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Energy Focus

Second Quarter Fiscal Year 2020 Conference Call

August 14, 2020

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PRESENTATION

Operator

Greetings, and welcome to the Energy Focus Second Quarter Fiscal Year 2020 Conference Call.

At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder this conference is being recorded.

I would now like to turn the conference over to your host, Mr. Brett Maas, with Hayden IR. Thank you. You may begin.

Brett Maas

Thank you, Operator, and good morning, everyone.

Joining me on the call today are James Tu, Executive Chairman and Chief Executive Officer; and Tod Nester, President and Chief Financial Officer.

Before we begin today's call, I would like to remind everyone that we will be making certain forward-looking statements. These statements are based upon information that represents the Company's current expectations or beliefs. The results realized may differ materially from those stated. For a discussion of the risks that could affect our results, please refer to the discussion under the heading Risk Factors on our most recent 10-Q as well as our 10-K—and the most recently filed 10-Q, sorry, with the SEC. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

Also please note that during this call and in the accompanying press release, certain financial metrics are presented on both GAAP and non-GAAP adjusted basis. Reconciliations of the adjusted results to the GAAP results are available in the tables attached to the earnings release, which is posted on our corporate website, energyfocus.com in the Investor Relations section of the site.

I'll now turn the call over to James. James, please go ahead.

James Tu

Thank you, Brett. Good morning, everyone, and thank you for joining our second quarter 2020 earnings conference call.

First of all, I hope you all stay safe and healthy as COVID-19 pandemic continued to rage across the country over the past few months. Deemed, as an essential business, we have continued our operations during the second quarter as normal, and implemented a Coronavirus contingency plan, or CCP, that mandates temperature taking, mask wearing and social distancing in our manufacturing facility and our corporate office.

We are fortunate that none of our employees so far have contracted COVID-19. We appreciate the hard work from all of our employees, the business from our customers and the support of our suppliers in this unprecedented time. We are continuing to enforce CCP until we believe that COVID-19 is no longer a clear public health risk.

Now turning to the review of our second quarter 2020 performance, it was both a challenging and encouraging quarter for Energy Focus. While our financial results were impacted by the previously announced shift of revenue from the second quarter into the third quarter, we continue to make exciting progress towards positioning our business for sustainable, profitable growth.

Despite a significant amount of sales being shifted from Q2 to Q3 and a notable slowdown of commercial activities due to COVID-19, our net sales of $3.3 million in Q2 still grew 8.2% year-over-year over the second quarter of 2019. Gross margins also continued to improve, while our loss from operations decreased significantly from $2.2 million to $1 million, excluding quarterly warrant fair value adjustment. Our continuing growth during the second quarter was supported by a more resilient military business, which grew 11% from last quarter and 139% from the same quarter a year ago.

As we mentioned in the last earnings call, through agile and continuous innovation, over the past year, we have dramatically improved our competitiveness in the Navy market, which also has not been impacted by COVID-19, like the commercial market. In the foreseeable future as well as on a long-term basis, we remain excited and optimistic about our ability to capture the LED lighting opportunities from the U.S. Navy, be it for retrofit or for new ship construction.

On the commercial side, as we communicated over the past few months, the COVID-19 pandemic certainly impacted our results in the second quarter. Many lighting upgrade projects was delayed as facility managers remained extremely cautious on making significant capital investment decisions due to uncertainty on occupancy levels, on both long-term and short-term basis. That said, judging from the countries that have suffered from COVID-19 a few months before the U.S. and that have seen the pandemic largely subside, general commercial activities mostly recovered, close to pre-COVID-19 levels, outside of the hardest hit sectors such as travel, entertainment and brick-and-mortar retail.

Therefore, we are cautiously optimistic that most organizations will gradually resume their planned lighting upgrade projects over the coming months and quarters once COVID-19 subsides. Meanwhile, we are very pleased to report that our EnFocus lighting control platform, continue to receive positive and enthusiastic responses from the market, across literally, our entire customer ecosystem, be it driving distributors, energy service companies, or large end users in government, health care and education industry.

