

POWERSECURE INTERNATIONAL, INC.

Form 10-Q

August 07, 2013

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2013

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-12014

**POWERSECURE INTERNATIONAL, INC.**

(Exact name of registrant as specified in its charter)

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

**84-1169358**  
(I.R.S. Employer  
Identification No.)

**1609 Heritage Commerce Court**

**Wake Forest, North Carolina**  
(Address of principal executive offices)

**27587**  
(Zip code)

**(919) 556-3056**  
(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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 Act). Yes  No

As of August 1, 2013, 19,323,606 shares of the issuer's Common Stock were outstanding.

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**POWERSECURE INTERNATIONAL, INC.**

**FORM 10-Q**

**For the Quarterly Period Ended June 30, 2013**

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**Table of Contents****PART I.****FINANCIAL INFORMATION****Item 1. Financial Statements****POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS (unaudited)**

(in thousands, except share data)

	June 30, 2013	December 31, 2012
<b>Assets</b>		
Current Assets:		
Cash and cash equivalents	\$ 26,653	\$ 19,122
Trade receivables, net of allowance for doubtful accounts of \$531 and \$336, respectively	74,526	57,147
Inventories	28,576	20,327
Income taxes receivable		592
Deferred tax asset, net	803	803
Prepaid expenses and other current assets	1,440	1,285
<b>Total current assets</b>	<b>131,998</b>	<b>99,276</b>
Property, plant and equipment:		
Equipment	52,713	48,447
Furniture and fixtures	460	375
Land, building and improvements	5,996	5,907
<b>Total property, plant and equipment, at cost</b>	<b>59,169</b>	<b>54,729</b>
Less accumulated depreciation and amortization	15,008	12,152
<b>Property, plant and equipment, net</b>	<b>44,161</b>	<b>42,577</b>
Other assets:		
Goodwill	28,073	12,884
Restricted annuity contract	2,484	2,447
Intangible rights and capitalized software costs, net of accumulated amortization of \$4,165 and \$3,588, respectively	6,870	1,328
Other assets	1,227	635
<b>Total other assets</b>	<b>38,654</b>	<b>17,294</b>
<b>Total Assets</b>	<b>\$ 214,813</b>	<b>\$ 159,147</b>

*See accompanying notes to consolidated financial statements.*

**Table of Contents****POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS (unaudited)**

(in thousands, except share data)

	June 30, 2013	December 31, 2012
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Accounts payable	\$ 25,364	\$ 14,150
Accrued and other liabilities	31,881	23,887
Accrued restructuring and cost reduction liabilities	360	709
Income taxes payable	983	
Current unrecognized tax benefit	242	242
Current portion of long-term debt	3,731	160
Current portion of capital lease obligation	910	886
Total current liabilities	63,471	40,034
Long-term liabilities:		
Revolving line of credit		
Long-term debt, net of current portion	23,429	2,080
Capital lease obligation, net of current portion	1,460	1,921
Deferred tax liability, net	57	955
Unrecognized tax benefit	640	640
Other long-term liabilities	2,627	2,518
Total long-term liabilities	28,213	8,114
Commitments and contingencies (Notes 8 and 10)		
Stockholders Equity:		
PowerSecure International stockholders equity:		
Preferred stock undesignated, \$.01 par value; 2,000,000 shares authorized; none issued and outstanding		
Preferred stock Series C, \$.01 par value; 500,000 shares authorized; none issued and outstanding		
Common stock, \$.01 par value; 50,000,000 shares authorized; 19,320,606 and 18,202,548 shares issued and outstanding, respectively	193	182
Additional paid-in-capital	122,465	112,738
Retained earnings (deficit)	471	(2,361)
Total PowerSecure International, Inc. stockholders equity	123,129	110,559
Non-controlling interest		440
Total stockholders equity	123,129	110,999
<b>Total Liabilities and Stockholders Equity</b>	<b>\$ 214,813</b>	<b>\$ 159,147</b>

See accompanying notes to consolidated financial statements.

**Table of Contents****POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME (unaudited)**

(in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Revenues	\$ 70,187	\$ 37,867	\$ 115,144	\$ 71,052
Cost of sales	50,304	25,663	81,521	49,293
Gross profit	19,883	12,204	33,623	21,759
Operating expenses:				
General and administrative	12,511	9,093	22,343	17,738
Selling, marketing and service	2,105	1,366	3,490	2,424
Depreciation and amortization	1,809	1,136	3,265	2,221
Total operating expenses	16,425	11,595	29,098	22,383
Operating income (loss)	3,458	609	4,525	(624)
Other income and (expenses):				
Gain on sale of unconsolidated affiliate		1,439		1,439
Interest income and other income	19	23	40	45
Interest expense	(130)	(116)	(235)	(224)
Income before income taxes	3,347	1,955	4,330	636
Income tax expense	1,305	621	1,679	228
Income from continuing operations	2,042	1,334	2,651	408
Discontinued operations (Note 6):				
Income from operations, net of tax		32		67
Gain on disposal, net of tax				
Income from discontinued operations, net of tax		32		67
Net income	2,042	1,366	2,651	475
Net loss attributable to non-controlling interest	57	277	181	565
Net income attributable to PowerSecure International, Inc.	\$ 2,099	\$ 1,643	\$ 2,832	\$ 1,040
Amounts attributable to PowerSecure International, Inc. common stockholders:				
Income from continuing operations, net of tax	\$ 2,099	\$ 1,611	\$ 2,832	\$ 973
Income from discontinued operations, net of tax		32		67
Net income	\$ 2,099	\$ 1,643	\$ 2,832	\$ 1,040
Basic earnings per share attributable to PowerSecure International, Inc. common stockholders:				
Income from continuing operations	\$ 0.11	\$ 0.09	\$ 0.15	\$ 0.05
Income from discontinued operations				0.01

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Net income attributable to PowerSecure International, Inc. common stockholders	\$ 0.11	\$ 0.09	\$ 0.15	\$ 0.06
Diluted earnings per share attributable to PowerSecure International, Inc. common stockholders:				
Income from continuing operations	\$ 0.11	\$ 0.09	\$ 0.15	\$ 0.05
Income from discontinued operations				
Net income attributable to PowerSecure International, Inc. common stockholders	\$ 0.11	\$ 0.09	\$ 0.15	\$ 0.05

*See accompanying notes to consolidated financial statements.*

**Table of Contents****POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)**

(in thousands)

	<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 2,651	\$ 475
Adjustments to reconcile net income to net cash used in operating activities:		
Gain on sale of unconsolidated affiliate		(1,439)
Income from discontinued operations		(67)
Depreciation and amortization	3,265	2,221
Stock compensation expense	289	576
Loss on disposal of miscellaneous assets	14	45
Changes in operating assets and liabilities, net of effect of acquisitions:		
Trade receivables, net	(11,025)	4,360
Inventories	(7,353)	861
Other current assets and liabilities	1,480	416
Other noncurrent assets and liabilities	(520)	(335)
Accounts payable	9,291	(378)
Accrued and other liabilities	(1,869)	(3,067)
Accrued restructuring and cost reduction liabilities	(349)	
Net cash provided by (used in) continuing operations	(4,126)	3,668
Net cash provided by discontinued operations		132
Net cash provided by (used in) operating activities	(4,126)	3,800
<b>Cash flows from investing activities:</b>		
Acquisitions, net of cash acquired	(9,542)	(3,523)
Purchases of property, plant and equipment	(3,856)	(3,330)
Additions to intangible rights and software development	(319)	(215)
Proceeds from sale of property, plant and equipment		14
Proceeds from sale of unconsolidated affiliate		1,445
Net cash used in investing activities	(13,717)	(5,609)
<b>Cash flows from financing activities:</b>		
Borrowings (payments) on revolving line of credit		
Proceeds from long-term borrowings	25,000	2,400
Principal payments on long-term debt	(80)	(80)
Principal payments on capital lease obligations	(437)	(414)
Repurchases of common stock	(9)	(1,010)
Proceeds from stock option exercises	900	14
Net cash provided by financing activities	25,374	910
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	7,531	(899)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	19,122	24,606



CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 26,653	\$ 23,707
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*See accompanying notes to consolidated financial statements.*

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**POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES**

**Notes to Unaudited Consolidated Financial Statements**

As of June 30, 2013 and December 31, 2012 and

For the Three and Six Month Periods Ended June 30, 2013 and 2012

(all amounts in thousands unless otherwise designated, except per share data)

**1. Description of Business and Basis of Presentation**

**Description of Business**

PowerSecure International, Inc., headquartered in Wake Forest, North Carolina, is a leading provider of products and services to electric utilities, and their large commercial, institutional and industrial customers.

Our Utility and Energy Technologies segment includes our three product and service offerings: our Distributed Generation products and services, our Utility Infrastructure products and services, and our Energy Efficiency products and services. These three groups are commonly focused on serving the needs of utilities and their commercial, institutional and industrial customers to help them generate, deliver, and utilize electricity more reliably and efficiently. Our strategy is focused on growing these three products and services because they require unique knowledge and skills that utilize our core competencies, and because they address large market opportunities due to their strong customer value propositions. These three groups of products and services share common or complementary utility relationships and customer types, common sales and overhead resources, and facilities. However, we discuss and distinguish our Utility and Energy Technologies business among these groups due to the unique market needs they are addressing, and the distinct technical disciplines and specific capabilities required for us to deliver them, including personnel, technology, engineering, and intellectual capital. Our Utility and Energy Technologies segment operates primarily out of our Wake Forest, North Carolina headquarters office, and its operations also include several satellite offices and manufacturing facilities, the largest of which are in the Raleigh, North Carolina, Randleman, North Carolina, McDonough, Georgia, Anderson, South Carolina, and Bethlehem, Pennsylvania areas. The locations of our sales organization and field employees for this segment are generally in close proximity to the utilities and commercial, industrial, and institutional customers they serve. Our Utility and Energy Technologies segment is operated through our largest wholly-owned subsidiary, PowerSecure, Inc.

We conduct all of our on-going business operations through our Utility and Energy Technologies segment. In 2011, we divested the non-core business operations of our Oil and Gas Services segment, which has ceased on-going operations. See Note 12 for more information concerning our reportable segments.

**Basis of Presentation**

**Organization** The accompanying consolidated financial statements include the accounts of PowerSecure International, Inc. and its subsidiaries, primarily PowerSecure, Inc. and its majority-owned and wholly-owned subsidiaries, UtilityEngineering, Inc., PowerServices, Inc., EnergyLite, Inc., EfficientLights, LLC ( EfficientLights ), Innovative Electronic Solutions Lighting, LLC ( IES ), Reid s Trailer, Inc. ( PowerFab ), Innovation Energies, LLC, Southern Energy Management PowerSecure, LLC ( PowerSecure Solar ), Solais Lighting, Inc. ( Solais ) and PowerPackages, LLC, as well as Southern Flow Companies, Inc. ( Southern Flow ), WaterSecure Holdings, Inc. ( WaterSecure ), and Marcum Gas Metering, Inc., which are collectively referred to as the Company or PowerSecure or we or us or our .

These consolidated financial statements have been prepared pursuant to rules and regulations of the Securities and Exchange Commission. The accompanying consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2012.

In management s opinion, all adjustments (all of which are normal and recurring) have been made which are necessary for a fair presentation of the consolidated financial position of us and our subsidiaries as of June 30, 2013 and the consolidated results of our operations and cash flows for the three and six months ended June 30, 2013 and 2012.



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**Principles of Consolidation** The consolidated financial statements include the accounts of PowerSecure International, Inc. and its subsidiaries after elimination of intercompany accounts and transactions.

**Non-controlling Interest** The non-controlling ownership interests in the income or losses of our majority-owned subsidiaries is included in our consolidated statements of income as a reduction or addition to net income to derive income attributable to PowerSecure International stockholders. Similarly, the non-controlling ownership interest in the undistributed equity of our majority-owned subsidiaries is shown as a separate component of stockholders' equity in our consolidated balance sheet.

Until May 20, 2013, we held a 90% controlling ownership interest in PowerSecure Solar, a distributed solar energy company which we acquired in June 2012. In addition, until May 22, 2013, we also held a 67% controlling ownership interest in IES, an LED lighting company in which we acquired a controlling interest in 2010. On May 20, 2013, we acquired the 10% non-controlling ownership interest in PowerSecure Solar in exchange for a cash payment of \$153 thousand. On May 22, 2013, we acquired the 33% non-controlling ownership interest in IES in exchange for 209 thousand shares of our common stock valued at a total of \$2.9 million on the date of acquisition, issued pursuant to our acquisition shelf registration statement on Form S-4. As a result of these non-controlling interest acquisitions, both PowerSecure Solar and IES are now wholly-owned subsidiaries and there will be no non-controlling interest in those entities after the acquisition dates.

The following is a reconciliation of the amounts attributable to the non-controlling interest in IES and PowerSecure Solar for the six months ended June 30, 2013 and 2012:

	Six Months Ended June 30, 2013		
	IES	PowerSecure Solar	Total
Balance, December 31, 2012	\$ (6)	\$ 446	\$ 440
Capital contribution			
Income (loss)	(143)	(38)	(181)
Acquisition of non-controlling interest	149	(408)	(259)
Balance, June 30, 2013	\$	\$	\$

	Six Months Ended June 30, 2012		
	IES	PowerSecure Solar	Total
Balance, December 31, 2011	\$ 909	\$	\$ 909
Capital contribution		433	433
Income (loss)	(551)	(14)	(565)
Balance, June 30, 2012	\$ 358	\$ 419	\$ 777

**Use of Estimates** The preparation of our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires that our management 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. Actual results could differ from those estimates. Significant estimates include, among others, percentage-of-completion estimates for revenue and cost of sales recognition, incentive compensation and commissions, allowance for doubtful accounts receivable, inventory valuation reserves, warranty reserves, deferred tax valuation allowance, purchase price allocations on business acquisitions and any impairment charges on long-lived assets and goodwill.

**Reclassifications** Certain 2012 amounts have been reclassified to conform to current year presentation. Such reclassifications had no effect on net income or stockholders' equity as previously reported.

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### **2. Summary of Significant Accounting Policies and Recent Accounting Standards**

**Revenue Recognition** For our turn-key distributed generation projects, our utility infrastructure projects, and our ESCO energy efficiency projects, we recognize revenue and profit as work progresses using the percentage-of-completion method, which relies on various estimates. Nearly all of our turn-key distributed generation, utility infrastructure, and ESCO projects are fixed-price contracts.

In applying the percentage-of-completion method to our distributed generation turn-key projects, including our traditional distributed generation projects and our solar projects, we have identified the key output project phases that are standard components of these projects. We have further identified, based on past experience, an estimate of the value of each of these output phases based on a combination of the costs incurred and the value added to the overall project. While the order of these phases varies depending on the project, each of these output phases is necessary to complete each project and each phase is an integral part of the turn-key product solution we deliver to our customers. We use these output phases and percentages to measure our progress toward completion of our construction projects. For each reporting period, the status of each project, by phase, is determined by employees who are managers of or are otherwise directly involved with the project and is reviewed by our accounting personnel. Utilizing this information, we recognize project revenues and associated project costs and gross profit based on the percentage associated with output phases that are complete or in process on each of our projects.

In applying the percentage-of-completion method to our utility infrastructure turn-key projects and our ESCO energy efficiency projects, revenues and gross profit are recognized as work is performed based on the relationship between actual costs incurred and total estimated costs at completion.

In all cases where we utilize the percentage-of-completion method, revenues and gross profit are adjusted prospectively for revisions in estimated total contract costs and contract values. Estimated losses, if any, are recorded when identified. While a project is in process, amounts billed to customers in excess of revenues recognized to date are classified as current liabilities. Likewise, amounts recognized as revenue in excess of actual billings to date are recorded as unbilled accounts receivable. In the event adjustments are made to the contract price, including, for example, adjustments for additional wire or other raw materials, we adjust the purchase price and related costs for these items when they are identified.

Because the percentage-of-completion method of accounting relies upon estimates described above, recognized revenues and profits are subject to revision as a project progresses to completion. Revisions in profit estimates are recorded to income in the period in which the facts that give rise to the revision become known. In the event we are required to adjust any particular project's estimated revenues or costs, the effect on the current period earnings may or may not be significant. If, however, conditions arise that require us to adjust our estimated revenues or costs for a series of similar construction projects, the effect on current period earnings would more likely be significant. In addition, certain contracts contain cancellation provisions permitting the customer to cancel the contract prior to completion of a project. Such cancellation provisions generally require the customer to pay/reimburse us for costs we incurred on the project, but may result in an adjustment to profit already recognized in a prior period.

We recognize equipment and product revenue when persuasive evidence of a commercial arrangement exists, delivery has occurred and/or services have been rendered, the price is fixed or determinable, and collectability is reasonably assured. Equipment and product sales are generally made directly to end users of the product, who are responsible for payment for the product, although in some instances we can be a subcontractor, which occurs most frequently on larger jobs that involve more scope than our products and services.

Service revenue includes regulatory consulting and rate design services, power system engineering services, energy conservation services, and monitoring and maintenance services. Revenues from these services are recognized when the service is performed and the customer has accepted the work.

Additionally, our utility infrastructure business provides services to utilities involving construction, maintenance, and upgrades to their electrical transmission and distribution systems which is not fixed price turn-key project-based work. These services are delivered by us under contracts which are generally of two types. In the first type, we are paid a fee based on the number of units of work we complete, an example of which could be the number of utility transmission poles we replace. In the second type, we are paid for the time and materials utilized to complete the work, plus a profit margin. In both cases, we recognize revenue as these services are delivered.

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Revenues for our recurring revenue distributed generation projects are recognized over the term of the contract or when energy savings are realized by the customer at its site. Under these arrangements, we provide utilities and their customers with access to PowerSecure-owned and operated distributed generation systems, for standby power and to deliver peak shaving benefits. These contracts can involve multiple parties, with one party paying us for the value of backup power (usually, but not always, a commercial, industrial, or institutional customer), and one party paying us a fee or credit for the value of the electrical capacity provided by the system during peak power demand (either the customer or a utility).

Sales of certain goods and services sometimes involve the provision of multiple deliverables. Revenues from contracts with multiple deliverables are recognized as each element is earned based on the selling price for each deliverable. The selling price for each deliverable is generally based on our selling price for that deliverable on a stand-alone basis, third-party evidence if we do not sell that deliverable on a stand-alone basis, or an estimated selling price if neither specific selling prices nor third-party evidence exists.

**Cash and Cash Equivalents** Cash and all highly liquid investments with a maturity of three months or less from the date of purchase, including money market mutual funds, short-term time deposits, and government agency and corporate obligations, are classified as cash and cash equivalents.

**Accounts Receivable** Our customers include a wide variety of mid-sized and large businesses, utilities and institutions. We perform ongoing credit evaluations of our customers' financial condition and generally do not require collateral. We monitor collections and payments from our customers and adjust credit limits of customers based upon payment history and a customer's current credit worthiness, as judged by us. We maintain a provision for estimated credit losses.

**Concentration of Credit Risk** We are subject to concentrations of credit risk from our cash and cash equivalents and accounts receivable. We limit our exposure to credit risk associated with cash and cash equivalents by placing them with multiple domestic financial institutions. Nevertheless, our cash in bank deposit accounts at these financial institutions frequently exceeds federally insured limits. We have not experienced any losses in such accounts.

From time to time, we have derived a material portion of our revenues from one or more significant customers. To date, nearly all our revenues have been derived from sales to customers within the United States.

**Inventories** Inventories are stated at the lower of cost (determined primarily on a specific-identification basis) or market. Our raw materials, equipment and supplies inventory consist primarily of equipment with long lead-times purchased for anticipated customer orders. Our work in progress inventory consists primarily of equipment and parts allocated to specific distributed generation turn-key projects and our utility infrastructure and ESCO project costs accounted for on the percentage-of-completion basis. Our finished goods inventory consists primarily of LED-based lighting products stocked to meet customer order and delivery requirements. We provide a valuation reserve primarily for raw materials, equipment and supplies and certain work in process inventory items that may be in excess of our needs, obsolete or damaged and requiring repair or re-work.

**Property, Plant and Equipment** Property, plant and equipment are stated at cost and are generally depreciated using the straight-line method over their estimated useful lives, which depending on asset class ranges from 3 to 30 years.

**Goodwill and Other Intangible Assets** We amortize the cost of specifically identifiable intangible assets that do not have an indefinite life over their estimated useful lives. We do not amortize goodwill and intangible assets with indefinite lives. We perform reviews of goodwill and intangible assets with indefinite lives for impairment annually, as of October 1, or more frequently if impairment indicators arise. We capitalize software development costs integral to our products once technological feasibility of the products and software has been determined. Purchased software and software development costs are amortized over five years, using the straight-line method. Patents and license agreements are amortized using the straight-line method over the lesser of their estimated economic lives or their legal term of existence, currently 3 to 5 years.

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**Debt Issuance Costs** Debt issuance costs are capitalized and included in other current and non-current assets in our consolidated balance sheets. These costs are amortized over the term of the corresponding debt instrument using the straight-line method for debt issuance costs related to the revolving portion of our credit facility and the effective interest method for debt issuance costs on our term loan debt. Amortization of debt issuance costs is included in interest expense in our consolidated statements of income.

