

ENERGY FOCUS, INC/DE
Form 10-K
March 27, 2013

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

FORM 10-K

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2012
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission file number 0-24230

ENERGY FOCUS, INC.
(Exact name of registrant as specified in its charter)

DELAWARE
(State of incorporation)

94-3021850
(I.R.S. Employer Identification No.)

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

Registrant's telephone number, including area code: 440.715.1300

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

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

Title of Each Class
Common Stock, Par Value \$0.0001

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive 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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

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

Approximate aggregate market value (on basis of closing bid price) of voting stock held by non-affiliates as of June 29, 2012 \$9,432,366

Number of the registrant's shares of common stock outstanding as of March 27, 2013: 44,698,650

Portions of the Proxy Statement for the 2013 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission are incorporated by reference into Part III of this report.

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PART I

Forward-Looking Statements

All references to “Energy Focus,” “we,” “us,” “our,” or “the Company” means Energy Focus, Inc. and its subsidiaries, except where it is made clear that the term means only the parent company.

Statements and information included in this Annual Report on Form 10-K that are not purely historical are forward-looking statements. Forward-looking statements in this Report on Form 10-K include statements regarding Energy Focus’ expectations, intentions, beliefs, and strategies regarding the future, including but not limited to; growth in the markets into which Energy Focus sells; conditions of the lighting industry and the economy in general; statements as to our competitive position; future operating results; net sales growth; expected operating expenses; gross product margin improvement; sources of net sales; anticipated revenue from government contracts; product development and enhancements; liquidity, ability to generate cash and cash reserves; our reliance upon a limited number of customers; our accounting policies; the effect of recent accounting announcements; the development and marketing of new products; relationships with customers and distributors; relationships with, dependence upon, and the ability to obtain components from suppliers; as well as our remarks concerning our ability to compete in certain markets; the evolution and future size of those markets; seasonal fluctuations; plans for and expected benefits of outsourcing and offshore manufacturing; trends in the price and performance of fiber optic lighting products; the benefits and performance of our lighting products; the adequacy of our current facilities; our strategy with regard to protecting our proprietary technology; and our ability to retain qualified employees.

When used in this report, the words “believes,” “expects,” “anticipates,” “intends,” “assumes,” “estimates,” “evaluates,” “opinion,” “forecasts,” “may,” “could,” “future,” “forward,” “plans,” “potential,” “probable,” and similar expressions are intended to identify forward-looking statements.

These forward-looking statements involve risks and uncertainties. We may make other forward-looking statements from time to time, including in press releases and public conference calls and webcasts. All forward-looking statements made by Energy Focus are based on information available to us at the time the statements are made, and we assume no obligation to update any forward-looking statements. It is important to note that the forward-looking statements are subject to a number of risks and uncertainties that could cause actual results to differ materially from those included in such forward-looking statements. Some of these risks and uncertainties are discussed below in “Item 1A. Risk Factors” of this Form 10-K.

Energy Focus®, EFO®, Fiberstars®, BritePak®, EFO-Ice®, and Intellitube® are our registered trademarks. We may also refer to trademarks of other corporations and organizations in this document.

Item 1. Business

Energy Focus, Inc. and its subsidiaries (“Energy Focus”), designs, develops, manufactures, and markets energy-efficient lighting products, and is a leading provider of turnkey, energy-efficient, lighting solutions in the governmental and public sector market, general commercial market, and the pool market. Energy Focus’ lighting technology offers significant energy savings, heat dissipation and maintenance cost benefits over conventional lighting for multiple applications. The Company was founded in 1985 as Fiberstars, Inc., and changed its name to Energy Focus, Inc. and incorporated in Delaware in May 2007.

Overview

We engage in the design, development, manufacturing, marketing, and installation of energy-efficient lighting systems and solutions where we serve two segments:

- Solutions providing turnkey, high-quality, energy-efficient lighting application alternatives primarily to the existing public-sector building market; and
- Product providing military, general commercial and industrial lighting and pool lighting offerings, each of which markets and sells energy-efficient lighting systems.

We continue to evolve our business strategy to include providing our customers with turnkey, comprehensive energy-efficient general lighting solutions, which use, but are not limited to, our patented and proprietary technology. Our products segment include light-emitting diode (“LED”), fiber optic, high-intensity discharge (“HID”), fluorescent tube and other highly energy-efficient lighting technologies. Typical savings related to our current technology of the Company approximates 80% in electricity costs, while providing full-spectrum light closely simulating daylight colors. Our strategy also incorporates continued investment into the research of new and emerging energy sources including LED and solar energy applications.

Our long-term strategy is to penetrate the \$100 billion existing building and \$300 million U.S. military lighting markets by providing turnkey, comprehensive energy-efficient lighting solutions, which utilize our proprietary energy-efficient lighting products. In March of 2012, we announced a cooperation agreement with Communal International Ltd. to develop the Asian Market for the Company’s LED products. We will continue to focus on markets where the benefits of our lighting solutions offerings, combined with our technology, are most compelling. These markets include schools, universities, hospitals, office buildings, parking garages, supermarkets, museums, cold storage facilities and manufacturing environments. The passage of the Energy Savings Performance Contracts legislation in nearly all the states and the Energy Independence and Security Act of 2007 by Congress created a natural market for our energy-efficient products. Under this Act, all incandescent light bulbs are mandated by federal law to utilize 25% to 30% less energy than today’s products by the years 2012 through 2014. Since many of our products are approximately 80% more efficient than incandescent bulbs, our focus is to increase the public’s awareness and knowledge of our technology and to establish comprehensive distribution channels so that demand can be fulfilled quickly.

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

- fundamental intellectual property and trade secrets in non-imaging optics and coatings,
- a broad and intimate understanding of lighting technologies,
- proven ability to develop systems which efficiently create, transport, and display light,
- a superior understanding of the existing building market drivers and the evolution towards “green” lighting products and energy-efficient lighting systems that maximize customer ROI,
- core competencies in execution of all facets of solutions sales, and
- strong relationships with the federal government for research and development.

Our tactical approach to implement our long term strategy includes:

- intensifying our focus on the existing building market by adding sales associates to expand our customer base,
- developing mainstream lighting technologies that directly compete against linear fluorescent general illumination lamps, and
 - continuing to increase our value added to our customers and increase gross margins.

We expect that these actions will result in the following outcomes:

- sales growth and improved financial performance,
- sales of military grade LED lighting products for the U.S. Armed Forces,
- the formation of a streamlined organization that is focused on creating economic value through energy-efficient products and solutions for existing building owners, and
- development of mainstream lighting products for the existing building market that are not currently available and are differentiated by their performance, energy consumption, longevity, and controllability.

During 2011, we made major progress in our plan to reposition the Company for growth and profitability. This plan involved three major areas of focus, which included:

- Dramatic reduction of operating expenses.
- Receipt of a \$23.1 million order for the U.S. Navy to retrofit approximately 7% of the Naval fighting fleet with LED lighting products, including Intellitube® lamps. We invoiced the U.S. Navy \$1.9 million through December 2011 for products and services related to this contract.
- Added sales resources and broadened our customer base at Stones River Companies, LLC (“SRC”) during 2011, which helped us grow our lighting retrofit business by 10% in 2012.

During 2012, we continued to focus on these areas and reduced our spending in sales and marketing and general and administrative expenses by 8% from 2011. We shipped an additional \$2.5 million against the U.S. Navy Contract, and grew total sales by 16% from 2011.

Our Products

We produce, source, and/or market a wide variety of lighting technologies to serve two general markets: commercial buildings and pool lighting. Our offerings include the following products:

- 25 Families of LED lamps and fixtures to serve the U.S. Navy,
 - LED docklights,
 - LED parking garage lamps and fixtures,
- LED cold storage globe lamps and LED fiber optic lighting systems,
 - LED landscape fixtures,
 - LED retrofit kits for HID applications,
- LED replacements for linear fluorescent lamps, and
 - LED lamps and fixtures.

In addition, we also sell customized components such as underwater lenses, color-changing LED lighting fixtures, and lighted water features, including waterfalls and laminar-flow water fountains. Furthermore, we continue to aggressively penetrate the government and military lighting markets. In this regard, we have many products being actively marketed to the United States federal government agencies through the General Services Administration website, <https://www.GSAAdvantage.gov>.

The key features of our products are as follows:

- Many of our products meet the lighting efficiency standards mandated for the year 2020.
- Our products qualify for federal and state tax incentives for commercial and residential consumers in certain states.
- Many of our products make use of proprietary optical and electronics delivery systems which enable high efficiencies with superior lighting qualities.

Sales, Marketing, and Distribution of our Offerings Portfolio

Products

Our products are sold through a combination of direct sales employees, independent sales representatives, and various distributors in different geographic markets throughout the world. Our distributors’ obligation to us is not contingent upon the resale of our products and, as such, does not prohibit revenue recognition. We also distribute our products through our SRC subsidiary.

Within the commercial and pool lighting business units, we continue to focus on general contractors and specifiers especially in the retail, hospitality, museum, and health care markets. Our lighting retrofit subsidiary, SRC, is heavily targeting the existing public building market and will provide an additional sales channel for our products for quick, energy-efficient upgrades.

Solutions

Our solutions-based sales are designed to enhance total value by providing turnkey, high-quality, energy-efficient lighting application alternatives that positively impact customers' profitability, the environment, and the communities served. These solutions are sold through our SRC subsidiary and include not only our proprietary energy-efficient lighting solutions, but also sourced lighting systems, energy audits and service agreements.

Through SRC, we target the existing public building market, particularly health care and hospitals, schools and universities, governments and municipalities, museums, hospitality and casinos, as well as industry and manufacturing. SRC's direct customers are large national ESCOs that provide energy-efficient upgrades around the country. Also within the solutions business unit, we serve multi-location food retailers, cold storage facilities, retailers, and industrial/commercial real estate companies.

Concentration of Sales

In 2012, our ten largest customers accounted for approximately 62% of our net sales. TLC Investments, LLC ("TLC"), accounted for approximately 15% of our consolidated net sales and 42% of our solutions segment net sales. Johnson Controls, Inc. accounted for approximately 10% of our consolidated net sales, and 11% of our product segment sales. Additionally, the U.S. Navy accounted for approximately 13% of our product segment sales, and Trane and Ameresco, Inc. ("Ameresco") accounted for approximately 24% and 19% of our solutions segment sales.

In 2011, our ten largest customers accounted for approximately 56% of our net sales. Ameresco accounted for approximately 15% of our consolidated net sales and 40% of our solutions segment net sales.

In 2010, our ten largest customers accounted for approximately 64% of our net sales. In 2010, two customers, Ameresco and Woodstone Energy, LLC ("Woodstone"), made up 20% and 17%, respectively, of consolidated net sales. Ameresco contributed 35% and Woodstone contributed 30% of our solutions segment net sales. The former Vice President of SRC, who resigned on December 31, 2011, was a minority owner of Woodstone and TLC. See Note 14, Related Party Transactions, for further information.

Manufacturing and Suppliers

We produce our lighting systems through a combination of internal and outsourced manufacturing and assembly operations. Our internal lighting system manufacturing consists primarily of fiber processing, final assembly, testing, and quality control. We use independent contractors to manufacture some components and sub-assemblies, and have worked with a number of our vendors to design custom components to meet our specific needs. We manage inventories of domestically produced component parts on a just-in-time basis, when practicable. Our quality assurance program provides for testing of all sub-assemblies at key stages in the assembly process as well as testing of finished products.

Many of our products are manufactured by third-party suppliers resulting in significant cost savings. Under a Production Share Agreement, we conduct contract manufacturing and assembly in Mexico through North American Production Sharing, Inc. and Industrias Unidas de BC, SA de CV ("NAPS"). Under this agreement, NAPS provides administrative and manufacturing services, including labor services and the use of manufacturing facilities in Mexico, for the manufacturing and assembly of certain fiber optic and LED lighting systems, equipment and related components. We also perform final assembly of products acquired from China, India, Japan and Taiwan. These suppliers generally supply products on a purchase order basis.

Research and Development

Research and development has remained a key focus of our Company; accordingly, we have committed substantial resources to this endeavor. Our research and development team is dedicated to continuous improvement and innovation of our current lighting technologies, including LED, fiber optics and HID systems.

Research and development expense, net of credits from the government, for the year ended December 31, 2012 was \$368 thousand. Research and development income, net of expenses, for the years ended December 31, 2011 and 2010

was \$515 thousand and \$202 thousand, respectively.

Our recent achievements include:

2012: We were awarded \$2.4 million in research contracts and grants. We were awarded approximately \$0.9 million to develop next generation lighting for future U.S. Navy vessels. Like our smaller berth light that has been sailing in the Virginia Class Nuclear submarines for almost two years, this next generation lighting will utilize a larger version of our optical wave guide technology. In January, we were awarded \$0.1 million in a subcontract under the Defense Advanced Research Projects Agency (“DARPA”) on the Manufacturable Gradient Index Optics Phase 2 BAA, where in part, we explored further optical advancements to Intellitube® technology. In November, we were awarded a \$0.2 million Phase I Small Business Innovation Research (“SBIR”) contract from the Department of Energy (“DoE”) for “Lighting Controls Software for Self-Commissioning and Optimized Energy Savings,” where we further develop the ultra low cost sensor network to compliment Intellitube®, the Company’s LED based fluorescent replacement technology. In December, we learned that we were selected to receive funding for at least a \$1.2 million award by the Executive Control Board of the National Shipbuilding Research Program (“NSRP”) for the development of a “New Best” LED lighting solution for the U.S. Navy’s 2-bulb fluorescent fixture. NSRP is a collaboration of U.S. Shipyards that focus on common issues with a goal of reducing the cost of acquiring, operating and maintaining Navy Ships. This new best solution utilizes our existing Intellitube® product.

2011: We were awarded \$26.1 million in government supply contracts and in research contracts and grants in 2011. In March 2011, we received a \$1.0 million grant from the State of Ohio Third Frontier to develop a photovoltaic “wall-pack” unit for outdoor LED lighting. In April 2011, we received a Phase 2 Small Business Technology Transfer (“STTR”) grant for \$0.6 million from the National Aeronautics and Space Administration (“NASA”) for “Innovative Solid State Lighting Replacements for Industrial and Test Facility Locations.” In May 2011, we received a \$0.4 million increase in funding for the “Very High Efficiency Solar Cell (“VHESC”) program. In July 2011, we received a \$1.0 million grant from the State of Ohio Third Frontier to develop an ultra-low cost light sensor to compliment Intellitube®. In August 2011 we received a \$23.1 million supply contract to provide LED fixtures and our proprietary Intellitube® LED lamps for use on the U.S. Navy Fleet. The government has the right to change quantities throughout the life of this supply contract.

2010: We were awarded \$3.0 million in research contracts and grants in 2010. These included three awards totaling \$1.6 million announced in January 2010. Two of these awards, “Explosion-Proof Solid State Lighting for Extreme Environments” and “A Spectrally Dynamic Berth Light for Active Circadian Cycle Management,” are Phase 2 SBIR grants from DARPA. The third award, “Innovative Solid State Lighting Replacements for Industrial and Test Facility Locations,” is a Phase 1 STTR program grant received from the NASA. A DoE award for \$1.0 million to develop high performance Sol-Gel coatings for lighting and solar applications was announced in August 2010. An additional \$0.4 million in Department of Defense funding to advance Energy Focus’ LED Intellitube® technology and applications was announced also in August 2010. In addition, we completed qualification of seven families of solid state lighting fixtures developed under Naval Sea Systems Command (“NAVSEA”) and DARPA contracts. The Company is currently shipping these products to the U. S. Navy.

Intellectual Property

We have a policy of seeking to protect our intellectual property through patents, license agreements, trademark registrations, confidential disclosure agreements and trade secrets, as management deems appropriate. Our intellectual property portfolio consists of 79 issued United States and foreign patents of which 54 are currently in force, various pending United States patent applications, and various pending Patent Cooperation Treaty patent applications filed with the World Intellectual Property Organization that serves as the basis for national patent filings in countries of interest. Our issued patents expire at various times between September 2014 and May 2031. Generally, the term of patent protection is twenty years from the earliest effective filing date of the patent application. There can be no assurance; however, that our issued patents are valid or that any patents applied for will be issued, and that our competitors or customers will not copy aspects of our lighting systems or obtain information that we regard as proprietary. There can also be no assurance that others will not independently develop products similar to ours. The laws of some foreign countries in which we sell or may sell our products do not protect proprietary rights to products to the same extent as the laws of the United States.

During 2012, we retained the services of an independent financial advisory firm to determine the fair market value of certain patents and related patent applications, trade secrets and know-how that we own. This intellectual property directly or indirectly relates to the current and anticipated Intellitube® products. The valuation, dated November 30, 2012, was conducted in accordance with the Statement on Standards for Valuation Services promulgated by the American Institute of Certified Public Accounts and concluded that the estimated fair market value of the assets under review was approximately \$70 million.

Backlog

We typically ship standard products within a few days after receipt of an order. Custom products are shipped within 30-60 days of receipt of an order. Generally, there is not a significant backlog of orders. Our products segment backlog at the end of 2012 was \$1.2 million, compared to \$1.9 million at the end of 2011. Our solutions segment

backlog on awarded contracts totaled approximately \$1.3 million compared to \$2.0 million at the end of 2011. Revenues from our 2012 backlog will be recognized over the course of 2013, as the services are performed or the materials are delivered.

Competition

Our commercial lighting products compete against a variety of lighting products, including conventional light sources such as incandescent light bulbs, metal halide lamps, LEDs, compact fluorescent lamps, competitive fiber optic lighting systems, and decorative lighting technologies. Our ability to compete depends substantially upon the superior performance and lower lifecycle cost of our products and services. Principal competitors in our markets include large lamp manufacturers, lighting fixture companies, distributors, lighting retrofit companies, and Energy Service Companies (“ESCOs”) whose financial resources may substantially exceed ours. These competitors may introduce new or improved products that may reduce or eliminate some of the competitive advantage of our products. We anticipate that the primary competition to our products will come from new technologies that offer increased energy efficiency, lower maintenance costs, and/or lower heat radiation. In certain applications, we compete with LED systems produced by large lighting companies such as Philips and General Electric. In traditional commercial lighting applications, we compete primarily with local and regional lighting manufacturers that, in many cases, are more established in their local markets than our Company. In traditional commercial lighting, fiber optic lighting products are offered by a number of smaller companies, some of which compete aggressively on price. Some of these competitors offer products with performance characteristics similar to those of our products. Additionally, some conventional lighting companies now manufacture or license fiber optic lighting systems that compete with our products.

Our pool lighting products compete with other sources of in-pool lighting, including colored and color-changing underwater lighting, and pool accent lighting. Principal competitive factors include price, performance, ease of installation, and maintenance requirements. In the pool lighting market, we face competition from suppliers and distributors who bundle lighting and non-lighting products and sell these packages to pool builders and installers. In addition, we face competition directly from manufacturers who produce their own lighting systems and components. In this market, competitive products are offered by Pentair's American Products Division, a major manufacturer of pool equipment and supplies, as well as Next Step Products LLC. In the spa lighting business, spa manufacturers install LED lighting systems during the manufacturing process.

Our SRC solutions business competes against other lighting retrofit companies, as well as some traditional ESCOs that self-perform the lighting component of their projects. We compete primarily on the basis of financial impact, technology, light quality and design, client relationships, lighting application knowledge, energy efficiency, customer service and marketing support.

Insurance and Bonding

All of our properties and equipment are covered by insurance and we believe that such insurance is adequate. In addition, we maintain general liability and workers compensation insurance in amounts that we believe are consistent with our risk of loss and industry practice. In regards to our solution segment, we are often required to provide various types of surety bonds as an additional level of security of our performance. We have a surety arrangement with one surety for which we provide cash collateral relating to our surety bonding program. We believe that this cash collateral is sufficient to support our current bonding requirements.

Employees

As of December 31, 2012, we had 71 associates, 14 of whom are located in the United Kingdom and 57 in the United States. None of our associates are subject to any collective bargaining agreement.

Business Segments

We have two reportable segments: products and solutions. The products segment includes pool lighting, general commercial lighting, government products, and research and development services, each of which markets and sells lighting systems. Our products are sold primarily in North America, Europe, and the Far East through a combination of direct sales employees, independent sales representatives and various distributors. Our solutions segment provides turnkey, high-quality, energy-efficient lighting application alternatives, which are designed to enhance total value by positively impacting customers' profitability, the environment and the communities served. These solutions are sold in North America through our direct sales employees, as well as our SRC subsidiary, and include not only our proprietary energy-efficient lighting solutions, but also sourced lighting systems, energy audits and service agreements.

Available Information

Our Web site is located at <http://www.foi.com>. We make available free of charge, on or through our Web site, our annual, quarterly, and current reports, as well as any amendments to those reports, as soon as reasonably practicable after electronically filing such reports with the Securities and Exchange Commission ("SEC"). Information contained on our Web site is not part of this report.