In addition, in June, EnFocus received the top product of the year award from Energy and Environment Leader for its outstanding ease, affordability, and sustainability to facilitate the stadium and human-centric lighting for buildings of all kinds, with a simple change of the lamps and switches. Such recognition by a globally influential organization in energy sustainability reflects a true accomplishment, ingenuity and hard work from our engineering team, led by our Chief Scientist, John Davenport, VP of Product Management, Simon Cheng and Director of Engineering, Greg Flies.

It also clearly affirms and exemplifies the superior environmental sustainability of lamp-based LED lighting system versus integrated fixtures, which has risen in popularity over the past decade, but could generate substantial amount of environmental waste, as the whole fixtures need to be replaced when the LEDs go out or simply become outdated. In fact, regulatory agencies in both the UK and EU are about to pass laws in the coming months to mandate manufacturers to change lighting system design so that the light sources can be replaced, effectively banning integrated fixtures and endorsing lamp-based modular systems.

The rise, or rather the revival, of LED lamps will only accelerate from here as regulation and investments in sustainability, continue to grow rapidly across the world in the face of worsening climate change impact. We believe that Energy Focus with years of dedicated innovation and proven leadership on LED lamp, and now lamp-based lighting control technologies centered around EnFocus is well-positioned to capitalize on this pavement change that will encompass the tens of billions of lamps and fixtures in the world over the coming years.

In addition to environmental sustainability, bringing circadian lighting to the mass market globally is what EnFocus is uniquely capable of. By using the existing power lines, EnFocus is able to provide digital communications between the switch and the lamp, enabling flicker-free, dimmable and color tunable lighting without changing the fixtures or introducing wireless communication protocol, or requiring complex commissioning and system integration. Therefore, it costs only about a third to a sixth of what other lighting control systems cost, and only takes a fraction of time required to install and is completely safe from hacking or other securities threats.

Over the past decade, numerous studies have proven that circadian lighting, a term that represents artificial lighting with optimal lumen intensity and color temperatures based on the circadian rhythm, our internal 24-hour biological clock, dramatically improved human comfort, productivity, learning, sleep as well as physiological, and emotional well-being. EnFocus now has the potential to bring such immensely positive human impact to buildings of all kinds and all over the world.

Because EnFocus is such a unique, powerful and highly demanded product line, over the past two months since we launched, we have been focusing on rapidly expanding our distribution network by signing up and engaging with new channel partners that include national and regional distributors, ESCOs and lighting agencies across the U.S. Over the past few weeks, we've also been installing product samples in numerous customer pilot sites, and we are seeing EnFocus being specified into more and more new lighting projects by our customers.

We've also just received our first significant order for EnFocus product from a state government agency. We expect this initial order to lead to additional orders to eventually cover the agency's nearly four million square feet of facilities in the state. All of this progress is bolstering our confidence that we will see EnFocus product generating meaningful sales once the current overhang on lighting upgrades from the COVID-19 impact subside and business in general normalizes. We believe that EnFocus has strong potential to become the leading lighting control and human-centric lighting technology for existing buildings, not only in the U.S. but also across the world.

Additionally, we have made very exciting progress over the past few months surrounding our development of the UV germicidal irradiation, our UVGI product. The first product will be launching in Q4 this year in this new category we are entering, is an EnFocus-powered UV troffer that would provide both flicker-free, dimmable and tunable lighting as well as UVGI air disinfection capability.

Numerous recent studies have shown that COVID-19 can be spread through respiratory micro droplets that could travel far distances and stay in the air for hours. In addition, the risk of transmission and infection is far greater in the indoor environment than outdoor.

Most UVGI products today either take a long time and significant cost, to design and commission, or could not disinfect the air when people are present. By simply replacing the existing 2x2 or 2x4 fluorescent or LED fixtures and the wall switch with EnFocus products, facilities such as hospitals, nursing homes, schools, offices, retail stores and prisons could offer the best quality human-centric lighting, while constantly disinfecting the air against airborne pathogens, such as bacteria, influenza and most notably viruses, such as SARS and COVID-19.