**Warranty Reserve** We provide a standard one year warranty for our distributed generation, switchgear, utility infrastructure, and ESCO equipment and a five to ten year warranty for our LED lighting-based products. In certain cases, we offer extended warranty terms for those product lines. In addition, we provide longer warranties for our PowerSecure Solar products and services including a warranty period of generally one to five years for defects in material and workmanship, a warranty period of generally ten to twenty years for declines in power performance, and a warranty period which can extend to fifteen to twenty-five years on the functionality of solar panels which is generally backed by the panel manufacturer. We reserve for the estimated cost of product warranties when revenue is recognized, and we evaluate our reserve periodically by comparing our warranty repair experience by product. The purchase price for extended warranties or extended warranties included in the contract terms are deferred as a component of our warranty reserve.

**Share-Based Compensation** We measure compensation cost for all stock-based awards at their fair value on date of grant and recognize the compensation expense over the service period for awards expected to vest, net of estimated forfeitures. We measure the fair value of restricted stock awards based on the number of shares granted and the last sale price of our common stock on the date of the grant, and we measure the fair value of stock options using the Black-Scholes valuation model.

Pre-tax share-based compensation expense for our stock options and restricted stock awards recognized during the three months ended June 30, 2013 and 2012 was \$148 thousand and \$281 thousand, respectively. Pre-tax share-based compensation expense for our stock options and restricted stock awards recognized during the six months ended June 30, 2013 and 2012 was \$289 thousand and \$576 thousand, respectively. All share-based compensation expense is included in general and administrative expense in the accompanying consolidated statements of income.

**Impairment or Disposal of Long-Lived Assets** We evaluate our long-lived assets whenever significant events or changes in circumstances occur that indicate that the carrying amount of an asset may be impaired. Recoverability of these assets is determined by comparing the forecasted undiscounted future cash flows from the operations to which the assets relate, based on management's best estimates using appropriate assumptions and projections at the time, to the carrying amount of the assets. If the carrying value is determined not to be recoverable from future operating cash flows, the asset is deemed impaired and an impairment loss is recognized equal to the amount by which the carrying amount exceeds the estimated fair value of the asset or assets.

**Income Taxes** We recognize deferred income tax assets and liabilities for the estimated future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. We have net operating loss carryforwards available in certain jurisdictions to reduce future taxable income. Future tax benefits for net operating loss carryforwards are recognized to the extent that realization of these benefits is considered more likely than not. To the extent that available evidence raises doubt about the realization of a deferred income tax asset, a valuation allowance is established.

We recognize a liability and income tax expense, including potential penalties and interest, for uncertain income tax positions taken or expected to be taken. The liability is adjusted for positions taken when the applicable statute of limitations expires or when the uncertainty of a particular position is resolved.

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***Derivative Financial Instruments*** We use derivative financial instruments in the form of interest rate swap contracts to manage interest rate risk associated with our floating rate debt. Commencing in July 2013, we entered into interest rate swap contracts to manage the balance of fixed and floating rate debt. Our accounting for such derivative financial instruments is based on our designation of these interest rate swaps as cash flow hedges. It is our policy to execute such interest rate swaps with creditworthy banks and not to enter into derivative financial instruments for speculative purposes. To qualify for designation in a hedging relationship, specific criteria must be met and the appropriate documentation maintained. Hedging relationships are established pursuant to our risk management policies and are initially and regularly evaluated to determine whether they are expected to be, and have been, highly effective hedges. For our interest rate swap contracts designated as a hedge of interest on our floating rate debt, the effective portion of the change in fair value of the derivative is reported in other comprehensive income and reclassified into earnings in the period in which the hedged item affects earnings. Amounts excluded from the effectiveness calculation and any ineffective portion of the change in fair value of the derivative are recognized currently in earnings.

***Subsequent Events*** Subsequent events are events or transactions that occur after the balance sheet date but before the financial statements are issued or are available to be issued and are classified as either recognized subsequent events or non-recognized subsequent events. We recognize and include in our financial statements the effects of subsequent events that provide additional evidence about conditions that existed at the balance sheet date. We disclose non-recognized subsequent events that provide evidence about conditions that arise after the balance sheet date but are not yet reflected in our financial statements when such disclosure is required to prevent the financial statements from being misleading.

## **Recent Accounting Pronouncements**

***Testing Indefinite-Lived Intangible Assets for Impairment*** In July 2012, the FASB issued ASU No. 2012-02, Intangibles—Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment. This standard, which amends the guidance on testing indefinite-lived intangible assets, other than goodwill, for impairment, provides companies with the option to first perform a qualitative assessment before performing the two-step quantitative impairment test. If the company determines, on the basis of qualitative factors, that the fair value of the indefinite-lived intangible asset is more likely than not to exceed its carrying amount, then the company would not need to perform the two-step quantitative impairment test. This standard does not revise the requirement to test indefinite-lived intangible assets annually for impairment. This standard became effective for us on a prospective basis commencing January 1, 2013. The adoption of this standard had no effect on our financial position or results of operations.

## **3. Earnings per Share**

Basic earnings per share is computed by dividing net income attributable to PowerSecure International, Inc. common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share attributable to PowerSecure International, Inc. common stockholders is computed using the weighted average number of common shares outstanding and, when dilutive, potential common shares from stock options using the treasury stock method. Diluted earnings per share excludes the impact of potential common shares related to stock options in periods in which we reported a loss from continuing operations or in which the option exercise price is greater than the average market price of our common stock during the period because the effect would be antidilutive.



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The following table sets forth the calculation of basic and diluted earnings per share attributable to PowerSecure International, Inc. common stockholders:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Income from continuing operations	\$ 2,099	\$ 1,611	\$ 2,832	\$ 973
Income from discontinued operations		32		67
<b>Net income</b>	<b>\$ 2,099</b>	<b>\$ 1,643</b>	<b>\$ 2,832</b>	<b>\$ 1,040</b>
Basic weighted-average common shares outstanding in period	19,024	18,846	18,635	18,874
Dilutive effect of stock options	333	95	306	141
Diluted weighted-average common shares outstanding in period	19,357	18,941	18,941	19,015
<b>Basic earnings per common share:</b>				
Income from continuing operations	\$ 0.11	\$ 0.09	\$ 0.15	\$ 0.05
Income from discontinued operations				0.01
Basic earnings per common share	\$ 0.11	\$ 0.09	\$ 0.15	\$ 0.06
<b>Diluted earnings per common share:</b>				
Income from continuing operations	\$ 0.11	\$ 0.09	\$ 0.15	\$ 0.05
Income from discontinued operations				
Diluted earnings per common share	\$ 0.11	\$ 0.09	\$ 0.15	\$ 0.05

**4. Acquisitions**

**Acquisition of Solais Lighting** On April 12, 2013, we acquired Solais Lighting, Inc., a Delaware corporation ( Solais ). Solais is a Connecticut-based LED lighting company with a proprietary portfolio of LED lamps and fixtures for commercial and industrial applications. Solais' innovative designs, which are covered by a variety of patents and patents pending, provide their products with enhanced light output, thermal management, optics and light quality, and aesthetics.

The acquisition of Solais strengthens and complements our existing LED business through the addition of new product lines and new skill sets around product design, product commercialization, and manufacturing and sourcing capabilities. In addition, Solais adds to our capabilities in marketing LED lighting through distributor channels.

The acquisition was accomplished through a merger of Solais into Brite Idela, Inc., a Delaware corporation and wholly-owned subsidiary we formed to effectuate the merger and renamed Solais Lighting, Inc. after the merger ( Solais PowerSecure ). As a result of the merger, the assets, properties, business, debts, liabilities and obligations of Solais prior to the merger became those of Solais PowerSecure.

The merger was consummated pursuant to an Agreement and Plan of Merger, dated as of April 12, 2013 (the Solais Merger Agreement ), by and among Solais, the stockholders of Solais (the Solais Stockholders ), us and Solais PowerSecure. The merger consideration paid by us to the stockholders of Solais was valued under the Solais Merger Agreement at an aggregate of \$15 million, less an adjustment deducting the working capital deficit of approximately \$0.2 million, and is subject to a post-closing true up adjustment of the final closing working capital balance. As a result, the aggregate merger consideration paid by us consisted of approximately \$6.5 million in cash plus 675,160 shares of our common stock. For purposes of the Merger and the merger consideration, the shares of common stock we issued in the acquisition of Solais were valued at

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\$12.22 per share, which was their volume-weighted average closing sale price as reported on the Nasdaq Global Select Market over the five trading days immediately preceding the date the merger was completed. For purposes of applying the purchase accounting provisions of ASC 805, *Business Combinations* (ASC 805), the shares of common stock we issued in the acquisition were valued at \$12.52 per share, which was the closing sale price of our common stock as reported on the Nasdaq Global Select Market on the date of acquisition. All outstanding shares of capital stock of Solais were converted into and exchanged for the merger consideration. The merger became effective on April 12, 2013.

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Total revenues and pre-tax loss from the Solais business since the date of acquisition included in the accompanying consolidated statements of income for the six months ended June 30, 2013 were \$1.6 million and \$0.2 million, respectively. In addition, acquisition related costs incurred by us in the amount of \$0.4 million were recognized as an expense during the six months ended June 30, 2013, and are included in general and administrative expense in the accompanying consolidated statements of income.

The Solais Merger Agreement contains customary representations and warranties as well as indemnification obligations, and limitations thereon, by us and the Solais Stockholders to each other, including a \$1.5 million two year escrow out of the cash portion of the merger consideration to support the indemnification obligations of the Solais Stockholders. In addition, the Solais Merger Agreement contains a four year covenant not to compete by James Leahy, the President and a Solais Stockholder, against us and our affiliates in the LED lighting business, and related customary restrictive covenants.

The following table summarizes the consideration paid to the Solais Stockholders and the preliminary fair value allocation of the purchase price. The cash consideration paid, and the allocation of the purchase price, are subject to a post-closing true-up adjustment of the final working capital balances acquired:

<b>Consideration paid to Seller:</b>	
Cash	\$ 6,535
Shares of Company common stock	8,453
Total consideration paid	\$ 14,988
Cash and cash equivalents	\$ 165
Accounts receivable, net	625
Inventories	338
Other current assets	62
Property, plant and equipment, net	286
Deferred tax asset	898
Identifiable intangible assets:	
Customer relationships	1,900
Noncompetition agreement	140
Developed technology	1,200
Accounts payable	(665)
Accrued and other liabilities	(1,011)
Total identifiable net assets	3,938
Goodwill	11,050
	<b>\$ 14,988</b>

As part of the preliminary purchase price allocation, we determined that the separately identifiable intangible assets acquired consisted of customer relationships, developed technology and noncompetition agreements. The fair value of the acquired identifiable intangible assets and the goodwill in the table above are provisional pending completion of the final valuations for those assets.

We used the income approach to value the customer relationships, developed technology and noncompetition agreements. This approach calculates the fair value by discounting the forecasted after-tax cash flows for each intangible asset back to a present value at an appropriate risk-adjusted rate of return. The data for these analyses was the cash flow estimates used to price the transaction. Fair value estimates are based on a complex series of judgments about future events and uncertainties and rely heavily on estimates and assumptions.

In estimating the useful lives of the acquired assets, we considered ASC 350-30-35, *General Intangibles Other Than Goodwill*, and reviewed the following factors: the expected use by the combined company of the assets acquired, the expected useful life of another asset (or group of assets) related to the acquired assets, legal, regulatory or other contractual provisions that may limit the useful life of an acquired asset, the effects of obsolescence, demand, competition and other economic factors, and the level of maintenance expenditures required to obtain the expected future cash flows from the assets. We amortize these intangible assets over their estimated useful lives on a straight-line basis.



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The goodwill of \$11.1 million arising from the acquisition consists largely of the assembled workforce of Solais, and the synergies and economies of scale expected from combining the operations of our PowerSecure subsidiary and Solais. All of the goodwill was assigned to our Utility and Energy Technologies segment. None of the acquired goodwill is expected to be deductible for tax purposes.

Supplemental pro forma information, as if the acquisition had occurred on January 1, 2012, is as follows:

	<b>PowerSecure International, Inc. Acquisition of Solais Lighting, Inc. Pro Forma Results of Operations Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
Revenues	\$ 116,854	\$ 72,884
Earnings Attributable to PowerSecure International, Inc.:		
Income from continuing operations	\$ 2,748	\$ 111
Net income	\$ 2,748	\$ 178
Diluted earnings per common share:		
Income from continuing operations	\$ 0.15	\$ 0.01
Net income	\$ 0.15	\$ 0.01

The supplemental pro forma information above is based on estimates and assumptions that we believe are reasonable. The pro forma information presented is not necessarily indicative of the consolidated results of operations in future periods or the results that actually would have been realized had the acquisition occurred on January 1, 2012. The supplemental pro forma results above exclude any benefits that may result from the acquisition due to synergies that are expected to be derived from the elimination of any duplicative costs. In addition, the pro forma results for the six months ended June 30, 2013 were adjusted to exclude aggregate acquisition-related cost of \$1.2 million incurred by PowerSecure and Solais, collectively, in 2013.

**Acquisition of ESCO Energy Efficiency Business** On February 28, 2013, we acquired certain assets, including contracts with customers relating to energy efficiency projects, of the ESCO business of Lime Energy Services Co. ( LESCO ), a Massachusetts corporation and wholly-owned subsidiary of Lime Energy Co., a Delaware corporation ( Lime ). The acquired ESCO business involves the design, installation and maintenance of energy conservation measures, primarily as a subcontractor to large energy service company providers, for the benefit of commercial, industrial and institutional customers as end users. The acquisition expanded our portfolio of energy efficient facility technologies and expertise, which now includes lighting solutions, HVAC system upgrades, building envelope upgrades, transformer efficiency upgrades and water conservation systems. The acquired business serves other larger ESCOs by providing energy efficiency solutions across a range of facilities, including high-rise office buildings, distribution facilities, manufacturing plants, retail sites, mixed use complexes, and large government sites.

The acquisition was consummated pursuant to an Asset Purchase and Sale Agreement, dated as of February 28, 2013 (the LESCO Purchase Agreement ), by and among LESCO, as the seller, Lime, as the seller's parent, and PowerSecure, as the purchaser. Pursuant to the LESCO Purchase Agreement, we completed the acquisition of certain assets and working capital liabilities and the assumption of customer contracts of LESCO, for cash. The assigned contracts required the consent of the customers to complete the assignment, so PowerSecure and LESCO entered into a subcontracting arrangement in the interim to facilitate our obtaining the rights and benefits, and taking on the duties and obligations, of LESCO under the assumed contracts after the closing. In connection with the acquisition, we entered into certain indemnifications to the surety on the bonds for certain projects that were bonded prior to the closing by LESCO, and have continued to do so after the closing with respect to the assumed contracts until the projects are completed or until the consents are obtained and the bonding can be completed in our name directly.

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The acquisition was effective as of the end of the day on February 28, 2013. Total revenues and pre-tax income from the ESCO business since the date of acquisition included in the accompanying consolidated statements of income for the six months ended June 30, 2013 were \$13.1 million and \$0.9 million, respectively. In addition, acquisition related costs in the amount of \$0.1 million were recognized as an expense during the six months ended June 30, 2013, and are included in general and administrative expense in the accompanying consolidated statements of income.

The LESCO Purchase Agreement contains customary representations and warranties as well as indemnification obligations by LESCO and Lime, on the one hand, and by us, on the other hand, to each other. In addition, the LESCO Purchase Agreement contains a five year covenant not to compete by LESCO and Lime against us and our affiliates in the acquired business, subject to certain exceptions related to their retained businesses, and related customary restrictive covenants. Correspondingly, the LESCO Purchase Agreement contains a five year covenant not to compete by us against LESCO and Lime and their affiliates in their retained business relating to small business direct install programs and related customary restrictive covenants, subject to certain exceptions such as for our current business.

The following table summarizes the consideration paid to LESCO, including amounts paid as part of a post-closing true-up adjustment, for the ESCO business and the components and the fair value allocation of the purchase price.

Consideration paid to Seller:	
Cash	\$ 1,971
Accounts receivable	\$ 5,728
Inventories	558
Property, plant and equipment, net	135
Identifiable intangible assets:	
Customer relationships	1,400
Trademarks	160
Backlog	120
Noncompetition agreement	90
Databases	90
Accounts payable	(1,259)
Accrued and other liabilities	(8,852)
Total identifiable net assets (liabilities)	(1,830)
Goodwill	3,801
	\$ 1,971

As part of the purchase price allocation, we determined that the separately identifiable intangible assets acquired consisted of customer relationships, trademarks, backlog, noncompetition agreement and a database and software license to use certain proprietary software tools that LESCO had developed, which are used to assist in the preparation of contract pricing.

We used the income approach to value the customer relationships, noncompetition agreements, trademarks, technology-based assets and order backlog. This approach calculates the fair value by discounting the forecasted after-tax cash flows for each intangible asset back to a present value at an appropriate risk-adjusted rate of return. The data for these analyses was the cash flow estimates used to price the transaction. Fair value estimates are based on a complex series of judgments about future events and uncertainties and rely heavily on estimates and assumptions.

In estimating the useful lives of the acquired assets, we considered ASC 350-30-35, *General Intangibles Other Than Goodwill*, and reviewed the following factors: the expected use by the combined company of the assets acquired, the expected useful life of another asset (or group of assets) related to the acquired assets, legal, regulatory or other contractual provisions that may limit the useful life of an acquired asset, the effects of obsolescence, demand, competition and other economic factors, and the level of maintenance expenditures required to obtain the expected future cash flows from the assets. We amortize these intangible assets over their estimated useful lives on a straight-line basis.

The goodwill of \$3.8 million arising from the acquisition consists largely of the assembled workforce of the ESCO business, and the synergies and economies of scale expected from combining the operations of our PowerSecure subsidiary and the ESCO business. All of the goodwill was

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assigned to our Utility and Energy Technologies segment and is expected to be deductible for tax purposes. As part of the post-closing true-up adjustment, the amount of the purchase price allocated to goodwill was reduced by \$18 thousand from our initial allocation.

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We have concluded that the acquisition of the ESCO business did not constitute a significant business for purposes of Rule 3-05 of Regulation S-X of the SEC, and thus no acquired business historical financial statements are required to be filed with the SEC. Pro forma financial disclosures required under ASC 805 for the six months ended June 30, 2013 and 2012 have not been included herein because the relevant quarterly financial information for the ESCO business is not yet available from the seller. We plan to provide such pro forma financial disclosures in a subsequent quarterly report promptly after the relevant financial information becomes available to us from the seller. Our net income for the three and six months ended June 30, 2013, includes the results of operations of the ESCO business since the date of acquisition.

**Acquisition of PowerLine** On May 20, 2013, we acquired the business and certain assets of Powerline EHV & Safety Training, LLC, a Georgia limited liability company ( PowerLine ). The acquired PowerLine business involves safety training in the electrical utility industry. The acquisition was consummated pursuant to an Asset Purchase Agreement, dated May 20, 2013 (the PowerLine Purchase Agreement ) between PowerLine, as the seller, and PowerSecure, as the purchaser. Pursuant to the PowerLine Purchase Agreement, we acquired certain training materials and property, plant and equipment for a cash payment of \$0.6 million at closing and annual cash installment payments of \$0.1 million over the next five years.

We intend to use the assets and resources of PowerLine to conduct safety training for our Utility Infrastructure personnel. The PowerLine acquisition provides us with dedicated efficient and effective safety resources for our employees, enhancing our overall safety programs. We do not intend to provide safety training services to third-parties and others outside of our Energy and Utility Services segment. Accordingly, there have been no revenues associated with the PowerLine acquisition since the date of acquisition. In addition, acquisition related costs in the amount of \$3 thousand were recognized as an expense during the six months ended June 30, 2013, and are included in general and administrative expense in the accompanying consolidated statements of income.

The following table summarizes the consideration paid to the PowerLine Stockholder and the preliminary fair value allocation of the purchase price.

<b>Consideration paid to Seller:</b>	
Cash	\$ 550
Installment payments payable, discounted value	497
Total consideration paid	\$ 1,047
Property, plant and equipment, net	\$ 10
Identifiable intangible assets:	
Training materials	200
Noncompetition agreement	500
Total identifiable net assets	710
Goodwill	337
	<b>\$ 1,047</b>

The goodwill of \$0.3 million arising from the acquisition consists largely of the cost efficiencies we expect to derive from a dedicated safety training program. All of the goodwill was assigned to our Utility and Energy Technologies segment and is expected to be deductible for tax purposes.

The operating costs of the PowerLine resources have been included within our Utility and Energy Technologies operating segment since the date of acquisition. Pro forma results of operations for the six months ended June 30, 2013 and 2012 have not be included herein as the effects of the acquisition were not material to our results of operations.