Item 1A. Risk Factors

We have a history of operating losses and may incur losses in the future, and our auditors have issued a “Going Concern” opinion.

We have experienced net losses of \$5.7 million, \$6.1 million and \$8.5 million for the years ended December 31, 2012, 2011 and 2010, respectively. As of December 31, 2012, we had an accumulated deficit of \$80.6 million. Although management continues to address many of the legacy issues that have historically burdened our financial performance, we still face challenges in order to reach profitability. In order for us to attain profitability and growth, we will need to successfully address these challenges, including improvement in gross margins, execution of our marketing and sales plans for our turnkey energy-efficient lighting solutions business, the development of new technologies into sustainable product lines, the continuation of cost reductions throughout our organization, and continued improvements in our supply chain performance.

Although we are optimistic about reaching profitability, there is a risk that our business may not be as successful as we envision. Our independent public accounting firm has issued an opinion in connection with our 2012 Annual Report on Form 10-K raising substantial doubt as to our ability to continue as a going concern. This opinion stems from our historically poor operating performance, and our historical inability to generate sufficient cash flow to meet obligations and sustain operations without obtaining additional external financing. Although we are optimistic about obtaining the funding necessary for us to continue as a going concern, there can be no assurances that this objective will be successful. As such, we will continue to review and pursue selected external funding sources, if necessary, to execute these objectives including, but not limited to, the following:

- obtain financing from traditional or non-traditional investment capital organizations or individuals,
 - potential sale or divestiture of one or more operating units, and
- obtain funding from the sale of our common stock or other equity or debt instruments.

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

- loans or other debt instruments may have terms and/or conditions, such as interest rate, restrictive covenants and control or revocation provisions, which are not acceptable to management or our Board of Directors,
- the current environment in capital markets combined with our capital constraints may prevent us from being able to obtain adequate debt financing,
- financing may not be available for parties interested in pursuing the acquisition of one or more of our operating units, and
- additional equity financing may not be available to us in the current capital environment and could lead to further dilution of shareholder value for current shareholders of record.

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

Our business is sensitive to changes in general economic conditions, both inside and outside the United States. An economic downturn may adversely impact our business. In our legacy businesses, sales of our lighting products depend significantly upon the level of new building construction, which is affected by housing market trends, interest rates and the weather. Sales of our pool and spa lighting products depend substantially upon the level of new pool construction, which is also affected by housing market and construction trends. In addition, due to the seasonality of construction and the sales of swimming pool and lighting products, our revenue and income have tended to be significantly lower in the first quarter of each year. We may experience substantial fluctuations in our operating results from period to period as a consequence of these factors. Slow growth in the economy or an economic downturn could adversely affect our ability to meet our working capital requirements and growth objectives, or could

otherwise adversely affect our business, financial condition and results of operations. As a result, any general or market-specific economic downturns, particularly those affecting new building construction and renovation, or that cause end-users to reduce or delay their purchases of lighting products, services, or retrofit activities, would have a material adverse effect on our business, cash flows, financial condition and results of operations.

If we are unable to respond effectively as new lighting technologies and market trends emerge, our competitive position and our ability to generate revenue and profits may be harmed.

To be successful, we will need to keep pace with rapid changes in LED technology, changing customer requirements, new product introductions by competitors and evolving industry standards, any of which could render our existing products obsolete if we fail to respond in a timely manner. Development of new products incorporating advanced technology is a complex process subject to numerous uncertainties. We have previously experienced, and could in the future, experience delays in the introduction of new products. If effective new sources of light other than LED's are discovered, our current products and technologies could become less competitive or obsolete. If others develop innovative proprietary lighting technology that is superior to ours, or if we fail to accurately anticipate technology and market trends, respond on a timely basis with our own development of new products and enhancements to existing products, and achieve broad market acceptance of these products and enhancements, our competitive position may be harmed and we may not achieve sufficient growth in our net sales to attain or sustain profitability.

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

The lighting industry is highly competitive. In the high performance lighting markets in which we sell our advanced lighting systems, our products compete with lighting products utilizing traditional lighting technology provided by many vendors. Additionally, in the advanced lighting markets in which we have primarily competed to date, competition has largely been fragmented among a number of small manufacturers. However, some of our competitors, particularly those that offer traditional lighting products, are larger companies with greater resources to devote to research and development, manufacturing and marketing.

Moreover, in the general lighting market, we expect to encounter competition from an even greater number of companies. Our competitors are expected to include the large, established companies in the general lighting industry, such as General Electric, Osram Sylvania and Royal Philips Electronics. Each of these competitors has undertaken initiatives to develop LED technology. These companies have global marketing capabilities and substantially greater resources to devote to research and development and other aspects of the development, manufacture and marketing of LED lighting products than we possess. The relatively low barriers to entry into the lighting industry and the limited proprietary nature of many lighting products also permit new competitors to enter the industry easily.

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

If we are unable to obtain and adequately protect our intellectual property rights, our ability to commercialize our products could be substantially limited.

We consider our technology and processes proprietary. If we are not able to adequately protect or enforce the proprietary aspects of our technology, competitors may utilize our proprietary technology. As a result, our business, financial condition and results of operations could be adversely affected. We protect our technology through a combination of patent, copyright, trademark and trade secret laws, employee and third-party nondisclosure agreements, and similar means. Despite our efforts, other parties may attempt to disclose, obtain or use our technologies. Our competitors may also be able to independently develop products that are substantially equivalent or superior to our products or slightly modify our patents. In addition, the laws of some foreign countries do not protect our proprietary rights as fully as do the laws of the United States. As a result, we may not be able to protect our proprietary rights adequately in the United States or abroad.

We have engaged in litigation in the past and litigation may be necessary in the future to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others. Litigation may also be necessary to defend against claims of infringement or invalidity by others. An adverse outcome in litigation or any similar proceedings could subject us to significant liabilities, require us to license disputed rights from others or require us to cease marketing or using certain products or technologies. We may not be able to obtain any licenses on acceptable terms, if at all. We also may have to indemnify certain customers if it is determined that we have infringed upon or misappropriated another party's intellectual property. The cost of addressing any intellectual property litigation claim, both in legal fees and expenses, and the diversion of management resources, regardless of whether the claim is valid, could be significant and could materially harm our business, financial condition and results of operations.

If critical components that we currently purchase from a small number of third-party suppliers become unavailable or third-party manufacturers otherwise experience delays, we may incur delays in shipment, which would damage our business.

We depend on others to manufacture a significant portion of the component parts incorporated into our products. We purchase our component parts from third-party manufacturers that serve the advanced lighting systems market and believe that alternative sources of supply are readily available for most component parts. However, consolidation in the lighting industry could result in one or more current suppliers being acquired by a competitor, rendering us unable to continue purchasing necessary amounts of key components at competitive prices.

In an effort to reduce manufacturing costs, we have outsourced the production of certain parts and components, as well as finished goods in our product lines, to a number of overseas suppliers. While we believe alternative sources for the production of these products are available, we have selected these particular manufacturers based on their ability to consistently produce these products per our specifications, ensuring the best quality product at the most cost effective price. We depend on our suppliers to satisfy performance and quality specifications and to dedicate sufficient production capacity within scheduled delivery times. Although we maintain contracts with selected suppliers, we may be vulnerable to unanticipated price increases, payment term changes and product shortages. Accordingly, the loss of all or one of these suppliers or delays in obtaining shipments could have a material adverse effect on our operations until such time as an alternative supplier could be found. We may be subject to various import duties applicable to materials manufactured in foreign countries and may be affected by various other import and export restrictions, as well as other considerations or developments impacting upon international trade, including economic or political instability, shipping delays and product quotas. These international trade factors will, under certain circumstances, have an impact on the cost of components, which will have an impact on the cost to us of the manufactured product and the wholesale and retail prices of our products.

If the companies to which we outsource the manufacture of our products fail to meet our requirements for quality, quantity, and timeliness, our revenue and reputation in the marketplace could be harmed.

We outsource a significant portion of the manufacture and assembly of our products. We currently depend on a small number of contract manufacturers to manufacture our products at plants in various locations throughout the world, primarily in the United States, Mexico, China and Taiwan. These manufacturers supply most of the necessary raw materials and provide all necessary facilities and labor to manufacture our products. We currently do not have long-term contracts with all of these manufacturers. If these companies were to terminate their arrangements with us without adequate notice, or fail to provide the required capacity and quality on a timely basis, we would be unable to manufacture and ship our lighting products until replacement manufacturing services could be obtained. To qualify a new contract manufacturer, familiarize it with our products, quality standards and other requirements, and commence volume production is a costly and time-consuming process. If it became necessary to do so, we may not be able to establish alternative manufacturing relationships on acceptable terms.

Our reliance on contract manufacturers involves certain additional risks, including the following:

- lack of direct control over production capacity and delivery schedules,
- lack of direct control over quality assurance, manufacturing yields, and production costs,
- risk of loss of inventory while in transit from China, Mexico and Taiwan, and
- risks associated with international commerce, particularly with China, Mexico and Taiwan, including unexpected changes in legal and regulatory requirements, changes in tariffs and trade policies, risks associated with the protection of intellectual property and political and economic instability.

Any interruption in our ability to manufacture and distribute products could result in delays in shipment, lost sales, reductions in revenue and damage to our reputation in the market, all of which would adversely affect our business.

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

We rely significantly on indirect sales channels to market and sell our products. Most of our products are sold through third-party independent distributors and sales representatives. In addition, these parties provide technical sales support to end-users. Our current agreements within these sales channels are non-exclusive with regard to lighting products in general, but exclusive with respect to LED lighting and fiber optic products. We anticipate that any such agreements we enter into in the future will be on similar terms. Furthermore, our agreements are generally short-term, and can be cancelled by these sales channels without significant financial consequence. We cannot control how these sales channels perform and cannot be certain that we or end-users will be satisfied by their performance. If these distributors and sales representatives significantly change their terms with us, or change their historical pattern of ordering products from us, there could be a significant impact on our net sales and profits.

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

Despite product testing, defects may be found in our existing or future products. This could result in, among other things, a delay in the recognition or loss of net sales, loss of market share or failure to achieve market acceptance. These defects could cause us to incur significant warranty, support and repair costs, divert the attention of our engineering personnel from our product development efforts, and harm our relationship with our customers. The occurrence of these problems could result in the delay or loss of market acceptance of our lighting products and would likely harm our business. Some of our products use line voltages (such as 120 or 240 AC), or are designed for

installation in environments such as swimming pools and spas, which involve enhanced risk of electrical shock, injury or death in the event of a short circuit or other malfunction. Defects, integration issues or other performance problems in our lighting products could result in personal injury or financial or other damages to end-users or could damage market acceptance of our products. Our customers and end-users could also seek damages from us for their losses. A product liability claim brought against us, even if unsuccessful, would likely be time consuming and costly to defend.

If we are unable to accurately estimate the risks, revenues or costs associated with a project, we may achieve a lower than expected profit or incur a loss on that project.

For the solutions segment of our business, we generally enter into fixed price contracts. Fixed price contracts require us to perform a contract for a specified price regardless of our actual costs. As a result, the profit that we realize on a contract is dependent on the extent to which we successfully manage our costs. Cost overruns, whether due to inefficiency, inaccurate estimates or other factors, result in lower profit or a loss on a project. A majority of our contracts are based on cost estimates that are subject to a number of assumptions. If our estimates of the risks, revenues or costs prove inaccurate or circumstances change, we may incur a lower profit or a loss on that project.

Additionally, we recognize certain contract revenues, including revenues from our solutions segment, using the percentage-of-completion method. Under this method, percentage-of-completion is determined by relating the actual cost of the work performed to date to the current estimated total cost of the respective contracts. When the estimate on a contract indicates a loss, we record the entire loss during the accounting period in which it is estimable. In the ordinary course of business, at a minimum on a quarterly basis, we prepare updated estimates of the total forecasted revenue, cost and profit or loss for each contract. The cumulative effect of revisions in estimates of the total forecasted revenue and costs during the course of the work is reflected in the accounting period in which the facts that caused the revision become known. To the extent that these revisions result in a reduction in revenue, we recognize a credit or a charge against current earnings, which could be material.

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

We derive a portion of our revenues from direct and indirect sales to U.S., state, local, and foreign governments and their respective agencies. Such contracts are subject to various procurement laws and regulations, and contract provisions relating to their formation, administration and performance. Failure to comply with these laws, regulations or provisions in our government contracts could result in the imposition of various civil and criminal penalties, termination of contracts, forfeiture of profits, suspension of payments, or suspension from future government contracting. If our government contracts are terminated, if we are suspended from government work, or if our ability to compete for new contracts is adversely affected, our business could suffer.

An inability to obtain bonding could limit the number of solutions segment projects we are able to pursue.

As is customary in the construction business, we are often required to provide surety bonds to secure our performance under construction contracts. Our ability to obtain surety bonds primarily depends upon our capitalization, working capital, past performance, management expertise and other external factors, including the overall capacity of the surety market. Surety companies consider such factors in relation to the amount of our backlog and their underwriting standards, which may change from time to time. The surety industry has undergone significant changes with several companies withdrawing completely from the industry or significantly reducing their bonding commitment. In addition, certain reinsurers of security risk have limited their participation in this market. Therefore, we could be unable to obtain surety bonds when required, which could adversely affect our future results of operations and revenues.

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

For the years ending December 31, 2012, net sales of our products outside of the United States represented 10% of our total net sales. We generally provide technical expertise and limited marketing support, while our independent international distributors generally provide sales staff, local marketing, and product services. We believe our international distributors are better able to service international markets due to their understanding of local market conditions and best business practices. International business operations are subject to inherent risks, including,

among others:

- unexpected changes in regulatory requirements, tariffs, and other trade barriers or restrictions,
 - potentially adverse tax consequences,
 - the burdens of compliance with a wide variety of foreign laws,
- import and export license requirements and restrictions of the United States and each other country in which we operate,
 - exposure to different legal standards and reduced protection for intellectual property rights in some countries,
 - currency fluctuations and restrictions, and
- political, social, and economic instability, including war and the threat of war, acts of terrorism, pandemics, boycotts, curtailment of trade or other business restrictions.

We may not fully recognize the anticipated revenue reported in our backlog.

The contracts we enter into for our solutions segment can be relatively large and typically range in the amount of \$0.1 million to as much as \$4.0 million. As of December 31, 2012, our solutions segment backlog of uncompleted work was \$1.3 million. We include a project in our backlog when a contract is awarded or a letter of intent is obtained. The revenue projected in our backlog may not be realized or may not result in the revenue or profits expected. If a project included in our backlog is canceled, suspended or the scope of work is reduced, it would result in a reduction to our backlog, which could affect the revenues and profits realized. If a customer should cancel a project, we may be reimbursed for costs expended to date but would have no contractual right to the total projected revenues included in our backlog. Cancellations or delays of significant projects could have a material adverse effect on future revenues, profits and cash flows.

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

To a large extent, our future success will depend on the continued contributions of certain employees, such as our current Chief Executive Officer, Chief Financial Officer and Chief Operating Officer. These and other key employees may be difficult to replace. Our future success will also depend on our ability to attract and retain qualified technical, sales, marketing, and management personnel, for whom competition is very intense. The loss of, or failure to attract, hire and retain any such persons could delay product development cycles, disrupt our operations, or otherwise harm our business or results of operations. We have been successful in hiring experienced energy solutions salespeople from leading firms in the industry, but if these individuals are not successful in achieving our expectations, then planned sales may not occur and the anticipated net sales may not be realized.

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

A significant portion of our research and development efforts have been supported directly by government funding and were contracted for short periods, usually one to two years. Further, a significant portion of net sales generated by SRC are derived from state government funding and supported by federal government funding. If government funding is reduced or eliminated, there is no guarantee that we would be able to continue to fund our activities in these areas at their current levels, if at all. If we are unable to maintain our access to government funding in these areas, there could be a significant impact on our net sales and profits.

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

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

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

We incur significant costs as a result of being a public company and our management is required to devote substantial time and financial resources to meet compliance obligations.

As a public company reporting to the Securities and Exchange Commission, we incur significant legal, accounting, investor relations, board compensation and other expenses. We are subject to the reporting requirements of the Securities Exchange Act of 1934, and the Sarbanes-Oxley Act of 2002, including section 404 that requires that we

annually evaluate and report on our systems of internal controls. In the future, there may be material weaknesses in our internal controls that would be required to be reported in future Annual Reports on Form 10-K and/or Quarterly Reports on Form 10-Q. A negative reaction by the equity markets to the reporting of a material weakness could cause our stock price to decline.

We could issue additional common stock or may need to request our shareholders to authorize additional shares of common stock, which might dilute the book value and market for our common stock.

We are authorized to issue 100,000,000 shares of common stock, of which 44.7 million shares were issued and outstanding, as of March 15, 2013. An additional 32 million shares have been reserved for issuance upon exercise of stock options, warrants or conversion of convertible debt. If or when these securities are exercised into shares of our common stock, the number of our shares of common stock outstanding will increase. Increases in our outstanding shares, and any sales of shares, could have an adverse affect on the trading activity and market price of our common stock. Our Board of Directors has the authority, without action or vote of our shareholders, to issue a sizeable part of our authorized but unissued shares. Such stock issuances could be made at a price that reflects a discount or a premium from the then-current trading price of our common stock. In addition, in order to raise capital or acquire businesses in the future, we may need to issue additional securities or promissory notes that are convertible or exchangeable for shares of our common stock. These issuances would dilute shareholders' percentage ownership interest, which would have the effect of reducing influence on matters on which our shareholders vote, and might dilute the book value of our common stock. Shareholders may incur additional dilution if holders of stock options, whether currently outstanding or subsequently granted, exercise those options, or if warrant holders exercise warrants purchasing shares of our common stock. If an insufficient amount of authorized, but unissued shares of common stock exists to issue in the future in connection with subsequent equity financing or acquisition transactions, we may be required to ask our shareholders to authorize additional shares before undertaking, or as a condition to completing, a financing or acquisition transaction. We cannot be assured that our shareholders would authorize an increase in the number of shares of our common stock.

As a “thinly-traded” stock, large sales can and have placed negative pressure on our common stock price.

Our common stock trades Over-The-Counter under the symbol EFOI. Despite certain increases of trading volume, from time to time we experience periods when our common stock could be considered “thinly-traded.” Additionally, we have entered into in the past or may enter into in the future, financing or acquisition transactions resulting in a large number of newly issued shares that become immediately tradable or tradable simultaneously in the future. These factors coupled with a limited number of market makers impairs the liquidity of our stock, not only the number of shares that can be bought and sold, but also the through possible delays in the timing of transactions, and lower prices for our common stock than might otherwise prevail. This could make it difficult or impossible for an investor to sell shares of our common stock within a desired timeframe or to obtain a desired price.

In addition, from time to time, certain of our shareholders may be eligible to sell all, or a portion of, their shares of common stock by means of ordinary brokerage transactions in the open market pursuant to Rule 144, promulgated under the Securities Act of 1933, or under effective resale prospectuses. Any substantial sale of our common stock pursuant to Rule 144 or any resale prospectus may have an adverse affect on the market price of our securities.

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

At any given time, we may be subject to litigation, the disposition of which may have an adverse affect upon our business, financial condition, or results of operation. Information regarding our current legal proceedings is presented below in Part I, Item 3.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our principal executive offices are located in approximately a 25,000 square foot facility in Solon, Ohio, under a lease agreement expiring on April 30, 2014. See Note 9, Commitments and Contingencies, to the Consolidated Financial Statements for additional information.

We also have leased facilities in Nashville, Tennessee, Pleasanton, California, and Berkshire, United Kingdom. In addition, we have a contract manufacturing facility near Tijuana, Mexico. We believe that our current facilities are adequate to support our current and anticipated operations.

Item 3. Legal Proceedings

From time to time, we may be involved in legal proceedings arising from the normal course of business. As of the date of this report, we have not received notice of any new legal proceedings.

Item 4. Submission of Matters to a Vote of Security Holders

During the fourth quarter of the year ended December 31, 2012, there were no matters submitted to a vote of security holders.

Executive Officers of the Registrant

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

Name	Age	Current Position and Business Experience
Joseph G. Kaveski	52	Chief Executive Officer and Director – May 2008 to present. Prior to joining Energy Focus, Mr. Kaveski led his own strategic consulting business, TGL Company. As a consultant, he worked with equity investors and publicly traded companies on strategic initiatives and planning. Other corporations Mr. Kaveski has worked for include Johnson Controls, Inc. where he was Vice President of Energy Management Services and Strategic Projects.
Eric W. Hilliard	45	Chief Operating Officer and Vice President – November 2006 to present. Prior to joining Energy Focus, Mr. Hilliard served in Business and Operations Management at Saint Gobain’s Aerospace Flight Structures Division from 2002 to 2006 overseeing the global sales and operations for composite flight structure components to customers such as Embraer, Gulfstream and EADS. Other career assignments include Goodrich Aerospace, Chemical Leaman, and the HJ Heinz Company serving in operational and international roles throughout his career.
Mark J. Plush	63	Chief Financial Officer and Vice President of Finance– July 2011 to present. Prior to joining Energy Focus, Mr. Plush served as Vice President and Chief Financial Officer with Keithley Instruments from 1998 to 2010.
Roger F. Buelow	40	Chief Technology Officer and Vice President – July 2005 to present. Vice President of Engineering from February 2003 to July 2005. Prior to joining Energy Focus, Mr. Buelow was the Director of Engineering at Unison Fiber Optic Lighting Systems, LLC, and was with GE Lighting.

