berchtold, our Chief Financial Officer, who will provide you further details and clarity on our financial results. Nick?

Nick Berchtold: Thanks Joe and I would also like to welcome all of our participants to today's conference call.

As Joe mentioned earlier our company did make tremendous progress in repositioning itself for future growth and profitability despite a highly recessionary global economy, particularly within those markets that our legacy businesses have traditionally served.

To reiterate some of our successes, we continue to drive significant costs out of our business versus prior year levels.

We successfully executed multiple financing arrangements,
We consolidated North American manufacturing operations,

We successfully executed the divestiture of our German business unit,
We successfully executed the acquisition of Stones River Companies and,
We successfully exited our lending relationship with Silicon Valley Bank and replaced that debt with secured loans which closed during the first quarter of 2010.

Our 2009 financial overview does reflect a year of challenges within our markets but also the clear beginning of our evolution into a turnkey energy efficient lighting solutions provider.

And now I'd like to provide you with a brief overview of total 2009 results. Specifically I'll be providing you with an overview of

Revenues,

Gross profits,

Operating expenses,

Net income and earnings per share,

Some additional granularity about the Stones River Companies acquisition,

Selected balance sheet and working capital items,

Our auditor's opinion and,

Finally, 2010 financing activities.

However before I move into the financial overview I would like to mention that the details within our consolidated statements of operations and consolidated statements of cash flows have been recast to include only continuing operations as of December 31, 2009.

Continuing operations within these statements are defined as Energy Focus Incorporated and Crescent Lighting Limited. There was no statement of operations for cash flows reported for the Stones River Companies affiliate during 2009 due to the absence of activity between the execution of our acquisition on December 31, 2009 and the date of our consolidated financial statements.

Results from our company's discontinued operations are separately reported within these statements. Our balance sheet, on the other hand, is presented on a consolidated basis and does include the impact of both the company's discontinued operations as well as the assets acquired during the Stones River Companies acquisition.

So let's first discuss revenues from continuing operations. Although 2009 continued to remain challenging due to the global recession, particularly within the housing and new construction markets, the company did show modest fourth-quarter growth on a year-over-year basis.

Specifically fourth quarter revenues were \$3.6 million, a 3.2% increase over revenues in the fourth quarter of 2008. As Joe mentioned, revenues from continuing operations for the total year 2009 were just under \$13 million which was down 38% versus 2008 revenues of \$20 million. Of this reduction in revenues, it is important to note that \$754,000 related to unfavorable exchange rates issues. Revenues for the total year 2009 including discontinued operations were approximately \$14 million which was down 39% versus 2008 revenues of \$23 million.

So let's now discuss gross profits. Gross profits for the full year 2009 were \$2.04 million, or a decrease of 50%, compared to 2008 levels. Total gross profit as a percentage of net sales declined 16.3% for the full year 2009 compared to 20.5% for the full year 2008. This decline was due primarily to the fact that our markets continued to deteriorate at a rate faster than our cost reduction initiatives could overcome. However, we did successfully relocate 100% of the North American manufacturing and assembly operation into our lower cost, Mexican manufacturing facility during the last half of 2009 and subsequently relocated our Solon Ohio distribution services during the first quarter of 2010.

As for 2010 trends, we've begun to see gross profit margin improvement as our gross profits measured as a percentage of revenues have increased 5% thus far this quarter due largely to the

changing dynamics of our business as well as the result of our manufacturing consolidation and fixed overhead reduction efforts. We expect these favorable trends to continue as the economy recovers and we recognize the ongoing benefits of our rationalization activities.

And next I'd like to discuss, operating expenses from continuing operations. Operating expenses for the full year 2009 excluding impairment and restructuring charges decreased \$2.07 million or 15% versus 2008 levels. Excluding one-time acquisition related fees of approximately \$435,000 our operating expenses decreased \$2.5 million or 18% versus 2008 levels.

Contributing factors to this significant cost reduction include fixed overhead related reductions, advertising sales and promotions reductions, research and development project cost reductions, and related services and professional fee cost reductions. In this regard, we expect to continue to obtain additional benefits from ongoing cost reductions throughout 2010.

The culmination of all these economic and transitional factors is that our net operating loss from continuing operations for the full year 2009 was \$9,814,000 or 62 cents loss per share versus \$12,673,000 loss or 89 cents per share loss in 2008.

Excluding the 2008 good will impairment charge of \$3,195,000 for continuing operations, the net loss was \$9,478,000 or 69 cents per share loss for the full year 2008.