Because the retrofit process is so simple and fast, which doesn't need to have any equipment specifier, system integrator or specialty technician involved, we believe that EnFocus UV troffer is going to be one of the most affordable and effective disinfection products in the marketplace today. Because there are currently billions of standard 2x2 and 2x4 fluorescent fixtures installed worldwide, EnFocus UV troffer is also ideal for rapid deployment and adoption, with no or minimal customization needed across different countries, to help organizations of all sizes everywhere in the world reduce virus and flu infection risk in the most timely manner.

We have filed provisional patent surrounding EnFocus UV troffer technologies in May 2020. Over the past few months, we have achieved critical technical breakthroughs required to facilitate the functionality and feature of the product and started fine-tuning the prototype. At this point, we aim to formally launch and start selling the product in the fourth quarter of 2020. So we look forward to sharing with you more details about the EnFocus UV troffer as well as other UVGI-related products under development in the near future.

With regard to our business outlook, as noted in the pre-announcement of our results in July, we expect third quarter sales in the range of $6 million to $7 million. This range includes the $1.7 million dollars in shipments, which were shifted from the second quarter into third quarter. Eliminating the timing factor of these shipments, our combined Q2 and Q3 sales in 2020 would be coming in between $9.3 million to $10.3 million compared with $6 million during the same period of 2019 and represents 65% to 72% year-over-year growth.

Last but not least, we are pleased to have obtained our new credit facilities that together immediately provide us over $3 million of additional gross capital in this crucial time as we are developing and launching a series of highly impactful and potential product, and we appreciate the hard work from our finance team. We believe that this additional credit availability will be sufficient to support our growth plans for the foreseeable future without unnecessarily diluting our stock at a valuation that we believe does not reflect the true potential of what's to come for the Company.

With that, I'll turn the call to Tod to review our financial performance during the quarter. Tod?

Tod Nestor

Thanks, James.

Net sales for the second quarter of 2020 were $3.3 million compared with 2019 second quarter net sales of $3.1 million, an increase of 8.2% year-over-year. The year-over-year increase in net sales was primarily driven by an increase in military sales. When compared to $3.8 million in the first quarter of 2020, net sales were down 11.8% on a sequential basis due in large part to the shift of a portion of certain military contract order from the second quarter to the third quarter, as James mentioned previously.

Sales to our top 10 customers increased 34.1% and sales to our top 20 customers increased 20.7% each compared to the second quarter last year. From a mix perspective, in the second quarter, military sales were $2.3 million representing 68.3% of total net sales compared to $951,000 or 30.9% of total net sales for the second quarter of 2019. The year-over-year increase in military sales was primarily due to increased sales to two of our top 10 customers compared to the second quarter of the last year and one particular customer, representing most of the increase.

Sales to commercial customers were $1.1 million, representing approximately $31.7 million of total net sales for the second quarter of 2020, down from $2.1 million or 69.1% of total net sales for the second quarter of 2019. The year-over-year decrease in commercial sales was mainly due to the impact of COVID-19, as James spoke about earlier. Overall, sales to our top 10 commercial customers declined 51% year-over-year and sales to our top 20 commercial customers declined 50%. This was more than offset by our military segment. Sales to our top 10 military customers increased 152%, and sales to our top 20 military customers increased 141%.

Gross profit for the second quarter of 2020 was $1.3 million compared with the gross profit loss of $109,000, inclusive of $500,000 of unfavorable inventory reserves in the year ago quarter, a significant year-over-year increase driven by higher military sales and lower material cost of sales. On a sequential basis, gross profit was also higher compared to $1 million in the first quarter of 2020. As a percentage of revenue, gross profit margin was 40.3% in the second quarter of 2020 compared to a negative gross profit margin in the second quarter of 2019 and 27.3% in the first quarter of 2020.