PART II

Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities

Our common stock is traded Over-The-Counter under the symbol EFOI. The following table sets forth the high, low, and close market prices per share for our common stock as reported by NASDAQ:

	High	Low	Close
First quarter 2012	\$ 0.72	\$ 0.16	\$ 0.42
Second quarter 2012	0.44	0.23	0.24
Third quarter 2012	0.29	0.21	0.24
Fourth quarter 2012	0.27	0.16	0.16
First quarter 2011	\$ 1.35	\$ 0.91	\$ 1.22
Second quarter 2011	1.16	0.38	0.48
Third quarter 2011	0.69	0.35	0.36
Fourth quarter 2011	0.47	0.17	0.20

In the second quarter of 2011, the NASDAQ Listing Qualifications Department notified the Company that the bid price of our common stock had closed at less than \$1.00 per share over the previous 30 consecutive business days, and provided us with 180 days, or until November 14, 2011, to regain compliance with the NASDAQ Capital Marketing listing rule. On November 14, 2011, the Company's stock had not traded above \$1.00 per share, and the Company was not in compliance with a second rule; shareholders' equity was less than \$5 million. Our stock began being listed on the Over The Counter Bulletin Board ("OTCBB") at the opening of the markets on November 29, 2011. On December 15, 2011, NASDAQ announced that the Company's stock was delisted.

Effective January 15, 2013, the Company's common stock was deleted from OTCBB, as it became ineligible for quotation due to quoting inactivity under SEC Rule 15c2-11.

Market prices during the timeframe when the Company's common stock traded on the OTCBB reflect inter-dealer prices, without retail markup, markdown or commission and may not necessarily represent actual transactions.

Stockholders

There were approximately 124 holders of record of our common stock as of March 7, 2013, however, a large number of our shareholders hold their stock in "street name" in brokerage accounts. Therefore, they do not appear on the shareholder list maintained by our transfer agent.

Dividends

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

Shares Authorized for Issuance under Equity Compensation Plans

The following table details information regarding our existing equity compensation plans as of December 31, 2012:

Equity Compensation Plan Information

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	2,184,583	2.20	3,345,667(1)

(1) Includes 123,867 shares available for issuance under the 1994 Employee Stock Purchase Plan.

Item 6. Selected Financial Data

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

SELECTED CONSOLIDATED FINANCIAL DATA
(IN THOUSANDS, EXCEPT PER SHARE DATA)

YEARS ENDED DECEMBER 31,	2012	2011	2010	2009	2008
OPERATING SUMMARY					
Net sales from continuing operations	\$ 29,837	\$ 25,752	\$ 35,129	\$ 12,489	\$ 20,032
Gross profit from continuing operations	6,237	5,171	6,403	2,040	4,106
Net loss from continuing operations	(5,709)	(6,055)	(8,517)	(9,814)	(12,673)
Net loss from discontinued operations	-	-	-	(1,201)	(1,775)
Net loss	(5,709)	(6,055)	(8,517)	(11,015)	(14,448)
Net loss per share:					
Basic	\$ (0.14)	\$ (0.25)	\$ (0.37)	\$ (0.70)	\$ (1.02)
Diluted	\$ (0.14)	\$ (0.25)	\$ (0.37)	\$ (0.70)	\$ (1.02)
Shares used in per share calculation:					
Basic	41,322	24,669	22,791	15,763	14,182
Diluted	41,322	24,669	22,791	15,763	14,182
FINANCIAL POSITION SUMMARY					
Total assets	\$ 14,353	\$ 13,778	\$ 20,374	\$ 17,378	\$ 23,636
Cash and cash equivalents	1,181	2,136	4,107	1,062	10,568
Credit line borrowings	1,590	701	-	-	1,904
Current portion of long-term borrowings	756	855	481	-	54
Long-term borrowings	1,793	955	1,344	715	245
Shareholders' equity	825	1,468	6,658	11,505	16,789
Common shares outstanding	44,699	24,913	23,962	21,250	14,835

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

Overview

Energy Focus, Inc. and its subsidiaries (the "Company") engage in the design, development, manufacturing, marketing, and installation of energy-efficient lighting systems and solutions where we serve two segments:

- Solutions providing turnkey, high-quality, energy-efficient lighting application alternatives primarily to the existing public-sector building market; and
- Product providing military, general commercial and industrial lighting and pool lighting offerings, each of which markets and sells energy-efficient lighting systems.

We continue to evolve our business strategy to include providing our customers with turnkey, comprehensive energy-efficient general lighting solutions, which use, but are not limited to, our patented and proprietary technology. Our products segment include light-emitting diode ("LED"), fiber optic, high-intensity discharge ("HID"), fluorescent tube and other highly energy-efficient lighting technologies. Typical savings related to our current technology of the Company approximates 80% in electricity costs, while providing full-spectrum light closely simulating daylight colors. Our strategy also incorporates continued investment into the research of new and emerging energy sources including LED and solar energy applications.

During 2011, we made major progress in our plan to reposition the Company for growth and profitability. This plan involved three major areas of focus, which included:

- Dramatic reduction of operating expenses.
- Receipt of a \$23.1 million order for the U.S. Navy to retrofit approximately 7% of the Naval fighting fleet with LED lighting products, including Intellitube® lamps. We invoiced the U.S. Navy \$1.9 million through December 2011 for products and services related to this contract.
- Added sales resources and broadened our customer base at Stones River Companies, LLC ("SRC") during 2011, which helped us grow our lighting retrofit business by 10% in 2012.

During 2012, we continued to focus on these areas and reduced our spending in sales and marketing and general and administrative expenses by 8% from 2011. We shipped an additional \$2.5 million against the U.S. Navy Contract, and grew total sales by 16% from 2011.

We were awarded \$2.4 million in research contracts and grants. We were awarded approximately \$0.9 million to develop next generation lighting for future U.S. Navy vessels. Like our smaller berth light that has been sailing in the Virginia Class Nuclear submarines for almost two years, this next generation lighting will utilize a larger version of our optical wave guide technology. In January, we were awarded \$0.1 million in a subcontract under the Defense Advanced Research Projects Agency ("DARPA") on the Manufacturable Gradient Index Optics Phase 2 BAA, where in part, we explored further optical advancements to Intellitube® technology. In November, we were awarded a \$0.2 million Phase I Small Business Innovation Research ("SBIR") contract from the Department of Energy ("DoE") for "Lighting Controls Software for Self-Commissioning and Optimized Energy Savings," where we further develop the ultra low cost sensor network to compliment Intellitube®, the Company's LED based fluorescent replacement technology. In December, we learned that we were selected to receive funding for at least a \$1.2 million award by the Executive Control Board of the National Shipbuilding Research Program ("NSRP") for the development of a "New Best" LED lighting solution for the U.S. Navy's 2-bulb fluorescent fixture. NSRP is a collaboration of U.S. Shipyards that focus on common issues with a goal of reducing the cost of acquiring, operating and maintaining Navy Ships. This new best solution utilizes Energy Focus' existing Intellitube® product.

Results of Operations

The following table sets forth the percentage of net sales represented by certain items reflected on our Consolidated Statements of Operations for the years ended December 31:

	2012		2011		2010	
Net sales	100.0	%	100.0	%	100.0	%
Cost of sales	79.1		79.9		81.8	
Gross profit	20.9		20.1		18.2	
Operating expenses:						
Research and development	1.2		(2.0)	)	(0.6))
Sales and marketing	19.1		24.1		18.3	
General and administrative	15.6		19.7		17.4	
Loss on impairment	2.2		-		0.4	
Valuation of equity instruments	-		0.2		5.1	
Change in estimate of contingent liabilities	(0.3)	)	(1.6))	-	
Restructuring	-		-		0.1	
Total operating expenses	37.8		40.4		40.7	
Loss from operations	(16.9)	)	(20.3)	)	(22.5))
Other income (expense):						
Interest expense	(1.7)	)	(3.3)	)	(1.6))
Other income (expense)	(0.5)	)	0.1		(0.1))
Loss before income taxes	(19.1)	)	(23.5)	)	(24.2))
Benefit from (provision for) income taxes	0.0		0.0		(0.0))
Net loss	(19.1)	) %	(23.5)	) %	(24.2)) %

Net sales

Our sales breakdown by business segment is as follows (in thousands):

	Year ending December 31,		
	2012	2011	2010
Solutions:			
Net sales - solutions segment	\$ 10,569	\$ 9,563	\$ 19,763
Products:			
Net sales - pool and commercial	14,948	11,911	12,265
Net sales - government			
products/R&D services	4,320	4,278	3,101
Total net sales - product segment	19,268	16,189	15,366
Total net sales	\$ 29,837	\$ 25,752	\$ 35,129

Net sales increased 16% in 2012 from 2011, due mainly to \$3.0 million of higher pool and commercial sales as the market begins to adopt LED lighting solutions. Additionally, solutions sales for SRC increased \$1.0 million, or 11%, from 2011. Net sales decreased 27% in 2011 from 2010. This decrease was primarily related to \$10.2 million of lower solution sales for SRC, due mainly to fewer contracts from two key Energy Services Companies (“ESCOs”). Slightly offsetting the decrease in 2011 from 2010 was an increase in government products/R&D services of \$1.2 million. The increase was due primarily to the U.S. Navy contract received in 2011; \$1.9 million of which was shipped through December 2011.

International sales

We have a foreign manufacturing operation in the United Kingdom, and net sales and expenses from these operations are denominated in local currency, thereby creating exposures to changes in exchange rates. Fluctuations in this operation's respective currency may have an impact on our business, results of operations and financial position. We currently do not use financial instruments to hedge our exposure to exchange rate fluctuations with respect to our international operations. As a result, we may experience foreign currency translation gains or losses due to the volatility of other currencies compared to the United States dollar, which may positively or negatively affect our results of operations attributed to these operations. International net sales accounted for 10.2% of net sales in 2012, compared to 15.6% in 2011, and 10.9% for 2010. The effect of changes in currency exchange rates was not material in 2012, 2011 or 2010. The breakdown of our global sales is as follows (in thousands):

	Years ended December 31,		
	2012	2011	2010
United States Domestic	\$ 26,798	\$ 21,730	\$ 31,314
International	3,039	4,022	3,815
Net sales	\$ 29,837	\$ 25,752	\$ 35,129

Gross profit

Gross profit was \$6.2 million, or 20.9% of net sales, in 2012, compared to \$5.2 million, or 20.1%, in 2011, and \$6.4 million, or 18.2% in 2010. The increase in 2012 resulted from higher sales, as well as gross profit margin improvements from pool and commercial products where we have been working with our supply chains to improve profit margins. Gross profit margins for the products segment was 25.0% in 2012, versus 22.5% in 2011. Gross profit margins for the solutions segment decreased 2.5 percentage points to 13.4% in 2012 from 2011 due to accepting lower margin contracts.

Gross profit decreased \$1.2 million in 2011 from 2010, although increased as a percentage of net sales by 1.9 percentage points. This was due to lower sales, partially offset by approximately a \$1.0 million reduction in manufacturing overhead costs as a result of our cost reduction efforts in the products segment. Gross profit for the product segment was 22.5% in 2011 and 19.3% in 2010, while the gross profit for the solutions segment was 15.9% in 2011 and 17.4% in 2010.

Operating expenses

Research and development

Gross research and development expenses were \$3.4 million in 2012, a 24.7% decrease from \$4.5 million in 2011. The decrease was due primarily to lower project costs related to developing product for the U.S. Navy, as well as lower patent expenses and employee incentive costs, which were partially offset by higher depreciation and consultant costs. In 2011, gross research and development increased 50.5% from \$3.0 million in 2010. This increase was due to higher salary expense, and project and consultant costs as a result of developing Intellitube® for the U.S. Navy contract. Patent expense also increased as a result of activities related to Intellitube®.

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

Total government reimbursements are the combination of revenues and credits from government contracts.

The gross and net research and development spending along with credits from government contracts is shown in the following table (in thousands):

Net Research & Development Spending	Year ending December 31,		
	2012	2011	2010
Total gross research and development expenses	3,355	4,456	2,961
Cost recovery through cost of sales	(2,150)	(3,519)	(2,382)
Cost recovery and other Credits	(837)	(1,452)	(781)
Net research & development expense / (income)	\$ 368	\$ (515)	\$ (202)

Sales and marketing

Sales and marketing expenses were \$5.7 million, or 19.1% of net sales, in 2012, compared to \$6.2 million, or 24.1% of net sales, in 2011. The decrease was due primarily to lower expenses in the products segment for salaries and benefits, as well as lower rent and recruiting, partially offset by higher consultant costs. In February 2012, the Company entered into an Asian Business Development/Collaboration Agreement with Communal International Ltd. The agreement has a 36 month term, and we expensed \$270 thousand in 2012 under this agreement. Please refer to Note 14, Related Party Transactions, to the Consolidated Financial Statements for a discussion of these transactions.

Sales and marketing expenses in 2011 decreased 3.4% from \$6.4 million, or 18.3% of net sales, in 2010. This decrease was due primarily to lower commissions in the solutions segment as a result of lower sales. In 2011, sales and marketing expenses for solutions totaled \$1.3 million versus \$1.4 million in 2010. Sales and marketing expenses for products in 2011 was \$4.6 million versus \$4.8 million in 2010, primarily due to lower salaries and benefits.

General and administrative

General and administrative expenses were \$4.6 million, or 15.6% of net sales, in 2012 versus \$5.1 million, or 19.7%, in 2011 and \$6.1 million or 17.4%, in 2010. The 8.2% decrease in 2012 was primarily due to lower amortization of intangible assets from the acquisition of SRC in the solutions segment, and lower corporate legal fees and discretionary spending. The 17.2% decrease in 2011 was due to lower amortization of intangible assets from the acquisition of SRC, lower stock option expense, and lower legal and accounting fees.

Loss on impairment

As of December 31, 2012, we wrote off \$672 thousand of goodwill related to the acquisition of SRC in Nashville, Tennessee, which occurred on December 31, 2009. Management tests goodwill annually for impairment at the reporting unit level and determines fair value through the use of a discounted cash flow valuation model. Based upon the historical losses incurred, it was determined that the goodwill was impaired.

Long-lived assets are reviewed for impairment whenever events or circumstances indicate the carrying amount may not be recoverable. In 2010, the Company decided to relocate the Solon, Ohio commercial products operations to its facilities in Mexico and California. This decision created a “triggering event” necessitating review of its long-lived assets. In performing the review, the Company obtained quoted market prices for similar assets while also considering market demand for these assets. As a result of this review, the Company recorded an impairment charge of \$156 thousand in 2010, which represented the difference between the fair value of the assets and their carrying value.

Valuation of equity instruments

During the first quarter of 2010, we recognized a non-cash charge of \$1.4 million related to the valuation of warrants to purchase shares of our common stock acquired by The Quercus Trust (“Quercus”) in our March 2008 equity financing. Furthermore, during the second quarter of 2010, we recognized non-cash charges of \$329 thousand related to the valuation of 350,000 warrants issued to Lincoln Park Capital Partners, LLC. In addition during 2011, we recorded non-cash charges of an additional \$56 thousand relating to the valuation of our common stock issued to Lincoln Park Capital Partners, LLC.

Change in estimate of contingent liabilities

In connection with the acquisition of SRC in December 2009, the Company recorded a performance-related contingent obligation related to a 2.5% payout payable over 42 months commencing January 1, 2010 and based upon the fair value of projected annual billings of the acquired business. The Company accrued for this contingent liability at its estimated fair value at the time of the acquisition. In the fourth quarter of 2012 and 2011, the Company reassessed the carrying value of the contingent liability related to the 2.5% payout and, based upon revised projected future billings, subsequently recorded reductions to the contingent liability of \$102 thousand and \$411 thousand, respectively. See Note 9, Commitments and Contingencies, for further information.

Restructuring

We incurred no restructuring charges during 2012 or 2011. For the twelve months ended December 31, 2010, we recognized restructuring expenses of \$26 thousand. These expenses were associated with the relocation of manufacturing equipment and operations in Solon, Ohio to a third-party warehouse facility located in California.

Other Income and Expenses

We had interest expense of \$511 thousand, \$861 thousand and \$573 thousand in 2012, 2011 and 2010, respectively. Interest expense is primarily related to our debt, which includes the amortization of debt discounts. Interest income was \$2 thousand in 2012 compared to \$4 thousand in 2011 and \$6 thousand in 2010.

Other income (expense) consists primarily of the amortization of loan origination costs, and facility and other fees related to the line of credit agreement.

Income Taxes

We provided a full valuation allowance against our United States deferred tax assets in 2012, 2011 and 2010. The net deferred tax assets for 2012 and 2011 were \$2 thousand for our United Kingdom subsidiary, which has been profitable in prior years. We had no net deferred liabilities at December 31, 2012 and 2011. There were no Federal tax expenses for the United States operations in 2012, 2011 and 2010, as any expected benefits were offset by an increase in the valuation allowance.

As of December 31, 2012, the Company has a net operating loss carry-forward of approximately \$70.7 million for federal, state and local income tax purposes. If not utilized, these carry-forwards will begin to expire in 2021 for federal and have begun to expire for state and local purposes. Due to changes in the Company's capital structure, the net operating loss carry-forward available to the Company in future years to offset future taxable liabilities may be limited under section 382 of the Internal Revenue Code (the "Code"). We are currently reviewing the rules under this section of the Code, but believe that the limitation on our net operating loss carry-forward may be significant.

Net Loss

The net loss was \$5.7 million for 2012, a 5.7% decrease from the net loss for 2011 of \$6.1 million. The net loss for 2012 includes a non-cash charge for \$672 thousand for the write-off of the goodwill associated with the 2009 acquisition of SRC. The net loss recorded in 2011 decreased \$2.5 million from the net loss of \$8.5 million for 2010. Included in the net loss for 2010 are non-cash charges of \$2.0 million related to a charge for the impairment of long-lived assets and the valuation of equity instruments.

Liquidity and Capital Resources

The accompanying financial statements have been prepared assuming the Company will continue as a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. We have incurred substantial losses, and as of December 31, 2012, we had an accumulated deficit of \$80.6 million. Although management continues to address the issues that have historically burdened our financial performance, we may require additional financing for operating expenses, working capital and other corporate purposes. In order for us to attain profitability and growth, we will need to improve gross margins, successfully execute our marketing and sales plans for our turnkey energy-efficient lighting solutions business, receive additional orders on and fulfill the \$23.1 million U.S. Navy supply contract, and develop new technologies that result in sustainable product lines.

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

2012	2011	2010
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Net cash (used in) provided by operating activities	\$ (6,966)	\$ (2,617)	\$ 1,493
Net cash used in investing activities	\$ (329)	\$ (237)	\$ (282)
Proceeds from issuances of common stock, net	\$ 4,826	\$ 456	\$ 669
Proceeds from exercise of stock options	-	5	8
Proceeds from other borrowings	1,500	605	1,150
Payments on other borrowings	(886)	(892)	-
Net proceeds on credit lint borrowings	889	701	-
Net cash provided by financing activities	\$ 6,329	\$ 875	\$ 1,827

At December 31, 2012, our cash and cash equivalents were \$1.2 million, compared to \$2.1 million at December 31, 2011, and \$4.1 million at December 31, 2010. The 2012 balance included restricted cash of \$252 thousand compared to \$19 thousand in 2011 and \$128 thousand in 2010. The restricted cash represents funds received from a grant from/for a branch of the United States government. We had \$4.1 million in borrowings as of December 31, 2012 including \$1.6 million outstanding on our line of credit. This compares with \$2.5 million at December 31, 2011, and \$1.8 million at December 31, 2010.

Cash (Used in) Provided by Operating Activities

Net cash (used in) provided by operating activities primarily consists of net losses adjusted by non-cash items, including depreciation, amortization, stock-based compensation, loss on impairment, and the effect of changes in working capital. In 2012, net cash used in operating activities resulted primarily from net loss of \$5.7 million and a \$2.7 million increase in receivables. Day's sales outstanding were 60 at December 31, 2012. Cash decreased during 2011 by a net loss of \$6.1 million, which was partially offset by \$2.4 million of non-cash charges to net income and a \$1.0 million decrease in net assets and liabilities.