**Table of Contents****5. Restructuring and Cost Reduction Program**

During the third quarter 2012, we initiated a cost reduction program, taking actions to restructure and streamline our organization to reduce our costs, and to set the framework to improve the scalability of our cost structure as we grow revenues. The associated cost reduction charges were incurred entirely in the second half of 2012 and consisted primarily of severance and related costs from the elimination of employee positions and costs associated with revisions to certain employment arrangements. The following table summarizes the restructuring and cost reduction plan activities and the balance of our accrued restructuring and cost reduction liabilities at and for the six month period ended June 30, 2013:

	<b>Employee Termination Costs</b>	<b>Employment Arrangement Revisions</b>	<b>Total</b>
Accrued restructuring and cost reduction liabilities, December 31, 2012	\$ 709	\$	\$ 709
Costs incurred and charged to expense			
Cash payments	(349)		(349)
Accrued restructuring and cost reduction liabilities, June 30, 2013	\$ 360	\$	\$ 360

The balance of accrued restructuring and cost reduction plan liabilities at June 30, 2013 is included in current liabilities in our consolidated balance sheet. We expect the majority of the balance of our accrued restructuring plan liabilities at June 30, 2013 will be paid during the next twelve months.

**6. Discontinued Operations**

Our discontinued operations does not include any activity during the three or six months ended June 30, 2013.

During the three and six months ended June 30, 2012, our discontinued operations consists of the revenues and expenses associated with the remaining shutdown activities of our PowerPackages business which was discontinued during 2011. PowerPackages provided medium speed engine distributed generation products and services within our Utility and Energy Technologies segment. All shutdown activities were completed during 2012. The results of PowerPackages discontinued operations for the three and six months ended June 30, 2012 were as follows:

	<b>Three Months Ended June 30, 2012</b>	<b>Six Months Ended June 30, 2012</b>
<b>PowerPackages Discontinued Operations:</b>		
Total revenues	\$ 115	\$ 336
Cost of sales and operating expenses	63	228
Income (loss) before income taxes	52	108
Income tax benefit expense	(20)	(41)
Income from operations	32	67
Gain on disposal		
Income tax on disposal		
Income from discontinued operations	\$ 32	\$ 67

There were no remaining assets or liabilities of the PowerPackages discontinued operations at either June 30, 2013 or December 31, 2012.



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We have had a long-term credit facility with Citibank, N.A. ( Citibank ), as administrative agent and lender, and other lenders since entering into a credit agreement in August 2007. At December 31, 2012, our credit agreement with Citibank along with Branch Banking and Trust Company ( BB&T ) as additional lender, consisted of a \$20.0 million senior, first-priority secured revolving line of credit maturing on November 12, 2014 and a \$2.6 million term loan maturing on November 12, 2016.

On June 19, 2013, we entered into an amendment to the credit agreement to (i) add a \$25 million, 7 year amortizing term loan to the credit facility, which amortizes and is payable quarterly over its term in equal principal amounts plus accrued interest (the \$25 Million Term Loan ), (ii) extend the maturity date of the revolving portion of the credit facility by two years to November 12, 2016, and (iii) modify certain covenants and other terms and conditions of the Credit Agreement.

The following table summarizes the balances outstanding on our long-term debt, including our revolving line of credit, with Citibank and BB&T at June 30, 2013 and December 31, 2012:

	June 30, 2013	December 31, 2012
Revolving line of credit, maturing November 12, 2016	\$	\$
Term loan, principal of \$40 thousand plus interest payable quarterly at variable rates, maturing November 12, 2016	2,160	2,240
Term loan, principal of \$893 thousand plus interest payable quarterly at variable rates, maturing June 30, 2020	25,000	
Total debt	27,160	2,240
Less: Current portion	(3,731)	(160)
Long-term debt, net of current portion	\$ 23,429	\$ 2,080

The credit agreement, as amended, provides for (i) a \$20 million senior, first-priority secured revolving line of credit that matures on November 12, 2016; (ii) a previously issued \$2.6 million term loan amortizing through November 2016; and (iii) the new \$25 Million Term Loan that amortizes through June 30, 2020. The credit facility has been guaranteed by all our active subsidiaries and is secured by the assets of us and those subsidiaries.

We have used, and intend to continue to use, the proceeds available under the credit facility including the new \$25 Million Term Loan to support our growth and future investments in Company-owned distributed generation projects, additional utility services equipment, working capital, other capital expenditures, acquisitions and general corporate purposes. The maturity date of the revolving portion of the credit facility was extended under the amendment by two years until November 12, 2016. The maturity date of the existing \$2.6 million term loan, of which \$2.2 million was outstanding as of June 30, 2013, is unaffected by the amendment. In connection with the extension of the revolving credit facility and the addition of the \$25 Million Term Loan, our previous option, prior to that maturity date, to convert a portion of outstanding principal balance of the revolving portion of the credit facility into a two year term loan at maturity has been eliminated.

Outstanding balances under the credit facility bear interest, at our discretion, at either the London Interbank Offered Rate ( LIBOR ) for the corresponding deposits of U. S. Dollars plus an applicable margin, which is on a sliding scale ranging from 2.00% to 3.25% based upon our leverage ratio, or at Citibank s alternate base rate plus an applicable margin, on a sliding scale ranging from 0.25% to 1.50% based upon our leverage ratio. Our leverage ratio is the ratio of our funded indebtedness as of a given date, net of our cash on hand in excess of \$5.0 million, to our consolidated EBITDA, as defined in the credit agreement, for the four consecutive fiscal quarters ending on such date. Citibank s alternate base rate is equal to the higher of the Federal Funds Rate as published by the Federal Reserve of New York plus 0.50%, Citibank s prime commercial lending rate and 30 day LIBOR plus 1.00%.

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In July 2013, we entered into forward interest rate swap contracts based on three-month LIBOR that effectively converts 80% of the outstanding balance of our \$25 Million Term Loan to fixed rate debt commencing October 1, 2013. In accordance with ASC 815, *Derivatives and Hedging*, we have designated the interest rate swaps as a cash flow hedge of the interest payments due on our floating rate debt. Accordingly, in future financial statements, the fair value of the interest rate swaps will be recorded as an asset or liability, the effective portion of the change in fair value of the interest rate swaps will be recorded in other comprehensive income and the quarterly settlements will be recorded as either an addition to or reduction of our interest expense for the period.

The credit facility is not subject to any borrowing base computations or limitations, but does contain certain financial covenants. Under the credit agreement, if cash on hand does not exceed funded indebtedness by at least \$5.0 million, then our minimum fixed charge coverage ratio must be in excess of 1.25, where the fixed charge coverage ratio is defined as the ratio of the aggregate of our trailing 12 month consolidated EBITDA plus our lease expense minus our taxes based on income and payable in cash, divided by the sum of our consolidated interest charges plus our lease expenses plus our scheduled principal payments and dividends, computed over the previous period. In addition, we are required to maintain a minimum consolidated tangible net worth, computed on a quarterly basis, of not less than the sum of \$75.0 million, plus an amount equal to 50% of our net income each fiscal year ending December 31, 2013, with no reduction for any net loss in any fiscal year, plus 90% of any equity we raise through the sale of equity interests, less the amount of any non-cash charges or losses. Also, the ratio of our funded indebtedness to our capitalization, computed as funded indebtedness divided by the sum of funded indebtedness plus stockholders equity, cannot exceed 30%. As of June 30, 2013, we were in compliance with these financial covenants.

The credit facility contains customary terms and conditions for credit facilities of this type, including restrictions or limits on our ability to incur additional indebtedness, create liens, enter into transactions with affiliates, pay dividends on our capital stock or consolidate or merge with other entities. In addition, the credit agreement contains customary events of default, including payment defaults, breach of representations and warranties, covenant defaults, cross-defaults, certain bankruptcy or insolvency events, judgment defaults and certain ERISA-related events, which were not modified by the amendment.

Our obligations under the credit facility are secured by guarantees ( Guarantees ) and security agreements (the Security Agreements ) by each of our active subsidiaries, including PowerSecure, Inc. and its subsidiaries. The Guarantees guaranty all of our obligations under the credit facility, and the Security Agreements grant to the Lenders a first priority security interest in virtually all of the assets of each of the parties to the credit agreement.

There was an aggregate balance of \$27.2 million outstanding under the two term loans under our credit facility as of June 30, 2013. There were no balances outstanding on the revolving portion of the credit facility at, or during the six months ended, June 30, 2013 or at December 31, 2012 or at August 7, 2013. We currently have \$20.0 million available to borrow under the revolving portion of the credit facility. The availability of this capital under our credit facility includes restrictions on the use of proceeds, and is dependent upon our ability to satisfy certain financial and operating covenants, as described above.

**8. Capital Lease Obligations**

We have a capital lease with SunTrust Equipment Finance and Leasing, an affiliate of SunTrust Bank, from the sale and leaseback of distributed generation equipment placed in service at customer locations. We received \$5.9 million from the sale of the equipment in December 2008 which we are repaying under the terms of the lease with monthly principal and interest payments of \$85 thousand over a period of 84 months. At the expiration of the term of the lease in December 2015, we have the option to purchase the equipment for \$1 dollar, assuming no default under the lease by us has occurred and is then continuing. The lease is guaranteed by us under an equipment lease guaranty. The lease and the lease guaranty constitute permitted indebtedness under our current credit agreement.

Proceeds of the lease financing were used to finance capital investments in equipment for our recurring revenue distributed generation projects. We account for the lease financing as a capital lease in our consolidated financial statements.

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The lease provides us with limited rights, subject to the lessor's approval which will not be unreasonably withheld, to relocate and substitute equipment during its term. The lease contains representations and warranties and covenants relating to the use and maintenance of the equipment, indemnification and events of default customary for leases of this nature. The lease also grants to the lessor certain remedies upon a default, including the right to cancel the lease, to accelerate all rent payments for the remainder of the term of the lease, to recover liquidated damages, or to repossess and re-lease, sell or otherwise dispose of the equipment.

The balance of our capital lease obligations shown in the consolidated balance sheet at June 30, 2013 and December 31, 2012 consist entirely of our obligations under the equipment lease described above.

### **9. Share-Based Compensation**

We recognize compensation expense for all share-based awards made to employees and directors based on estimated fair values on the date of grant.

**Stock Plans** Historically, we have granted stock options and restricted stock awards to employees and directors under various stock plans. We currently maintain two stock plans. Under our 1998 Stock Incentive Plan, as amended (the "1998 Stock Plan"), we granted incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, performance awards and other stock-based awards to our officers, directors, employees, consultants and advisors for shares of our common stock. Stock options granted under the 1998 Stock Plan contained exercise prices not less than the fair market value of our common stock on the date of grant, and had a term of 10 years from the date of grant. Nonqualified stock option grants to our directors under the 1998 Stock Plan generally vested over periods up to two years. Qualified stock option grants to our employees under the 1998 Stock Plan generally vested over periods up to five years. The 1998 Stock Plan expired on June 12, 2008, and no additional awards may be made under the 1998 Stock Plan, although awards granted prior to such date will remain outstanding and subject to the terms and conditions of those awards.

In March 2008, our board of directors adopted the PowerSecure International, Inc. 2008 Stock Incentive Plan (the "2008 Stock Plan"), which was approved by our stockholders at the Annual Meeting of Stockholders held on June 9, 2008. The 2008 Stock Plan authorizes our board of directors to grant incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, performance awards and other stock-based awards to our officers, directors, employees, consultants and advisors for up to an aggregate of 0.6 million shares of our common stock. Stock options granted under the 2008 Stock Plan must contain exercise prices not less than the fair market value of our common stock on the date of grant, and must contain a term not in excess of 10 years from the date of grant. On June 19, 2012, at our 2012 Annual Meeting of Stockholders, our stockholders adopted and approved an amendment and restatement of the 2008 Stock Incentive Plan, including an amendment to increase the number of shares of our common stock authorized thereunder by 1.4 million shares to a total of 2.0 million shares. The 2008 Stock Plan replaced our 1998 Stock Plan.

**Stock Options** Net income for the three months ended June 30, 2013 and 2012 includes \$37 thousand and \$22 thousand, respectively, of pre-tax compensation costs related to outstanding stock options. Net income for the six months ended June 30, 2013 and 2012 includes \$76 thousand and \$59 thousand, respectively, of pre-tax compensation costs related to outstanding stock options. All of the stock option compensation expense is included in general and administrative expenses in the accompanying consolidated statements of income.

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A summary of option activity for the six months ended June 30, 2013 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Balance, December 31, 2012	838	\$ 7.21		
Granted	13	11.42		
Exercised	(167)	5.40		
Expired				
Forfeited	(8)	6.14		
Balance, June 30, 2013	676	\$ 7.75	4.47	\$ 7.28
Exercisable, June 30, 2013	528	\$ 8.25	3.51	\$ 6.78

A summary of option activity for the six months ended June 30, 2012 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Balance, December 31, 2011	911	\$ 6.98		
Granted	10	6.88		
Exercised	(4)	3.56		
Expired				
Forfeited	(10)	8.36		
Balance, June 30, 2012	907	\$ 6.98	4.52	\$ n/m (1)
Exercisable, June 30, 2012	761	\$ 7.18	3.95	\$ n/m (1)

(1) The aggregate exercise prices of the options exceed the aggregate fair value of the underlying shares of common stock based on the closing sale price of the common stock on the NASDAQ Global Select Market on June 30, 2012.

The weighted average grant date fair value of the options granted during the six months ended June 30, 2013 and 2012 was \$4.52 and \$2.43, respectively. The fair value of the stock options granted during the three months ended June 30, 2013 and 2012 was measured using the Black-Scholes valuation model with the following assumptions:

	Six Months Ended June 30,	
	2013	2012
Expected stock price volatility	45.0%	39.0%
Risk free interest rate	0.9%	1.0%
Annual dividends	\$	\$
Expected life (years)	5	5

The fair value of stock option grants is amortized to expense over the respective service periods using the straight-line method and assuming a forfeiture rate of 5%. As of June 30, 2013 and December 31, 2012, there was \$315 thousand and \$357 thousand, respectively, of total

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unrecognized compensation costs related to stock options. These costs at June 30, 2013 are expected to be recognized over a weighted average period of approximately 1.6 years.

During the three months ended June 30, 2013 and 2012, the total intrinsic value of stock options exercised was \$1,035 thousand and \$3 thousand, respectively. Cash received from stock option exercises during the three months ended June 30, 2013 and 2012 was \$685 thousand and \$3 thousand, respectively. The total grant date fair value of stock options vested during the three months ended June 30, 2013 and 2012 was \$52 thousand and \$52 thousand, respectively.

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During the six months ended June 30, 2013 and 2012, the total intrinsic value of stock options exercised was \$1,224 thousand and \$12 thousand, respectively. Cash received from stock option exercises during the six months ended June 30, 2013 and 2012 was \$900 thousand and \$14 thousand, respectively. The total grant date fair value of stock options vested during the six months ended June 30, 2013 and 2012 was \$57 thousand and \$57 thousand, respectively.

**Restricted Stock Awards** Net income for the three months ended June 30, 2013 and 2012 includes \$111 thousand and \$258 thousand, respectively, of pre-tax compensation costs related to the vesting of outstanding restricted stock awards granted to directors, certain officers and our employees. Net income for the six months ended June 30, 2013 and 2012 includes \$213 thousand and \$517 thousand, respectively, of pre-tax compensation costs related to the vesting of outstanding restricted stock awards granted to directors, certain officers and our employees. All of the restricted stock award compensation expense during the three and six months ended June 30, 2013 and 2012 is included in general and administrative expenses in the accompanying consolidated statements of income.

A summary of restricted stock award activity for the six months ended June 30, 2013 is as follows:

	Unvested Restricted Shares	Weighted Average Grant Date Fair Value
Balance, December 31, 2012	100	\$ 5.62
Granted	68	12.02
Vested	(31)	4.42
Forfeited		
Balance, June 30, 2013	137	\$ 9.07

A summary of restricted stock award activity for the six months ended June 30, 2012 is as follows:

	Unvested Restricted Shares	Weighted Average Grant Date Fair Value
Balance, December 31, 2011	410	\$ 11.47
Granted	59	4.21
Vested	(81)	7.76
Forfeited		
Balance, June 30, 2012	388	\$ 11.13

Restricted shares are subject to forfeiture and cannot be sold or otherwise transferred until they vest. If the holder of the restricted shares leaves us before the restricted shares vest, other than due to termination by us without cause, then any unvested restricted shares will be forfeited and returned to us. The restricted shares granted to directors vest in equal amounts over a period of one or three years, depending on the nature of the grant. The restricted shares granted to employees generally vest over three or five years. All restricted and unvested shares automatically vest upon a change in control.

The fair value of the restricted shares is amortized on a straight-line basis over the respective vesting period. At June 30, 2013, the balance of unrecognized compensation cost related to unvested restricted shares was \$1,131 thousand, which is expected to be recognized over a weighted average period of approximately 3.4 years.



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### **10. Commitments and Contingencies**

**Performance Bonds and Parent Guarantees** In the ordinary course of business, we are required by certain customers to post surety or performance bonds in connection with services that we provide to them. These bonds provide a guarantee to the customer that we will perform under the terms of a contract and that we will pay subcontractors and vendors. If we fail to perform under a contract or to pay subcontractors and vendors, the customer may demand that the surety make payments or provide services under the bond. We must reimburse the surety for any expenses or outlays it incurs. As of June 30, 2013, we had approximately \$79 million in surety bonds outstanding, including outstanding surety bonds issued in connection with the contracts and projects acquired from Lime in the acquisition of the ESCO business (See Note 4). To date, we have not been required to make any reimbursements to our sureties for bond-related costs. We believe that it is unlikely that we will have to fund significant claims under our surety arrangements in the foreseeable future. In addition, from time to time, PowerSecure International, Inc. guarantees the obligations of its subsidiaries, including obligations under certain contracts with customers and vendors.

**Other Matters** From time to time, we hire employees that are subject to restrictive covenants, such as non-competition agreements with their former employers. We comply, and require our employees to comply, with the terms of all known restrictive covenants. However, we have in the past and may in the future receive claims and demands by some former employers alleging actual or potential violations of these restrictive covenants. These claims are inherently difficult to predict, and therefore we generally cannot provide any assurance of the outcome of claims. We do not have any specific claims outstanding at this time.

From time to time, in the ordinary course of business we encounter issues with component parts that affect the performance of our distributed generation systems, switchgear systems, utility infrastructure products, engines, generators, alternators, breakers, fuel systems, LED and other lighting products, electrical circuit boards, power drivers, photovoltaic energy systems, inverters, and other complex electrical products. While we strive to utilize high quality component parts from reputable suppliers, and to back-up their quality and performance with manufacturers warranties, even the best parts and components have performance issues from time to time, and these performance issues create significant financial and operating risks to our business, operations and financial results. Because we regularly develop new products and technical designs, we often incorporate component parts into these new products in configurations, for uses, and in environments, for which limited experience exists and which exposes us to performance risks that may not be covered by warranties. As we strive to bring solutions to customers with unique capabilities that provide performance and cost advantages, from time to time we use new suppliers and new products for applications where track record of performance does not exist, or is difficult to ascertain. Although we believe our suppliers' warranties cover many of these performance issues, from time to time we face disputes with our suppliers with respect to those performance issues and their warranty obligations. Additionally, the outcome of any warranty claims is inherently difficult to predict due to the uncertainty of technical solutions, cost, customer requirements, and the uncertainty inherent in litigation and disputes generally, and thus there is no assurance we will not be adversely affected by these, or other performance issues with key parts and components. Moreover, from time to time performance issues are not covered by manufacturer's warranties, certain suppliers may not be financially able to fulfill their warranty obligations, and customers may also claim damages as a result of those performance issues. Also, the mere existence of performance issues, even if finally resolved with our suppliers and customers, can have an adverse effect on our reputation for quality, which could adversely affect our business.

We estimate that from time to time we have performance issues related to component parts which have a cost basis of approximately 5-10% of our estimated annual revenues, although not necessarily limited to this amount, which are installed in equipment we own and have sold to various customers across our business lines, and additional performance issues could arise in the future. In addition, the failure or inadequate performance of these components pose potential material and adverse effects on our business, operations, reputation and financial results, including reduced revenues for projects in process or future projects, reduced revenues for recurring revenue contracts which are dependent on the performance of the affected equipment, additional expenses and capital cost to repair or replace the affected equipment, inventory write-offs for defective components held in inventory, asset write-offs for company-owned systems which have been deployed, the cancellation or deferral of contracts by our customers, or claims made by our customers for damages as a result of performance issues.

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We have experienced performance issues with two types of component parts, in particular, which we have made significant progress in correcting or mitigating, but which continue to represent operational and financial risks to our business: 1) a supplier of a substantial distributed generation system component indicated its warranty does not cover performance issues related to its being used in conjunction with a component from another supplier, and this configuration has been installed in many of the distributed generation systems deployed for our customers, and 2) generators from a certain supplier have had performance issues in a distributed generation system we own, and for which we have a performance-based recurring revenue contract that is dependent on the system's successful operation. In both of these matters, we have actively worked to correct and resolve the performance issues and have made progress in mitigating their risk, although the risk is not eliminated. Given that we continue to have risk related to these performance issues, and the inherent uncertainty in assessing and quantifying the costs and certainty regarding the resolution of these types of technical issues, we are unable to estimate the potential negative impacts from these particular items, if any, in addition to other component part performance issues discussed above. In addition, we have not recorded any specific adjustment to our warranty reserve for these particular performance issues, other than our regular reserves for minor repairs, as the estimated cost, if any, of fulfilling our warranty obligations for these performance issues within a possible range of outcomes is not determinable as of this date.