The loss from discontinued operations for the full year 2009 was a loss of \$1,201,000 or 8 cents per share versus \$1,775,000 loss for the full year 2008.

Now I'd like to turn to the acquisition of the Stones River Companies. On December 31 2009 the company acquired 100% of the member interest of Stones River Companies.

The company acquired approximately \$4.7 million in assets including accounts receivable, fixed assets and other intangible assets. Of this total, \$672,000 of the purchase price was recorded on the company's consolidated balance sheet as goodwill. Purchase price consideration was paid in the form of cash, shares of Energy Focus common stock and a convertible note as well as some other contingent consideration. The acquisition has been accounted for as a stock purchase and accordingly has been included in the accompanying consolidated financial statements of the company as of December 31 2009.

Now I'd like to speak about a few selected balance sheet items. First, cash and cash equivalents at December 31, 2009 was \$1,062,000 versus \$10,568,000 at December 31, 2008. Cash on hand reported at December 31, 2009 does exclude \$2.5 million of cash collateralized for performance payment bonding which is categorized within our balance sheet as other assets. Total cash outflows during 2009 were \$9,506,000 versus total cash inflows of \$2,156,000 during 2008. The dramatic change is a result of the following:

- 1) full year impact of depressed global economic conditions which severely impacted our businesses,
- 2) the elimination of our third party lines of credit with Silicon Valley Bank and Sparkasse Bank which relates to our German affiliate,
- 3) the impacts of the diligence, purchase price, closing and bonding securitization cash flows associated with the Stones River Companies acquisition,
- 4) and lastly, the impact of reduced year-over-year proceeds from various financing activities entered in to by the company.

From a working capital perspective, accounts receivable decreased from \$2,617,000 at the end of December 2008 to \$1,664,000 at the end of December 2009, excluding accounts receivables acquired through the Stones River Companies acquisition.

Although accounts receivable was severely and adversely impacted by the recession, the company's continued laser focus on working capital improvements again showed significant gains as the company's days sales outstanding metrics improved from 67 days at the end of December 2008 to 31 days at the end of December 2009.

From an inventory perspective, inventory was valued at \$3,770,000 at the end of 2009 versus \$5,539,000 at the end of December 2008.

Inventory turns moved to 3.12 and continued to show improvement as the company continues to intently focus on managing its inventory investment.

In 2009, the company eliminated \$2,204,000 in outside third party lines of credit with both Silicon Valley Bank and Sparkasse Bank. A portion of this reduction was offset by the company's entry into letter of credit agreements with selected employees and other insiders.

These agreements have 24 month terms and include detachable warrants to purchase shares of the company's common stock. Issuance of these instruments are subject to shareholder approval.

And now to discuss our independent auditor's opinion. Consistent with 2008, the company's independent public accounting firm has issued an opinion raising doubts as to the company's ability to continue as a going concern. This opinion stems from the company's historical operating performance, the ongoing global recession and the company's historical inability to internally generate cash flows to meet its obligations and sustain operations. Although the company is very optimistic about its future operating performance and ability to internally generate working capital needs, there can be no assurances that the company will be successful in satisfying those needs. However, it is with great pleasure that I announce to you the successful execution of two financing arrangements that were both completed in the first quarter of 2010.

On March 17 2010, the company entered into a purchase agreement with an investor whereby the investor agreed to purchase 350,000 shares of the company's common stock together with a warrant to purchase equivalent amounts of shares subject to SEC requirements. The investor also agreed to purchase additional shares of stock at the company's option over the company's next 25 months.

Secondly on March 30 2010, the company entered into an agreement with an investor under which it sold a secured and subordinated promissory note in the principle amount of over \$1 million. The company secured the full amount of this financing with the pledge of its United States gross accounts receivable and selected equipment.

Although we can't guarantee that similar external financing opportunities will continue to exist in the future I'm pleased to inform you that Energy Focus well positioned for dynamic growth in 2010 and beyond.

So in conclusion, I'd like to thank you for the opportunity to speak with you today and we'll now turn the call back over to Kevin, our operator who will now open up the lines for questions.

Operator: Thank you very much. Ladies and gentlemen, if you have any questions at this time, press star 1 on your phone and you'll be placed into the queue. We'll ask that you check you mute button before you signal to make sure that your signal reaches our equipment. So again, star 1 for any questions and we will pause for a few moments.

First up, we have Theodore Brown; go ahead please.

Theodore Brown: Hi, here I am. Thank you for taking the call. Gentlemen, a pleasure to hear your good words and your ideas that '10 will be a great year. I would like to have a little bit more information about the filing of the 8-K filing which had to do with Lincoln Park.