Cash Used in Investing Activities

Net cash used in investing activities was for the purchase of property and equipment. The Company expects capital expenditures in 2013 will be somewhat higher than they were in 2012. In many cases, the expenditures are included in the funding received for our various government contracts. We capitalize these expenditures if the equipment belongs to the Company per the contract terms and will continue to be used after the completion of the contract.

Cash Provided by Financing Activities

During the first quarter of 2012, the Company raised \$4.8 million, net of issuance costs, by entering into Securities Purchase Agreements with ten investors. Under the terms of the agreements, 19.6 million units, each consisting of one share of common stock and one-half warrant to purchase one share of common stock were issued. The units were priced at \$0.25 each based upon a formula involving the stock's 30-day average price prior to February 24, 2012. Each warrant entitles the holder to purchase one share of common stock at an exercise price of \$0.54. Please refer to Note 10, Shareholders' Equity, for a discussion of these transactions.

During the fourth quarter of 2012, the Company raised \$1.5 million by entering into three-year unsecured subordinated convertible notes. The convertible debt matures on December 31, 2015, has a 5% annual interest rate, and is convertible into common stock of the Company at a price of \$0.23 per share. Please refer to Note 8, Debt, for a discussion of this transaction.

During the first quarter of 2013, the Company embarked on a program to raise up to \$3.8 million in convertible debt, and through March 6, 2013, had raised \$1.7 million. The structure of the financing consists of unsecured subordinated convertible promissory notes that mature on December 31, 2016, have a 5% annual interest rate, and are convertible into common stock of the Company at a price of \$0.23 per share. See Note 16, Subsequent Events, for a discussion of these transactions.

Credit Facilities

On December 22, 2011, the Company entered into a \$4.5 million revolving line of credit with Rosenthal & Rosenthal. The total loan amount available to us under the line of credit is equal to 85% of our net amount of eligible receivables, plus available inventory (the lesser of 50% of the lower of cost or market value of eligible inventory, or \$250 thousand). At December 31, 2012, we had \$1.6 million outstanding and approximately \$200 thousand available

under the line of credit based upon eligible receivables and inventories balances. The credit facility is secured by a lien on our domestic assets. The interest rate for borrowing on accounts receivable is 8.5%, on inventories 10.0% and on overdrafts 13.0%. Additionally, there is an annual 1% facility fee on the entire amount of the credit facility, \$4.5 million, payable at the beginning of the year. The Credit Facility is a three year agreement, expiring on December 31, 2014, unless terminated sooner. There are liquidated damages if the Credit Facility is terminated prior to December 31, 2014, which are based on the maximum credit facility amount then in effect. The damages are: 3% if terminated prior to the first anniversary of the closing date, 2% if terminated prior to the second anniversary of the closing date, and 1% if terminated prior to the third anniversary of the closing date. We are required to comply with certain financial covenants, measured quarterly, including, as defined in the agreement: a tangible net worth amount and a working capital amount. We were in compliance with the financial covenants at December 31, 2012.

Contractual Obligations

The following summarizes our contractual obligations as of December 31, 2012, consisting of current and future payments for borrowings in the United States, and minimum lease payments under operating leases (in thousands):

Year ending December 31,	United States Long-Term Borrowings	Non-Cancelable Operating Leases	Total
2013	\$804	\$ 591	\$1,395
2014	59	212	271
2015	1,566	88	1,654
2016	72	78	150
2017 and thereafter	96	27	123
Total contractual obligations, gross	2,597	996	3,593
Less: discounts on long-term borrowings and sublease payments	(48)	-	(48)
Total contractual obligations, net	\$2,549	\$ 996	\$3,545

There are additional obligations due in 2013 related to the acquisition of SRC. For further information regarding our contractual obligations, refer to Note 8, Debt, and Note 9, Commitments and Contingencies, to the Consolidated Financial Statements.

Off-Balance Sheet Arrangements

We had no off-balance sheet arrangements as of December 31, 2012 or 2011.

Going Concern

Our independent public accounting firm has issued an opinion in connection with our 2012 Annual Report on Form 10-K raising substantial doubt as to the Company's ability to continue as a going concern. This opinion stems from our historically poor operating performance and our historical inability to generate sufficient cash flow to meet obligations and sustain operations without obtaining additional external financing. We remain optimistic about obtaining the funding necessary to continue as a going concern; however, there can be no assurances that this objective will be successful. As such, the Company continues to review and pursue selected external funding sources, if necessary, to execute these objectives including, but not limited to, the following:

- obtain financing from traditional and non-traditional investment capital organizations or individuals,
 - potential sale or divestiture of one or more operating units, and
 - obtain funding from the sale of common stock or other equity or debt instruments.

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

- loans or other debt instruments may have terms and/or conditions, such as interest rate, restrictive covenants, and control or revocation provisions, which are not acceptable to management or the Board of Directors,
- the current environment in capital markets combined with our capital constraints may prevent us from being able to obtain adequate debt financing,
- financing may not be available for parties interested in pursuing the acquisition of one or more of our operating units, and

- additional equity financing may not be available to us in the current capital environment and could lead to further dilution of shareholder value for current shareholders of record.

Critical Accounting Policies and Estimates

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

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

Revenue Recognition

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

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

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

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

Revenues and profits from our solutions segment are generally recognized by applying percentage-of-completion for the period to the estimated profits for the respective contracts. Percentage-of-completion is determined by relating the actual cost of the work performed to date to the current estimated total cost of the respective contracts. When the estimate on a contract indicates a loss, the Company's policy is to record the entire loss during the accounting period in which it is estimable. In the ordinary course of business, at a minimum on a quarterly basis, the Company prepares updated estimates of the total forecasted revenue, cost and profit or loss for each contract. The cumulative effect of revisions in estimates of the total forecasted revenue and costs during the course of the work is reflected in the accounting period in which the facts that caused the revision become known. The financial impact of these revisions to any one contract is a function of both the amount of the revision and the percentage-of-completion of the contract. Revenues from our solutions segment will generally be larger contracts and may range from three to eighteen months in duration.

In accordance with normal practices in the industry, we include in current assets and current liabilities amounts related to contracts realizable and payable. Billings in excess of costs represents the excess of contract billings to date over the amount of contract costs and profits (or contract revenue) recognized to date on a percentage-of-completion basis. Costs in excess of billings represents the excess of contract costs and profits (or contract revenue) recognized to date on the percentage-of-completion basis over the amount of contract billings to date on the remaining contracts. See Note 7, Contracts in Progress, for additional information.

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

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

Allowances for Doubtful Accounts, Returns, and Discounts

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

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

In 2012, the total allowance was \$265 thousand, with \$176 thousand related to accounts receivable and \$89 thousand related to sales returns. In 2011, the total allowance was \$447 thousand, with \$224 thousand related to accounts receivable and \$223 thousand related to sales returns. We review these allowance accounts periodically and adjust them accordingly for current conditions.

Long-lived Assets

Property and equipment is stated at cost and include expenditures for additions and major improvements. Expenditures for repairs and maintenance are charged to operations as incurred. We use the straight-line method of depreciation over their estimated useful lives of the related assets (generally two to fifteen years) for financial reporting purposes. Accelerated methods of depreciation are used for federal income tax purposes. When assets are sold or otherwise disposed of, the cost and accumulated depreciation are removed from the accounts and any gain or loss is reflected in the Consolidated Statement of Operations. Refer to Note 4, Property and Equipment, to the Consolidated Financial Statements for additional information.

We classify intangible assets into two categories: (1) intangible assets with definite lives subject to amortization, and (2) goodwill. We determine the useful lives of our identifiable intangible assets after considering the specific facts and circumstances related to each intangible asset. Factors we consider when determining useful lives include the contractual term of any agreement related to the asset, the historical performance of the asset, our long-term strategy for using the asset, any laws or other local regulations which could impact the useful life of the asset, and other economic factors, including competition and specific market conditions. Intangible assets that are deemed to have definite lives are amortized, on a straight-line basis or other method which best approximates cash flows, over their useful lives, ranging from 5 to 10 years. Goodwill represents the excess of the purchase price over the fair value of identifiable net assets acquired in a business acquisition. Refer to Note 5, Goodwill and Intangible Assets, to the Consolidated Financial Statements for additional information.

Long-lived assets, other than goodwill, are reviewed for impairment whenever events or circumstances indicate the carrying amount may not be recoverable. Events or circumstances that would result in an impairment review primarily include operations reporting losses, a significant change in the use of an asset, or the planned disposal or sale of the asset. The asset would be considered impaired when the future net undiscounted cash flows generated by the asset are less than its carrying value. An impairment loss would be recognized based on the amount by which the carrying value of the asset exceeds its fair value, as determined by quoted market prices (if available) or the present value of expected future cash flows.

We evaluate goodwill for impairment at least annually using the projected present value of future cash flows of the reporting unit, taking into account historical performance. A significant amount of judgment is required in estimating fair value of the reporting unit. Based on historical losses incurred, it was determined that goodwill was impaired, and in 2012, we wrote off the entire \$672 thousand balance of goodwill, which resulted from our 2009 acquisition of SRC, as a result of our evaluation.

Valuation of Inventories

We state inventories at the lower of standard cost (which approximates actual cost determined using the first-in-first-out method) or market. We establish provisions for excess and obsolete inventories after evaluation of historical sales, current economic trends, forecasted sales, product lifecycles, and current inventory levels. During 2012, 2011 and 2010, we charged \$217 thousand, \$236 thousand, and \$295 thousand, respectively, to cost of sales for excess and obsolete inventories. Adjustments to our estimates, such as forecasted sales and expected product lifecycles, could harm our operating results and financial position.

Accounting for Income Taxes

As part of the process of preparing our Consolidated Financial Statements, we are required to estimate our income tax liability in each of the jurisdictions in which we do business. This process involves estimating our actual current tax expense together with assessing temporary differences resulting from differing treatment of items, such as deferred

revenues, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in our Consolidated Balance Sheet. We then assess the likelihood that these deferred tax assets will be recovered from future taxable income and, to the extent that we believe that recovery is more likely than not, or is unknown, we establish a valuation allowance.

Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities, and any valuation allowance recorded against our deferred tax assets. At December 31, 2012 and 2011, we have recorded a full valuation allowance against our deferred tax assets in the United States due to uncertainties related to our ability to utilize our deferred tax assets, primarily consisting of certain net operating losses carried forward. The valuation allowance is based upon our estimates of taxable income by jurisdiction and the period over which our deferred tax assets will be recoverable.

As of December 31, 2012, the Company has a net operating loss carry-forward of approximately \$70.7 million for federal, state and local income tax purposes. If not utilized, these carry-forwards will begin to expire in 2021 for federal and have begun to expire for state and local purposes. Due to changes in the Company's capital structure, the net operating loss carry-forward available to the Company in future years to offset future taxable liabilities may be limited under Section 382 of the Internal Revenue Code (the "Code"). Management is currently reviewing the rules under this section of the Code, but believes that the limitation on our net operating loss carry-forward may be significant. Refer to Note 11, Income Taxes, to the Consolidated Financial Statements for additional information.

Share-Based Payments

The cost of employee and director stock options, as well as other share-based compensation arrangements, is reflected in the Consolidated Financial Statements based on the estimated fair value of the awards on the grant date using the Black-Scholes option pricing model. Weighted average assumptions used in the model include the expected life of the options, risk-free interest rate, and volatility. The estimated expected life of the option is calculated based on the contractual life of the option, the vesting life of the option, and historical exercise patterns of vested options. As our stock is thinly traded, the volatility estimates are calculated using historical pricing experience of a peer group over the most recent period corresponding to the expected term as of the grant date. The cost is recognized over the period during which an employee or director is required to provide service in exchange for the award.

The assumptions used in calculating the fair value of share-based awards represent our best estimates, but these estimates involve inherent uncertainties and the application of management judgment. Although we believe the assumptions and estimates we have made are reasonable and appropriate, changes in assumptions could materially impact our reported financial results.

Recently Issued Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (“FASB”) issued ASU 2011-04, Fair Value Measurement, amending ASC Topic 820, which eliminates terminology differences between U.S. generally accepted accounting principles (“GAAP”) and International Financial Reporting Standards (“IFRS”) on the measurement of fair value and related fair value disclosures. While largely consistent with existing fair value measurement principles and disclosures, the changes were made as part of the continuing efforts to converge GAAP and IFRS. The adoption of this guidance was effective for interim and annual periods beginning after December 15, 2011, and its adoption did not have a material impact on the financial statements of the Company.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income, amending ASC Topic 220. Under ASU 2011-05, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The guidance was issued to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. The guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Its adoption did not have a material impact on the Company’s financial statements.

In July 2012, the FASB issued ASU 2012-02, Intangibles — Goodwill and Other, amending ASC Topic 350. Under the revised guidance, entities testing indefinite-lived intangible assets for impairment have the option of performing a qualitative assessment before calculating fair value. If entities determine, on the basis of qualitative factors, that it is more likely than not that the fair value of the indefinite-lived intangible is less than the carrying amount, the fair value calculation would be required. The ASU also requires that the same qualitative factors be considered when determining whether an interim impairment evaluation is necessary. The guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. The adoption of this guidance is not expected to have a material effect on our financial statements.

Item 7A. Qualitative and Quantitative Disclosures About Market Risk

As of December 31, 2012, we had \$97 thousand in cash held in foreign currencies based on the exchange rate at December 31, 2012. The balances for cash held overseas in foreign currencies are subject to exchange rate risk. We have a policy of maintaining cash balances in local currencies. Periodically, cash will be transferred in order to repay inter-company debts.

Item 8. Financial Statements and Supplementary Data

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Energy Focus, Inc.

We have audited the accompanying consolidated balance sheets of Energy Focus, Inc. and its subsidiaries (collectively the "Company") as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income (loss), shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2012. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 Energy Focus, Inc. and Subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2012, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2, the Company incurred net losses of \$5,709,000, \$6,055,000, and \$8,517,000 during the years ended December 31, 2012, 2011, and 2010, respectively. The continued losses, among other factors, as discussed in Note 2 to the financial statements, raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Plante & Moran, PLLC

Cleveland, Ohio
March 27, 2013

ENERGY FOCUS, INC.
CONSOLIDATED BALANCE SHEETS

As of December 31,
(amounts in thousands except share and per share amounts)

	2012	2011
ASSETS		
Current assets:		
Cash and cash equivalents	\$1,181	\$2,136
Trade accounts receivable less allowances of \$265 and \$447, respectively	5,319	2,738
Retainage receivable	634	474
Inventories, net	2,581	2,429
Costs in excess of billings	99	171
Prepaid and other current assets	1,012	881
Total current assets	10,826	8,829
Property and equipment, net	1,800	2,105
Goodwill	-	672
Intangible assets, net	608	1,027
Collateralized assets	1,000	1,000
Other assets	119	145
Total assets	\$14,353	\$13,778
LIABILITIES		
Current liabilities:		
Accounts payable	\$5,879	\$5,653
Accrued liabilities	2,265	1,995
Deferred revenue	751	1,373
Billings in excess of costs	464	154
Credit line borrowings	1,590	701
Current maturities of long-term debt	756	855
Total current liabilities	11,705	10,731
Other liabilities	30	71
Acquisition-related contingent liabilities	-	553
Long-term debt	1,793	955
Total liabilities	13,528	12,310
SHAREHOLDERS' EQUITY		
Preferred stock, par value \$0.0001 per share:		
Authorized: 2,000,000 shares in 2012 and 2011 Issued and outstanding: no shares in 2012 and 2011	-	-
Common stock, par value \$0.0001 per share:		
Authorized: 100,000,000 shares in 2012, and 60,000,000 shares in 2011 Issued and outstanding: 44,698,650 in 2012 and 24,913,135 in 2011	4	1
Additional paid-in capital	80,985	75,962
Accumulated other comprehensive income	460	420
Accumulated deficit	(80,624)	(74,915)
Total shareholders' equity	825	1,468

Total liabilities and shareholders' equity	\$14,353	\$13,778
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The accompanying notes are an integral part of these financial statements.

ENERGY FOCUS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
For the years ended December 31,
(amounts in thousands except per share amounts)

	2012	2011	2010
Net sales	\$29,837	\$25,752	\$35,129
Cost of sales	23,600	20,581	28,726
Gross profit	6,237	5,171	6,403
Operating expenses:			
Research and development	368	(515)	(202)
Sales and marketing	5,696	6,200	6,415
General and administrative	4,646	5,062	6,115
Loss on impairment	672	-	156
Valuation of equity instruments	-	56	1,812
Change in estimate of contingent liabilities	(102)	(411)	-
Restructuring	-	-	26
Total operating expenses	11,280	10,392	14,322
Loss from operations	(5,043)	(5,221)	(7,919)
Other income (expense):			
Interest income	2	4	6
Interest expense	(511)	(861)	(573)
Other income (expense)	(157)	21	(25)
Loss before income taxes	(5,709)	(6,057)	(8,511)
Benefit from (provision for) income taxes	-	2	(6)
Net loss	\$(5,709)	\$(6,055)	\$(8,517)
Net loss per share - basic and diluted	\$(0.14)	\$(0.25)	\$(0.37)
Shares used in computing net loss per share - basic and diluted	41,322	24,669	22,791

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

ENERGY FOCUS, INC.
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
 For the years ended December 31,
 (amounts in thousands)

	2012	2011	2010
Net loss	\$(5,709	) \$(6,055	) \$(8,517
Other comprehensive income (loss):			
Foreign currency translation adjustments	40	(3	) (51
Comprehensive loss	\$(5,669	) \$(6,058	) \$(8,568

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

ENERGY FOCUS, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
For the years ended December 31, 2012, 2011, and 2010
(amounts in thousands)

	Common Stock		Additional	Accumulated	Accumulated	Total
	Shares	Amount	Paid-in Capital	Other Comprehensive Income	Deficit	
Balances at December 31, 2009	21,250	\$ 1	\$ 71,373	\$ 474	\$ (60,343)	\$ 11,505
Issuance of common stock under rights offering	-	-	1,421	-	-	1,421
Issuance of common stock	948	-	1,195	-	-	1,195
Issuance of common stock under employee stock option and stock purchase plans	20	-	15	-	-	15
Stock-based compensation	-	-	552	-	-	552
Stock options exercised	14	-	8	-	-	8
Warrants issued for financing	-	-	528	-	-	528
Warrants exercised	1,730	-	2	-	-	2
Foreign currency translation adjustment	-	-	-	(51)	-	(51)
Net loss	-	-	-	-	(8,517)	(8,517)
Balances, December 31, 2010	23,962	\$ 1	\$ 75,094	\$ 423	\$ (68,860)	\$ 6,658
Issuance of common stock	412	-	463	-	-	463
Issuance of common stock under employee stock option and stock purchase plans	157	-	47	-	-	47
Stock-based compensation	215	-	319	-	-	319
Stock options exercised	7	-	-	-	-	-
Warrants issued for financing	-	-	33	-	-	33
Warrants exercised	160	-	6	-	-	6
Foreign currency translation adjustment	-	-	-	(3)	-	(3)
Net loss	-	-	-	-	(6,055)	(6,055)
Balances, December 31, 2011	24,913	\$ 1	\$ 75,962	\$ 420	\$ (74,915)	\$ 1,468
Issuance of common stock	19,600	3	4,798	-	-	4,801
Issuance of common stock under employee stock option and stock purchase plans	186	-	25	-	-	25
Stock-based compensation	-	-	200	-	-	200
Foreign currency translation adjustment	-	-	-	40	-	40
Net loss	-	-	-	-	(5,709)	(5,709)
Balances, December 31, 2012	44,699	\$ 4	\$ 80,985	\$ 460	\$ (80,624)	\$ 825

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

ENERGY FOCUS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended December 31, (amounts in thousands)

	2012	2011	2010
Cash flows from operating activities:			
Net loss	\$(5,709)	\$(6,055)	\$(8,517)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Loss on impairment	672	-	156
Depreciation	637	589	790
Stock-based compensation	200	426	878
Valuation of equity instruments	-	56	1,812
Provision for doubtful accounts receivable	147	115	44
Amortization of intangible assets	419	649	1,073
Amortization of discounts on long-term borrowings	236	574	349
Amortization of loan origination fees	113	-	-
Deferred revenue	(311)	16	1,215
Change in estimate of contingent liabilities	(102)	(411)	-
(Gain) loss on disposal of property and equipment	(3)	(11)	(22)
Changes in assets and liabilities:			
Accounts receivable, inventories, and other assets	(3,158)	3,411	(1,694)
Accounts payable and accrued liabilities	(107)	(1,976)	5,409
Total adjustments	(1,257)	3,438	10,010
Net cash (used in) provided by operating activities	(6,966)	(2,617)	1,493
Cash flows from investing activities:			
Proceeds from the sale of property and equipment	3	19	50
Acquisition of property and equipment	(332)	(256)	(332)
Net cash used in investing activities	(329)	(237)	(282)
Cash flows from financing activities:			
Proceeds from issuances of common stock, net	4,826	456	669
Proceeds from exercise of stock options	-	5	8
Proceeds from other borrowings	1,500	605	1,150
Payments on other borrowings	(886)	(892)	-
Net proceeds on credit line borrowings	889	701	-
Net cash provided by financing activities	6,329	875	1,827
Effect of exchange rate changes on cash	11	8	7
Net (decrease) increase in cash and cash equivalents	(955)	(1,971)	3,045
Cash and cash equivalents at beginning of year	2,136	4,107	1,062
Cash and cash equivalents at end of year	\$1,181	\$2,136	\$4,107
Classification of cash and cash equivalents:			
Cash and cash equivalents	\$929	\$2,117	\$3,979
Restricted cash held	252	19	128
Cash and cash equivalents at end of period	\$1,181	\$2,136	\$4,107

(Continued on following page)

ENERGY FOCUS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended December 31, (amounts in thousands)

Supplemental Information	2012	2011	2010
Interest paid	\$186	\$328	\$171
Non-cash investing and financing activities:			
Fully depreciated assets disposed of	\$2	\$1,050	\$1,548

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

ENERGY FOCUS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Nature of Operations

Energy Focus, Inc. and its subsidiaries (the “Company”) engage in the design, development, manufacturing, marketing, and installation of energy-efficient lighting systems and solutions where the Company serves two segments:

- solutions providing turnkey, high-quality, energy-efficient lighting application alternatives primarily to the existing public-sector building market; and
- products providing military, general commercial and industrial lighting and pool lighting offerings, each of which markets and sells energy-efficient lighting systems.