From time to time, we are involved in other disputes, claims, proceedings and legal actions arising in the ordinary course of business. We intend to vigorously defend all claims against us. Although the ultimate outcome of these proceedings cannot be accurately predicted due to the inherent uncertainty of litigation, in the opinion of management, based upon current information, no other currently pending or overtly threatened proceeding is expected to have a material adverse effect on our business, financial condition or results of operations.

**11. Income Taxes**

The income tax expense recorded at June 30, 2013 and 2012 represents our income before income taxes multiplied by our best estimate of our expected annual effective tax rate taking into consideration our expectation of future earnings, federal alternative minimum tax, state income tax for state jurisdictions in which we expect taxable income, potential effects of adverse outcomes on tax positions we have taken, true-up effects of prior tax provision estimates compared to actual tax returns, and our net operating loss carryforwards.

At December 31, 2012, we had a net noncurrent deferred tax liability of \$955 thousand. The acquisition of Solais in April 2013 (see note 4) included approximately \$5.0 million of net operating loss carryforwards available to be utilized against our future taxable income, subject to significant limitations in the amount that can be utilized in any single year. In addition, the acquisition of Solais resulted in a noncurrent deferred tax liability associated with estimated future tax consequences attributable to temporary differences between the financial statement carrying amounts of intangible assets acquired and their respective tax bases. As a net result of the above items, the balance of our net noncurrent deferred tax liability decreased to \$57 thousand at June 30, 2013. This decrease in our net noncurrent deferred tax liability at June 30, 2013 had no effect on our income tax expense for the three or six months ended June 30, 2013.

**12. Segment Information**

We conduct our core business operations through our Utility and Energy Technologies segment. In 2011, we divested the non-core business operations of our Oil and Gas Services segment, which has ceased operations.

Our reported segments are strategic business units with different products and services and serve different customer bases. They are separate because each segment requires different technology and marketing strategies. Our operating segments also represent components for which discrete financial information is available and is (or was, in the case of our Oil and Gas Services segment) reviewed regularly by the chief operating decision-maker, or decision-making group, to evaluate performance and make operating decisions.

***Utility and Energy Technologies*** Our Utility and Energy Technologies segment includes our three product and service offerings: our Distributed Generation products and services, our Utility Infrastructure products and services, and our Energy Efficiency products and services. These three groups are commonly focused on serving the needs of utilities and their commercial, institutional and industrial customers to help them generate, deliver, and utilize electricity more efficiently. These three groups of products and services share common or complementary utility relationships and customer types, common sales and overhead resources, and facilities. However, we discuss and distinguish our Utility and Energy Technologies business among these groups due to the unique market needs they are addressing, and the distinct technical disciplines and specific capabilities required for us to deliver them, including personnel, technology, engineering, and intellectual capital. Our Utility and Energy Technologies segment is operated through our largest wholly-owned subsidiary, PowerSecure, Inc.



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**Oil and Gas Services** In 2011, we divested the non-core business operations of our Oil and Gas Services segment. The results of the Oil and Gas Services segment for 2012, which are not material, are included in the Unallocated Corporate and Other column in the tables below.

The accounting policies of the reportable segments are the same as those described in Note 2 of the Notes to Consolidated Financial Statements. We evaluate the performance of our operating segments based on income (loss) before income taxes. There are no intersegment sales. Summarized financial information concerning our reportable segments is shown in the following table. Unallocated Corporate and Other amounts include corporate overhead, insignificant results related to our divested Oil and Gas Services Segment, and other income and interest expense amounts which, for purposes of evaluating the operations of our segments, are not allocated to our segment activities. Total asset amounts exclude intercompany receivable balances eliminated in consolidation.

	Three Months Ended June 30, 2013		
	Utility and Energy Technologies	Unallocated Corporate and Other	Total
Revenues	\$ 70,187	\$	\$ 70,187
Cost of Sales	50,304		50,304
<b>Gross Profit</b>	<b>19,883</b>		<b>19,883</b>
Operating expenses:			
General and administrative	10,880	1,631	12,511
Selling, marketing and service	2,105		2,105
Depreciation and amortization	1,809		1,809
Total operating expenses	14,794	1,631	16,425
Operating Income (loss)	5,089	(1,631)	3,458
Other income and (expenses):			
Gain on sale of unconsolidated affiliate			
Interest income and other income		19	19
Interest expense	(55)	(75)	(130)
Income (loss) before income taxes	\$ 5,034	\$ (1,687)	\$ 3,347
Total capital expenditures	\$ 2,718	\$	\$ 2,718
Total goodwill	\$ 28,073	\$	\$ 28,073
Total assets	\$ 190,937	\$ 23,876	\$ 214,813

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	<b>Three Months Ended June 30, 2012</b>		
	<b>Utility and Energy Technologies</b>	<b>Unallocated Corporate and Other</b>	<b>Total</b>
Revenues	\$ 37,867	\$	\$ 37,867
Cost of Sales	25,663		25,663
<b>Gross Profit</b>	<b>12,204</b>		<b>12,204</b>
Operating expenses:			
General and administrative	7,694	1,399	9,093
Selling, marketing and service	1,366		1,366
Depreciation and amortization	1,136		1,136
Total operating expenses	10,196	1,399	11,595
<b>Operating Income (loss)</b>	<b>2,008</b>	<b>(1,399)</b>	<b>609</b>
Other income and (expenses):			
Gain on sale of unconsolidated affiliate		1,439	1,439
Interest income and other income		23	23
Interest expense	(68)	(48)	(116)
Income (loss) before income taxes	\$ 1,940	\$ 15	\$ 1,955
Total capital expenditures	\$ 2,482	\$	\$ 2,482
Total goodwill	\$ 12,884	\$	\$ 12,884
Total assets	\$ 122,010	\$ 21,974	\$ 143,984

	<b>Six Months Ended June 30, 2013</b>		
	<b>Utility and Energy Technologies</b>	<b>Unallocated Corporate and Other</b>	<b>Total</b>
Revenues	\$ 115,144	\$	\$ 115,144
Cost of Sales	81,521		81,521
<b>Gross Profit</b>	<b>33,623</b>		<b>33,623</b>
Operating expenses:			
General and administrative	19,482	2,861	22,343
Selling, marketing and service	3,490		3,490
Depreciation and amortization	3,265		3,265
Total operating expenses	26,237	2,861	29,098
<b>Operating Income (loss)</b>	<b>7,386</b>	<b>(2,861)</b>	<b>4,525</b>
Other income and (expenses):			
Gain on sale of unconsolidated affiliate			
Interest income and other income		40	40
Interest expense	(113)	(122)	(235)
Income (loss) before income taxes	\$ 7,273	\$ (2,943)	\$ 4,330

Total capital expenditures	\$ 4,175	\$	\$ 4,175
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	Six Months Ended June 30, 2012		
	Utility and Energy Technologies	Unallocated Corporate and Other	Total
Revenues	\$ 71,052	\$	\$ 71,052
Cost of Sales	49,293		49,293
<b>Gross Profit</b>	<b>21,759</b>		<b>21,759</b>
Operating expenses:			
General and administrative	15,143	2,595	17,738
Selling, marketing and service	2,424		2,424
Depreciation and amortization	2,221		2,221
Total operating expenses	19,788	2,595	22,383
Operating Income (loss)	1,971	(2,595)	(624)
Other income and (expenses):			
Gain on sale of unconsolidated affiliate		1,439	1,439
Interest income and other income		45	45
Interest expense	(130)	(94)	(224)
Income (loss) before income taxes	\$ 1,841	\$ (1,205)	\$ 636
Total capital expenditures	\$ 3,545	\$	\$ 3,545

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

#### **Introduction**

The following discussion and analysis of our consolidated results of operations for the three and six month period ended June 30, 2013, which we refer to as the second quarter 2013 and six month period 2013, respectively, and the three and six month period ended June 30, 2012, which we refer to as the second quarter 2012 and six month period, respectively, and of our consolidated financial condition as of June 30, 2013 should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this report.

#### **Cautionary Note Regarding Forward-Looking Statements**

This Quarterly Report on Form 10-Q and the documents incorporated into this report by reference contain forward-looking statements within the meaning of and made under the safe harbor provisions of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. From time to time in the future, we may make additional forward-looking statements in presentations, at conferences, in press releases, in other reports and filings and otherwise. Forward-looking statements are all statements other than statements of historical fact, including statements that refer to plans, intentions, objectives, goals, strategies, hopes, beliefs, projections, prospects, expectations or other characterizations of future events or performance, and assumptions underlying the foregoing. The words may, could, should, would, will, project, intend, continue, believe, anticipate, estimate, forecast, expect, plan, potential, opportunity and scheduled, various other comparable terminology and similar expressions are often, but not always, used to identify forward-looking statements. Examples of forward-looking statements include, but are not limited to, statements about the following:

our prospects, including our future business, revenues, expenses, net income, earnings per share, margins, profitability, cash flow, cash position, liquidity, financial condition and results of operations, our targeted growth rate and our expectations about realizing the revenues in our backlog and in our sales pipeline, and our expectations about changes in the condition or amounts of our revenue backlog and sales pipeline;

the effects on our business, financial condition and results of operations of current and future economic, business, market and regulatory conditions, including the current economic and market conditions and their effects on our customers and their capital spending and ability to finance purchases of our products, services, technologies and systems;

the effects of fluctuations in sales on our business, revenues, expenses, net income, earnings per share, margins, profitability, cash flow, liquidity, financial condition and results of operations;

our products, services, technologies and systems, including their quality and performance in absolute terms and as compared to competitive alternatives, their benefits to our customers and their ability to meet our customers' requirements, and our ability to successfully develop and market new products, services, technologies and systems;

our markets, including our market position and our market share;

our ability to successfully develop, operate, grow and diversify our operations and businesses;

our business plans, strategies, goals and objectives, and our ability to successfully achieve them;

the effects on our financial condition, results of operations and prospects of our business acquisitions;



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the sufficiency of our capital resources, including our cash and cash equivalents, funds generated from operations, availability of borrowings under our credit and financing arrangements and other capital resources, to meet our future working capital, capital expenditure, lease and debt service and business growth needs;

the value of our assets and businesses, including the revenues, profits and cash flow they are capable of delivering in the future;

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industry trends and customer preferences and the demand for our products, services, technologies and systems;

the nature and intensity of our competition, and our ability to successfully compete in our markets;

fluctuations in our effective tax rates, including the expectation that with the utilization of a significant portion of our tax net operating losses during fiscal 2011 our tax expense in future years will likely approximate prevailing statutory tax rates;

business acquisitions, combinations, sales, alliances, ventures and other similar business transactions and relationships; and

the effects on our business, financial condition and results of operations of litigation, warranty claims and other claims and proceedings that arise from time to time.

Any forward-looking statements we make are based on our current plans, intentions, objectives, goals, strategies, hopes, beliefs, projections and expectations, as well as assumptions made by and information currently available to management. Forward-looking statements are not guarantees of future performance or events, but are subject to and qualified by substantial risks, uncertainties and other factors, which are difficult to predict and are often beyond our control. Forward-looking statements will be affected by assumptions and expectations we might make that do not materialize or that prove to be incorrect and by known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from those expressed, anticipated or implied by such forward-looking statements. These risks, uncertainties and other factors include, but are not limited to, those described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012, as amended or supplemented in subsequently filed Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, as well as other risks, uncertainties and factors discussed elsewhere in this report, in documents that we include as exhibits to or incorporate by reference in this report, and in other reports and documents we from time to time file with or furnish to the Securities and Exchange Commission. In light of these risks and uncertainties, you are cautioned not to place undue reliance on any forward-looking statements that we make.

Any forward-looking statements contained in this report speak only as of the date of this report, and any other forward-looking statements we make from time to time in the future speak only as of the date they are made. We undertake no duty or obligation to update or revise any forward-looking statement or to publicly disclose any update or revision for any reason, whether as a result of changes in our expectations or the underlying assumptions, the receipt of new information, the occurrence of future or unanticipated events, circumstances or conditions or otherwise.

**Overview**

PowerSecure International, Inc., headquartered in Wake Forest, North Carolina, is a leading provider of products and services to electric utilities, and their large commercial, institutional and industrial customers.

Our Utility and Energy Technologies segment consists of our three product and service offerings: our Distributed Generation products and services, our Utility Infrastructure products and services, and our Energy Efficiency products and services. These three groups are commonly focused on serving the needs of utilities and their commercial, institutional and industrial customers to help them generate, deliver and utilize electricity more reliably and efficiently.

Our strategy is focused on growing these three product and service offerings because they address large unmet market opportunities due to their strong customer value propositions, and because they require unique knowledge and skills that utilize our core competencies. These three product and service groups share a number of common or complementary utility relationships and customer types, common sales and overhead resources, and common facilities.

Our business operates primarily out of our Wake Forest, North Carolina headquarters office, and its operations also include several satellite offices and manufacturing facilities, the largest of which are in the Raleigh and Randleman, North Carolina, McDonough, Georgia, Anderson, South Carolina, and Bethlehem, Pennsylvania areas. The locations of our sales organization and field employees are generally in close proximity to the utilities and the commercial, industrial and institutional customers they serve. Our Utility and Energy Technologies segment is operated through our largest wholly-owned subsidiary, PowerSecure, Inc.

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We conduct all of our on-going business operations through our Utility and Energy Technologies segment. In 2011, we divested the non-core business operations of our Oil and Gas Services segment, which has ceased operations.

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### ***Distributed Generation***

Our Distributed Generation products and services involve manufacturing, installing and operating electric generation equipment on site at a facility where the power is used, including commercial, institutional and industrial operations, generally on behalf of electric utilities. Our systems provide a dependable backup power supply during power outages, and provide a more efficient and environmentally sustainable source of power during high cost periods of peak power demand. These two sources of value benefit both utilities and their large customers. In addition, our solar energy systems provide utilities and their customers with environmentally sustainable power to augment their core power requirements.

Our Distributed Generation systems are sold to customers utilizing two basic economic models, each of which can vary depending on the specific customer and application. In our traditional business model, which is still our primary model, we sell the distributed generation system to the customer. We refer to this as a project-based or a customer-owned model. For Distributed Generation systems sold under the project-based model, the customer acquires ownership of the Distributed Generation assets upon our completion of the project. Our revenues and profits from the sale of systems under this model are recognized over the period during which the system is installed. In the project-based model, after the system is installed we will also usually receive a modest amount of on-going monthly revenues to monitor the system for backup power and peak shaving purposes, as well as to maintain the system.

Our second business model is structured to generate long-term recurring revenues for us, which we refer to as our recurring revenue model or PowerSecure-owned or company-owned model. For Distributed Generation systems completed under this model, we retain ownership of the Distributed Generation system after it is installed at the customer's site. Because of this, we invest the capital required to design and build the system, and our revenues are derived from regular fees paid over the life of the recurring revenue contract by the utility or the customer, or both, for access to the system for standby power and peak shaving. The life of these recurring revenue contracts is typically from five to fifteen years. The fees that generate our revenues in the recurring revenue model are generally paid to us on a monthly basis and are established at amounts intended to provide us with attractive returns on the capital we invest in installing and maintaining the distributed generation system. Our fees for recurring revenue contracts are generally structured either as a fixed monthly payment, or as a shared savings recurring revenue contract. For our shared savings recurring revenue contracts, a portion or all of our fees are earned out of the pool of peak shaving savings the system creates for the customer.

In both economic models, we believe that the customer value proposition is strong. In the customer-owned model, where the customer pays for and obtains ownership of the system, the customer's typical targeted returns on investment range from 15% to 25%, with a payback targeted at three to five years. These paybacks to the customer result from a combination of the benefits of peak shaving, which creates lower total electricity costs, and the value that the backup power provides in avoiding losses from business interruptions due to power outages. Additionally, utilities gain the benefits of smoother electricity demand curves and lower peaks, as the result of having highly reliable standby power supporting customers in their utility systems, power distribution and transmission efficiencies, and of avoiding major capital outlays that would have been required to build centralized power plants and related infrastructure for peaking needs. In our PowerSecure-owned model, where we pay for, install and maintain ownership of the system in exchange for the customer paying us smaller fees over a period of years, utilities and their customers receive access to our system and the related benefits of distributed generation without making a large up-front investment of capital. Under the PowerSecure-owned model, contracts can be structured between us and the utility, us and the customer, or all three parties.

In the six month period 2013, 84.0% of our Distributed Generation revenues consisted of customer-owned sales, and 16.0% of our Distributed Generation revenues were derived from recurring revenue sales. Sales of customer-owned systems deliver revenues and profits that are recorded on our financial statements over the course of the project, which is generally over a three to eighteen month timeframe depending on the size of the project, and sales of PowerSecure-owned projects are recorded over a longer time frame of five to fifteen years depending on the life of the underlying contract. Therefore, changes in the sales of customer-owned systems have significant impacts on our near-term revenues and profits and cause them to fluctuate from period-to-period. By contrast, sales under the PowerSecure-owned system model generate revenues and profits that are more consistent from period-to-period and have higher gross margins, and generate revenues and profits over a longer time period, although smaller in dollar amount in any particular period because they are recognized over the life of the contract. Our PowerSecure-owned recurring revenue model requires us to invest our own capital in the project without any return on capital until after the project is completed, installed, commissioned and successfully operating.

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Our 2012 acquisition of PowerSecure Solar provides us with the ability to provide solar energy systems through our Distributed Generation business platform. These solar energy systems are sold under the project-based, customer-owned model, and we also plan to own and operate these systems under a PowerSecure-owned, recurring revenue model.

### ***Utility Infrastructure***

Our Utility Infrastructure products and services are focused on helping electric utilities design, build, upgrade and maintain infrastructure that enhances the efficiency of their grid systems. Through our UtilityServices business, we provide transmission and distribution system construction and maintenance products and services, install advanced metering and efficient lighting, and provide emergency storm restoration services. Additionally, through our UtilityEngineering and PowerServices consulting engineering firms, we provide utilities with a wide range of engineering and design services, as well as consulting services for regulatory and rate design matters.

Revenues for our UtilityServices business are generally earned, billed, and recognized in two primary models. Under the first model, we have regular, on-going assignments with utilities to provide regular maintenance and upgrade services. These services are earned, billed, and recognized either on a fixed fee basis, based on the number of work units we perform, such as the number of utility transmission poles we upgrade, or on a time and materials basis, based on the number of hours we invest in a particular project, plus amounts for the materials we utilize and install. Under the second model, we are engaged to design, build and install large infrastructure projects, including substations, transmission lines and similar infrastructure, for utilities and their customers. In these types of projects we are generally paid a fixed price for the project, plus any modifications or scope additions. We recognize revenues from these projects on a percentage-of-completion basis as they are completed. In addition to these two primary models, in the future we could be engaged by utilities and their customers to build or upgrade transmission and distribution infrastructure that we own and maintain. In those cases, we would receive fees over a long-term contract in exchange for providing the customer with access to the infrastructure to transmit or receive power.

Revenues for our UtilityEngineering and PowerServices businesses are earned, billed, and recognized based on the number of hours invested in the particular projects and engagements they are serving. Similar to most traditional consulting businesses, these hours are billed at rates that reflect the general technical skill or experience level of the consultant or supervisor providing the services. In some cases, our engineers and consultants are engaged on an on-going basis with utilities, providing resources to supplement utilities' internal engineering teams over long-term time horizons. In other cases, our engineers and consultants are engaged to provide services for very specific projects and assignments.

### ***Energy Efficiency***

Our Energy Efficiency products and services are focused on providing energy solutions to utilities, municipalities, and commercial, institutional and industrial customers with strong value propositions that are designed to reduce their energy costs, improve their operations, and benefit the environment. Our Energy Efficiency product area includes our EfficientLights, IES and EnergyLite businesses and brands, all of which are focused on bringing light emitting diode, or LED, lighting solutions to the marketplace. In addition, our LED lighting offerings were recently broadened and enhanced with our April 2013 acquisition of Solais Lighting. Our Energy Efficiency products and services also include our ESCO energy efficiency facility upgrade solutions, which we acquired in February 2013.

Our EfficientLights LED lighting products are focused on solutions for grocery, drug and convenience stores. These LED lighting products include our EfficientLights fixture for reach-in refrigerated cases, shelf and canopy lights for open refrigerated cases, overhead lighting for walk-in storage coolers, parking lot lights, and security lighting.

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Our IES LED lighting products are focused on solutions for utilities, commercial and industrial, and OEM applications. These LED lighting products include area lights, street lights, and other specialty lighting applications. In addition, IES's product portfolio includes component parts, such as power drivers, light engines and thermal management solutions for OEMs.

Through our EnergyLite business and brand we market our SecureLite and PowerLite family of area lights and street lights, as well as other specialty lighting products. These products are marketed to customers and utilities directly, and through third party distribution arrangements.

Additionally, through our recent acquisition of Solais, we provide LED lamps and fixtures for department stores and other commercial applications. Solais strengthens and complements our existing LED business through the addition of these new product lines and customer channels, and also enhances our skill sets around product design, product commercialization, and manufacturing and sourcing capabilities. In addition, Solais adds to our capabilities in marketing LED lighting through distributor channels.