And I assume you made some comments about that in your closing. But if you could talk a little bit about the need for doing that and also the number of shares that we are going to have outstanding when, let's say, nine months from now, what do you -- what you kind of predict to be the outstanding in about nine months, go ahead.

Joe Kaveski: Hi Ted, thanks for joining the call and for your participation in the rights offering.

The Lincoln Park Capital transaction that we're speaking of right now addresses our need that developed at the end of last year where the company found that our capital requirements were slightly higher than what we had anticipated due to the pricing of the bonding facility necessary for the new SRC acquisition.

So the company had to shift more of its funds over at the bonding company in order to get the bonding facility that we needed.

Having said that the LPC transaction is actually like a very small pipe. Initially we will receive \$375,000 from that and what it allows Lincoln Park Capital to do with the company's permission is to buy in small chunks off a shelf.

The company is in 100% total control from this point forward of the amount of shares that are bought and when they are purchased. And so to that end, we might sell about 50,000 shares per month.

Now, I want to reiterate that the need was to replace what the company had to shift over to the bonding company to obtain a bonding facility for the SRC acquisition and to replace some of the credit facility funds that were lost when we terminated the Silicon Valley Bank line of credit.

Nine months from now, let's say that the company allowed them to purchase 50,000 shares per month. (which we are going to be very miserly about). In that case, that would be about 500,000 additional shares at the end of nine months. But again whether the company allows any more shares to be purchased off the shelf is 100% in the company's control.

Theodore Brown: And what is the number right now, 15.7 million shares?

Joe Kaveski: About 20.8 million total outstanding shares.

Theodore Brown: Okay. Good. All right. Great. And I assume that they are very bullish about you too because otherwise they would not have made an arrangement which in some ways does make the company look good.

Joe Kaveski: Yes, we share your view.

Theodore Brown: Thank you.

Joe Kaveski: Thank you again Ted.

Operator: Moving on now to a question from Larry Sotham.

Joe Kaveski: Good afternoon Larry.

Larry Sotham: Larry Sotham from Connecticut. The - I was wondering if you could just talk a little bit more about what you're seeing in terms of types of orders and what we need in terms of especially away from the Stones River, your other business, and what you see as a level of sales that could allow you to be better than break even?

Joe Kaveski: Well, we are realizing increasing sales from our LED based products whether those products are actually going into military vessels or whether those products are being sold by independent representatives to large customers or through our own national accounts sales organization. And through lighting retrofit companies, similar and including to our own SRC where they are primarily being installed in large transportation facilities, distribution warehouses, and in schools, hospitals and commercial office building.

We believe that our first quarter SRC sales contribution will continue percentage wise as we look toward year end. And, in that particular regard, we provided guidance of \$35 million in revenue.

We also have provided guidance that we fully intend to be net cash flow positive from operations in 2010. This is a significant departure from previous years where we will generate cash from operations versus burning cash from operations.

Larry Sotham: Okay, my concern, my interest is strictly what can we get on a sustainable cash generating basis and eliminates the need for pipes, etcetera.

Joe Kaveski: Yes, if I can add to that, it is the management's belief that the fundamentals of the business are there for sustainable growth. Meaning that where money is being spent in the market today relative to lighting technology is the public sector. This is expected to increase as we move forward as stimulus money entering into the market.

Now with our purchase of SRC, the company has a sales and delivery vehicle into the existing building public sector market and that should provide sustainable growth for the foreseeable future.

Larry Sotham: Okay, thank you.

Joe Kaveski: Thank you.

Operator: Before we move to our next question, I'd like to remind everyone that it is star 1 if you'd like to ask any questions and we'll move on now to Seth Gelsthorpe.

Joe Kaveski: Hi Seth.

Seth Gelsthorpe: Hi, good afternoon.

Joe Kaveski: Thank you for joining us.

Seth Gelsthorpe: Thank you for doing it. What I'm curious about is a little expansion on something you just touched on, and that is the synergistic relationship between the Energy Focus products and the contracts that SRC will execute on.

In other words, what kind of product revenue on the EFO side of things will be generated by the execution of these contracts? So if they sign -- I just don't know how to understand that or measure it or think of it even.

So maybe you could just kind of explain how much of the product content of an SRC contract will be from Energy Focus products? Maybe that is the way to think of it.

Joe Kaveski: Thank you for asking that question Seth. There's probably a couple of different parts to your question so let me answer your question with an example. With the \$16.5 million in contracts that we've announced to date, probably less than 10% of the products that are utilized in those projects will be Energy Focus products..