The Company continues to evolve its business strategy to include providing its customers with turnkey, comprehensive energy-efficient lighting solutions, which use, but are not limited to, its patented and proprietary technology. The Company’s products segment includes light-emitting diode (“LED”), fiber optic, high-intensity discharge (“HID”), fluorescent tube and other highly energy-efficient lighting technologies. Typical savings related to current technology of the Company approximates 80% in electricity costs, while providing full-spectrum light closely simulating daylight colors. The Company’s strategy also incorporates continued investment into the research of new and emerging energy sources including LED and solar energy applications.

2. Summary of Significant Accounting Policies

The significant accounting policies of the Company, which are summarized below, are consistent with generally accepted accounting principles and reflect practices appropriate to the business in which the Company operates.

Use of Estimates

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

Reclassifications

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

Basis of Presentation

The financial statements include the accounts of the Company and its subsidiaries, Stones River Companies, LLC (“SRC”) in Nashville, Tennessee, and Crescent Lighting Limited (“CLL”) located in the United Kingdom. All significant inter-company balances and transactions have been eliminated.

ENERGY FOCUS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Going Concern

The Company has experienced net losses of \$5.7 million, \$6.1 million and \$8.5 million for the years ended December 31, 2012, 2011 and 2010, respectively. As of December 31, 2012, the Company had an accumulated deficit of \$80.6 million. Although management continues to address many of the legacy issues that have historically burdened the Company's financial performance, the Company still faces challenges in order to reach profitability. In order for the Company to attain profitability and growth, we will need to improve gross margins, successfully execute our marketing and sales plans for our turnkey energy-efficient solutions business, receive additional orders on and fulfill the \$23.1 million U.S. Navy supply contract, develop new technologies that result in sustainable product lines, continue our cost reduction efforts throughout the Company, and continue to improve our supply chain performance.

The Company's independent public accounting firm has issued an opinion in connection with the Company's 2012 Annual Report on Form 10-K raising substantial doubt as to the Company's ability to continue as a going concern. This opinion stems from the Company's historically poor operating performance and the Company's historical inability to generate sufficient cash flow to meet obligations and sustain operations without obtaining additional external financing. The Company remains optimistic about obtaining the funding necessary to continue as a going concern, however, there can be no assurances that this objective will be successful. As such, the Company continues to review and pursue selected external funding sources, if necessary, to execute these objectives including, but not limited to, the following:

- obtain financing from traditional and non-traditional investment capital organizations or individuals,
 - potential sale or divestiture of one or more operating units, and
- obtain funding from the sale of common stock or other equity or debt instruments.

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

- loans or other debt instruments may have terms and/or conditions, such as interest rate, restrictive covenants, and control or revocation provisions, which are not acceptable to management or the Board of Directors,
- the current environment in capital markets combined with the Company's capital constraints may prevent the Company from being able to obtain any debt financing,
- financing may not be available for parties interested in pursuing the acquisition of one or more operating units of the Company, and
- additional equity financing may not be available to the Company in the current capital environment and could lead to further dilution of shareholder value for current shareholders of record.

Revenue Recognition

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

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

Revenues from the Company's products segment business are generally recognized upon shipping based upon the following:

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

ENERGY FOCUS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Revenues and profits from the Company's solutions segment are generally recognized by applying percentage-of-completion for the period to the estimated profits for the respective contracts. Percentage-of-completion is determined by relating the actual cost of the work performed to date to the current estimated total cost of the respective contracts. When the estimate on a contract indicates a loss, the Company's policy is to record the entire loss during the accounting period in which it is estimable. In the ordinary course of business, at a minimum on a quarterly basis, the Company prepares updated estimates of the total forecasted revenue, cost and profit or loss for each contract. The cumulative effect of revisions in estimates of the total forecasted revenue and costs during the course of the work is reflected in the accounting period in which the facts that caused the revision become known. The financial impact of these revisions to any one contract is a function of both the amount of the revision and the percentage-of-completion of the contract. Revenues from the Company's solutions segment will generally be larger contracts and may range from three to eighteen months in duration.

In accordance with normal practices in the industry, the Company includes in current assets and current liabilities amounts related to contracts realizable and payable. Billings in excess of costs represent the excess of contract billings to date over the amount of contract costs and profits (or contract revenue) recognized to date on a percentage-of-completion basis. Costs in excess of billings represent the excess of contract costs and profits (or contract revenue) recognized to date on the percentage-of-completion basis over the amount of contract billings to date on the remaining contracts. See Note 7, Contracts in Progress, for additional information.

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

The Company warrants its products against defects or workmanship issues. It sets up allowances for estimated returns, discounts, and warranties upon recognition of revenue, and these allowances are adjusted periodically to reflect actual and anticipated returns, discounts, and warranty expenses. These allowances are based on past history and historical trends, and contractual terms. Distributor's obligation to the Company is not contingent upon the resale of its products and as such does not prohibit revenue recognition.

Cash Equivalents

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. The Company has \$1.1 million in cash on deposit with financial institutions in the United States as of December 31, 2012, of which \$252 thousand is designated as restricted cash and relates to funds received from a grant from/for a branch of the United States government. The remaining cash of \$97 thousand is on deposit with a European bank in the United Kingdom.

Inventories

The Company states inventories at the lower of standard cost (which approximates actual cost determined using the first-in-first-out method) or market. The Company establishes provisions for excess and obsolete inventories after evaluation of historical sales, current economic trends, forecasted sales, product lifecycles, and current inventory levels. Charges to cost of sales for excess and obsolete inventories amounted to \$217 thousand, \$236 thousand and \$295 thousand in 2012, 2011 and 2010, respectively.

Accounts Receivable

The Company's customers currently are concentrated in the United States and Europe. In the normal course of business, the Company extends unsecured credit to its customers related to the sale of its services and products. Typical credit terms require payment within thirty days from the date of delivery or service. The Company evaluates and monitors the creditworthiness of each customer on a case-by-case basis. The Company also provides allowances for sales returns and doubtful accounts based on its continuing evaluation of its customers' ongoing requirements and credit risk. The Company writes-off accounts receivable when management deems that they have become uncollectible and payments subsequently received on such receivables are credited to the allowance for doubtful accounts. The Company does not generally require collateral from its customers.

ENERGY FOCUS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Retainage Receivable

The Company's solutions segment sales are normally subject to a holdback of a percentage of the sale as retainage. This holdback is recorded on the Company's Consolidated Balance Sheet as "Retainage receivable." Retainage is a portion of the total bid price of a project that is held back by the customer until the project is complete and functioning satisfactorily according to the contract terms. Retainage percentages typically range from 5% to 10% and are collected anywhere from three to eighteen months from the inception of the project. For the year ended December 31, 2012 and 2011, the Company had retainage receivable from its customers totaling \$634 thousand and \$474 thousand, respectively.

Income Taxes

As part of the process of preparing its financial statements, the Company estimates its income tax liability in each of the jurisdictions in which it does business. This process involves estimating the Company's actual current tax expense together with assessing temporary differences resulting from differing treatment of items, such as deferred revenues, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in the Consolidated Balance Sheets. The Company then assesses the likelihood that these deferred tax assets will be recovered from future taxable income and, to the extent to which the Company believes that recovery is more likely than not, or is unknown, the Company establishes a valuation allowance.

Significant management judgment is required in determining the provision for income taxes, deferred tax assets and liabilities, and any valuation allowance recorded against such deferred tax assets. At December 31, 2012, the Company has a full valuation allowance against deferred tax assets in the United States due to uncertainties related to its ability to utilize those deferred tax assets, primarily consisting of certain net operating losses carried forward. The valuation allowance is based on estimates of taxable income by jurisdiction and the periods over which its deferred tax assets could be recoverable.

As of December 31, 2012, the Company has a net operating loss carry-forward of approximately \$70.7 million for federal, state and local income tax purposes. If not utilized, these carry-forwards will begin to expire in 2021 for federal and have begun to expire for state and local purposes. Due to changes in the Company's capital structure, the net operating loss carry-forward available to the Company in future years to offset future taxable liabilities may be limited under Section 382 of the Internal Revenue Code (the "Code"). Management is currently reviewing the rules under this section of the Code, but believes that the limitation on the Company's net operating loss carry-forward may be significant. Please refer to Note 11, Income taxes, for additional information.

Collateralized Assets

The Company maintains \$1.0 million of cash collateral related to the Company's surety bonding program associated with SRC. This cash is pledged to the surety carrier until which time the Company is able to provide sufficient alternative means of collateralization satisfactory to the surety carrier.

Fair Value Measurements

The carrying amounts of certain financial instruments including cash and cash equivalents, accounts receivable, and accounts payable approximate fair value due to their short maturities. Based on borrowing rates currently available to the Company for loans with similar terms, the carrying value of long-term debt obligations also approximates fair

value.

Long-Lived Assets

Property and equipment is stated at cost and include expenditures for additions and major improvements. Expenditures for repairs and maintenance are charged to operations as incurred. We use the straight-line method of depreciation over their estimated useful lives of the related assets (generally two to fifteen years) for financial reporting purposes. Accelerated methods of depreciation are used for federal income tax purposes. When assets are sold or otherwise disposed of, the cost and accumulated depreciation are removed from the accounts and any gain or loss is reflected in the Consolidated Statement of Operations. Refer to Note 4, Property and Equipment, for additional information.

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ENERGY FOCUS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company classifies intangible assets into two categories: (1) intangible assets with definite lives subject to amortization, and (2) goodwill. We determine the useful lives of our identifiable intangible assets after considering the specific facts and circumstances related to each intangible asset. Factors we consider when determining useful lives include the contractual term of any agreement related to the asset, the historical performance of the asset, our long-term strategy for using the asset, any laws or other local regulations which could impact the useful life of the asset, and other economic factors, including competition and specific market conditions. Intangible assets that are deemed to have definite lives are amortized, on a straight-line basis or other method which best approximates cash flows, over their useful lives, ranging from 5 to 10 years. Goodwill represents the excess of the purchase price over the fair value of identifiable net assets acquired in a business acquisition. Refer to Note 5, Goodwill and Intangible Assets, for additional information.

Long-lived assets, other than goodwill, are reviewed for impairment whenever events or circumstances indicate the carrying amount may not be recoverable. Events or circumstances that would result in an impairment review primarily include operations reporting losses, a significant change in the use of an asset, or the planned disposal or sale of the asset. The asset would be considered impaired when the future net undiscounted cash flows generated by the asset are less than its carrying value. An impairment loss would be recognized based on the amount by which the carrying value of the asset exceeds its fair value, as determined by quoted market prices (if available) or the present value of expected future cash flows.

The Company evaluates goodwill for impairment at least annually using the projected present value of future cash flows of the reporting unit, taking into account historical performance. A significant amount of judgment is required in estimating fair value of the reporting unit. Based on historical losses incurred, it was determined that goodwill was impaired, and in 2012, we wrote off the entire \$672 thousand balance of goodwill, which resulted from our 2009 acquisition of SRC, as a result of our evaluation.

Certain Risks and Concentrations

The Company sells its products and solutions services through a combination of direct sales employees, independent sales representatives, and various distributors in different geographic markets throughout the world. The Company performs ongoing credit evaluations of its customers and generally does not require collateral. Although the Company maintains allowances for potential credit losses that it believes to be adequate, a payment default on a significant sale could materially and adversely affect its operating results and financial condition.

At December 31, 2012 and 2011, four customers accounted for 75% and 44% of net accounts receivable, including retainage receivable, respectively. For 2012 and 2011, four customers accounted for 42% and 36% of net sales, respectively. In 2010, two customers accounted for 36% of net sales.

The Company requires substantial amounts of purchased materials from selected vendors. With specific materials, the Company purchases 100% of its requirement from a single vendor. Substantially all of the materials the Company requires are in adequate supply. However, the availability and costs of materials may be subject to change due to, among other things, new laws or regulations, suppliers' allocation to other purchasers, interruptions in production by suppliers, and changes in exchange rates and worldwide price and demand levels. The Company's inability to obtain adequate supplies of materials for its products at favorable prices could have a material adverse effect on its business, financial position, or results of operations by decreasing the Company's profit margins and by hindering its ability to deliver products to its customers on a timely basis.

Research and Development

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

Net Loss Per Share

Basic loss per share is computed by dividing net loss available to common shareholders by the weighted average number of shares of common stock outstanding for the period. The effect of common stock equivalents is not considered as it would be anti-dilutive.

ENERGY FOCUS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Stock-Based Compensation

The Company has recognized compensation expense based on the estimated grant date fair value method under the authoritative guidance. Management applies the Black-Scholes option pricing model to determine the fair value of stock options and apply judgment in estimating key assumptions that are important elements of the model in expense recognition. These elements include the expected life of the option, the expected stock-price volatility, and expected forfeiture rates. See Note 10, Shareholders' Equity, for additional information.

Foreign Currency Translation

The Company's international subsidiary uses its local currency as its functional currency. Assets and liabilities are translated at exchange rates in effect at the balance sheet date and income and expense accounts are translated at average exchange rates during the year. Resulting translation adjustments are recorded directly to "Accumulated other comprehensive income" within shareholders' equity. Foreign currency transaction gains and losses are included as a component of "Other (expense)/income". Gains and losses from foreign currency translation are included as a separate component of "Other comprehensive loss" within the Consolidated Statement of Comprehensive Income (Loss).

Advertising Expenses

The Company expenses the costs of advertising, which consists of costs for the placement of advertisements in various media. Advertising expenses were \$289 thousand, \$273 thousand and \$206 thousand for the years ended December 31, 2012, 2011 and 2010, respectively.

Product Warranties

The Company warrants finished goods against defects in material and workmanship under normal use and service for periods generally between one and five years. Settlement costs consist of actual amounts expensed for warranty services which are largely a result of third-party service calls, and the costs of replacement products. A liability for the estimated future costs under product warranties is maintained for products outstanding under warranty and is included in "Accrued liabilities" in the Consolidated Balance Sheets. The warranty activity for the respective years is as follows (in thousands):

	Year ended December 31,	
	2012	2011
Balance at the beginning of the year	\$ 100	\$ 126
Accruals for warranties issued	143	44
Settlements made during the year (in cash or in kind)	(84)	(70)
Balance at the end of the year	\$ 159	\$ 100

Recent Accounting Standards and Pronouncements

In May 2011, the Financial Accounting Standards Board ("FASB") issued ASU 2011-04, Fair Value Measurement, amending ASC Topic 820, which eliminates terminology differences between U.S. generally accepted accounting

principles (“GAAP”) and International Financial Reporting Standards (“IFRS”) on the measurement of fair value and related fair value disclosures. While largely consistent with existing fair value measurement principles and disclosures, the changes were made as part of the continuing efforts to converge GAAP and IFRS. The adoption of this guidance was effective for interim and annual periods beginning after December 15, 2011, and its adoption did not have a material impact on the financial statements of the Company.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income, amending ASC Topic 220. Under ASU 2011-05, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The guidance was issued to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. The guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Its adoption did not have a material impact on the Company’s financial statements.

ENERGY FOCUS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In July 2012, the FASB issued ASU 2012-02, Intangibles — Goodwill and Other, amending ASC Topic 350. Under the revised guidance, entities testing indefinite-lived intangible assets for impairment have the option of performing a qualitative assessment before calculating fair value. If entities determine, on the basis of qualitative factors, that it is more likely than not that the fair value of the indefinite-lived intangible is less than the carrying amount, the fair value calculation would be required. The ASU also requires that the same qualitative factors be considered when determining whether an interim impairment evaluation is necessary. The guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. The adoption of this guidance is not expected to have a material effect on our financial statements.

3. Inventories

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

	December 31,	
	2012	2011
Raw materials	\$ 1,649	\$ 1,517
Finished goods	932	912
Inventories, net	\$ 2,581	\$ 2,429

4. Property and Equipment

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

	December 31,	
	2012	2011
Equipment (useful life 3 - 15 years)	\$ 5,963	\$ 5,831
Tooling (useful life 2 - 5 years)	2,600	2,440
Furniture and fixtures (useful life 5 years)	132	129
Computer software (useful life 3 years)	462	431
Leasehold improvements (the shorter of useful life or lease life)	633	630
Construction in progress	50	27
Property and equipment at cost	9,840	9,488
Less: accumulated depreciation	(8,040)	(7,383)
Property and equipment, net	\$ 1,800	\$ 2,105

Depreciation expense was \$637 thousand, \$589 thousand and \$790 thousand for the years ending December 31, 2012, 2011 and 2010, respectively.

As a result of the Company's efforts to reduce overhead costs and in conjunction with the renegotiation efforts related to the lease at its Solon, Ohio office, which expired April 30, 2011, the decision was made to relocate Solon, Ohio commercial products manufacturing operations to its facilities in Mexico and California. This decision would enable the Company to reduce the square footage of the premises leased and strategically align the products segment of the Company which is located in California. As a result of these strategic changes, the Company performed an evaluation

of its property, plant and equipment at the Solon office as of December 31, 2010, as this strategic change created a “triggering event” necessitating such a review. In performing this review, the Company obtained quoted market prices for similar assets while also considering market demand for these assets. As a result of this review, the Company recorded an impairment charge of \$156 thousand, which represented the difference between the fair value of the asset group and its carrying value and is included in the Consolidated Statements of Operations under the caption “Loss on Impairment.”

ENERGY FOCUS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. Goodwill and Intangible Assets

The following table summarizes information related to net carrying value of intangible assets (in thousands):

	Amortization Life (in years)	2012	December 31, 2011
Goodwill		\$ -	\$ 672
Definite-lived intangible assets:			
Tradenames	10	350	400
Customer relationships	5	258	627
Total definite-lived intangible assets		608	1,027
Total intangible assets, net		\$ 608	\$ 1,699

The Company evaluates goodwill for impairment at least annually using the projected present value of future cash flows of the reporting unit, taking into account historical performance. A significant amount of judgment is required in estimating fair value of the reporting unit. Based on historical losses incurred, it was determined that goodwill was impaired, and in 2012, we wrote off the entire \$672 thousand balance of goodwill, which resulted from our 2009 acquisition of SRC, as a result of our evaluation.