Adjusting gross profit margins for excess and obsolete, in-transit and NRV inventory reserve results in adjusted gross margins of 33.0% for the second quarter of 2020 compared to 23.4% in the second quarter of 2019 and 25.2% in the first quarter of 2020. We continue to expect our gross margins to be in the mid-20s in the near term and begin to approach the high 20s or 30s percentage range as we introduce new products and make further improvements to our supply chain depending on our sales mix and inventory valuations. We may see—however, we may see fluctuations from quarter-to-quarter as we've seen this quarter.

Operating expenses in the second quarter of 2020 were $2.3 million or 68.2% of sales compared to $2 million or 66.2% of sales in the year ago quarter, an increase of $232,000 or 11.4% year-over-year, which was driven by higher payroll expenses and legal fees, partially offset by lower sales and marketing expenses, primarily trade show expenses due to canceled or postponed events as a result of COVID-19. Product development expenses decreased slightly by $5,000 year-over-year to $313,000 in the second quarter of 2020. Sequentially, product development expenses increased compared to $282,000 in the first quarter of 2020.

SG&A expenses increased 23.7% to $2 million in the second quarter of 2020 compared to $1.6 million in the year ago quarter. The increase was a direct result of increases in payroll expenses and approximately $277,000 in legal fees related to corporate activities like the reverse stock split and the new lines of credit, partially offset by decreases in travel and trade show expenses due to COVID-19. Sequentially, SG&A expenses decreased approximately 3% from the first quarter of 2020. While our initial efforts to reduce costs were quite straightforward and consisted of simply eliminated wasteful spending, we are now targeting several expense lines with SG&A—of SG&A with more strategic and directed efforts for further reductions through various strategic sourcing initiatives.

Loss from operations during the second quarter of 2020 was $929,000, an improvement of $1.2 million compared to a loss from operations of $2.1 million in the second quarter of 2019. The loss also improved $334,000 sequentially from $1.3 million in the first quarter of 2020.

Net loss for the second quarter of 2020 was $4.3 million or $1.36 loss per share compared with a loss of $2.3 million or $0.91 loss per share in the year ago quarter. Importantly, the net loss in the current quarter includes a below-the-line nonoperational and noncash adjustment in the fair value of outstanding warrants of $3.3 million. Excluding this adjustment, our net loss would have been $1 million or $0.33 per share loss per basic and diluted share, an improvement of nearly $1.3 million year-over-year.

Adjusted EBITDA, which excludes depreciation and amortization, interest expense, stock-based and other incentive compensation, and a loss of $3.3 million related to the fair value of warrants, improved to a loss of $746,000 for the second quarter of 2020 compared with a loss of $2 million in the second quarter of 2019 and a loss of $1.1 million in the first quarter of 2020.

Now I would like to turn to the balance sheet. As of June 30, 2020, we had cash of $2.7 million compared to $350,000 at the end of 2019. The increase in cash was primarily due to the issuance of new capital through a shelf registered sale of equity in the first quarter. We continue to analyze our cash needs, considering sales prospects, current performance of the business and our targets for continued improvement. Simultaneously, we also continue to explore and consider a variety of financing sources should the need arise for additional external financing.

Total debt, excluding the warranty, as of June 30, 2020, included short-term credit line borrowings of $1.3 million, outstanding notes payable of $603,000 and the PPP loan for $795,000 for total debt outstanding of $2.7 million, and we had cash of $2.7 million as of June 30, 2020, resulting in net debt of approximately zero at the end of the second quarter. This compares to $3.4 million of total debt as of December 31, 2019, which was comprised of short-term credit line borrowings of $715,000, convertible notes outstanding of $1.7 million and notes payable of $1 million. Netted against cash of $350,000, we had a net debt position of $3.1 million at year-end.

As a reminder, total availability is a measurement of our access to cash at any given point in time, is a much more relevant metric than simply looking at a cash balance on the balance sheet. While excess borrowing availability under our credit facility represents the difference between the maximum borrowing capacity of—to credit facility and actual borrowings on the credit facility. We increased our total availability from the second quarter of 2019 to the end of the second quarter of 2020 from $2.5 million to $3.9 million, respectively, primarily as a result of the increase in our cash balance.