The reason for this is that our historical products have been designed for specialty applications. For example, our legacy products were great at illuminating artwork or over a fish counter because we don't cook the fish. Our products were not designed for general illumination. However, there is fundamental IP embedded in those products and the company has the knowledge for creating general illumination products. We demonstrated this to our shareholders during the rights offering.

So now the company is laser focused on leveraging our IP and our fundamental knowledge to create the equivalent of a near plug and play linear fluorescent lamp that could save up to 80% more savings than the best fluorescent lighting systems available today that are used in existing buildings.

We believe this is huge when you consider that in the United States there are over 70 billion square feet of lighted space in over 5 million non-residential - meaning commercial and industrial buildings and the majority of the lighting technology used in these buildings is the linear fluorescent lamp that our technology will be replacing. The market opportunity is just absolutely astounding.

Now today we are seeing accelerated sales in our generation one product which is an LED tube replacement for a linear fluorescent lamp that performs wonderfully in for instance cold spaces and parking garage facilities.

We have also demonstrated our generation two product which is under development right now. Gen two uses one LED to create light and has embedded control within it versus our Gen one product that we are selling today.

So as we look to the future, I believe that over 50% of the general illumination products used in these contracts to be Energy Focused products.

Seth Gelsthorpe: And will Stones River in the process of doing that sort of be impartial? I mean, on the one hand, you want to sell your product but on the other hand, you want them to be able to deliver an absolutely superior energy saving solution.

Joe Kaveski: I'm glad you put it that way Seth because I have communicated to SRC to sell to their customers' what products that create the best economic value. Beyond maximizing value for our customers, this provides added incentive to our product development staff to create the most advanced lighting products that create the largest economic value in the market place.

And so from that particular regard SRC has been given full permission to go buy other manufacturer's technology if they achieve higher levels of performance and create superior economic value.

Now you know having said that, Energy Focus wins either way. Because even if we end up buying another manufacturer's product, the company is still making a margin on those non-Energy Focus products.

Of course, the company would prefer all products to be our own products because the company makes more margin. However, the company wins either way and that's the exciting part of being in the lighting design and retrofit business as well as a manufacturer.

Seth Gelsthorpe: And then if I could ask one more question and I will quit. Are there - and this is getting way ahead of myself in even speaking of this or asking this - but are there other companies like Stones River Companies in the commercial lighting space?

They are energy services companies, but they play in a different market. Are there other companies like that that might one day be also synergistic to Energy Focus?

Joe Kaveski: The answer to that question is yes Seth, absolutely. To what Stones River was prior to the acquisition, I counted about 115 what I would call legitimate lighting services, lighting retrofits, companies across the United States; however, I can't think of one of those companies that had the technology edge that we have now brought to Stones River. And that's a key differentiator in terms of creating economic value for the client and the types of solutions that we can design.

In the state of the art and the technology that you can bring to bear, so I think we are very different from all of the other manufacturers and lighting retrofit companies today in the fact that we have high technology products with a sales and delivery vehicle that actually deliver the needed superior energy savings for business.

We've got the channel.

Operator: Next up we have Jay Emmons.

Jay Emmons: Hi Joe, hi guys, congratulations on your really good news.

Joe Kaveski: Well thank you Jay, we appreciate it and we appreciate your continuing support sir.

Jay Emmons: You're welcome. A quick one for you, with the new financing with Lincoln Park and their ability to buy stock over the next 25 months, I assume that is at market prices currently - prices that...

Joe Kaveski: That is correct Jay.

Jay Emmons: Okay, no discount or anything like that?

John Davenport: Yes, it is based upon market but it looks backwards over the previous ten days and takes an average of the lowest three days. However, it tracks the market's pricing of the stock.

Jay Emmons: Good.

John Davenport: And they are absolutely prohibited from short selling and hedging.

Jay Emmons: Great, I'm glad to hear that. Well looking forward to the rest of 2010.

Joe Kaveski: Thanks Jay.

Operator: With that, ladies and gentlemen, we will conclude the question and answer session and I'll hand the call back to management for any additional or closing remarks.

Joe Kaveski: I'd like to conclude the call today by thanking you for joining us and restating that our strategy is working and the evidence is the great start that we've had in 2010 and what we have forecasted to continue through the year. We look forward to offer you some further guidance during our next earnings call.

So thank you again. Have a great evening.

Operator: Thanks again for joining us, everyone; that will conclude today's call. Once again, have a good day.

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