Amortization expense for intangible assets subject to amortization was \$419 thousand for the year ended December 31, 2012, as compared to \$649 thousand and \$1,073 thousand for the years ended December 31, 2011 and 2010, respectively. The Company amortizes tradenames on a straight-line basis over the estimated useful lives of the intangible assets. Customer relationships are amortized over their expected useful lives on an accelerated method that approximates the cash flows associated with those relationships. Based on the carrying value of amortized intangible assets, the Company estimates amortization expense for future years to be as follows (in thousands):

Year ending December 31,	Amount
2013	\$ 253
2014	105
2015	50
2016	50
2017	50
2018 and thereafter	100
Total amortization expense	\$ 608

ENERGY FOCUS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

6. Accrued Liabilities (Current):

Accrued liabilities consisted of the following (in thousands):

	December 31,	
	2012	2011
Accrued sales commissions and incentives	\$ 514	\$ 395
Accrued warranty expense	159	100
Accrued professional fees	153	161
Accrued employee benefits	319	296
Accrued interest	87	13
Accrued taxes	162	202
Accrued performance-related contingent consideration	728	351
Accrued subcontractor services	-	286
Accrued other expenses	143	191
Total accrued expenses	\$ 2,265	\$ 1,995

7. Contracts in Progress

Costs and estimated earnings on contracts in progress for the year ending December 31, 2012 and 2011 are summarized in the table below (in thousands):

	December 31,	
	2012	2011
Costs incurred on uncompleted contracts	\$ 7,067	\$ 3,193
Estimated earnings	1,330	855
Total revenues	8,397	4,048
Less: billings to date	8,762	4,031
Total	\$ (365)	\$ 17
Balance sheet classification:		
Costs in excess of billings on uncompleted contracts	\$ 99	\$ 171
Billings in excess of costs on uncompleted contracts	(464)	(154)
Total	\$ (365)	\$ 17

8. Debt

Credit Facilities

On December 22, 2011, the Company entered into a \$4.5 million revolving line of credit with Rosenthal & Rosenthal. The total loan amount available to the Company under the line of credit is equal to 85% of its net amount of eligible receivables, plus available inventory (the lesser of 50% of the lower of cost or market value of eligible inventory, or \$250 thousand). The credit facility is secured by a lien on the domestic assets of the Company. The

interest rate is 8.5% for borrowing on accounts receivable, 10.0% on inventories and 13% on overdrafts. Additionally, there is an annual 1% facility fee on the entire amount of the credit facility payable at the beginning of the year. The credit facility is a three year agreement, expiring on December 31, 2014, unless terminated sooner. There are liquidated damages if the credit facility is terminated prior to December 31, 2014, which are based on the maximum credit facility amount then in effect. The damages are: 3% if terminated prior to the first anniversary of the closing date, 2% if terminated prior to the second anniversary of the closing date, and 1% if terminated prior to the third anniversary of the closing date. The Company is required to comply with certain financial covenants as defined in the agreement, including: a tangible net worth amount and a working capital amount. The Company was in compliance with the financial covenants at December 31, 2012. Borrowings under the revolving line of credit were \$1.6 million and \$701 thousand at December 31, 2012 and 2011, respectively, and are recorded in the Consolidated Balance Sheets as a current liability under the caption "Credit line borrowings."

ENERGY FOCUS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company maintained a British pounds sterling-denominated bank overdraft facility with Lloyds Bank Plc through its United Kingdom subsidiary in the amount of £100,000, which had been renewed on an annual basis in May. However, in May of 2012, this facility was not renewed. The interest rate on the facility at December 31, 2011 was 3.60%, and there were no borrowing against it at that time.

Borrowings

	December 31, 2012	December 31, 2011
Unsecured Convertible Notes (1)	\$ 1,500	\$ -
Convertible Promissory Note - TLC Investments LLC (2)	500	500
Cognovit Note - Keystone Ruby, LLC (3)	277	325
Letter of Credit Agreement - Mark Plush (4)	250	250
Unsecured Promissory Note - Quercus Trust (5)	70	70
Letter of Credit Agreement - Quercus Trust (6)	-	300
Secured Subordinated Promissory Note - EF Energy Partners LLC (7)	-	287
Letter of Credit Agreement - John Davenport (8)	-	250
Discounts on long-term borrowings	(48)	(172)
Subtotal	2,549	1,810
Less: Current maturities of long-term debt	(756)	(855)
Long-term debt	\$ 1,793	\$ 955

- (1) Notes mature on December 31, 2015, bear interest at 5%, and are convertible into common stock of the Company at \$0.23 per share.
- (2) Note matures on June 30, 2013, bears interest at the Wall Street Journal Prime Rate plus two percent (2%), and is convertible into 500,000 shares of the Company's common stock. Additionally, as a provision to this note, if the reported closing price of a share of common stock of the Company is not equal to or greater than \$2.00 for at least twenty (20) trading days between June 30, 2010 and June 30, 2013, the Company shall pay TLC an additional fee of \$500 thousand on the maturity date. The Company accrued for this contingent liability at its fair value at the time of inception of the note. The Convertible Note is secured by a first-lien-position security interest in the assets of SRC. See Note 9, Commitments and Contingencies.
- (3) Note matures on April 1, 2017 and bears interest at 10%. Per the terms of the note, if the Company does not renew its lease by December 31, 2013, the note becomes payable immediately.
- (4) LOC matures on August 11, 2013, and bears interest at 12.5%. The LOC is collateralized by a cash deposit with an insurance company issuing the Company's contract performance bonds and by 32% of the unpledged stock of Crescent Lighting, Ltd. ("CLL"), a subsidiary of the Company. As an incentive to enter into the LOC, the Company issued five-year, detached warrants to purchase 125,000 shares of common stock at an exercise price of \$0.01 per share. See Note 14, Related Party Transactions.
- (5) Note matures on June 1, 2109 and bears interest at 1%.
- (6) As of December 31, 2011, the Company was in default on this LOC as it matured on December 31, 2011. The LOC was paid in full in March 2012. The interest rate was 12.5%.
- (7) Note was to mature on March 30, 2013, but was paid in full in March 2012. The interest rate was 12.5%.
- (8)

On December 21, 2011, the LOC with John Davenport was amended to extend the due date from December 31, 2011, to a month by month basis as long as interest continued to be earned at 12.5%. The LOC was subsequently paid in March 2012. As an incentive to enter into the LOC, the Company issued five-year, detached warrants to purchase 125,000 shares of common stock at an exercise price of \$0.01 per share. See Note 14, Related Party Transactions.

ENERGY FOCUS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Future maturities of remaining borrowings are (in thousands):

Year ending December 31,	Long-Term Debt
2013	\$ 804
2014	59
2015	1,566
2016	72
2017	26
2018 and thereafter	70
Gross long-term borrowings	2,597
Less: discounts on long-term borrowings	(48)
Total commitment, net	2,549
Less: portion classified as current	(756)
Long-term borrowings, net	\$ 1,793

9. Commitments and Contingencies

The Company leases certain equipment, manufacturing, warehouse and office space under non-cancelable operating leases expiring through 2017 under which it is responsible for related maintenance, taxes, and insurance. Future minimum non-cancelable lease commitments are as follows (in thousands):

Year ending December 31,	Minimum Lease Commitments
2013	\$ 591
2014	212
2015	88
2016	78
2017	27
Total commitment	\$ 996

Certain leases included above contain escalation clauses and, as such, rent expense was recorded on a straight-line basis over the term of the lease. Net rent expense was \$641 thousand, \$779 thousand and \$830 thousand for the years ended December 31, 2012, 2011, and 2010, respectively.

In connection with the acquisition of SRC in December 2009, the Company recorded a performance-related contingent obligation related to a 2.5% payout payable over 42 months commencing January 1, 2010 and based upon the fair value of projected annual billings of the acquired business, and a \$500 thousand fee if the market price of the Company's common stock is not equal to or greater than \$2.00 per share for at least twenty trading days between June 30, 2010 and June 30, 2013. The Company accrued for each of these contingent liabilities at their respective fair values at the time of the acquisition. For the years ending December 31, 2012, 2011 and 2010, the Company paid \$186 thousand, \$304 thousand and \$519 thousand, respectively, relating to the 2.5% payout.

In the fourth quarter of 2012 and 2011, the Company reassessed the carrying value of the contingent liability related to the 2.5% payout and, based upon revised projected future billings, subsequently recorded reductions to the contingent

liability of \$102 thousand and \$411 thousand, respectively, which has been recorded in the Company's Consolidated Statements of Operations under the caption "Change in estimate of contingent liabilities."

ENERGY FOCUS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10. Shareholders' Equity

Private Placement

Between February 29, 2012 and March 2, 2012, the Company raised \$4.9 million by entering into Securities Purchase Agreements with ten investors, under which it sold 19,600,000 units, each of which consists of one share of the Company's common stock, par value \$0.0001 per share, and one-half warrant to purchase one share of common stock. The purchase price of each unit was \$0.25, based on a formula involving the stock's 30 day average price prior to February 24, 2012. Each warrant entitles the holder to purchase one share of common stock at an exercise price of \$0.54. Each warrant is immediately separable from the unit and immediately exercisable, and expires three years from the date of issuance. The Company used the proceeds of the offering to retire debt and for working capital purposes. Eight of the ten investors were new investors and the largest single investment was \$1.0 million.

Warrants

The Company has issued warrants in conjunction with various private placements of its common stock, debt financing arrangements and acquisitions. There have been no warrants issued to employees, directors, or consultants for compensation purposes.

As a result of the Private Placement in 2012 discussed above, warrants that were issued in 2008 originally priced at \$3.08 per share were re-priced to \$1.97 per share, and warrants issued in 2009 originally price at \$0.65 per share were re-priced to \$0.49 per share. The warrants were re-priced in accordance with their respective agreements, based upon a formula taking into account the dilutive effect of new share issuances and the price of those issuances relative to the number of shares outstanding prior to the issuances and the original exercise price of the warrants.

The activity relating to warrants was as follows:

	Warrants Outstanding	Weighted Average Exercise Price
Balance, December 31, 2009	4,437,639	\$ 1.24
Warrants issued	855,000	0.50
Warrants exercised	(1,730,062)	0.01
Warrants cancelled	(271,199)	4.50
Balance, December 31, 2010	3,291,378	\$ 1.42
Warrants issued	125,000	0.01
Warrants exercised	(160,000)	0.01
Balance, December 31, 2011	3,256,378	\$ 1.43
Warrants issued	9,800,000	0.54
Balance, December 31, 2012	13,056,378	\$ 0.76
Exercisable, December 31, 2012	12,856,378	\$ 0.77

In December 2009, the Company entered into a strategic alliance with Woodstone Energy LLC ("Woodstone"), a commercial and industrial energy services company. This strategic alliance created a path for contracts totaling not less than \$15 million to be issued by Woodstone to SRC. In return for this Woodstone commitment, the Company

issued 600,000 warrants. 400,000 of those warrants became exercisable by Woodstone upon the written commitment of \$10 million in specific secured contracts. The remaining 200,000 warrants will become exercisable upon the written commitment of an additional \$5 million in specific secured contracts. SRC has received approximately \$4.4 million in specific secured contracts toward the additional \$5 million through December 31, 2012. The warrants are exercisable at \$0.49 per share and expire on December 31, 2014.

ENERGY FOCUS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The number of warrants and weighted average remaining life (in years) by price for both total outstanding warrants and total exercisable warrants at December 31, 2012 was as follows:

Exercise Price	Number of Shares Outstanding	Weighted Average Remaining Contractual Life (in years)	Number of Shares Exercisable	Weighted Average Remaining Contractual Life (in years)
\$ 0.01	300,000	2.7	300,000	2.7
\$ 0.49	600,000	2.0	400,000	2.0
\$ 0.54	9,800,000	2.2	9,800,000	2.2
\$ 1.20	350,000	2.2	350,000	2.2
\$ 1.97	2,006,378	0.2	2,006,378	0.2
	13,056,378	3.4	12,856,378	3.4

Stock-based Compensation

On September 30, 2008, the Company's shareholders approved its 2008 Incentive Stock Plan (the "Plan"). The Plan was subsequently amended in 2010 and 2012 to increase the maximum aggregate number of stock awards to 5,000,000 shares, plus any shares remaining available for grant under existing plans. Under existing plans, only a limited number of shares remained available for grant. The Company has two other equity-based compensation plans under which options are currently outstanding; however, no new awards may be granted under these plans as they have been terminated or have expired. At December 31, 2012, there are 3.3 million shares available in the Plan for grant. Generally, stock options are granted at fair market value and expire ten years after the grant date. Employee grants generally vest in three or four years, while grants to non-employee directors generally vest in one year. Executive officers and certain other employees have been awarded options with different vesting criteria. The specific terms of each grant are determined by the Compensation Committee of the Company's Board of Directors.

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

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

	Years ended December 31,		
	2012	2011	2010
Cost of sales	\$ -	\$ -	\$ 2
Research and development	27	37	43
Sales and marketing	27	141	96
General and administrative	146	248	737
Total stock-based compensation	\$ 200	\$ 426	\$ 878

At December 31, 2012 and 2011, the Company had unamortized stock compensation expense of \$228 thousand and \$373 thousand, respectively. The remaining weighted average life was approximately 1.0 and 1.3 years as of December 31, 2012 and 2011, respectively.

ENERGY FOCUS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Stock Options

The per share weighted average fair value of stock options granted during 2012, 2011, and 2010 was \$0.15, \$0.47 and \$0.80, respectively. We estimate the fair value of each stock option on the date of grant using the Black-Scholes option pricing model and the following assumptions:

	2012		2011		2010	
Expected life of option (years)	5.6		6.1		4.0	
Risk-free interest rate	0.82	%	2.36	%	1.61	%
Expected volatility	59.00	%	56.35	%	98.31	%
Dividend yield	0	%	0	%	0	%

The estimated expected life of the option is calculated based on contractual life of the option, the vesting life of the option, and historical exercise patterns of vested options. The risk-free interest rate is based on U.S. treasury security rates corresponding to the expected term in effect as of the grant date. As the Company's stock is thinly traded, the volatility estimates are calculated using historical pricing experience of a peer group over the most recent period corresponding to the expected term as of the grant date. The Company has not paid dividends in the past, and does not expect to pay dividends over the corresponding expected term as of the grant date.

Options outstanding under all plans at December 31, 2012 have a contractual life of ten years, and vesting periods between one and four years. A summary of option activity under all plans was as follows:

	Number of Options	Weighted Average Exercise Price Per Share
Outstanding at December 31, 2009	1,769,750	\$ 3.63
Granted	1,115,000	1.08
Cancelled	(993,583)	1.68
Exercised	(13,750)	0.60
Outstanding at December 31, 2010	1,877,417	\$ 3.36
Granted	1,040,000	0.84
Cancelled	(591,419)	2.99
Exercised	(7,500)	0.60
Outstanding at December 31, 2011	2,318,498	\$ 2.28
Granted	120,000	0.27
Cancelled	(253,915)	2.22
Exercised	-	-
Outstanding at December 31, 2012	2,184,583	\$ 2.20
Vested and Expected to Vest at December 31, 2012	2,058,833	\$ 2.29
Exercisable at December 31, 2012	1,494,063	\$ 2.87

The "Expected to Vest" option are the unvested options that remain after applying the pre-vesting forfeiture rate assumption to total unvested options.

ENERGY FOCUS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The options outstanding at December 31, 2012 have been segregated into ranges for additional disclosure as follows:

Range of Exercise Prices	Number of Shares Outstanding	Weighted Average Remaining Contactual Life (in years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$0.26- \$0.71	729,500	8.2	\$ 0.52	341,279	\$ 0.56
\$1.00- \$1.40	803,333	7.5	\$ 1.16	501,034	\$ 1.07
\$2.00- \$3.35	248,750	5.0	\$ 2.12	248,750	\$ 2.12
\$4.91- \$6.45	167,000	4.5	\$ 6.04	167,000	\$ 6.04
\$7.00- \$11.66	236,000	2.7	\$ 8.29	236,000	\$ 8.29
	2,184,583	6.7	\$ 2.20	1,494,063	2.87

Restricted Stock

In the past, the Company has issued restricted stock to Executive Officers and Director in lieu of a portion of cash compensation or Directors' fees. Additionally, in 2010 a key employee was issued restricted stock as a bonus. The restricted stock was valued at the fair market value of the Company's Common Stock on grant date, and expense was amortized over the applicable service period.

A summary of restricted stock activity was as follows:

	Restricted Stock Outstanding	Weighted Average Grant Date Fair Value
At December 31, 2009	228,128	\$ 0.67
Granted	392,490	1.01
Vested	(122,989)	1.51
At December 31, 2010	497,629	\$ 0.73
Granted	114,767	0.96
Vested	(197,721)	\$ 0.87
At December 31, 2011	414,675	\$ 0.73
Granted	-	-
Vested	-	-
At December 31, 2012	414,675	\$ 0.73

1994 Employee Stock Purchase Plan

A total of 600,000 shares of common stock have been reserved for issuance under the 1994 Employee Stock Purchase Plan, as amended. The plan permits eligible employees to purchase common stock through payroll deductions at a price equal to the lower of 85% of the fair market value of the Company's common stock at the beginning or end of the offering period. Employees may end their participation at any time during the offering period, and participation ends automatically on termination of employment with the Company. At December 31, 2012, 2011, and 2010,

approximately 476,000, 291,000 and 134,000 shares had been issued under this plan since inception, respectively.

ENERGY FOCUS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. Income Taxes

The Company files income tax returns in the United States federal jurisdiction, as well as in various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to United States federal, state, and local, or non-United States income tax examinations by tax authorities for years before 2009. The Company's practice is to recognize interest and penalties related to income tax matters in income tax expense when and if they become applicable. As of December 31, 2012 and 2011, there were no accrued interest and penalties related to uncertain tax positions.

The components of the benefit from (provision for) income taxes are as follows (in thousands):

	Years ended December 31,		
	2012	2011	2010
Current			
Federal	\$ -	\$ -	\$ -
Foreign	-	12	-
State	-	2	(10)
	-	14	(10)
Deferred			
Federal	-	-	- 7
Restructuring	68	25	93
Programming inventory	13	-	13
Total	\$ 81	\$ 25	\$ 106

Restructuring charges of \$144 million were incurred in 2011, of which \$91 million were at our *Media Networks* segment and \$53 million at *Filmed Entertainment*. The restructuring charges included \$123 million of severance and \$21 million of lease termination and other exit activities.

The restructuring charges gave rise to certain future liabilities, the components of which are detailed below for 2013, 2012 and 2011. The payments during 2013 reflected in the table below are related to the 2011 restructuring plan. The remaining liability at September 30, 2013 includes \$17 million of severance payments yet to be paid out with respect to the 2011 plan pursuant to the respective underlying contractual arrangements.

Restructuring Liability (in millions)	Media	Filmed	Total
	Networks	Entertainment	
September 30, 2010	\$ 4	\$ 9	\$ 13

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Additions	82	44	126
Severance payments	(3)	(9)	(12)
Revisions to initial estimates	(3)	-	(3)
September 30, 2011	80	44	124
Severance payments	(39)	(31)	(70)
Lease payments	(3)	(4)	(7)
September 30, 2012	38	9	47
Additions	61	25	86
Severance payments	(20)	(7)	(27)
Lease payments	(3)	-	(3)
September 30, 2013	\$ 76	\$ 27	\$ 103

Table of Contents**VIACOM INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(continued)****NOTE 14. INCOME TAXES**

Earnings from continuing operations before provision for income taxes consist of the following:

Earnings from Continuing Operations before Provision for Income Taxes (in millions)	Year Ended September 30,		
	2013	2012	2011
United States	\$ 3,040	\$ 2,984	\$ 2,749
International	479	486	496
Pre-tax earnings from continuing operations	\$ 3,519	\$ 3,470	\$ 3,245

The provision for income taxes from continuing operations consists of the following:

Provision for Income Taxes from Continuing Operations (in millions)	Year Ended September 30,		
	2013	2012	2011
Current provision for income taxes:			
Federal	\$ 401	\$ 872	\$ 453
State and local	23	117	53
International	152	183	180
Total current provision for income taxes	576	1,172	686
Deferred provision for income taxes	494	(87)	376
Provision for income taxes	\$ 1,070	\$ 1,085	\$ 1,062

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A reconciliation of the effective income tax rate on continuing operations to the U.S. federal statutory income tax rate is as follows:

Effective Tax Rate	Year Ended September 30,		
	2013	2012	2011
U.S. federal statutory income tax rate	35.0%	35.0%	35.0%
State and local taxes, net of federal benefit	2.2	2.2	2.6
Effect of international operations	(2.6)	(0.8)	(2.0)
Audit settlements	(1.3)	(1.4)	(2.0)
Qualified production activities deduction	(2.1)	(3.0)	(2.5)
Change in valuation allowance	(1.8)	(1.4)	-
All other, net	1.0	0.7	1.6
 Effective tax rate, continuing operations	 30.4%	 31.3%	 32.7%

We recognized net discrete tax benefits of \$54 million in 2013, \$94 million in 2012 and \$52 million in 2011, which served to reduce the provision for income taxes for those periods. The benefits in 2013 principally reflect the release of tax reserves with respect to certain effectively settled tax positions, as well as the recognition of certain capital loss carryforward and tax credit benefits. The benefits in 2012 include certain operating and capital loss carryforward benefits as well as the release of tax reserves with respect to certain effectively settled tax positions, and the benefits in 2011 principally relate to the release of tax reserves with respect to certain effectively settled tax positions.

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The tax effects of the items recorded as deferred tax assets and liabilities are:

Deferred Taxes	September 30,	
(in millions)	2013	2012
Deferred tax assets:		
Accrued liabilities	\$ 199	\$ 332
Postretirement and other employee benefits	294	394
Tax credit and loss carryforwards	274	216
All other	188	219
Total deferred tax assets	955	1,161
Valuation allowance	(277)	(324)
Total deferred tax assets, net*	\$ 678	\$ 837
Deferred tax liabilities:		
Property, equipment and intangible assets	\$ (436)	\$ (415)
Unbilled revenue	(133)	(105)
Financing obligations	(120)	-
Film & TV production expenditures	(535)	(254)
Total deferred tax liabilities	(1,224)	(774)
Deferred taxes, net	\$ (546)	\$ 63

* Includes \$45 million noncurrent deferred tax assets, net reflected within *Other assets - noncurrent* in the Consolidated Balance Sheet as of September 30, 2013.