Accordingly, as of June 30, 2020, we had total availability of $3.9 million, which consisted of $2.7 million of cash and $1.2 million of excess borrowing availability under our credit facility. Subsequent to the end of the quarter, we closed two new credit facilities with new lenders, as we've mentioned. The net result was a significant increase in our current borrowing capacity with access to additional capital as we continue to grow our business. Importantly, we secured this added capacity while simultaneously improving our credit terms. In addition, our all-in blended borrowing costs will be lower.

Total borrowing capacity under new facilities at closing also expanded from $1.7 million to $4.1 million or by $2.4 million, with additional room to expand. In addition, one of the key benefits of refinancing our credit agreements was increasing the total availability under the new lines of credit. As I mentioned earlier, the total availability for Energy Focus as of June 30, 2020, was $3.9 million under the prior credit facility. However, at the date of closing, we were able to increase total availability from $2.6 million to $4.9 million, simply due to our new credit facilities, a 1.86 times or $2.3 million improvement.

This will increase borrowing capacity—this increase in borrowing capacity is critical to funding our future growth for our new as well as popular high turnover products and inventories, such as EnFocus tubes and switches, our popular RedCap product and our other innovative products we will be launching in the future. Accounts receivable were $2.5 million at the end of the second quarter of 2020 compared to $2.3 million at the end of 2019, an increase of $181,000 on higher sales.

Net inventories declined to $5.9 million as of June 30, 2020, compared to $6.2 million at the end of 2019. The decrease was due to our continued efforts to reduce slow-moving inventory as well as prudent ordering (phon) inventory needed for future sales. Accounts payable increased to $2.6 million as of June 30, 2020, up from $1.3 million as of the end of 2019. This increase was driven in large part by buying higher turning inventory in support of revenue growth.

Now to cash flow statement. Cash used in operations was $703,000 in the first six months of 2020. The net loss was $4.9 million, inclusive of noncash items, such as depreciation, stock-based compensation and a $2.4 million change in fair value of the warrants. We generated cash from working capital of $1.8 million—$1.3 million was generated from accounts payable and $600,000 from inventories, both driven by timing of inventory receipts. Net cash provided by financing activities was $3.2 million, driven primarily by the equity raised in January.

Our product warranty liability remains manageable and not material. The combination of low failure rates of our tubes has allowed us to continue to experience minimal cost for our warranties and still be able to offer valuable 10-year and 5-year warranties to our customers. Energy Focus' hallmark quality remains a strong selling point for our products and is reflected in our ability to offer these warranties.

In the current environment, I'd like to provide updates of the impact on COVID-19 on our business. We continue to operate under our customized COVID-19 contingency plan at the Company, with employees alternating working at the plant and from home. We are constantly learning from others and adopting best practice to keep our employees safe and to make sure we do what is necessary to keep the Company operating safely.

James and I have already discussed the impact of COVID-19 on the commercial business, and we continue to experience and what the best (phon) solutions and workarounds to the challenges posed by the pandemic to our supply chain. There's no doubt that COVID-19 presents a lot of uncertainty for many businesses right now. But Energy Focus' DNA is very entrepreneurial, and we are very good at adapting and responding to change effectively, quickly and efficiently. The new word in our vocabulary to how we react to COVID-19's impact is safely as well.

With that, we would like to open the call to questions.

Operator

Thank you. At this time, we will be conducting a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys.

Our first question comes from the line of Amit Dayal with H.C. Wainwright. Please proceed with your question.

Amit Dayal

Thank you. Good morning, James. Good morning, Tod. Hope you guys are…

James Tu

Good morning, Amit. Thank you.

Amit Dayal

I am good, thank you.