We generate revenues from our EfficientLights, IES, EnergyLite, and Solais lighting products through the sale of our proprietary LED lights. These lights are sold as retrofits for existing traditional lighting, and to a lesser extent for initial lighting installations. Occasionally we also provide installation services, although that is not a significant portion of our business. We also assist our customers in receiving utility incentives for LED lighting. Our customers are primarily large retail chains, utilities, and department stores, and their installations of LED lighting is across numerous stores over a diverse geographic scope. We also sell our LED lights to, and through, OEMs and distributors. We expect our customer base and sales channels to continue to grow and develop as LED technology continues to be more widely adopted. As we bring additional products to market, we expect to employ a similar business model with our LED lighting products.

Our Energy Efficiency area also includes our ESCO solutions, which involves the design, installation and maintenance of energy conservation measures, primarily as a subcontractor to large energy service company providers, for the benefit of commercial, industrial and institutional customers as end users. Through our recent acquisition of our ESCO capabilities, we expanded our portfolio of energy efficient facility technologies and expertise, to include lighting solutions, HVAC system upgrades, building envelope upgrades, transformer efficiency upgrades and water conservation systems. Our solutions serve the Super ESCOs by providing these energy efficiency solutions across a range of facilities, including high-rise office buildings, distribution facilities, manufacturing plants, retail sites, mixed use complexes, and large government sites.

***Oil and Gas Services*** In 2011, we divested the non-core business operations of our Oil and Gas Services segment. The results of the Oil and Gas Services segment for 2012, which are not material, are included in the Unallocated Corporate and Other amounts in the tables below, wherever applicable.

## **Recent Developments**

On July 31, 2013, we announced that we received approximately \$23 million of new business awards, including approximately \$11 million of new turn-key distributed generation business, approximately \$10 million of additional new utility infrastructure business, and approximately \$2 million in new energy efficiency business.

On June 20, 2013, we announced that we amended our existing credit facility with Citibank and BB&T to (i) add a \$25 million, 7 year term loan to the credit facility (the \$25 Million Term Loan); (ii) extend the maturity date of the revolving portion of the credit facility by two years to November 12, 2016; and (iii) modify certain covenants and other terms and conditions of the credit agreement. In July 2013, we executed forward interest rate swaps to achieve a fixed interest rate on approximately 80% of the \$25 Million Term Loan, commencing October 1, 2013.

On June 6, 2013, we announced that we added approximately \$75 million to our revenue backlog, including approximately \$49 million from a renewed and expanded three year utility infrastructure award to serve a large investor-owned utility. These new business awards also included \$26 million of additional revenue which was comprised of \$18 million of new distributed generation business, \$4 million of additional new utility infrastructure business, and \$4 million in new energy efficiency business.

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On May 23, 2013, we announced that we acquired the minority ownership interests in our PowerSecure Solar and IES subsidiaries increasing our ownership interests to 100% in each of these businesses. The purchase price for the 10% PowerSecure Solar minority interest was \$153 thousand cash. The purchase price for the 33% IES minority interest was 209,060 shares of our common stock, par value \$.01 per share, valued at a total of \$2.9 million at the date of acquisition. In addition, we announced the acquisition of 100% of the business and certain assets of Powerline EHV & Safety Training, LLC ( PowerLine ). The acquired PowerLine business involves safety training in electrical utility work and enhances our utility infrastructure safety and training programs with additional resources and capabilities. The purchase price for the PowerLine business was \$1.1 million which included a cash payment of \$0.6 million at closing and annual cash installment payments of \$0.1 million payable over the next five years.

**Financial Results Highlights**

Our consolidated revenues during the second quarter 2013 increased by \$32.3 million, or 85.4%, compared to our consolidated revenues during the second quarter 2012. The drivers of this quarter-over-quarter revenue increase were the across the board increases in revenues in each of our product and service areas, including a \$17.2 million, or 133.2%, increase in revenues from Utility Infrastructure products and services, a \$7.7 million, or 87.1%, increase in revenues from Energy Efficiency products and services, and a \$7.4 million, or 46.1%, increase in revenues from Distributed Generation products and services. Overall, \$14.8 million of incremental revenue growth occurred in our existing operations, representing a 39.2% quarter-over-quarter increase, and the remaining \$17.5 million of the increase in revenues is due to incremental revenues from our recently acquired PowerSecure Solar, Solais and ESCO operations. This revenue growth, which is a continuation of our growth in recent years, is the result of our focused strategy of growing our revenues on a short-term and long-term basis by expanding our product and services lines, our customer and market base, our geographic footprint, and our utility partners.

Our second quarter 2013 gross margin as a percentage of revenue decreased to 28.3% compared to 32.2% in the second quarter 2012. This quarter-over-quarter gross margin decrease was due to the overall growth of our Utility Infrastructure, Solar, and ESCO energy efficiency revenues, as a percentage of our total revenues, in the second quarter 2013, which are generally our lowest gross margin product and service categories. As is always the case, variability in our quarterly gross margins is also caused by regular on-going differences in the mix of specific projects completed in each quarter.

Our operating expenses during the second quarter 2013 increased by \$4.8 million, or 41.7%, compared to our operating expenses during the second quarter 2012. The quarter-over-quarter increase in operating expenses is largely due to \$2.7 million of incremental operating expenses during the second quarter 2013 at our recently acquired PowerSecure Solar, Solais and ESCO operations. In addition, we incurred \$0.5 million in incremental acquisition costs related to our acquisitions of Solais and PowerLine in the second quarter 2013 compared to \$0.1 million of such costs in the second quarter 2012. The majority of the remaining quarter-over-quarter increase in our operating expenses is due to an increase in selling expenses related to our significantly higher revenue and backlog, depreciation and amortization from capital expenditures primarily driven by our investments in Company-owned distributed generation systems, utility infrastructure equipment and acquisition related intangibles, and increases in personnel and equipment to drive and support our growth. The increase in personnel and equipment includes expenses to continue to strengthen our safety resources and programs.

Our second quarter 2013 operating expenses, as a percentage of our revenues, decreased by 7.2 percentage points compared to the second quarter 2012, partially as a result of our 2012 cost reduction program which has allowed us to leverage our operating expenses against a greater level of revenues year-over-year. Our recent acquisitions have provided opportunities to further leverage our future operating expenses against future revenues, including near and mid-term opportunities to increase operating margins in our energy efficiency product and service lines. This includes manufacturing and sourcing synergies that our Solais acquisition is expected to bring to our existing LED lighting operations, and other cost reduction opportunities. We have commenced initiatives to accelerate the realization of the expected benefits, and we expect these actions to result in a charge of between \$2 million and \$4 million during the second half of 2013.

Our income from continuing operations attributable to PowerSecure International, Inc. shareholders for the second quarter 2013 was \$2.1 million, or \$0.11 per diluted share, compared to income from continuing operations attributable to PowerSecure International, Inc. shareholders of \$1.6 million, or \$0.09 per diluted share, for the second quarter 2012, which included a \$1.4 million gain, or \$0.05 per diluted share, from the sale of our WaterSecure operations. There was no similar gain during the second quarter 2013. The second quarter 2013 included \$0.5 million, or \$0.01 per diluted share, of expenses related to our acquisition activities during the quarter.

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We had no income or loss from discontinued operations during the second quarter 2013 and our income from discontinued operations was negligible for the second quarter 2012. We do not expect to incur any additional income or loss in future periods from our discontinued operations as all of the related assets and liabilities were disposed during 2012.

In total, our consolidated net income attributable to PowerSecure International, Inc. common stockholders for the second quarter 2013 was \$2.1 million, or \$0.11 per diluted share, which compared to net income attributable to PowerSecure International, Inc. common stockholders of \$1.6 million, or \$0.09 per diluted share, for the second quarter 2012.

Our consolidated revenues during the six month period 2013 increased by \$44.1 million, or 62.1%, compared to our consolidated revenues during the six month period 2012. The drivers of this period-over-period revenue increase were the across the board increases in revenues in each of our product and service areas, including a \$23.9 million, or 91.9%, increase in revenues from Utility Infrastructure products and services, a \$15.9 million, or 55.5%, increase in revenues from Distributed Generation products and services, and a \$4.3 million, or 26.1%, increase in revenues from Energy Efficiency products and services. Overall, \$23.7 million of incremental revenue growth occurred in our existing operations, representing a 33.3% period-over-period increase, and the remaining \$20.4 million of the increase in revenues is due to incremental revenues from our recently acquired PowerSecure Solar, Solais and ESCO operations.

Our six month period 2013 gross margin as a percentage of revenue decreased to 29.2% compared to 30.6% in the six month period 2012. This period-over-period gross margin decrease was due to the overall growth of our Utility Infrastructure, Solar, and ESCO energy efficiency revenues, as a percentage of our total revenues, in the six month period 2013, which are generally our lowest gross margin product and service categories.

Our operating expenses during the six month period 2013 increased by \$6.7 million, or 30.0%, compared to our operating expenses during the six month period 2012. The period-over-period increase in operating expenses is largely due to \$3.8 million of incremental operating expenses during the six month period 2013 at our recently acquired PowerSecure Solar, Solais and ESCO operations. In addition, we incurred \$0.5 million in incremental acquisition costs in the six month period 2013 compared to \$0.1 million of such costs in the six month period 2012. The majority of the remaining year-over-year increase in our operating expenses is due to an increase in selling expenses related to our significantly higher revenue and backlog, depreciation and amortization from capital expenditures primarily driven by our investments in Company-owned distributed generation systems, utility infrastructure equipment and acquisition related intangibles, and increases in personnel and equipment to drive and support our growth. The increase in personnel and equipment includes expenses to continue to strengthen our safety resources and programs.

Our six month period 2013 operating expenses, as a percentage of our revenues, decreased by 6.2 percentage points compared to the six month period 2012, partially as a result of our 2012 cost reduction program which has allowed us to leverage our operating expenses against a greater level of revenues year-over-year. Our recent acquisitions have provided opportunities to further leverage our future operating expenses against future revenues, including near and mid-term opportunities to increase operating margins in our energy efficiency product and service lines. This includes manufacturing and sourcing synergies that our Solais acquisition is expected to bring to our existing LED lighting operations, and other cost reduction opportunities. We have commenced initiatives to accelerate the realization of the expected benefits, and we expect these actions to result in a charge of between \$2 million and \$4 million during the second half of 2013.

Our income from continuing operations attributable to PowerSecure International, Inc. shareholders for the six month period 2013 was \$2.8 million, or \$0.15 per diluted share, compared to income from continuing operations attributable to PowerSecure International, Inc. shareholders of \$1.0 million, or \$0.05 per diluted share, for the six month period 2012.

We had no income or loss from discontinued operations during the six month period 2013 and our income from discontinued operations was negligible for the six month period 2012. We do not expect to incur any additional income or loss in future periods from our discontinued operations as all of the related assets and liabilities were disposed during 2012.



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In total, our consolidated net income attributable to PowerSecure International, Inc. common stockholders for the six month period 2013 was \$2.8 million, or \$0.15 per diluted share, which compared to net income attributable to PowerSecure International, Inc. common stockholders of \$1.0 million, or \$0.05 per diluted share, for the six month period 2012.

As discussed below under **Fluctuations**, our financial results will fluctuate from quarter to quarter and year to year. Thus, there is no assurance that our past results, including the results of our year ended December 31, 2012 or our quarter ended June 30, 2013, will be indicative of our future results, especially in light of the current economic conditions and unfavorable credit and capital markets.

**Backlog**

As of the date of this report, our revenue backlog expected to be recognized after June 30, 2013 is \$245 million. This includes revenue related to the new business awards described above under **Recent Developments**. Our revenue backlog represents revenue expected to be recognized after June 30, 2013, for periods including the third quarter of 2013 onward. This backlog figure compares to the revenue backlog of \$206 million we reported in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2013 filed on May 8, 2013 (the date we last reported our backlog). Our revenue backlog and the estimated timing of revenue recognition is outlined below, including project-based revenues expected to be recognized as projects are completed and recurring revenues expected to be recognized over the life of the contracts:

**Revenue Backlog to be recognized after June 30, 2013**

Description		Anticipated Revenue	Estimated Primary Recognition Period
Project-based Revenue	Near term	\$ 131 Million	3Q13 through 1Q14
Project-based Revenue	Long term	\$ 45 Million	2Q14 through 2015
Recurring Revenue		\$ 69 Million	3Q13 through 2020

**Revenue Backlog to be recognized after June 30, 2013 \$ 245 Million**

*Note: Anticipated revenue and estimated primary recognition periods are subject to risks and uncertainties as indicated in **Cautionary Note Regarding Forward-Looking Statements** above. Consistent with past practice, these amounts are not intended to constitute our total revenue over the indicated time periods, as we have additional, regular on-going revenues. Examples of additional, regular recurring revenues include revenues from engineering fees, and service revenue, among others. Numbers may not add due to rounding.*

Orders in our backlog are subject to delay, deferral, acceleration, resizing, or cancellation from time to time by our customers, subject to contractual rights, and estimates are utilized in the determination of the backlog amounts. Given the irregular sales cycle of customer orders, and especially of large orders, our revenue backlog at any given time is not necessarily an accurate indication of our future revenues.

**Operating Segments**

Our Utility and Energy Technologies segment includes our core business, and is the only segment in which we have on-going business operations. In 2011, we divested the non-core business operations of our Oil and Gas Services segment. The results of our Oil and Gas Services segment for 2012, which are not material, are included in the unallocated Corporate and Other amounts in the tables below, wherever applicable. Our strategic decision to divest the Oil and Gas Services segment has enabled us to invest in and grow our Utility and Energy Technologies segment. All of our on-going operating activities are now conducted through our Utility and Energy Technologies segment.

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Our reported segments are strategic business units with different products and services which serve different customer bases. They are separate because each segment has different customer sets, requires different technology and marketing strategies, and has separate service delivery and management platforms. Our operating segments also represent components for which discrete financial information is available and is (or was, in the case of our Oil and Gas Services segment) reviewed regularly by the chief operating decision-maker, or decision-making group, to evaluate performance and make operating decisions.

**Results of Operations**

The following discussion regarding segment revenues, gross profit, costs and expenses, and other income and expenses excludes revenues, gross profit, and costs and expenses of our PowerPackages business and operations, which were discontinued in 2011, the financial results of which for the second quarter and six month period 2012 are classified as discontinued operations in our financial statements.

**Second Quarter 2013 Compared to Second Quarter 2012***Revenues*

Our consolidated revenues are generated entirely by sales and services provided by our Utility and Energy Technologies segment. We currently provide a variety of Utility and Energy Technologies products and services, including Distributed Generation products and services, Utility Infrastructure products and services, and Energy Efficiency products and services. The following table summarizes our Utility and Energy Technologies segment revenues for the periods indicated (dollars in thousands):

	Quarter Ended June 30,		Period-over-Period Difference	
	2013	2012	\$	%
Utility and Energy Technologies:				
Distributed Generation	\$ 23,581	\$ 16,139	\$ 7,442	46.1%
Utility Infrastructure	30,111	12,912	17,199	133.2%
Energy Efficiency	16,495	8,816	7,679	87.1%
<b>Total</b>	<b>\$ 70,187</b>	<b>\$ 37,867</b>	<b>\$ 32,320</b>	<b>85.4%</b>

Our consolidated revenues for the second quarter 2013 increased \$32.3 million, or 85.4%, compared to the second quarter 2012 due to an increase in sales in each of our Utility and Energy Technologies segment products and services, including increases in Distributed Generation, Utility Infrastructure and Energy Efficiency revenues. This revenue growth, which is a continuation of our growth in recent years, includes \$14.8 million of incremental revenue growth in our existing operations and \$17.5 million of incremental revenues from our recently acquired PowerSecure Solar, Solais and ESCO operations. This revenue growth is the result of our focused strategy of growing our revenues by expanding our product and services lines, our customer and market base, our geographic footprint and our utility partners.

Our Utility and Energy Technologies segment distributed generation revenues are significantly affected by the number, size and timing of our Distributed Generation, Utility Infrastructure and Energy Efficiency projects as well as the percentage of completion of in-process projects, and the percentage of customer-owned as opposed to PowerSecure-owned distributed generation recurring revenue projects. Our Distributed Generation sales have fluctuated significantly in the past and are expected to continue to fluctuate significantly in the future. The increase in our Utility and Energy Technologies segment revenues in the second quarter 2013 over the second quarter 2012 consisted of a \$17.1 million, or 133.2%, increase in revenues from Utility Infrastructure products and services, a \$7.4 million, or 46.1%, increase in revenues from Distributed Generation products and services, and a \$7.7 million, or 87.1%, increase in revenues from Energy Efficiency products and services. The quarter-over-quarter increase in our Utility Infrastructure product sales and services was due to an increase in the number of utilities that we service, and an increase in those utilities' spending levels on transmission and distribution system maintenance and construction projects, as well as energy companies spending on electrical infrastructure to support oil and gas production. The quarter-over-quarter increase in our Distributed Generation product sales and services was driven by increases in customer-owned project sales and increases in solar distributed generation project sales from the acquisition of PowerSecure Solar in June 2012. The quarter-over-quarter increase in our Energy Efficiency revenues in the second quarter 2013 compared to the second quarter 2012 was driven by an additional \$13.9 million in energy efficiency revenues from the acquisition of our ESCO business in February 2013 and the acquisition of Solais Lighting in April 2013, partially offset by decreases in revenues from EfficientLights lighting products for our grocery customers due to difficult financial conditions in the grocery sector.



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Our future revenues will depend on the continuing recovery of the domestic economy, the health of the credit markets and the continuing levels of customer spending for capital improvements and energy efficiency projects, as well as our ability to secure new significant purchase orders and to realize the growth opportunities provided by our recent acquisitions and any future acquisitions. The amount and timing of our future revenues will also be affected by the amount and proportion of revenues generated by future PowerSecure-owned distributed generation recurring revenue projects, which result in revenue being recognized over a longer period. We are particularly susceptible to changes in economic conditions because our product offerings are generally considered discretionary investment items by our customers, who may delay or defer large sales orders, especially when economic conditions are not positive.

*Gross Profit and Gross Profit Margin*

Our segment gross profit represents our revenues less our cost of sales. Our segment gross profit margin represents our gross profit divided by our revenues. The following table summarizes our Utility and Energy Technologies segment cost of sales along with our segment gross profit and gross profit margin for the periods indicated (dollars in thousands):

	Quarter Ended June 30,		Period-over-Period Difference	
	2013	2012	\$	%
<b>Utility and Energy Technologies:</b>				
Cost of Sales	\$ 50,304	\$ 25,663	\$ 24,641	96.0%
Gross Profit	\$ 19,883	\$ 12,204	\$ 7,679	62.9%
Gross Profit Margin	28.3%	32.2%		

Cost of sales and services include materials, personnel and related overhead costs incurred to manufacture products and provide services. The 96.0% increase in our consolidated cost of sales and services for the second quarter 2013 compared to the second quarter 2012, was driven by the increase in costs associated with the 85.4% increase in sales, together with the factors discussed below leading to the reduction in our gross profit margin.

An important driver in the period-over-period change in our gross profit margin is the relative gross margins we generally earn in each of our Distributed Generation, Utility Infrastructure and Energy Efficiency product and service categories. Our Distributed Generation products and services generally yield gross profit margins in the 20-45% range, our Utility Infrastructure products and services generally yield gross profit margins in the 5-30% range, and our Energy Efficiency products generally yield gross margins in the 15-40% range. The gross profit margin we realize within these ranges largely correlates to the amount of value-added products and services we deliver, with highly engineered, turn-key projects realizing higher gross profit margins due to the benefits they deliver our customers and the value we deliver because we are vertically integrated. Because of these gross profit margin differences, changes in the mix of our product lines affect our consolidated gross profit margin results. In addition, our recently acquired Solar and ESCO businesses have lower gross margins, which are generally in the 15-25% range.

Our Utility and Energy Technologies segment gross profit increased \$7.7 million, or 62.9%, in the second quarter 2013 compared to the second quarter 2012. As a percentage of revenue, our Utility and Energy Technologies segment gross profit margin in the second quarter 2013 was 28.3%, a decrease of 3.9 percentage points compared to the second quarter 2012. Our lower gross profit margins in the second quarter 2013 compared to the second quarter 2012 were due to an increase in the growth and amount of Utility Infrastructure, Solar, and ESCO energy efficiency revenues, as a percentage of our total revenues, in the second quarter 2013 which are generally our lowest gross margin product and service categories. As is always the case, variability in our gross margins is also caused by regular on-going differences in the mix of specific projects completed in each quarter. In the long-term, we expect that gross profit margins for this segment will increase somewhat because of anticipated greater productivity, operations and manufacturing efficiencies, improvements in technology, and growth in our higher-margin recurring revenue projects. In the near-term, however, we expect the total gross margins in this segment will remain in the upper 20%-range as we continue to realize revenues from our recent ESCO energy efficiency acquisition, which carries lower gross margins and will lower our total gross margins as a percentage of revenue.