We have recorded valuation allowances for certain deferred tax assets, which are primarily related to net operating losses in foreign jurisdictions and capital losses in the U.S., as sufficient uncertainty exists regarding the future realization of these assets.

We have \$335 million of U.S. tax loss carryforwards at September 30, 2013. The utilization of these carryforwards as an available offset to future taxable income is subject to limitations under U.S. federal income tax laws. These carryforwards begin to expire in fiscal year 2016. In addition, we have \$371 million of tax losses in various international jurisdictions that are primarily from countries with unlimited carry forward periods and \$107 million of tax losses that expire in the fiscal years 2015 through 2031. The pre-valuation allowance deferred tax asset amount related to these U.S. and international tax loss carryforwards is \$274 million.

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As of September 30, 2013, we have not made any provision for U.S. income taxes on approximately \$2.1 billion of unremitted earnings of our international subsidiaries since these earnings are permanently reinvested outside the U.S. If these earnings were to be remitted in the future, the related U.S. income tax liability may be reduced by any foreign income taxes previously paid on these earnings. Under current U.S. tax laws, repatriating unremitted earnings could result in incremental taxes of 10% - 15% on the repatriated amounts depending on the territory. To the extent that any tax reform legislation were to lower the U.S. federal statutory income tax rate from its current 35%, there could be a corresponding reduction in the estimate of incremental taxes that would result from repatriating unremitted earnings.

Table of Contents**VIACOM INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(continued)

A reconciliation of the beginning and ending amounts of unrecognized tax benefits, excluding interest and penalties, is as follows:

Unrecognized Tax Benefits (in millions)	Year Ended September 30,		
	2013	2012	2011
Balance at beginning of the period	\$ 207	\$ 212	\$ 304
Gross additions based on tax positions related to the current year	29	28	17
Gross additions for tax positions of prior years	5	24	3
Gross reductions for tax positions of prior years	(50)	(44)	(97)
Settlements	(25)	(2)	(11)
Expiration of the statute of limitation	(7)	(11)	(4)
Balance at end of the period	\$ 159	\$ 207	\$ 212

The total amount of unrecognized tax benefits at September 30, 2013, if recognized, would favorably affect the effective tax rate.

As discussed in Note 2, we recognize interest and penalties accrued related to unrecognized tax benefits as a component of the *Provision for income taxes* in the Consolidated Statements of Earnings. We recognized interest and penalties of \$9 million in 2013, \$15 million in 2012 and \$14 million in 2011. We had accruals of \$35 million and \$66 million related to interest and penalties recorded as a component of *Other liabilities - current and noncurrent* in the Consolidated Balance Sheets at September 30, 2013 and 2012, respectively. The reduction in the accrual for interest and penalties during the year was related to the release of certain effectively settled tax positions as well as settlements.

We and our subsidiaries file income tax returns with the Internal Revenue Service (IRS) and various state and international jurisdictions. The IRS concluded its examination of our U.S. consolidated income tax returns through 2008 in 2013. Currently, there are no material potential income tax liabilities still in dispute with respect to the IRS examination of 2009. We anticipate the IRS will begin its examination of our 2010 and 2011 U.S. consolidated federal income tax returns in the first quarter of fiscal 2014. Tax authorities are also conducting examinations of Viacom subsidiaries in various state and local jurisdictions, including New York City. Due to potential resolution of unrecognized tax positions involving multiple tax periods and jurisdictions, it is reasonably possible that a reduction of up to \$75 million of unrecognized income tax benefits may occur within 12 months, some of which, depending on the nature of the settlement, may affect our income tax provision and therefore benefit the resulting effective tax rate. The majority of these uncertain tax positions, when recognized in the financial statements, would be recorded in the Consolidated Statements of Earnings as part of the *Provision for income taxes*. The actual amount could vary significantly depending on the ultimate timing and nature of any settlements.

NOTE 15. SUPPLEMENTAL CASH FLOW AND OTHER INFORMATION

Supplemental Cash Flow Information

Year Ended September 30,

(in millions)	2013	2012	2011
Cash paid for interest*	\$ 475	\$ 409	\$ 420
Cash paid for income taxes	\$ 463	\$ 1,069	\$ 1,050

* Includes cash payments related to discontinued operations of \$28 million and \$3 million in 2013 and 2012, respectively.

Table of Contents**VIACOM INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(continued)

Cash paid for income taxes in the year ended September 30, 2013 reflects the benefit from the retroactive reenactment of legislation allowing for accelerated tax deductions on certain qualified film and television productions. Cash paid for income taxes in 2012 is net of approximately \$100 million related to a federal tax refund resulting from the carryback of capital losses against taxes previously paid on capital gains.

Interest Expense, net	Year Ended September 30,		
(in millions)	2013	2012	2011
Interest expense	\$ (468)	\$ (425)	\$ (419)
Interest income	4	8	7
Interest expense, net	\$ (464)	\$ (417)	\$ (412)

Other Items, net	Year Ended September 30,		
(in millions)	2013	2012	2011
Gain on sale of HBO Pacific Partners and LAPT ^V	\$ 111	\$ -	\$ -
Other investment gains	46	-	-
Impairment of investment	(23)	-	-
Foreign exchange loss	(23)	(8)	(4)
Other gains/(losses)	(5)	3	(2)
Other items, net	\$ 106	\$ (5)	\$ (6)

Sales of HBO Pacific Partners and LAPT^V

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In the fourth quarter of 2013, we completed the sales of our 20% interest in HBO Pacific Partners and our 22.5% interest in LAPTV, partnerships that own pay television channels under various brand names and that were accounted for under the equity method. The sales resulted in aggregate total proceeds of \$124 million and a gain of \$111 million.

Redeemable Noncontrolling Interest	Year Ended September 30,		
(in millions)	2013	2012	2011
Beginning balance	\$ 179	\$ 152	\$ 131
Net earnings	14	16	12
Distributions	(13)	(16)	(12)
Translation adjustment	(4)	7	(1)
Redemption value adjustment	24	20	22
Ending balance	\$ 200	\$ 179	\$ 152

Accounts Receivable

We had \$379 million and \$372 million of noncurrent trade receivables as of September 30, 2013 and 2012, respectively. The accounts receivable were primarily in the *Filmed Entertainment* segment, included within *Other assets* in our Consolidated Balance Sheets, and principally related to long-term television license arrangements. Such amounts are due in accordance with the underlying terms of the respective agreements and are principally from investment grade companies with which we have historically done business under similar terms, for which credit loss allowances are generally not considered necessary.

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VIACOM INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(continued)

Collaborative Arrangements

Our collaborative arrangements principally relate to contractual arrangements with other studios to jointly finance and distribute theatrical productions (co-financing arrangements). A co-financing arrangement typically involves joint ownership of the film asset with each partner responsible for distribution of the film in specific territories. The partners share in the profits and losses of the film in accordance with their respective ownership interest. The amounts recorded in the Consolidated Statements of Earnings related to collaborative arrangements were not material.

NOTE 16. REPORTING SEGMENTS

The following tables set forth our financial performance by reporting segment. Our reporting segments have been determined in accordance with our internal management structure. We manage our operations through two reporting segments: (i) *Media Networks* and (ii) *Filmed Entertainment*. Typical intersegment transactions include the purchase of advertising by the *Filmed Entertainment* segment on *Media Networks* properties and the purchase of *Filmed Entertainment* 's feature films exhibition rights by *Media Networks*. The elimination of such intercompany transactions in the Consolidated Financial Statements is included within eliminations in the tables below.

Our measure of segment performance is adjusted operating income (loss). Adjusted operating income (loss) is defined as operating income (loss), before equity-based compensation and certain other items identified as affecting comparability, including restructuring and other charges, when applicable.

Revenues by Segment	Year Ended September 30,		
	2013	2012	2011
(in millions)			
Media Networks	\$ 9,656	\$ 9,194	\$ 9,145
Filmed Entertainment	4,282	4,820	5,923
Eliminations	(144)	(127)	(154)
Total revenues	\$ 13,794	\$ 13,887	\$ 14,914

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Adjusted Operating Income

Year Ended September 30,

(in millions)	2013	2012	2011
Media Networks	\$ 4,096	\$ 3,889	\$ 3,848
Filmed Entertainment	234	325	341
Corporate expenses	(251)	(192)	(207)
Equity-based compensation	(128)	(122)	(128)
Eliminations	(9)	1	-
Restructuring and other charges	(106)	-	(144)
Operating income	3,836	3,901	3,710
Interest expense, net	(464)	(417)	(412)
Equity in net earnings of investee companies	41	12	40
Loss on extinguishment of debt	-	(21)	(87)
Other items, net	106	(5)	(6)
Earnings from continuing operations before provision for income taxes	\$ 3,519	\$ 3,470	\$ 3,245

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(continued)

Depreciation and Amortization and Total Assets (in millions)	Depreciation and Amortization Year Ended September 30,			Total Assets September 30,	
	2013	2012	2011	2013	2012
Media Networks	\$ 144	\$ 144	\$ 177	\$ 16,653	\$ 16,401
Filmed Entertainment	89	87	89	5,647	5,251
Corporate/Eliminations	4	5	5	1,529	598
Total	\$ 237	\$ 236	\$ 271	\$ 23,829	\$ 22,250

Capital Expenditures (in millions)	Year Ended September 30,		
	2013	2012	2011
Media Networks	\$ 103	\$ 101	\$ 96
Filmed Entertainment	53	46	55
Corporate	4	7	4
Total capital expenditures	\$ 160	\$ 154	\$ 155

Revenues by Component (in millions)	Year Ended September 30,		
	2013	2012	2011
Advertising	\$ 4,855	\$ 4,756	\$ 4,997
Feature film	3,742	4,366	5,482
Affiliate fees	4,245	3,889	3,519
Ancillary	1,096	1,003	1,070
Eliminations	(144)	(127)	(154)
Total revenues	\$ 13,794	\$ 13,887	\$ 14,914

Revenues generated from international markets were 26%, 29% and 29% of total consolidated revenues in 2013, 2012 and 2011, respectively. Our principal international businesses are in Europe. The United Kingdom and Germany together accounted for approximately 44%, 44% and 42% of total revenues in the Europe, Middle East and Africa (EMEA) region in 2013, 2012 and 2011, respectively.

Geographic Information	Revenues*			Long-lived Assets**	
	Year Ended September 30,			September 30,	
(in millions)	2013	2012	2011	2013	2012
United States	\$ 10,152	\$ 9,804	\$ 10,538	\$ 4,982	\$ 5,238
EMEA	2,173	2,423	2,587	418	396
All other	1,469	1,660	1,789	75	104
Total	\$ 13,794	\$ 13,887	\$ 14,914	\$ 5,475	\$ 5,738

*Revenue classifications are based on customers' locations. Transactions within Viacom between geographic areas are not significant.

**Reflects total assets less current assets, deferred tax assets, goodwill, intangibles and investments.

NOTE 17. RELATED PARTY TRANSACTIONS

NAI, directly and through a wholly-owned subsidiary, is the controlling stockholder of both Viacom and CBS. Sumner M. Redstone, the controlling stockholder, Chairman and Chief Executive Officer of NAI, serves as our Executive Chairman and Founder and as the Executive Chairman and Founder of CBS. Shari Redstone, who is Sumner Redstone's daughter, is the President and a director of NAI, and serves as non-executive Vice Chair of the

Table of Contents**VIACOM INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(continued)**

Board of Directors of both Viacom and CBS. George Abrams, one of our directors, serves on the boards of both NAI and Viacom, and Frederic Salerno, another of our directors, serves on the boards of both Viacom and CBS. Philippe Dauman, our President and Chief Executive Officer, also serves on the boards of both NAI and Viacom. Transactions between Viacom and related parties are overseen by our Governance and Nominating Committee.

Viacom and NAI Related Party Transactions

NAI licenses films in the ordinary course of business for its motion picture theaters from all major studios, including Paramount. During the years ended September 30, 2013, 2012 and 2011, Paramount earned revenues from NAI in connection with these licenses in the aggregate amounts of approximately \$19 million, \$19 million and \$44 million, respectively.

Viacom and CBS Corporation Related Party Transactions

In the ordinary course of business, we are involved in transactions with CBS and its various businesses that result in the recognition of revenues and expenses by us. Transactions with CBS are settled in cash.

Paramount earns revenues and recognizes expenses associated with its distribution of certain television products into the home entertainment market on behalf of CBS. Pursuant to its agreement with CBS, Paramount distributes CBS's library of television and other content on DVD and Blu-ray disc on a worldwide basis. Under the terms of the agreement, Paramount is entitled to retain a fee based on a percentage of gross receipts and is generally responsible for all out-of-pocket costs, which are recoupable prior to any participation payments to CBS. In April 2013, Paramount and CBS extended the term of the agreement. Paramount also earns revenues from CBS through leasing of studio space and licensing of certain film products.

The *Media Networks* segment recognizes advertising revenues and purchases television programming from CBS. The cost of the programming purchases is initially recorded as acquired program rights inventory and amortized over the estimated period that revenues will be generated.

Both of our segments recognize advertising expenses related to the placement of advertisements with CBS.

The following table summarizes the transactions with CBS as included in our Consolidated Financial Statements:

CBS Related Party Transactions (in millions)	Year Ended September 30,		
	2013	2012	2011
Consolidated Statements of Earnings			
Revenues	\$ 264	\$ 285	\$ 341
Operating expenses	\$ 327	\$ 347	\$ 434
Consolidated Balance Sheets			
	2013	September 30, 2012	
Accounts receivable	\$ 5	\$ 7	
Other assets	-	1	

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Total due from CBS	\$	5	\$	8
Accounts payable	\$	3	\$	1
Participants' share and residuals, current		115		143
Program rights obligations, current		99		110
Program rights obligations, noncurrent		139		169
Other liabilities		15		24
Total due to CBS	\$	371	\$	447

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(continued)

Other Related Party Transactions

In the ordinary course of business, we are involved in related party transactions with equity investees, principally related to investments in unconsolidated VIEs as more fully described in Note 3. These related party transactions primarily relate to the provision of advertising services, licensing of film and programming content, distribution of films and provision of certain administrative support services, for which the impact on our Consolidated Financial Statements is as follows:

Other Related Party Transactions (in millions)	2013	Year Ended September 30, 2012	2011
Consolidated Statements of Earnings			
Revenues	\$ 216	\$ 309	\$ 239
Operating expenses	\$ 63	\$ 120	\$ 83
Selling, general and administrative	\$ (17)	\$ (16)	\$ (16)
	2013	September 30, 2012	
Consolidated Balance Sheets			
Accounts receivable	\$ 84	\$ 114	
Other assets	1	3	
Total due from other related parties	\$ 85	\$ 117	
Accounts payable	\$ 4	\$ 8	
Other liabilities	26	17	
Total due to other related parties	\$ 30	\$ 25	

All other related party transactions are not material in the periods presented.

Table of Contents**VIACOM INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(continued)****NOTE 18. DISCONTINUED OPERATIONS**

Discontinued operations for all periods presented principally relates to Harmonix, which was sold in December 2010. Other discontinued operations activity in all years reflects adjustments related to businesses previously sold.

Discontinued Operations

(in millions)	Harmonix	All Other	Total
Year ended September 30, 2013			
Pre-tax earnings (losses) from discontinued operations	\$ (19)	\$ -	\$ (19)
Income tax benefit (provision)	7	-	7
Net earnings (losses) from discontinued operations	\$ (12)	\$ -	\$ (12)
Year ended September 30, 2012			
Pre-tax earnings (losses) from discontinued operations	\$ (398)	\$ 8	\$ (390)
Income tax benefit (provision)	21	5	26
Net earnings (losses) from discontinued operations	\$ (377)	\$ 13	\$ (364)
Year ended September 30, 2011			
Revenues from discontinued operations	\$ 49	\$ -	\$ 49
Pre-tax earnings (losses) from discontinued operations	\$ (31)	\$ 8	\$ (23)
Income tax benefit (provision)	15	(2)	13
Net earnings (losses) from discontinued operations	\$ (16)	\$ 6	\$ (10)

Discontinued operations activity for the year ended September 30, 2012 principally reflects the \$383 million charge related to the earn-out dispute with the former shareholders of Harmonix. Activity for the year ended September 30, 2013 principally reflects interest on the dispute.

The pre-tax loss from discontinued operations for the year ended September 30, 2011 is a \$12 million loss from operations for the period through the date of the sale of Harmonix and a \$14 million loss on disposal.

For tax purposes, the disposal of Harmonix and related earn-out payment generated tax benefits of approximately \$250 million, of which approximately \$103 million has been utilized as of September 30, 2013. The remaining benefit will be available to offset qualifying future cash

taxes.

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(continued)

NOTE 19. QUARTERLY FINANCIAL DATA (unaudited):**2013**

(in millions, except per share information)	First	Second	Third	Fourth	Year Ended September 30, 2013
Revenues	\$ 3,314	\$ 3,135	\$ 3,693	\$ 3,652	\$ 13,794
Operating income	\$ 797	\$ 847	\$ 1,085	\$ 1,107	\$ 3,836
Net earnings from continuing operations (Viacom and noncontrolling interests)	\$ 482	\$ 489	\$ 666	\$ 812	\$ 2,449
Net earnings (Viacom and noncontrolling interests)	\$ 479	\$ 486	\$ 662	\$ 810	\$ 2,437
Net earnings from continuing operations attributable to Viacom	\$ 473	\$ 481	\$ 647	\$ 806	\$ 2,407
Net earnings attributable to Viacom	\$ 470	\$ 478	\$ 643	\$ 804	\$ 2,395
Basic net earnings per share, continuing operations attributable to Viacom	\$ 0.94	\$ 0.98	\$ 1.34	\$ 1.72	\$ 4.95
Basic net earnings per share attributable to Viacom	\$ 0.94	\$ 0.97	\$ 1.33	\$ 1.72	\$ 4.93
Diluted net earnings per share, continuing operations attributable to Viacom	\$ 0.93	\$ 0.96	\$ 1.32	\$ 1.69	\$ 4.86
Diluted net earnings per share attributable to Viacom	\$ 0.92	\$ 0.96	\$ 1.31	\$ 1.68	\$ 4.84

2012

(in millions, except per share information)	First	Second	Third	Fourth	Year Ended September 30, 2012
Revenues	\$ 3,952	\$ 3,331	\$ 3,241	\$ 3,363	\$ 13,887
Operating income	\$ 1,016	\$ 932	\$ 903	\$ 1,050	\$ 3,901
Net earnings from continuing operations (Viacom and noncontrolling interests)	\$ 601	\$ 599	\$ 536	\$ 649	\$ 2,385
Net earnings (Viacom and noncontrolling interests)	\$ 222	\$ 596	\$ 547	\$ 656	\$ 2,021
Net earnings from continuing operations attributable to Viacom	\$ 591	\$ 588	\$ 523	\$ 643	\$ 2,345
Net earnings attributable to Viacom	\$ 212	\$ 585	\$ 534	\$ 650	\$ 1,981
Basic net earnings per share, continuing operations attributable to Viacom	\$ 1.07	\$ 1.09	\$ 1.00	\$ 1.26	\$ 4.42
Basic net earnings per share attributable to Viacom	\$ 0.39	\$ 1.09	\$ 1.02	\$ 1.27	\$ 3.73
Diluted net earnings per share, continuing operations attributable to Viacom	\$ 1.06	\$ 1.08	\$ 0.99	\$ 1.24	\$ 4.36
Diluted net earnings per share attributable to Viacom	\$ 0.38	\$ 1.07	\$ 1.01	\$ 1.26	\$ 3.69

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

None.

Item 9A. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

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

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2013. Based on that evaluation, management has concluded that, as of such date, our disclosure controls and procedures were effective.

Management's Report on Internal Control over Financial Reporting

Management's Report on Internal Control over Financial Reporting is set forth on page 67.

Audit Opinion on Internal Control over Financial Reporting

The effectiveness of the Company's internal control over financial reporting has been audited by PricewaterhouseCoopers, LLP an independent registered public accounting firm, as stated in their report, which is included herein on page 68.

Changes in Internal Control Over Financial Reporting

In 2013, we continued the global business transformation initiative we disclosed in our 2012 Form 10-K to integrate and upgrade certain financial processing systems to an enterprise-wide system solution, and we anticipate additional implementations throughout other parts of our business over the next year. We continue to evaluate and monitor our internal controls as processes and procedures in each of the affected areas evolve.

Item 9B. Other Information.