Just thinking about EnFocus, again, a pretty exciting launch for you guys. Contribution in 3Q and 4Q of 2020, it looks like from the commentary, not much contribution in the third quarter from EnFocus, but going into the fourth quarter, and even into 2021, how are you preparing for the ramp? How should we think about EnFocus sort of being an important driver for growth for you guys from a contribution perspective?

James Tu

Yes. That's definitely the question we're asking ourselves every day, right? Because the—I think in the normal times, EnFocus, probably would have been a much bigger product already in Q3. Just based on the feedback we've got from—as we described earlier, various types of users, channel partners, they love it, right? I mean this is a lighting control system that finally people can afford, and people are willing to put in the building.

I would say that, that's really worldwide, right? I mean we have got interesting inquiries from over 30 countries. This would have been a much bigger product by now, but because of COVID-19, we just don't know the sort of the momentum—when the momentum of the business activities will start picking up. Our guess is that in fourth quarter, we should be—we're just starting—some projects being implemented. We mentioned that there has already been specified in some projects. I think fourth quarter is a little bit uncertain.

A lot depends on when the facility managers are ready to make decisions. That's the question that is very hard to predict which is part of the reason why we have been focusing on developing the UV products as soon as we can. There is an urgency element to that because people—if you ask subsidy managers today, what's their top concern, it's about safety of their occupants, right? How do you get people back to the building? I think there are just not a lot of options out there that are really effective. EnFocus UV troffer is going to be one of those solutions that we believe is very affordable, very effective and can be deployed very quickly, right?

I mean, you—again, as I mentioned you don't need any specified designer in between, you can basically replace the fixtures and the switches, and then you've got very effective air disinfection in the room, literally in every building. So that has an urgency—immediacy to it in terms of getting sales. We are hopeful that when we launch in Q4, it could start contributing more significant from Q1. It's too early to tell if we can make some pre-shipment orders. We did some orders before the shipments in Q4.

That's probably the best answer we could do right now in terms of the Q4, most immediate impact. We do know that once the cloud is lifted or at least stabilized, we could see pretty substantial meaningful sales from EnFocus and EnFocus UV. I don't know, is there anything else?

Tod Nestor

No, that's perfect.

Amit Dayal

You know briefly, and I understand the lack of visibility you have right now because of current circumstances. But just again on the EnFocus sales and marketing side, are you taking control over that more—that process with your internal resources and team or are you going about selling that in the traditional way? I'm just trying to see if there's anything you are doing that allows you a little bit more control over the sales process for EnFocus.

James Tu

Yes. When it comes to product development dimension, we have a very strong team internally. We are expanding that engineering team as much as we can aggressively. We also work with our suppliers, leveraging their later-stage engineering capabilities or resources. As I said, we put the UV development in top priority because it's not only good for our business. I mean, right now, that's what people are concerned about. That's what people are willing to buy back for people they can get money from, the federal, from the state, from the subsidies.

That's good for our business. But it's also a good business. I mean, it's just that people need. You can help save lives, reduce infections. We want to make that our top priority. We put our resources there to launch the product. The first product, as I mentioned, is EnFocus UV troffer. There will be other products, and we'll be announcing in the coming months that will continue to expand our portfolio in UVGI. That's probably a very big, I would say, a strategic plus for the Company. We now have a very strong lighting portfolio, and then we are building aggressively on the UVGI portfolio.

When it comes to EnFocus sales and UVGI product sales, they—we are expanding, as I mentioned, aggressively on the channel partnership network. That is the one thing that is very different than a couple of months ago before we launched EnFocus where we focus most on end users and the contractors. Now we are reaching out to as many agents and distributors and contractors as possible to help us deliver the product to the projects they are already working on.

That's the best leverage of everybody's time. If you look at like three months back and versus today, the customers we are talking to are relatively larger. Many more customers are talking to—and obviously that trend continued to evolve, to strengthen over the coming months as we expand the distribution.

Amit Dayal

Yes, and then moving to the gross margin, James, for 3Q, could these gross margins remain elevated with contribution from military sales remaining strong?