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Our gross profit and gross profit margin have been, and we expect will continue to be, affected by many factors, including the following:

the absolute level of revenue achieved in any particular period, given that portions of our cost of sales are relatively fixed over the near-term, the most significant of which is personnel and equipment costs;

the allocation of revenue among each of our Distributed Generation, Utility Infrastructure and Energy Efficiency product and service categories, and products and services within these categories, which have different gross profit margins;

our ability to improve our operating efficiency and benefit from economies of scale;

our level of investments in our businesses, particularly for anticipated or new business awards;

improvements in technology and manufacturing methods and processes;

the mix of higher and lower margin projects, products and services, and the impact of new products and technologies on our pricing and volumes;

our ability to manage our materials and labor costs, including any future inflationary pressures;

the costs to maintain and operate distributed generation systems we own in conjunction with recurring revenue contracts, including the price of fuel, run hours, weather, and the amount of fuel utilized in their operation, as well as their operating performance;

the geographic density of our projects;

the selling price of products and services sold to customers, and the revenues we expect to generate from recurring revenue projects;

the rate of growth of our new businesses, which tend to incur costs in excess of revenues in their earlier phases and then become profitable and more efficient over time if they are successful;

the impact of acquisitions of businesses, assets and technologies, including differing margins of new products and services acquired and our ability to strategically benefit from cost efficiencies these acquisitions provide and to manage the costs of our related growth from acquisitions;

the ability to realize gross margin increases from our recent Solais acquisition, and the impact of the lower gross margin profile of our ESCO energy efficiency acquisition;

costs and expenses of business shutdowns, when they occur; and

other factors described below under Fluctuations.

Some of these factors are not within our control, and we cannot provide any assurance that we can continue to improve upon those factors that are within our control, especially given the current economic climate as well as our longer term movement to an expected higher percentage of recurring revenue projects. Moreover, our gross revenues are likely to fluctuate from quarter to quarter and from year to year, as discussed in

Fluctuations below. Accordingly, there is no assurance that our future gross profit margins will improve or even remain at historic levels in the future, and will likely decrease if revenues decrease.

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Our operating expenses include general and administrative expense, selling, marketing and service expense, depreciation and amortization, and, from time to time, restructuring and cost reduction charges. The following table sets forth our consolidated operating expenses for the periods indicated (dollars in thousands):

	Quarter Ended June 30,		Period-over-Period Difference	
	2013	2012	\$	%
<b>Consolidated Operating Expenses:</b>				
General and administrative	\$ 12,511	\$ 9,093	\$ 3,418	37.6%
Selling, marketing and service	2,105	1,366	739	54.1%
Depreciation and amortization	1,809	1,136	673	59.2%
<b>Total</b>	<b>\$ 16,425</b>	<b>\$ 11,595</b>	<b>\$ 4,830</b>	<b>41.7%</b>

Costs related to personnel, including wages, benefits, stock compensation, bonuses and commissions, are the most significant component of our operating expenses. During the second quarter 2013, we incurred \$0.4 million of incremental operating expenses at our PowerSecure Solar operations, which we acquired in June 2012; we incurred \$1.6 million of incremental operating expenses at our ESCO business operations, which we acquired in February 2013; we incurred \$0.7 million of incremental operating expenses at Solais Lighting, which we acquired in May 2013; and we incurred \$0.4 million of incremental acquisition costs compared to the second quarter 2012. In addition, our increase in operating costs was driven by an increase in selling expenses related to our significantly higher revenue and backlog, additional depreciation and amortization from capital expenditures primarily driven by capital expenditures for Company-owned distributed generation systems, utility infrastructure equipment and acquisition related intangibles, and increases in personnel and equipment to drive and support our growth. The increase in personnel and equipment includes expenses to continue to strengthen our safety resources and programs.

During the second half of 2012, we initiated a restructuring and cost reduction program to reduce our costs, streamline our organization, and set the framework to improve the scalability of our cost structure as we grow revenues. The goal of this program was to reduce expenses as a percentage of revenues as we grow to drive improvements in our operating margin. Partially as a result of this program, our operating expenses for the second quarter 2013, as a percentage of our revenues, decreased by 7.2 percentage points compared to the second quarter 2012, as we leveraged our operating expenses against a greater level of revenues, quarter-over-quarter. Our recent acquisitions have provided opportunities to further leverage our future operating expenses against future revenues, including near and mid-term opportunities to increase operating margins in our energy efficiency product and service lines. This includes manufacturing and sourcing synergies that our Solais acquisition is expected to bring to our existing LED lighting operations, and other cost reduction opportunities. We have commenced initiatives to accelerate the realization of the expected benefits, and we expect these actions to result in a charge of between \$2 million and \$4 million during the second half of 2013.

In the longer term, we expect our operating costs to grow to support the growth of our business, although at a lower growth rate than revenues, and that growth will be dependent in large part upon future economic and market conditions. Accordingly, the timing and the amount of future increases in operating expenses will depend on the timing and level of future improvements in economic and business conditions and the effects of such economic recovery on our revenues, as well as upon the success of our cost reduction initiative. We cannot provide any assurance as to if, when, how much or for how long economic conditions will improve, or the effects of future economic conditions on our revenues, expenses or net income.

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*General and Administrative Expenses.* General and administrative expenses include personnel wages, benefits, stock compensation, and bonuses and related overhead costs for the support and administrative functions incurred in our Utility and Energy Technologies segment together with unallocated corporate general and administrative costs. The 37.6% increase in our consolidated general and administrative expenses in the second quarter 2013, as compared to the second quarter 2012, was due primarily to an increase in personnel, rent, travel and other expenses to support our increasing levels of revenue and investments in new business opportunities. Our second quarter 2013 general and administrative expenses, as a percentage of our revenues, decreased by 6.2 percentage points compared to the second quarter 2012, partially as a result of our cost reduction initiative initiated in 2012. The following table provides further detail of our general and administrative expenses by segment (dollars in thousands):

	Quarter Ended June 30,		Period-over-Period Difference	
	2013	2012	\$	%
<b>Segment G&amp;A Expenses:</b>				
Utility and Energy Technologies:				
Personnel costs	\$ 7,265	\$ 5,106	\$ 2,159	42.3%
Vehicle lease and rental	811	654	157	24.0%
Insurance	339	266	73	27.4%
Rent-office and equipment	317	256	61	23.8%
Professional fees and consulting	198	133	65	48.9%
Travel	611	307	304	99.0%
Development costs	34	166	(132)	(79.5)%
Other	1,305	806	499	61.9%
Unallocated Corporate and Other	1,631	1,399	232	16.6%
<b>Total</b>	<b>\$ 12,511</b>	<b>\$ 9,093</b>	<b>\$ 3,418</b>	<b>37.6%</b>

The increase in each of the expense categories above during the second quarter 2013 compared to the second quarter 2012 was incurred primarily as a result of the incremental general and administrative expenses incurred associated with our recently acquired PowerSecure Solar, ESCO and Solais operations. Over the long-term, we expect our expenses in these areas to increase, although at lower growth rates than our revenues, as we strive to leverage our cost structure and deliver higher operating profit margins.

Unallocated corporate general and administrative expenses include similar personnel costs as described above as well as costs incurred for the benefit of all of our business operations, such as acquisition costs, legal, Sarbanes-Oxley compliance, public company reporting, director expenses, accounting costs, and stock compensation expense on our stock options and restricted stock grants which we do not allocate to our operating segments. The increase in our unallocated corporate and other general and administrative expenses during the second quarter 2013 as compared to the second quarter 2012 was due primarily to \$0.5 million of incremental acquisition costs incurred in connection with the recent acquisitions of the ESCO business, Solais Lighting and PowerLine, compared to \$0.1 million of such costs in the second quarter 2012. We expect our unallocated corporate costs for the remainder of 2013 to decrease slightly compared to the levels incurred during the second quarter 2013.

*Selling, Marketing and Service Expenses.* Selling, marketing and service expenses consist of personnel and related overhead costs, including commissions for sales and marketing activities, together with travel, advertising and promotion costs incurred in our Utility and Energy Technologies segment. The 54.1% increase in selling, marketing and service expenses in the second quarter 2013, as compared to the second quarter 2012, was due to increases in commissions, travel, advertising and promotion, and bad debt expenses. The following table provides further detail of our segment selling, marketing and service expenses (dollars in thousands):

	Quarter Ended June 30,		Period-over-Period Difference	
	2013	2012	\$	%
<b>Segment Selling, Marketing and Service:</b>				
Utility and Energy Technologies:				
Salaries	\$ 740	\$ 742	\$ (2)	(0.3)%
Commission	421	312	109	34.9%



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Travel	332	186	146	78.5%
Advertising and promotion	321	144	177	122.9%
Bad debt expense (recovery)	291	(18)	309	1,716.7%
Total	\$ 2,105	\$ 1,366	\$ 739	54.1%

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In the future, we expect our near-term and long-term Utility and Energy Technologies segment selling, marketing and services expenses to grow in order to reflect, drive and support future growth.

*Depreciation and Amortization Expenses.* Depreciation and amortization expenses include the depreciation of property, plant and equipment and the amortization of certain intangible assets including capitalized software development costs and other intangible assets. The 59.2% increase in depreciation and amortization expenses in the second quarter 2013, as compared to the second quarter 2012, primarily reflects increased depreciation resulting from capital investments at our Utility and Energy Technologies segment during 2012, as well as amortization expense associated with acquisition related intangible assets. These capital investments are primarily investments in PowerSecure-owned distributed generation systems for projects deployed under our recurring revenue model as well as investments in Utility Infrastructure equipment to support its growth. In the future, we expect our near-term and long-term depreciation and amortization expenses to grow reflecting depreciation on additional capital expenditures as well as expense associated with amortization of intangible assets acquired in connection with our recent acquisitions.

*Other Income and Expenses*

Our other income and expenses include interest income, interest expense, gain on sale of unconsolidated affiliate and income taxes. The following table sets forth our other income and expenses for the periods indicated, by segment (dollars in thousands):

	Quarter Ended June 30,		Period-over-Period Difference	
	2013	2012	\$	%
<b>Other Segment Income and (Expenses):</b>				
Utility and Energy Technologies:				
Interest income and other income	\$	\$	\$	n/m
Interest expense	(55)	(68)	13	(19.1)%
<b>Segment total</b>	<b>(55)</b>	<b>(68)</b>	<b>13</b>	
Unallocated Corporate and Other:				
Gain on sale of unconsolidated affiliate		1,439	(1,439)	(100.0)%
Interest income and other income	19	23	(4)	(17.4)%
Interest expense	(75)	(48)	(27)	56.3%
Income tax expense	(1,305)	(621)	(684)	110.1%
<b>Segment total</b>	<b>(1,361)</b>	<b>793</b>	<b>(715)</b>	
<b>Total</b>	<b>\$ (1,416)</b>	<b>\$ 725</b>	<b>\$ (702)</b>	

*Interest Income and Other Income.* Interest income and other income for each segment consists primarily of interest we earn on the interest-bearing portion of our cash and cash equivalent balances. In total, interest income and other income decreased slightly during the second quarter 2013, as compared to the second quarter 2012. This slight decrease was attributable to a reduction in interest-bearing cash and cash equivalent balances in the second quarter 2013 compared to the second quarter 2012. Our future interest income will depend on our cash and cash equivalent balances, which will increase and decrease depending upon our profit, capital expenditures, acquisitions, and our working capital needs, and future interest rates.

*Interest Expense.* Interest expense for each segment consists of interest and finance charges on the revolving portion of our credit facility, term loans and capital leases. In total, interest expense increased during the second quarter 2013, as compared to the second quarter 2012. The increase in our interest expense reflects interest on our new \$25.0 million term loan, partially offset by reduction in balances outstanding on our capital lease obligation and our prior existing term loan due to regular payments made on those obligations over the year. We expect our future interest and finance charges to increase in the immediate future as a result of our recent \$25.0 million term loan borrowings under our credit facility to fund working capital needs and future recurring revenue projects at our Utility and Energy Technologies segment.



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*Gain on Sale of Unconsolidated Affiliate.* Gain on sale of unconsolidated affiliate included in our Unallocated Corporate and Other segment consists of our minority ownership share of the gain recognized by our WaterSecure operations related to the sale of substantially all of the assets and business of MM 1995-2 in June 2011. At the time of the sale, MM 1995-2 deferred \$4.0 million of the gain until such time as certain contingencies associated with the sale were eliminated and the associated escrowed sales proceeds were received. These contingencies expired and were resolved in the second quarter 2012 and \$3.9 million of the funds that were placed into escrow were released. In June 2012, we received our share of the escrowed sales proceeds and recorded a corresponding gain in the amount of \$1.4 million during the second quarter 2012. There was no similar gain in the second quarter 2013.

*Income Taxes.* The income tax expense or benefit we record is the result of applying our annual effective tax rate by our pre-tax income or loss. Our effective tax rate and our income tax expense or benefit includes the effects of permanent differences between our book and taxable income, changes in our deferred tax assets and liabilities, changes in the valuation allowance for our net deferred tax assets, state income taxes in various state jurisdictions in which we have taxable activities, and expenses associated with uncertain tax positions that we have taken or expense reductions from uncertain tax positions as a result of a lapse of the applicable statute of limitations. Our overall effective tax rate in the second quarter 2013 increased, as compared to the second quarter 2012, as we expect our effective tax rate in 2013 will more closely approximate statutory rates. Our overall income tax expense in the second quarter 2013 increased, as compared to the second quarter 2012, due to the income tax expense associated with the increase in our pre-tax income and an increase in our expected effective tax rate.

*Non-controlling Interest.* Until May 20, 2013, we held a 90% controlling ownership interest in PowerSecure Solar, a distributed solar energy company which we acquired in June 2012. In addition, until May 22, we also held a 67% controlling ownership interest in IES, an LED lighting company which we acquired in 2010. On May 20, 2013, we acquired the 10% non-controlling ownership interest in PowerSecure Solar in exchange for a cash payment of \$153 thousand. On May 22, 2013, we acquired the 33% non-controlling ownership interest in IES in exchange for 209 thousand shares of our common stock valued at a total of \$2.9 million on the date of acquisition. As a result of these non-controlling interest acquisitions, both PowerSecure Solar and IES are now wholly-owned subsidiaries and there will be no non-controlling interest in those entities after the acquisition dates.

Until the acquisitions of the non-controlling interests described above, the non-controlling ownership interest in the income or loss of IES and PowerSecure Solar was reflected as a reduction or addition to net income or losses to derive income attributable to PowerSecure International stockholders. The decrease in the addition for the non-controlling interest in the loss of our majority-owned subsidiaries in the second quarter 2013, as compared to the second quarter 2012, is a result of our acquisition of the non-controlling interests in May 2013 as well as development activities we incurred in the second quarter 2012 at IES to bring a broader complement of new lighting products to market which resulted in improved operating results at IES during the second quarter 2013.

**Six Month Period 2013 Compared to Six Month Period 2012***Revenues*

The following table summarizes our Utility and Energy Technologies segment revenues for the periods indicated (dollars in thousands):

	Six Months Ended June 30,		Period-over-Period Difference	
	2013	2012	\$	%
Utility and Energy Technologies:				
Distributed Generation	\$ 44,538	\$ 28,644	\$ 15,894	55.5%
Utility Infrastructure	49,961	26,040	23,921	91.9%
Energy Efficiency	20,645	16,368	4,277	26.1%
<b>Total</b>	<b>\$ 115,144</b>	<b>\$ 71,052</b>	<b>\$ 44,092</b>	<b>62.1%</b>

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Our consolidated revenues for the six month period 2013 increased \$44.1 million, or 62.1%, compared to the six month period 2012 due to an increase in sales in each of our Utility and Energy Technologies segment products and services, including increases in Distributed Generation, Utility Infrastructure and Energy Efficiency revenues. This revenue growth, which is a continuation of our growth in recent years, includes \$23.7 million of incremental revenue growth in our existing operations and \$20.4 million incremental revenues from our recently acquired PowerSecure Solar, Solais and ESCO operations, and is the result of our focused strategy of growing our revenues by expanding our product and services lines, our customer and market base, our geographic footprint and our utility partners.

Our Utility and Energy Technologies segment distributed generation revenues are significantly affected by the number, size and timing of our Distributed Generation, Utility Infrastructure and Energy Efficiency projects as well as the percentage of completion of in-process projects, and the percentage of customer-owned as opposed to PowerSecure-owned distributed generation recurring revenue projects. Our Distributed Generation sales have fluctuated significantly in the past and are expected to continue to fluctuate significantly in the future. The increase in our Utility and Energy Technologies segment revenues in the six month period 2013 over the six month period 2012 consisted of a \$23.9 million, or 91.9%, increase in revenues from Utility Infrastructure products and services, a \$15.9 million, or 55.5%, increase in revenues from Distributed Generation products and services, and a \$4.3 million, or 26.1%, increase in revenues from Energy Efficiency products and services. The period-over-period increase in our Utility Infrastructure product sales and services was due to an increase in the number of utilities that we service, and an increase in those utilities' spending levels on transmission and distribution system maintenance and construction projects, as well as energy companies spending on electrical infrastructure to support oil and gas production. The period-over-period increase in our Distributed Generation product sales and services was driven by increases in customer-owned project sales and increases in solar distributed generation project sales from the acquisition of PowerSecure Solar in June 2012. The period-over-period increase in our Energy Efficiency revenues in the six month period 2013 compared to the six month period 2012 was driven by an additional \$14.7 million in energy efficiency revenues from the acquisition of our ESCO business in February 2013 and the acquisition of Solais Lighting in April 2013, partially offset by decreases in revenues from EfficientLights lighting products from our grocery customers due to difficult financial conditions in the grocery sector.

*Gross Profit and Gross Profit Margin*

The following table summarizes our Utility and Energy Technologies segment cost of sales along with our segment gross profit and gross profit margin for the periods indicated (dollars in thousands):

	Six Months Ended June 30,		Period-over-Period Difference	
	2013	2012	\$	%
<b>Utility and Energy Technologies:</b>				
Cost of Sales	\$ 81,521	\$ 49,293	\$ 32,228	65.4%
Gross Profit	\$ 33,623	\$ 21,759	\$ 11,864	54.5%
Gross Profit Margin	29.2%	30.6%		

The 65.4% increase in our consolidated cost of sales and services for the six month period 2013 compared to the six month period 2012, was driven by the increase in costs associated with the 62.1% increase in sales, together with the factors discussed below leading to the reduction in our gross profit margin.

An important driver in the period-over-period change in our gross profit margin is the relative gross margins we generally earn in each of our Distributed Generation, Utility Infrastructure and Energy Efficiency product and service categories. Our Distributed Generation products and services generally yield gross profit margins in the 20-45% range, our Utility Infrastructure products and services generally yield gross profit margins in the 5-30% range, and our Energy Efficiency products generally yield gross margins in the 15-40% range. The gross profit margin we realize within these ranges largely correlates to the amount of value-added products and services we deliver, with highly engineered, turn-key projects realizing higher gross profit margins due to the benefits they deliver our customers and the value we deliver because we are vertically integrated. Because of these gross profit margin differences, changes in the mix of our product lines affect our consolidated gross profit margin results. In addition, our recently acquired Solar and ESCO businesses have lower margins, which are generally in the 15-25% range.

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Our Utility and Energy Technologies segment gross profit increased \$11.9 million, or 54.5%, in the six month period 2013 compared to the six month period 2012. As a percentage of revenue, our Utility and Energy Technologies segment gross profit margin in the six month period 2013 was 29.2%, a decrease of 1.4 percentage points compared to the six month period 2012. Our lower gross profit margins in the six month period 2013 compared to the six month period 2012 were due to an increase in the growth and amount of Utility Infrastructure, Solar, and ESCO energy efficiency revenues, as a percentage of our total revenues, in the six month period 2013 which are generally our lowest gross margin product and service categories. As is always the case, variability in our gross margins is also caused by regular on-going differences in the mix of specific projects completed in each quarter. In the long-term, we expect that gross profit margins for this segment will increase somewhat because of anticipated greater productivity, operations and manufacturing efficiencies, improvements in technology, and growth in our higher-margin recurring revenue projects. In the near-term, however, we expect the total gross margins in this segment will remain in the upper 20%-range as we continue to realize revenues from our recent ESCO energy efficiency acquisition, which carries lower gross margins and will lower our total gross margins as a percentage of revenue.

*Operating Expenses*

The following table sets forth our consolidated operating expenses for the periods indicated (dollars in thousands):

	Six Months Ended June 30,		Period-over-Period Difference	
	2013	2012	\$	%
<b>Consolidated Operating Expenses:</b>				
General and administrative	\$ 22,343	\$ 17,738	\$ 4,605	26.0%
Selling, marketing and service	3,490	2,424	1,066	44.0%
Depreciation and amortization	3,265	2,221	1,044	47.0%
<b>Total</b>	<b>\$ 29,098</b>	<b>\$ 22,383</b>	<b>\$ 6,715</b>	<b>30.0%</b>

During the six month period 2013, we incurred \$1.0 million of incremental operating expenses at our PowerSecure Solar operations, which we acquired in June 2012; we incurred \$2.0 million of incremental operating expenses at our ESCO business operations, which we acquired in February 2013; we incurred \$0.7 million of incremental operating expenses at our Solais Lighting operations, which we acquired in April 2013; and we incurred \$0.5 million of incremental acquisition costs compared to the six month period 2012. In addition, the increase in our operating costs was driven by an increase in selling expenses related to our significantly higher revenue and backlog, additional depreciation and amortization from capital expenditures primarily driven by capital expenditures for Company-owned distributed generation systems, utility infrastructure equipment and acquisition related intangibles, and increases in personnel and equipment to drive and support our growth. The increase in personnel and equipment includes expenses to continue to strengthen our safety resources and programs.