None.

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PART III

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

The information required by this item with respect to our directors and certain corporate governance practices will be contained in our Proxy Statement for our 2014 Annual Meeting of Stockholders (the Proxy Statement) under the headings Corporate Governance, Our Board of Directors, Item 1 Election of Directors and Section 16(a) Beneficial Ownership Reporting Compliance, which information is incorporated herein by reference. The information required by this item with respect to our executive officers (i) will be contained in the Proxy Statement under the headings Corporate Governance and Section 16(a) Beneficial Ownership Reporting Compliance and (ii) is included in Part I of this Form 10-K under the caption Our Executive Officers, which information is incorporated herein by reference.

Item 11. *Executive Compensation.*

The information required by this item will be contained in the Proxy Statement under the headings Executive Compensation, Compensation Committee Interlocks and Insider Participation and Compensation Committee Report, which information is incorporated herein by reference.

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

The information required by this item will be contained in the Proxy Statement under the headings Equity Compensation Plan Information and Security Ownership of Certain Beneficial Owners and Management, which information is incorporated herein by reference.

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

The information required by this item will be contained in the Proxy Statement under the headings Related Person Transactions and Our Board of Directors, which information is incorporated herein by reference.

Item 14. *Principal Accounting Fees and Services.*

The information required by this item will be contained in the Proxy Statement under the heading Services Provided by the Independent Auditor and Fees Paid, - which information is incorporated herein by reference.

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PART IV

Item 15. Exhibits, Financial Statement Schedules.

(a) 1. *Financial Statements.*

Management's Report on Internal Control over Financial Reporting
Report of Independent Registered Public Accounting Firm
Consolidated Statement of Earnings for the years ended September 30, 2013, 2012 and 2011
Consolidated Statement of Comprehensive Income for the years ended September 30, 2013, 2012 and 2011
Consolidated Balance Sheets as of September 30, 2013 and 2012
Consolidated Statement of Cash Flows for the years ended September 30, 2013, 2012 and 2011
Consolidated Statement of Stockholders' Equity for the years ended September 30, 2013, 2012 and 2011
Notes to Consolidated Financial Statements

2. *Financial Statement Schedules.*

Schedule II. Valuation and Qualifying Accounts

All other Schedules are omitted since the required information is not present or is not present in amounts sufficient to require submission of the schedule.

3. *Exhibits.*

The exhibits listed in Item 15(b) of this Part IV are filed or incorporated by reference as part of this Form 10-K. The Index to Exhibits is on page 115.

(b) *Exhibits.*

The exhibits listed in Item 15(b) of this Part IV are filed or incorporated by reference as part of this Form 10-K. The Index to Exhibits is on page 115.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

VIACOM INC.

By: /s/ Philippe P. Dauman
Philippe P. Dauman
President and Chief Executive Officer

Date: November 14, 2013

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of Viacom Inc. and in the capacities and on the dates indicated:

Signature	Title	Date
/s/ Philippe P. Dauman	President and Chief Executive Officer;	November 14, 2013
Philippe P. Dauman	Director	
/s/ Thomas E. Dooley	Senior Executive Vice President and Chief	November 14, 2013
Thomas E. Dooley	Operating Officer; Director	
/s/ Wade Davis	Executive Vice President,	November 14, 2013
Wade Davis	Chief Financial Officer	
/s/ Katherine Gill-Charest	Senior Vice President, Controller	November 14, 2013
Katherine Gill-Charest	(Chief Accounting Officer)	
*	Executive Chairman of the Board	November 14, 2013
Sumner M. Redstone	and Founder	
*	Vice Chair of the Board	November 14, 2013
Shari Redstone		
*	Director	November 14, 2013
George S. Abrams		

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*	Director	November 14, 2013
Cristiana Falcone Sorrell		
*	Director	November 14, 2013
Alan C. Greenberg		

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Signature	Title	Date
*	Director	November 14, 2013
Robert K. Kraft		
*	Director	November 14, 2013
Blythe J. McGarvie		
*	Director	November 14, 2013
Deborah Norville		
*	Director	November 14, 2013
Charles E. Phillips, Jr.		
*	Director	November 14, 2013
Frederic V. Salerno		
*	Director	November 14, 2013
William Schwartz		
*By: /s/ Michael D. Fricklas Michael D. Fricklas		November 14, 2013
<i>Attorney-in-Fact for the Directors</i>		

Table of Contents**Item 15(a).****VIACOM INC.****SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS**

(in millions)	Beginning of period	Additions - expense and other	Deductions	End of period
Year ended September 30, 2013:				
Allowance for doubtful accounts	\$ 36	\$ 8	\$ (11)	\$ 33
Sales returns and allowances	\$ 282	\$ 503	\$ (524)	\$ 261
Inventory obsolescence reserves	\$ 74	\$ 3	\$ (2)	\$ 75
Deferred tax valuation allowance	\$ 324	\$ 75	\$ (122)	\$ 277
Year ended September 30, 2012:				
Allowance for doubtful accounts	\$ 49	\$ 6	\$ (19)	\$ 36
Sales returns and allowances	\$ 309	\$ 595	\$ (622)	\$ 282
Inventory obsolescence reserves	\$ 73	\$ 11	\$ (10)	\$ 74
Deferred tax valuation allowance	\$ 222	\$ 161	\$ (59)	\$ 324
Year ended September 30, 2011:				
Allowance for doubtful accounts	\$ 76	\$ 9	\$ (36)	\$ 49
Sales returns and allowances	\$ 254	\$ 693	\$ (638)	\$ 309
Inventory obsolescence reserves	\$ 73	\$ 20	\$ (20)	\$ 73
Deferred tax valuation allowance	\$ 144	\$ 94	\$ (16)	\$ 222

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Item 15(b).

INDEX TO EXHIBITS

Exhibit No.	Description of Exhibit
3.1	Amended and Restated Certificate of Incorporation of Viacom Inc. effective December 31, 2005 (incorporated by reference to Exhibit 3.1 to the Annual Report on Form 10-K of Viacom Inc. filed March 16, 2006) (File No. 001-32686).
3.2	Amended and Restated Bylaws of Viacom Inc. effective September 15, 2011 (incorporated by reference to Exhibit 3.2 to the Current Report on Form 8-K of Viacom Inc. filed September 21, 2011) (File No. 001-32686).
4.1	Indenture, dated as of April 12, 2006, between Viacom Inc. and The Bank of New York (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K of Viacom Inc. filed April 17, 2006) (File No. 001-32686).
4.2	First Supplemental Indenture, dated as of April 12, 2006, between Viacom Inc. and The Bank of New York, including Form of 5.75% Senior Note due 2011, Form of 6.25% Senior Note due 2016 and Form of 6.875% Senior Debenture due 2036 (incorporated by reference to Exhibit 4.2 to the Current Report on Form 8-K of Viacom Inc. filed April 17, 2006) (File No. 001-32686).
4.3	Second Supplemental Indenture, dated as of June 16, 2006, between Viacom Inc. and The Bank of New York, including Form of Floating Rate Senior Note due 2009 (incorporated by reference to Exhibit 4.4 to the Registration Statement on Form S-4 of Viacom Inc. filed August 21, 2006) (File No. 333-136756).
4.4	Third Supplemental Indenture, dated as of December 13, 2006, between Viacom Inc. and The Bank of New York, as trustee (including forms of Senior Notes) (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K of Viacom Inc. filed December 19, 2006) (File No. 001-32686).
4.5	Fourth Supplemental Indenture, dated as of October 5, 2007, between Viacom Inc. and The Bank of New York, as trustee (including forms of Senior Notes and Senior Debentures) (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K of Viacom Inc. filed October 9, 2007) (File No. 001-32686).
4.6	Fifth Supplemental Indenture, dated as of August 26, 2009, between Viacom Inc. and The Bank of New York Mellon, as trustee (including forms of Senior Notes) (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K of Viacom Inc. filed August 26, 2009) (File No. 001-32686).
4.7	Sixth Supplemental Indenture, dated as of September 29, 2009, between Viacom Inc. and The Bank of New York Mellon, as trustee (including forms of Senior Notes) (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K of Viacom Inc. filed September 30, 2009) (File No. 001-32686).
4.8	Seventh Supplemental Indenture, dated as of February 22, 2011, between Viacom Inc. and The Bank of New York Mellon, as trustee (including form of Senior Notes) (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K of Viacom Inc. filed February 23, 2011) (File No. 001-32686).
4.9	Eighth Supplemental Indenture, dated as of March 31, 2011, between Viacom Inc. and The Bank of New York Mellon, as trustee (including form of Senior Notes) (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K of Viacom Inc. filed March 31, 2011) (File No. 001-32686).

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Exhibit No.	Description of Exhibit
4.10	Ninth Supplemental Indenture, dated as of December 12, 2011, between Viacom Inc. and The Bank of New York Mellon, as trustee (including form of Senior Notes) (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K of Viacom Inc. filed December 12, 2011) (File No. 001-32686).
4.11	Tenth Supplemental Indenture, dated as of February 28, 2012, between Viacom Inc. and The Bank of New York Mellon, as trustee (including form of Senior Notes) (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K of Viacom Inc. filed February 28, 2012) (File No. 001-32686).
4.12	Eleventh Supplemental Indenture, dated as of June 14, 2012, between Viacom Inc. and The Bank of New York Mellon, as trustee (including form of Senior Notes) (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K of Viacom Inc. filed June 14, 2012) (File No. 001-32686).
4.13	Twelfth Supplemental Indenture, dated as of November 26, 2012, between Viacom Inc. and The Bank of New York Mellon, as Trustee (including forms of Senior Debentures) (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K of Viacom Inc. filed November 30, 2012) (File No. 001-32686).
4.14	Thirteenth Supplemental Indenture, dated as of December 4, 2012, between Viacom Inc. and The Bank of New York Mellon, as Trustee (including forms of Senior Debentures) (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K of Viacom Inc. filed December 21, 2012) (File No. 001-32686).
4.15	Fourteenth Supplemental Indenture, dated as of December 17, 2012, between Viacom Inc. and The Bank of New York Mellon, as Trustee (including forms of Senior Debentures) (incorporated by reference to Exhibit 4.2 to the Current Report on Form 8-K of Viacom Inc. filed December 21, 2012) (File No. 001-32686).
4.16	Fifteenth Supplemental Indenture, dated as of March 14, 2013, between Viacom Inc. and The Bank of New York Mellon, as Trustee (including forms of the Securities) (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K of Viacom Inc. filed March 14, 2013) (File No. 001-32686).
4.17	Sixteenth Supplemental Indenture, dated as of August 19, 2013, between Viacom Inc. and The Bank of New York Mellon, as Trustee (including forms of the Securities) (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K of Viacom Inc. filed August 19, 2013) (File No. 001-32686).
10.1	\$2.0 Billion Three-Year Credit Agreement, dated as of October 8, 2010, among Viacom Inc., the subsidiaries of Viacom Inc. designated as borrowers from time to time thereunder, the Lenders named therein, JPMorgan Chase Bank, N.A., as Administrative Agent, Citibank, N.A. and Bank of America, N.A., as Syndication Agents, and Deutsche Bank Securities Inc., Morgan Stanley MUFG Loan Partners, LLC, The Royal Bank of Scotland PLC and Wells Fargo Bank, N.A., as Documentation Agents (incorporated by reference to Exhibit 10.1 to the Transition Report on Form 10-K of Viacom Inc. filed November 12, 2010) (File No. 001-32686).
10.2	First Amendment, dated as of December 2, 2011, to the \$2.0 Billion Three-Year Credit Agreement, dated as of October 8, 2010, among Viacom Inc., the subsidiaries of Viacom Inc. designated as borrowers from time to time thereunder, the Lenders named therein, JPMorgan Chase Bank, N.A., as Administrative Agent, Citibank, N.A. and Bank of America, N.A., as Syndication Agents, and Deutsche Bank Securities Inc., Morgan Stanley MUFG Loan Partners, LLC, The Royal Bank of Scotland PLC and Wells Fargo Bank, N.A., as Documentation Agents (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q of Viacom Inc. filed February 2, 2012) (File No. 001-32686).

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Exhibit No.	Description of Exhibit
10.3	Second Amendment, dated as of November 9, 2012, to the Credit Agreement, dated as of October 8, 2010, as amended on December 2, 2011, among Viacom Inc., the subsidiaries of Viacom Inc. designated as borrowers from time to time thereunder, the Lenders named therein, JPMorgan Chase Bank, N.A., as Administrative Agent, Citibank, N.A. and Bank of America, N.A., as Syndication Agents, and Deutsche Bank Securities Inc., Morgan Stanley MUFJ Loan Partners, LLC, The Royal Bank of Scotland PLC and Wells Fargo Bank, N.A., as Documentation Agents (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q of Viacom Inc. filed January 31, 2013) (File No. 001-32686).
10.4	Summary of Viacom Inc. Compensation for Outside Directors (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K of Viacom Inc. filed March 27, 2013) (File No. 001-32686).**
10.5	Amended Compensation Arrangement for Non-Executive Vice Chair (incorporated by reference to Exhibit 10.5 to the Quarterly Report on Form 10-Q of Viacom Inc. filed November 9, 2006) (File No. 001-32686).**
10.6	Viacom Inc. 2006 Stock Option Plan for Outside Directors (incorporated by reference to Exhibit 10.8 to the Annual Report on Form 10-K of Viacom Inc. filed March 16, 2006) (File No. 001-32686).**
10.7	Viacom Inc. 2006 RSU Plan for Outside Directors (incorporated by reference to Exhibit 10.9 to the Annual Report on Form 10-K of Viacom Inc. filed March 16, 2006) (File No. 001-32686).**
10.8	Viacom Inc. 2011 Stock Option Plan for Outside Directors (incorporated by reference to Exhibit B to the Definitive Proxy Statement of Viacom Inc. filed April 16, 2010) (File No. 001-32686), as amended by Amendment No. 1 to Viacom Inc. 2011 Stock Option Plan for Outside Directors (incorporated by reference to Exhibit 10.2 to the Quarterly Report on Form 10-Q of Viacom Inc. filed January 31, 2013) (File No. 001-32686).**
10.9	Viacom Inc. 2011 RSU Plan for Outside Directors (incorporated by reference to Exhibit C to the Definitive Proxy Statement of Viacom Inc. filed April 16, 2010) (File No. 001-32686), as amended by Amendment No. 1 to Viacom Inc. 2011 RSU Plan for Outside Directors (incorporated by reference to Exhibit 10.3 to the Quarterly Report on Form 10-Q of Viacom Inc. filed January 31, 2013) (File No. 001-32686).**
10.10	Viacom Inc. Deferred Compensation Plan for Outside Directors (incorporated by reference to Exhibit 10.11 to the Annual Report on Form 10-K of Viacom Inc. filed March 16, 2006) (File No. 001-32686).**
10.11	Viacom Inc. Senior Executive Short-Term Incentive Plan, as amended and restated effective January 18, 2012 (incorporated by reference to Exhibit A to the Definitive Proxy Statement of Viacom Inc. filed January 27, 2012) (File No. 001-32686).**
10.12	Viacom Inc. 2006 Long-Term Management Incentive Plan, as amended and restated effective January 1, 2011 (incorporated by reference to Exhibit A to the Definitive Proxy Statement of Viacom Inc. filed April 16, 2010) (File No. 001-32686).**
10.12.1	Form of Stock Option/RSU Confirmation Sheet (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q of Viacom Inc. filed August 5, 2011) (File No. 001-32686).**
10.12.2	Form of Terms and Conditions to the Stock Option Certificate (incorporated by reference to Exhibit 10.2 to the Quarterly Report on Form 10-Q of Viacom Inc. filed August 5, 2011) (File No. 001-32686).**
10.12.3	Form of Terms and Conditions to the Restricted Share Units Certificate (incorporated by reference to Exhibit 10.3 to the Quarterly Report on Form 10-Q of Viacom Inc. filed August 5, 2011) (File No. 001-32686).**

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Exhibit No.	Description of Exhibit
10.12.4	Form of Terms and Conditions to the Performance Share Units (incorporated by reference to Exhibit 10.4 to the Quarterly Report on Form 10-Q of Viacom Inc. filed August 5, 2011) (File No. 001-32686).**
10.13	Viacom Excess Pension Plan, as amended and restated January 1, 2009 (incorporated by reference to Exhibit 10.13 to the Annual Report on Form 10-K of Viacom Inc. filed February 12, 2009) (File No. 001-32686).**
10.14	Amendment, effective as of March 31, 2009, to Viacom Excess Pension Plan, as amended and restated January 1, 2009 (incorporated by reference to Exhibit 10.13 to the Transition Report on Form 10-K of Viacom Inc. filed November 12, 2010) (File No. 001-32686).**
10.15	Viacom Excess 401(k) Plan for Designated Senior Executives, as amended and restated January 1, 2009 (incorporated by reference to Exhibit 10.14 to the Annual Report on Form 10-K of Viacom Inc. filed February 12, 2009) (File No. 001-32686).**
10.16	Amendments, effective as of April 1, 2009 and December 31, 2009, to Viacom Excess 401(k) Plan for Designated Senior Executives, as amended and restated January 1, 2009 (incorporated by reference to Exhibit 10.15 to the Transition Report on Form 10-K of Viacom Inc. filed November 12, 2010) (File No. 001-32686).**
10.17	Viacom Bonus Deferral Plan for Designated Senior Executives, as amended and restated January 1, 2009 (incorporated by reference to Exhibit 10.15 to the Annual Report on Form 10-K of Viacom Inc. filed February 12, 2009) (File No. 001-32686).**
10.18	Amendment, effective as of December 31, 2009, to Viacom Bonus Deferral Plan for Designated Senior Executives, as amended and restated January 1, 2009 (incorporated by reference to Exhibit 10.17 to the Transition Report on Form 10-K of Viacom Inc. filed November 12, 2010) (File No. 001-32686).**
10.19	Employment Agreement with Sumner M. Redstone, dated September 25, 2006 (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K of Viacom Inc. filed September 26, 2006) (File No. 001-32686).**
10.20	Employment Agreement between Viacom Inc. and Philippe P. Dauman, as amended and restated as of April 14, 2010 (incorporated by reference to Exhibit 10.2 to the Quarterly Report on Form 10-Q of Viacom Inc. filed April 29, 2010) (File No. 001-32686).**
10.21	Employment Agreement between Viacom Inc. and Thomas E. Dooley, as amended and restated as of May 27, 2010 (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q of Viacom Inc. filed August 5, 2010) (File No. 001-32686).**
10.22	Employment Agreement between Viacom Inc. and Michael D. Fricklas, dated as of October 2, 2009 (incorporated by reference to Exhibit 10.17 to the Annual Report on Form 10-K of Viacom Inc. filed February 11, 2010) (File No. 001-32686), as amended by Letter Agreement dated August 6, 2012 (incorporated by reference to Exhibit 10.21 to the Annual Report on Form 10-K of Viacom Inc. filed November 15, 2012) (File No. 001-32686).**
10.23	Employment Agreement between Viacom Inc. and James W. Barge, effective as of October 1, 2010 (incorporated by reference to Exhibit 10.23 to the Transition Report on Form 10-K of Viacom Inc. filed November 12, 2010) (File No. 001-32686).**
10.24	Employment Agreement between Viacom Inc. and Wade Davis, dated as of November 27, 2012 (incorporated by reference to Exhibit 10.4 to the Quarterly Report on Form 10-Q of Viacom Inc. filed January 31, 2013) (File No. 001-32686).**

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Exhibit No.	Description of Exhibit
10.25	Service Agreement, dated as of March 1, 1994, between George S. Abrams and Former Viacom (incorporated by reference to Exhibit 10(q) to the Annual Report on Form 10-K of Former Viacom filed on March 31, 1995) (File No. 001-09553), assigned to Viacom Inc.**
10.26	Separation Agreement dated as of December 19, 2005 by and between Former Viacom and New Viacom Corp. (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K of New Viacom Corp. filed December 21, 2005) (File No. 001-32686).
10.27	Tax Matters Agreement dated as of December 30, 2005 by and between Former Viacom and New Viacom Corp. (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K of Viacom Inc. filed January 5, 2006) (File No. 001-32686).
21.1*	Subsidiaries of Viacom Inc.
23.1*	Consent of PricewaterhouseCoopers LLP, independent registered public accounting firm for Viacom Inc.
24.1*	Powers of Attorney.
31.1*	Certification of the Chief Executive Officer of Viacom Inc. pursuant to Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of the Chief Financial Officer of Viacom Inc. pursuant to Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of the Chief Executive Officer of Viacom Inc. furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification of the Chief Financial Officer of Viacom Inc. furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document.
101.SCH*	XBRL Taxonomy Extension Schema.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase.
101.LAB*	XBRL Taxonomy Extension Label Linkbase.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase.

* Filed herewith.

** Represents a management contract or compensatory plan or arrangement required to be filed as an exhibit.