Tod Nestor

I would say that the recent quarter is—I wouldn't say it will be a normal quarter. It was higher because of the mix. The high military mix in the quarter. We will expect in the mid to higher 20s generally as the commercial sector becomes a higher portion of the mix as we grow EnFocus, we will expect a sort of higher 20s to be more of the range. We do have a focus on our gross profit dollars. Some of these larger volume opportunities are there. That is a very important element of our growth. We believe the incremental dollars available to us that haven't been there in the past, will have a good blend of rate and dollars flowing to the bottom line. We still believe that range of the mid- 20s to the high 20s, low 30s is where you'll see us on more of a normalized basis.

Amit Dayal

Understood, and then just one last question with respect to sort of the COVID-impacted environment, are you facing issues with deployment? Has that sort of environment improved for you? Then on the collection side, are you comfortable with how you are able to handle your accounts receivables, etc., in this environment?

Tod Nestor

I'll handle the receivables side. The—we have had—so we have a couple—we're the beneficiaries of good luck on that. There's two aspects. We implemented an insurance program on our accounts receivables late last year. The timing of that couldn't have been better. That—but at the same time, we haven't experienced really any material defaults either. We do a very good job of assessing the credits upfront. One of the reasons we did go to the partner we're working with on that was they have a very robust ability to assess the credits of our customers.

We think we have a very good "credit review" and a credit line process. We provide the proper lines of credit, and then the collections we're quite good at. We have very, very low default rates. It's one of the reasons we received such favorable terms on the recent AR borrowing facility we just refinanced with.

We continue to experience very good receivable collections and I'd say, more favorable than probably most commercial entities. We have not experienced abnormal default rates. Amit, what was your first part of the question? I missed that, I'm sorry.

Amit Dayal

Yes. The first part was just any challenges from a deployment perspective, obviously, access to facilities, etc., in the second quarter may have been tougher. I was just thinking if that has improved for you guys and that hopefully facilitates the revenues as well?

James Tu

Yes. I think the people are working. It's not like the managers are not working. They are working, they're just not making as many decisions as they usually do. They—imagine you're hospital, school, government agencies and state government agencies, your budgets are likely going to be constrained, and you are worried about how much money you're going to get next year, right?

Because the states are having huge deficits now at the moment. That's the uncertainty that overhangs, and hospitals, you would think that the COVID-19 would give business, the hospitals—their business are not good because they are not having the usual business because of COVID-19. People are not going to hospitals as much. These are the budget concern of the facility managers. The excess is not an issue. It's the decision-making that we are consulting with. Which, again, we are literally using the UVGI product portfolio to offset that short-term softness.

The softness might linger for months or quarters, we don't know. We could also see like what we have seen, like I had mentioned earlier, that some countries that already—that have seen the COVID-19 cases drop to the minimum level, they are seeing people coming back in most of the facilities. If we are three months away from that, we could see a resurgence of business then. That's really the uncertainty we are looking at.

On the other hand, we are very excited about the UV product because it helps people come back to the facility, right? It's going to reach out to—we had the capital outside of the usual organizational capital budget. You could get this from federal funding now for COVID-19 relief, to implement these technologies, these products. That's what we're planning to sort of offset the short-term uncertainty on the EnFocus or typical lamp products that are on the—in the commercial market.

Amit Dayal

That's all I have guys. Thank you so much for all the color. Appreciate it.

James Tu

Thanks, Amit.

Operator

Thank you. Ladies and gentlemen, as a reminder if you'd like to join the question queue please press star, one on your telephone keypad.

Our next question comes from the line of Jason Revland with Revland Wealth Advisors. Please proceed with your question.

Jason Revland

Hi, everyone.

James Tu

Hi, good morning.

Jason Revland

Good day (inaudible) Thanks for taking my call.

I'm a new shareholder as of a few weeks back, and really got to know the story well. After listening to today's call, I really get the sense that you're gearing up for something significant as far as satisfying demand, given the balance sheet, the credit line activities, the targeting of larger distribution partners. I'm very encouraged to hear that today.