During the second half of 2012, we initiated a restructuring and cost reduction program to reduce our costs, streamline our organization, and set the framework to improve the scalability of our cost structure as we grow revenues. The goal of this program was to reduce expenses as a percentage of revenues as we grow to drive improvements in our operating margin. Partially as a result of this program, our operating expenses for the six month period 2013, as a percentage of our revenues, decreased by 6.2 percentage points compared to the six month period 2012, as we leveraged our operating expenses against a greater level of revenues, year-over-year. Our recent acquisitions have provided opportunities to further leverage our future operating expenses against future revenues, including near and mid-term opportunities to increase operating margins in our energy efficiency product and service lines. This includes manufacturing and sourcing synergies that our Solais acquisition is expected to bring to our existing LED lighting operations, and other cost reduction opportunities. We have commenced initiatives to accelerate the realization of the expected benefits, and we expect these actions to result in a charge of between \$2 million and \$4 million during the second half of 2013.

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*General and Administrative Expenses.* The 26.0% increase in our consolidated general and administrative expenses in the six month period 2013, as compared to the six month period 2012, was due primarily to an increase in personnel, rent, travel and other expenses to support our increasing levels of revenue and investments in new business opportunities. Our six month period 2013 general and administrative expenses, as a percentage of our revenues, decreased by 5.6 percentage points compared to the six month period 2012, partially as a result of our cost reduction initiative initiated in 2012. The following table provides further detail of our general and administrative expenses by segment (dollars in thousands):

	Six Months Ended June 30,		Period-over-Period Difference	
	2013	2012	\$	%
<b>Segment G&amp;A Expenses:</b>				
Utility and Energy Technologies:				
Personnel costs	\$ 13,059	\$ 9,917	\$ 3,142	31.7%
Vehicle lease and rental	1,462	1,322	140	10.6%
Insurance	632	563	69	12.3%
Rent-office and equipment	628	499	129	25.9%
Professional fees and consulting	430	315	115	36.5%
Travel	982	615	367	59.7%
Development costs	81	299	(218)	(72.9)%
Other	2,207	1,613	594	36.8%
Unallocated Corporate and Other	2,862	2,595	267	10.3%
<b>Total</b>	<b>\$ 22,343</b>	<b>\$ 17,738</b>	<b>\$ 4,605</b>	<b>26.0%</b>

The increase in each of the expense categories above during the six month period 2013 compared to the six month period 2012 was incurred primarily as a result of the incremental general and administrative expenses incurred associated with our recently acquired PowerSecure Solar, ESCO and Solais operations. Over the long-term, we expect our expenses in these areas to increase, although at lower growth rates than our revenues, as we strive to leverage our cost structure and deliver higher operating profit margins.

The increase in our unallocated corporate and other general and administrative expenses during the six month period 2013 as compared to the six month period 2012 was due primarily to \$0.5 million of incremental acquisition costs incurred in connection with the recent acquisitions of the ESCO business, Solais Lighting and PowerLine, compared to \$0.1 million of such costs in the six month period 2012. We expect our unallocated corporate costs for the remainder of 2013 to decrease slightly compared to the levels incurred during the six month period 2013.

*Selling, Marketing and Service Expenses.* The 44.0% increase in selling, marketing and service expenses in the six month period 2013, as compared to the six month period 2012, was due to increases in compensation, travel, advertising and promotion, and bad debt expenses. The following table provides further detail of our segment selling, marketing and service expenses (dollars in thousands):

	Six Months Ended June 30,		Period-over-Period Difference	
	2013	2012	\$	%
<b>Segment Selling, Marketing and Service:</b>				
Utility and Energy Technologies:				
Salaries	\$ 1,425	\$ 1,402	\$ 23	1.6%
Commission	687	406	281	69.2%
Travel	605	377	228	60.5%
Advertising and promotion	472	291	181	62.2%
Bad debt expense (recovery)	301	(52)	353	678.8%
<b>Total</b>	<b>\$ 3,490</b>	<b>\$ 2,424</b>	<b>\$ 1,066</b>	<b>44.0%</b>





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In the future, we expect our near-term and long-term Utility and Energy Technologies segment selling, marketing and services expenses to grow in order to reflect, drive and support future growth.

*Depreciation and Amortization Expenses.* The 47.0% increase in depreciation and amortization expenses in the six month period 2013, as compared to the six month period 2012, primarily reflects increased depreciation resulting from capital investments at our Utility and Energy Technologies segment during 2012, as well as amortization expense associated with acquisition related intangible assets. These capital investments are primarily investments in PowerSecure-owned distributed generation systems for projects deployed under our recurring revenue model as well as investments in Utility Infrastructure equipment to support its growth. In the future, we expect our near-term and long-term depreciation and amortization expenses to grow reflecting depreciation on additional capital expenditures as well as expense associated with amortization of intangible assets acquired in connection with our recent acquisitions.

*Other Income and Expenses*

The following table sets forth our other income and expenses for the periods indicated, by segment (dollars in thousands):

	Six Months Ended		Period-over-Period	
	June 30, 2013	2012	Difference \$	%
<b>Other Segment Income and (Expenses):</b>				
Utility and Energy Technologies:				
Interest income and other income	\$	\$	\$	n/m
Interest expense	(113)	(130)	17	(13.1)%
<b>Segment total</b>	<b>(113)</b>	<b>(130)</b>	<b>17</b>	
Unallocated Corporate and Other:				
Gain on sale of unconsolidated affiliate		1,439	(1,439)	(100.0)%
Interest income and other income	40	45	(5)	(11.1)%
Interest expense	(122)	(94)	(28)	29.8%
Income tax expense	(1,679)	(228)	(1,451)	636.4%
<b>Segment total</b>	<b>(1,761)</b>	<b>1,162</b>	<b>(2,923)</b>	
<b>Total</b>	<b>\$ (1,874)</b>	<b>\$ 1,032</b>	<b>\$ (2,906)</b>	

*Interest Income and Other Income.* In total, interest income and other income decreased slightly during the six month period 2013, as compared to the six month period 2012. This slight decrease was attributable to a reduction in interest-bearing cash and cash equivalent balances in the six month period 2013 compared to the six month period 2012. Our future interest income will depend on our cash and cash equivalent balances, which will increase and decrease depending upon our profit, capital expenditures, acquisitions, our working capital needs, and future interest rates.

*Interest Expense.* In total, interest expense increased during the six month period 2013, as compared to the six month period 2012. The increase in our interest expense reflects interest on our new \$25.0 million term loan, partially offset by reduction in balances outstanding on our capital lease obligation and our prior existing term loan due to regular payments made on those obligations over the year. We expect our future interest and finance charges to increase in the immediate future as a result of our recent \$25.0 million term loan borrowings under our credit facility to fund working capital needs and future recurring revenue projects at our Utility and Energy Technologies segment.

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*Gain on Sale of Unconsolidated Affiliate.* Gain on sale of unconsolidated affiliate included in our Unallocated Corporate and Other segment consists of our minority ownership share of the gain recognized by our WaterSecure operations related to the sale of substantially all of the assets and business of MM 1995-2 in June 2011. At the time of the sale, MM 1995-2 deferred \$4.0 million of the gain until such time as certain contingencies associated with the sale were eliminated and the associated escrowed sales proceeds were received. These contingencies expired and were resolved in the second quarter 2012 and \$3.9 million of the funds that were placed into escrow were released. In June 2012, we received our share of the escrowed sales proceeds and recorded a corresponding gain in the amount of \$1.4 million during the six month period 2012. There was no similar gain in the six month period 2013.

*Income Taxes.* Our overall effective tax rate in the six month period 2013 increased, as compared to the six month period 2012, as we expect our effective tax rate in 2013 will more closely approximate statutory rates. Our overall income tax expense in the six month period 2013 increased, as compared to the six month period 2012, due to the income tax expense associated with the increase in our pre-tax income and an increase in our expected effective tax rate.

*Non-controlling Interest.* The decrease in the addition for the non-controlling interest in the loss of our majority-owned subsidiaries in the six month period 2013, as compared to the six month period 2012, is a result of our acquisition of the non-controlling minority shareholders interests of both IES and PowerSecure Solar in May 2013 as well as development activities we incurred in the six month period 2012 at IES to bring a broader complement of new lighting products to market which resulted in improved operating results at IES during the six month period 2013.

## **Fluctuations**

Our revenues, expenses, margins, net income, cash flow, cash, working capital debt, balance sheet positions, and other operating results have fluctuated significantly from quarter-to-quarter, period-to-period and year-to-year in the past and are expected to continue to fluctuate significantly in the future due to a variety of factors, many of which are outside of our control. Factors that affect our operating results include the following:

the effects of general economic and financial conditions, including the sluggish economy and the challenging and uncertain capital and credit markets, the potential economic consequences if Congress fails to act to avoid certain important upcoming fiscal, deficit and budgetary deadlines, and the potential for such economic and market challenges to continue or recur in the future, negatively impacting our business operations and our revenues and net income, including the negative impact these conditions could have on the timing of and amounts of orders from our customers, and the potential these factors have to negatively impact our access to capital to finance our business;

the size, timing and terms of sales and orders, especially large customer orders, as well as the effects of the timing of phases of completion of projects for customers, and customers delaying, deferring or canceling purchase orders or making smaller purchases than expected;

our ability to make strategic acquisitions of key businesses, technologies and other assets and resources, to realize the expected benefits from such acquisitions, and effectively integrate the acquired businesses, assets and personnel in our organization, and to manage the costs related to such acquisitions, including our recent acquisitions of the ESCO business and of Solais.

our strategy to increase our revenues through long-term recurring revenue projects, recognizing that increasing our revenues from recurring revenue projects will require up-front capital expenditures and will protract our revenue and profit recognition from those projects over a longer period compared to turn-key sales, while at the same time increasing our gross margins over the long-term;

our ability to sell, complete and recognize satisfactory levels of near-term quarterly revenues and net income related to our project-based sales and product and service revenues, which are recognized and billed as they are completed, in order to maintain our current profits and cash flow and to satisfy our financial covenants in our credit facility and to successfully finance the recurring revenue portion of our business model;

our ability to maintain and grow our Utility Infrastructure revenues, and maintain and increase pricing, utilization rates and productivity rates, given the significant levels of vehicles, tools and labor in which we have invested and which are required to serve utilities in this business area, and the risk that our utility customers will change work volumes or pricing, or will displace us from providing services;

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if our safety performance and safety record does not meet the standards of our utility customers, we could be abruptly and immediately released from our work assignments with those utilities, and we could lose the opportunity to obtain additional or new work from those utilities, which could materially and adversely affect our revenues, net income and cash flows;

our ability to obtain adequate supplies of key components and materials of suitable quality for our products on a timely and cost-effective basis, including the impact of potential supply line constraints, substandard parts, changes in environmental requirements, and fluctuations in the cost of raw materials and commodity prices, including without limitation with respect to our Energy Efficiency business unit in relation to third party manufacturing arrangements we have with vendors in China and other component parts that originate in Japan;

our ability to grow, on a profitable basis, sales of our solar distributed energy systems as a result our newly acquired PowerSecure Solar business;

the performance of our products, services and technologies, and the ability of our systems to meet the performance standards they are designed and built to deliver to our customers, including but not limited to our recurring revenue projects for which we retain the on-going risks associated with the performance and ownership of the systems;

our ability to access significant capital resources on a timely basis in order to fund working capital requirements, fulfill large customer orders, finance capital required for recurring revenue projects, and finance working capital and equipment for our Utility Infrastructure business;

our ability to develop new products, services and technologies with competitive advantages and positive customer value propositions;

our ability to implement our business plans and strategies and the timing of such implementation;

the pace of revenue and profit realization from our new businesses and the development and growth of their markets, including the timing, pricing and market acceptance of our new products and services;

our success in controlling and reducing our costs and expenses, such as under our cost reduction program we implemented in 2012;

changes in our pricing policies and those of our competitors, including the introduction of lower cost competing technologies and the potential for them to impact our pricing and our profit margins;

variations in the length of our sales cycle and in the product and service delivery and construction process;

changes in the mix of our products and services having differing margins;

changes in our expenses, including prices for materials such as copper, aluminum and other raw materials, labor costs and other components of our products and services, fuel prices including diesel, natural gas, oil and gasoline, and our ability to hedge or otherwise manage these prices to protect our costs and revenues, minimize the impact of volatile exchange rates and mitigate

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unforeseen or unanticipated expenses;

changes in our valuation allowance for our net deferred tax asset, and the resulting impact on our current tax expenses, future tax expenses and balance sheet account balances;

the effects of severe weather conditions, such as hurricanes, on the business operations of our customers, and the potential effect of such conditions on our results of operations;

the life cycles of our products and services, and competitive alternatives in the marketplace;

budgeting cycles of utilities and other industrial, commercial and institutional customers, including impacts of the current downturn in the economy and difficult capital markets conditions on capital projects and other spending items;

changes and uncertainties in the lead times required to obtain the necessary permits and other governmental and regulatory approvals for projects;

the development and maintenance of business relationships with strategic partners such as utilities and large customers;

economic conditions and regulations in the energy industry, especially in the electric utility industry, including the effects of changes in energy prices, electricity pricing and utility tariffs;

changes in the prices charged by our suppliers;

the effects of governmental regulations and regulatory changes in our markets, including emissions regulations; and

the effects of litigation, warranty claims and other claims and proceedings.

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Because we have little or no control over most of these factors, our operating results are difficult to predict. Any adverse change in any of these factors could negatively affect our business and results of operations.

Our revenues and other operating results are heavily dependent upon the size and timing of customer orders and payments, and the timing of the completion of those projects. The timing of large individual orders, and of project completion, is difficult for us to predict. Because our operating expenses are based on anticipated revenues over the long-term and because a high percentage of these are relatively fixed, a shortfall or delay in recognizing revenues can cause our operating results to vary significantly from quarter-to-quarter and can result in significant operating losses or declines in profit margins in any particular quarter. If our revenues fall below our expectations in any particular quarter, we may not be able to or it may not be prudent to reduce our expenses rapidly in response to the shortfall, which can result in us suffering significant operating losses or declines in profit margins in that quarter.

As we develop new lines of business, our revenues and costs will fluctuate because generally new businesses require start-up expenses and it takes time for revenues to develop, which can result in losses in early periods. Another factor that could cause material fluctuations in our quarterly results is an increase in recurring, as opposed to project-based, sources of revenue we generate for our distributed generation and utility infrastructure projects. To date, the majority of our Utility and Energy Technologies segment revenues have consisted of project-based distributed generation revenues, project-based utility infrastructure revenues and sales of LED lighting fixtures, which are recognized as the sales occur or the projects are completed. Recurring revenue projects, compared to project-based sales, are generally more profitable over time, and growth in this business model can result in delayed recognition of revenue and net income, especially in the short-term, as we implement an increased number of these recurring revenue projects.

Due to all of these factors and the other risks, uncertainties and other factors discussed in this report and in our Annual Report on Form 10-K for the year ended December 31, 2012, quarter-to-quarter, period-to-period or year-to-year comparisons of our results of operations should not be relied on as an indication of our future performance. Quarterly, period or annual comparisons of our operating results are not necessarily meaningful or indicative of future performance.

## **Liquidity and Capital Resources**

### *Overview*

We have historically financed our operations and growth primarily through a combination of cash on hand, cash generated from operations, borrowings under credit facilities, leasing, and proceeds from private and public sales of equity. On a going forward basis, we expect to require capital primarily to finance our:

operations;

inventory;

accounts receivable;

property and equipment expenditures, including capital expenditures related to distributed generation PowerSecure-owned recurring revenue projects;

software purchases or development;

debt service requirements;

lease obligations;

deferred compensation obligations;

restructuring and cost reduction obligations;

business and technology acquisitions and other growth transactions; and

stock repurchases.

**Table of Contents*****Working Capital***

At June 30, 2013, we had working capital of \$68.5 million, including \$26.7 million in cash and cash equivalents, compared to working capital of \$59.2 million, including \$19.1 million in cash and cash equivalents at December 31, 2012. Changes in the components of our working capital from December 31, 2012 to June 30, 2013 and from December 31, 2011 to June 30, 2012 are explained in greater detail below. At June 30, 2013 and December 31, 2012, we had \$27.2 million and \$2.2 million borrowed under our credit facility term loans, respectively. At both June 30, 2013 and December 31, 2012, we had \$20.0 million of available and unused borrowing capacity from the revolving portion of our credit facility. The availability of this capacity under our credit facility includes restrictions on the use of proceeds, and is dependent upon our ability to satisfy certain financial and operating covenants including financial ratios, as discussed below.

***Cash Flows***

The following table summarizes our cash flows for the periods indicated (dollars in thousands):

	<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
Net cash provided by (used in) operating activities	\$ (4,126)	\$ 3,800
Net cash used in investing activities	(13,717)	(5,609)
Net cash provided by financing activities	25,374	910
Net increase (decrease) in cash and cash equivalents	\$ 7,531	\$ (899)

***Cash Provided by (Used in) Operating Activities***

Cash provided by (used in) operating activities consists primarily of net income adjusted for certain non-cash items including depreciation and amortization and stock-based compensation expenses. Cash provided by (used in) operating activities also include the effect of changes in working capital and other activities and cash provided by discontinued operations.

Cash used in operating activities of \$4.1 million for the six month period 2013 included the effects of the following:

our income from continuing operations of \$2.7 million;

non-cash charges of \$3.3 million in depreciation and amortization;

stock-based compensation expense of \$0.3 million;

an increase of \$11.0 million in accounts receivable;

an increase of \$7.4 million in inventories;

an increase of \$9.3 million of accounts payable;

a decrease of \$2.2 million of accrued expenses including restructuring charges; and



a net decrease of \$1.0 million in other assets and liabilities.

Cash provided by operating activities of \$3.8 million for the six month period 2012 included the effects of the following:

our income from continuing operations of \$0.4 million;

gain on sale of unconsolidated affiliate of \$1.4 million;

non-cash charges of \$2.2 million in depreciation and amortization;

stock-based compensation expense of \$0.6 million;

a decrease of \$4.4 million in accounts receivable;

a decrease of \$0.9 million in inventories;

a decrease of \$0.4 million of accounts payable;

a decrease of \$3.0 million of accrued expenses; and

cash provided by discontinued operations of \$0.1 million.

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### *Cash Used in Investing Activities*

Cash used in investing activities was \$13.7 million in the six month period 2013 and cash used in investing activities was \$5.6 million in the six month period 2012. Historically, our principal cash investments have related to the purchase of equipment used in our production facilities, the acquisitions of certain contract rights, the acquisition and installation of equipment related to our recurring revenue sales, and the acquisition of businesses or technologies. During the six month period 2013, we used \$9.5 million as partial consideration to acquire the ESCO, Solais Lighting, and PowerLine businesses, we used \$1.7 million to purchase and install equipment at our recurring revenue distributed generation sites and we used \$2.5 million principally to acquire operational assets. During the six month period 2012, we used \$3.5 million to acquire a 90% ownership interest in PowerSecure Solar, we used \$2.3 million to purchase and install equipment at our recurring revenue distributed generation sites, we used \$1.2 million principally to acquire operational assets, and we received \$1.4 million from the sale of our WaterSecure operations.

### *Cash Provided by Financing Activities*

Cash provided by financing activities was \$25.4 million in the six month period 2013 and cash provided by financing activities was \$0.9 million in the six month period 2012. During the six month period 2013, we received \$25.0 million from the proceeds of a term loan under our credit facility, we received \$0.9 million from the exercise of stock options and we used \$0.5 million to repay our capital lease and term loan obligations. During the six month period 2012, we received \$2.4 million proceeds from a term loan under our credit facility, we used \$1.0 million to repurchase shares of our common stock and we used \$0.5 million to repay our capital lease and term loan obligations.

### *Capital Spending*

Our capital expenditures during the six month period 2013 were approximately \$4.2 million, of which we used \$1.7 million to purchase and install equipment for our PowerSecure-owned recurring revenue distributed generation systems, and we used \$2.5 million to purchase equipment and other capital items. Our capital expenditures during the six month period 2012 were approximately \$3.5 million, of which we used \$2.3 million to purchase and install equipment for our PowerSecure-owned recurring revenue distributed generation systems, and we used \$1.2 million to purchase equipment and other capital items.

We anticipate making total capital expenditures of approximately \$8.0 million for all of fiscal year 2013, including capital expenditures for our company-owned distributed generation systems deployed under long-term recurring revenue contracts, and operational assets, particularly for equipment used in our Utility Infrastructure business. Customer demand for our Distributed Generation systems under recurring revenue contract arrangements, and economic and financial conditions could cause us to reduce or increase those capital expenditures. The vast majority of our capital spending has to date been and will continue to be used for investments in assets related to our recurring revenue projects as well as equipment to support our growth.

### *Indebtedness*

*Long-term credit facility.* We have had a long-term credit facility with Citibank, N.A. ( Citibank ), as administrative agent and lender, and other lenders since entering into a credit agreement in August 2007. At December 31, 2012, our credit agreement with Citibank along with Branch Banking and Trust Company ( BB&T ) as additional lender, consisted of a \$20.0 million senior, first-priority secured revolving line of credit maturing on November 12, 2014 and a \$2.6 million term loan maturing on November 12, 2016.