My first question is, what are the engineering or testing steps that are left in place before you can actively sell the UV product? Have you trialed it with any of your partners yet?

James Tu

The first part of your question is the engineering side, and which I already mentioned that we have overcome the key challenges on the engineering side. It's being fine-tuned right now. The product is working. It's working as we like. But we are fine-tuning to make it finalized. Our plan is to finalize the product design next month, which is September. Then we really could start going into production in Q4 and start selling as early as early Q4.

It depends on, again, the process of the—UL process, how long it's going to take. We are—that's why we are projecting Q4. But we—obviously, as we—as I mentioned, we want to get this product out as soon as possible to—not only for the business but for the better good.

In terms of selling the product, we have already, obviously, consulted with some of our customers, our early customers, just like what we did with EnFocus, literally a three month, four month lag. That how they think about the product. I can say that there's a pretty good level of interest. Again, we haven't shown deeper product yet. we're still in the prototyping phase, we're finalizing that next month. But so far, all the indications are telling us that people would want this product.

Jason Revland

Great, and my last question is, is there any sort of federal funding or state level funding opportunities that might assist you in the sale of that new UV product in some way?

James Tu

Yes. We have not explored that actively. We have been still focused on developing this product. Eventually I mean, it's very straightforward. If this product works, we don't need the funding, right? That said, now we have the products that have pretty much close to finalization.

We might start actually seeking federal and state assistance in terms of getting this product to more places faster. We don't necessarily need the research funding. We have already spent that money, and we have already did the work. That's one aspect of it. How do we get this product to more agencies, more schools, more hospitals as fast as we can?

Number two is that there are other UVGI products in the work that has already—well under development that I haven't talked about. Those are the projects that we would likely seek federal support as well. But again, we don't need it. Can we get those support so it helps us move faster, we will be exploring those options?

Jason Revland

If I might just ask one more, as far as some of the very large light manufacturers, do you see any possible opportunities to, let's say, partner with them, license out the IP that now seems to have somewhat added protection? Just maybe expand the market through, let's say, a much larger partner at some point?

James Tu

Yes. That's a very good question and very important question actually because we have considered, obviously, licensing EnFocus in the future. We have just been focusing on getting the product out, asking, piloting, sampling with our current customers. We like to get the product in more facilities over the next few months and quarters. Then we can consider licensing the platform. We do see a clear potential of that.

The other thing is that this platform is so unique and so powerful that we could continue to develop more products on top of it. The best example is this UVGI EnFocus troffer. This troffer leverages on the EnFocus capability. You can bring UVGI equipment into a room, for example, a building, but how do you control it? It's—that control aspect is going to involve cost. It's going to involve with design and everything, wireless sometimes, but then you've got the wireless protocol you have to deal with.

This EnFocus platform enabled the UV product to go into an existing building very quickly with the simple change of switch. That enabled a lot of rapid deployment of advanced lighting technologies like the EnFocus UVGI troffer. We obviously are already starting to develop additional products on top of EnFocus. We'll continue to do that.

We'll continue to move forward to expand the product portfolio. We will be considering licensing it over the next few months and quarters after we have enough sales and more facility implementing our products.

Tod Nestor

I'd like to just build on that with two additional short comments, James. One is that it would also be—EnFocus platform allows it to be done affordably. That whole UVGI capability is done affordably versus any of the current alternatives. On the partnership front, that can take many forms, not just licensing. There's many forms we're considering and talking about to leverage that intellectual property across the world, so to deploy it quickly and leverage our intellectual property.

Jason Revland

Great, James, thank you. It's great to have you back on board. This has been a great call. Thank you very much.

James Tu

Thank you, thanks Jason and welcome on board.

Operator

Thank you. Ladies and gentlemen, that concludes our question-and-answer session. I'll turn the floor back to Mr. Tu for any final comments.

James Tu

Thanks, everyone, for your participation on our call, and we look forward to talking to you soon in the next earnings call. Stay tuned, and have a great weekend.

Operator

Thank you. This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.