On June 19, 2013, we entered into an amendment to the credit agreement to (i) add a \$25 million, 7 year amortizing term loan to the credit facility, which amortizes and is payable quarterly over its term in equal principal amounts plus accrued interest (the \$25 Million Term Loan ), (ii) extend the maturity date of the revolving portion of the credit facility by two years to November 12, 2016, and (iii) modify certain covenants and other terms and conditions of the Credit Agreement. On July 1, 2013, we executed interest rate swaps to achieve a fixed interest rate on approximately 80% of the \$25 Million Term Loan. Except as amended, the remainder of the credit agreement remains in full force and effect.

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The following table summarizes the balances outstanding on our long-term debt, including our revolving line of credit, with Citibank and BB&T at June 30, 2013 and December 31, 2012:

	June 30, 2013	December 31, 2012
Revolving line of credit, maturing November 12, 2016	\$	\$
Term loan, principal of \$40 thousand plus interest payable quarterly at variable rates, maturing November 12, 2016	2,160	2,240
Term loan, principal of \$893 thousand plus interest payable quarterly at variable rates, maturing June 30, 2020	25,000	
Total debt	27,160	2,240
Less: Current portion	(3,731)	(160)
Long-term debt, net of current portion	\$ 23,429	\$ 2,080

The credit agreement, as amended, provides for (i) a \$20 million senior, first-priority secured revolving line of credit that matures on November 12, 2016; (ii) a previously issued \$2.6 million term loan amortizing through November 2016; and (iii) the new \$25 Million Term Loan that amortizes through June 30, 2020. The credit facility has been guaranteed by all our active subsidiaries and is secured by the assets of us and those subsidiaries.

We have used, and intend to continue to use, the proceeds available under the credit facility including the new \$25 Million Term Loan to support our growth and future investments in Company-owned distributed generation projects, additional utility services equipment, working capital, other capital expenditures, acquisitions and general corporate purposes. The maturity date of the revolving portion of the credit facility was extended under the amendment by two years until November 12, 2016. The maturity date of the existing \$2.6 million term loan, of which \$2.2 million was outstanding as of June 30, 2013, is unaffected by the amendment. In connection with the extension of the revolving credit facility and the addition of the \$25 Million Term Loan, our previous option, prior to that maturity date, to convert a portion of outstanding principal balance of the revolving portion of the credit facility into a two year term loan at maturity has been eliminated.

Outstanding balances under the credit facility bear interest, at our discretion, at either the London Interbank Offered Rate ( LIBOR ) for the corresponding deposits of U. S. Dollars plus an applicable margin, which is on a sliding scale ranging from 2.00% to 3.25% based upon our leverage ratio, or at Citibank's alternate base rate plus an applicable margin, on a sliding scale ranging from 0.25% to 1.50% based upon our leverage ratio. Our leverage ratio is the ratio of our funded indebtedness as of a given date, net of our cash on hand in excess of \$5.0 million, to our consolidated EBITDA, as defined in the credit agreement, for the four consecutive fiscal quarters ending on such date. Citibank's alternate base rate is equal to the higher of the Federal Funds Rate as published by the Federal Reserve of New York plus 0.50%, Citibank's prime commercial lending rate and 30 day LIBOR plus 1.00%.

In July 2013, we entered into forward interest rate swap contracts based on three-month LIBOR that effectively converts 80% of the outstanding balance of our \$25 Million Term Loan to fixed rate debt commencing October 1, 2013. In accordance with ASC 815, *Derivatives and Hedging*, we have designated the interest rate swaps as a cash flow hedge of the interest payments due on our floating rate debt. Accordingly, in future financial statements, the fair value of the interest rate swaps will be recorded as an asset or liability, the effective portion of the change in fair value of the interest rate swaps will be recorded in other comprehensive income and the quarterly settlements will be recorded as either an addition to or reduction of our interest expense for the period.

The credit facility is not subject to any borrowing base computations or limitations, but does contain certain financial covenants. Under the credit agreement, if cash on hand does not exceed funded indebtedness by at least \$5.0 million, then our minimum fixed charge coverage ratio must be in excess of 1.25, where the fixed charge coverage ratio is defined as the ratio of the aggregate of our trailing 12 month consolidated EBITDA plus our lease expense minus our taxes based on income and payable in cash, divided by the sum of our consolidated interest charges plus our lease expenses plus our scheduled principal payments and dividends, computed over the previous period. In addition, we are required to maintain a minimum consolidated tangible net worth, computed on a quarterly basis, of not less than the sum of \$75.0 million, plus an amount equal to 50% of our net income each fiscal year ending December 31, 2013, with no reduction for any net loss in any fiscal year, plus 90% of any equity we raise through the sale of equity interests, less the amount of any non-cash charges or losses. Also, the ratio of our funded indebtedness to our capitalization, computed as funded indebtedness divided by the sum of funded indebtedness plus stockholders equity, cannot exceed 30%. As of June 30, 2013, we were in compliance with these financial covenants.



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The credit facility contains customary terms and conditions for credit facilities of this type, including restrictions or limits on our ability to incur additional indebtedness, create liens, enter into transactions with affiliates, pay dividends on our capital stock or consolidate or merge with other entities. In addition, the credit agreement contains customary events of default, including payment defaults, breach of representations and warranties, covenant defaults, cross-defaults, certain bankruptcy or insolvency events, judgment defaults and certain ERISA-related events, which were not modified by the amendment.

Our obligations under the credit facility are secured by guarantees ( *Guarantees* ) and security agreements (the *Security Agreements* ) by each of our active subsidiaries, including PowerSecure, Inc. and its subsidiaries. The Guarantees guaranty all of our obligations under the credit facility, and the Security Agreements grant to the Lenders a first priority security interest in virtually all of the assets of each of the parties to the credit agreement.

There was an aggregate balance of \$27.2 million outstanding under the two term loans under our credit facility as of June 30, 2013. There were no balances outstanding on the revolving portion of the credit facility at, or during the six months ended, June 30, 2013 or at December 31, 2012 or at August 7, 2013. We currently have \$20.0 million available to borrow under the revolving portion of the credit facility. The availability of this capital under our credit facility includes restrictions on the use of proceeds, and is dependent upon our ability to satisfy certain financial and operating covenants, as described above.

*Capital Lease Obligation.* We have a capital lease with SunTrust Equipment Finance and Leasing, an affiliate of SunTrust Bank, from the sale and leaseback of distributed generation equipment placed in service at customer locations. We received \$5.9 million from the sale of the equipment in December 2008 which we are repaying under the terms of the lease with monthly principal and interest payments of \$85 thousand over a period of 84 months. At the expiration of the term of the lease in December 2015, we have the option to purchase the equipment for \$1 dollar, assuming no default under the lease by us has occurred and is then continuing. The lease is guaranteed by us under an equipment lease guaranty. The lease and the lease guaranty constitute permitted indebtedness under our current credit agreement.

Proceeds of the lease financing were used to finance capital investments in equipment for our recurring revenue distributed generation projects. We account for the lease financing as a capital lease in our consolidated financial statements.

The lease provides us with limited rights, subject to the lessor's approval which will not be unreasonably withheld, to relocate and substitute equipment during its term. The lease contains representations and warranties and covenants relating to the use and maintenance of the equipment, indemnification and events of default customary for leases of this nature. The lease also grants to the lessor certain remedies upon a default, including the right to cancel the lease, to accelerate all rent payments for the remainder of the term of the lease, to recover liquidated damages, or to repossess and re-lease, sell or otherwise dispose of the equipment.

Under the lease guaranty, we have unconditionally guaranteed the obligation of our PowerSecure subsidiary under the lease for the benefit of the lessor. Our capital lease obligation at June 30, 2013 and December 31, 2012 was \$2.4 million and \$2.8 million, respectively.

*Preferred Stock Redemption.* The terms of our Series B preferred stock required us to redeem all shares of our Series B preferred stock that remained outstanding on December 9, 2004 at a redemption price equal to the liquidation preference of \$1 thousand per share plus accumulated and unpaid dividends. Our remaining redemption obligation at June 30, 2013, to holders of outstanding shares of Series B preferred stock that have not been redeemed, is \$0.1 million.

**Table of Contents****Contractual Obligations and Commercial Commitments**

We incur various contractual obligations and commercial commitments in our normal course of business. We lease certain office space, operating facilities and equipment under long-term lease agreements; in June 2013, we completed a \$25.0 million term loan under our credit facility; to the extent we borrow under the revolving portion of our credit facility, we are obligated to make future payments under that facility; we have an obligation to make installment payments on the PowerLine acquisition; we have restructuring and cost reduction obligations; and we have a deferred compensation obligation. At June 30, 2013, we also had a liability for unrecognized tax benefits and related interest and penalties totaling \$0.9 million. We do not expect a significant payment related to these obligations within the next year and we are unable to make a reasonably reliable estimate if and when cash settlement with a taxing authority would occur. Accordingly, the information in the table below, which is as of June 30, 2013, does not include the liability for unrecognized tax benefits (dollars in thousands):

Contractual Obligations	Total	Payments Due by Period			
		Remainder of 2013	1 - 3 Years	4 - 5 Years	More than 5 Years
Revolving portion of credit facility (1)	\$	\$	\$	\$	\$
Term loans (2)	30,612	2,341	9,024	9,883	9,364
Capital lease obligations (2)	2,792	761	2,031		
Operating leases	10,103	1,485	5,015	3,065	538
Deferred compensation (3)	2,661		2,661		
Installment payments due on acquisition	550		220	220	110
Series B preferred stock	104	104			
Restructuring and cost reduction obligations	360	188	172		
<b>Total</b>	<b>\$ 47,182</b>	<b>\$ 4,879</b>	<b>\$ 19,123</b>	<b>\$ 13,168</b>	<b>\$ 10,012</b>

- (1) Total repayments are based upon borrowings outstanding as of June 30, 2013, not actual or projected borrowings after such date. Repayments do not include interest that may become due and payable in any future period.
- (2) Repayments amounts include interest on the term loans at the interest rate in effect as of June 30, 2013 and on the capital lease obligation at the interest rate per the agreement.
- (3) Total amount represents our expected obligation on the deferred compensation arrangement and does not include the value of the restricted annuity contract, or interest earnings thereon, that we purchased to fund our obligation.

**Performance Bonds and Parent Guarantees**

In the ordinary course of business, we are required by certain customers to post surety or performance bonds in connection with services that we provide to them. These bonds provide a guarantee to the customer that we will perform under the terms of a contract and that we will pay subcontractors and vendors. If we fail to perform under a contract or to pay subcontractors and vendors, the customer may demand that the surety make payments or provide services under the bond. We must reimburse the surety for any expenses or outlays it incurs. As of June 30, 2013, we had approximately \$79 million in surety bonds outstanding, including those surety bonds issued in connection with the contracts and projects acquired from Lime in the acquisition of the ESCO business on February 28, 2013. We believe that it is unlikely that we will have to fund significant claims under our surety arrangements in the foreseeable future. In addition, from time to time, PowerSecure International, Inc. guarantees the obligations of its subsidiaries, including obligations under certain contracts with customers and vendors.

**Off-Balance Sheet Arrangements**

During the second quarter 2013, we did not engage in any material off-balance sheet activities or have any relationships or arrangements with unconsolidated entities established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities nor do we have any commitment or intent to provide additional funding to any such entities.

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### ***Liquidity***

Based upon our plans and assumptions as of the date of this report, we believe that our capital resources, including our cash and cash equivalents, amounts available under our credit facility, along with funds expected to be generated from our operations, will be sufficient to meet our anticipated cash needs, including for working capital, capital spending and debt service commitments, for at least the next 12 months. However, any projections of future cash needs and cash flows are subject to substantial risks and uncertainties. See *Cautionary Note Regarding Forward-Looking Statements* above in this report and Part II *Item 1A. Risk Factors*. Although we believe that we have sufficient capital to fund our activities and commitments for at least the next 12 months, our future cash resources and capital requirements may vary materially from those now planned. Our ability to meet our capital needs in the future will depend on many factors, including the effects of the current economic and financial crisis, the timing of sales, the mix of products, the amount of recurring revenue projects, our ability to meet our financial covenants under our credit facility, unanticipated events over which we have no control increasing our operating costs or reducing our revenues beyond our current expectations, and other factors listed above under *Fluctuations* above. For these reasons, we cannot provide any assurance that our actual cash requirements will not be greater than we currently expect or that these sources of liquidity will be available when needed.

We also continually evaluate opportunities to expand our current, or to develop new, products, services, technology and businesses that could increase our capital needs. In addition, from time to time we consider the acquisition of, or the investment in, complementary businesses, products, services and technology that might affect our liquidity requirements. We may seek to raise any needed or desired additional capital from the proceeds of public or private equity or debt offerings at the parent level or at the subsidiary level or both, from asset or business sales, from traditional credit financings or from other financing sources. In addition, we continually evaluate opportunities to improve our credit facilities, through increased credit availability, lower debt costs or other more favorable terms. However, our ability to obtain additional capital or replace or improve our credit facilities when needed or desired will depend on many factors, including general economic and market conditions, our operating performance and investor and lender sentiment, and thus cannot be assured. In addition, depending on how it is structured, a financing could require the consent of our current lending group. Even if we are able to raise additional capital, the terms of any financings could be adverse to the interests of our stockholders. For example, the terms of a debt financing could restrict our ability to operate our business or to expand our operations, while the terms of an equity financing, involving the issuance of capital stock or of securities convertible into capital stock, could dilute the percentage ownership interests of our stockholders, and the new capital stock or other new securities could have rights, preferences or privileges senior to those of our current stockholders.

Accordingly, we cannot provide any assurance that sufficient additional funds will be available to us when needed or desired or that, if available, such funds can be obtained on terms favorable to us and our stockholders and acceptable to those parties who must consent to the financing. Our inability to obtain sufficient additional capital on a timely basis on favorable terms when needed or desired could have a material adverse effect on our business, financial condition and results of operations.

### **Critical Accounting Policies**

Management's discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates, judgments 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. On an on-going basis, we evaluate our estimates, including those related to revenue recognition and percentage of completion, fixed price contracts, product returns, warranty obligations, bad debt, inventories, cancellations costs associated with long term commitments, incentive compensation, investments, intangible assets, assets subject to disposal, income taxes, restructuring, service contracts, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making estimates and judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Estimates, by their nature, are based on judgment and available information. Therefore, actual results could differ from those estimates and could have a material impact on our consolidated financial statements.

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We have identified the accounting principles which we believe are most critical to understanding our reported financial results by considering accounting policies that involve the most complex or subjective decisions or assessments. These accounting policies described below include:

revenue recognition;

allowance for doubtful accounts;

inventory valuation reserve;

warranty reserve;

impairment of goodwill and long-lived assets;

deferred tax valuation allowance;

uncertain tax positions;

costs of exit or disposal activities and similar nonrecurring charges; and

stock-based compensation.

The accounting policies listed above are described in our Annual Report on Form 10-K for the year ended December 31, 2012 in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. In addition, in July 2013, we commenced utilizing forward interest rate swaps as a hedge of interest on our floating rate debt. The following describes our accounting policies related to interest rate swaps in greater detail:

**Derivative Financial Instruments.** We use derivative financial instruments in the form of interest rate swap contracts to manage interest rate risk associated with our floating rate debt. Commencing in July 2013, we entered into interest rate swap contracts to manage the balance of fixed and floating rate debt. Our accounting for such derivative financial instruments is based on our designation of these interest rate swaps as cash flow hedges. It is our policy to execute such interest rate swaps with creditworthy banks and not to enter into derivative financial instruments for speculative purposes. To qualify for designation in a hedging relationship, specific criteria must be met and the appropriate documentation maintained. Hedging relationships are established pursuant to our risk management policies and are initially and regularly evaluated to determine whether they are expected to be, and have been, highly effective hedges. For our interest rate swap contracts designated as a hedge of interest on our floating rate debt, the effective portion of the change in fair value of the derivative is reported in other comprehensive income and reclassified into earnings in the period in which the hedged item affects earnings. Amounts excluded from the effectiveness calculation and any ineffective portion of the change in fair value of the derivative are recognized currently in earnings.

### **Recent Accounting Pronouncements**

**Testing Indefinite-Lived Intangible Assets for Impairment** In July 2012, the FASB issued ASU No. 2012-02, Intangibles—Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment. This standard, which amends the guidance on testing indefinite-lived intangible assets, other than goodwill, for impairment, provides companies with the option to first perform a qualitative assessment before



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performing the two-step quantitative impairment test. If the company determines, on the basis of qualitative factors, that the fair value of the indefinite-lived intangible asset is more likely than not to exceed its carrying amount, then the company would not need to perform the two-step quantitative impairment test. This standard does not revise the requirement to test indefinite-lived intangible assets annually for impairment. This standard became effective for us on a prospective basis commencing January 1, 2013. The adoption of this standard had no effect on our financial position or results of operations.

**Table of Contents****Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to certain market risks arising from transactions we enter into in the ordinary course of business. These market risks may adversely affect our financial condition, results of operations and cash flow. These market risks include, but are not limited to, fluctuations in interest rates and commodity prices, and to a lesser extent fluctuations in currency exchange rates.

We employ interest rate swap agreements for the purpose of hedging certain specifically identified interest rates. The use of these financial instruments is intended to mitigate some of the risks associated with fluctuations in interest rates, but does not eliminate such risks. We do not use derivative financial instruments for trading or speculative purposes, and except as indicated in this item we do not use derivative financial instruments to manage or hedge our exposure to interest rate changes, commodity price risks, foreign currency exchange risks or other market risks.

*Interest Rate Risk.* We are exposed to market risk resulting from changes in interest rates. Changes in the interest rates affect the income we receive from our investments of excess cash in short-term interest-bearing marketable securities, because that income is dependent upon the interest rate of the securities held, and the interest expenses we pay on our borrowings under our credit facility, because the interest rate on our borrowings is based on floating interest rates as described in Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations of this report. Our lease with SunTrust is at a fixed interest rate and thus not impacted by changes in interest rates.

At June 30, 2013, our cash and cash equivalents balance was approximately \$26.7 million, and \$27.2 million was outstanding on two term loans under the credit facility. Our credit facility, which is comprised of a revolving credit line and term loans, bears interest at a rate based on LIBOR or an alternative base rate based on prevailing interest rates, in each case plus an applicable margin based on our leverage ratio. From time to time we may enter into interest rate swap agreements to reduce our exposure to interest rate fluctuations under the credit facility. In July 2013, we entered into forward interest rate swap contracts based on three-month LIBOR that will effectively convert the notional amount of \$19.3 million, or 80% of the outstanding balance, of our \$25 million variable rate term loan debt to fixed rate debt commencing October 1, 2013.

In accordance with ASC 815, *Derivatives and Hedging*, we have designated the interest rate swaps as cash flow hedges of the interest payments due on that portion of our floating rate debt. Accordingly, in future financial statements, the fair value of the interest rate swaps will be recorded as an asset (other assets) or as a liability (other long-term liabilities), the effective portion of the change in fair value of the interest rate swaps will be recorded in other comprehensive income and the quarterly settlements will be recorded as either an addition to or reduction of our interest expense for the period. The remainder of our indebtedness under our credit facility continues to bear interest at variable rates that fluctuate.

Pursuant to the swap contracts, the three-month LIBOR rate on the term loan is swapped for a fixed rate of 1.73%. When added to the term loan's current applicable margin, the interest rate applicable to 80% of the term loan will be effectively fixed at 3.73%, subject only to changes in the applicable margin. Notwithstanding the terms of the swap contracts, we remain fully obligated for all amounts due and payable on the term loan. The initial counterparties to the swap contracts are the financial institutions that are also lenders under our credit facility, but the swap contracts may be assigned to other counterparties. The termination dates of the swap contracts and maturity date of the term loan are both June 2020. We may enter into additional swap transactions in the future from time to time.

Our cash equivalents are invested in a combination of bank deposits, money market or U.S. government mutual funds, short-term time deposits, and government agency and corporate obligations, or similar kinds of instruments, the income of which generally increases or decreases in proportion to increases or decreases, respectively, in interest rates. While we believe we have our cash and cash equivalents invested in very low risk investments, they are not risk free, as our bank deposits are generally in excess of FDIC insurance limits.

We do not believe that changes in interest rates have had a material impact on us in the past or are likely to have a material impact on us in the foreseeable future. For example, for the second quarter 2013, a hypothetical 1% (100 basis points) increase in the interest rate on the variable rate portion of our average outstanding borrowings under our credit facility would have resulted in an increase in our interest expense of \$12 thousand, and an increase in our interest income from the average balance of our interest-bearing cash equivalents of less than approximately \$3 thousand. Conversely, a hypothetical 1% (100 basis points) decrease of 1% (100 basis points) in the interest rate on the variable rate portion our average outstanding borrowings under our credit facility would have resulted in a decrease in our interest expense of \$12 thousand, and a decrease in our interest income from the average balance of our interest-bearing cash equivalents of less than approximately \$3 thousand.

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*Commodity Price Risk.* From time to time we are subject to market risk from fluctuating commodity prices in certain raw materials we use in our products and from diesel fuel we use to power our generators. To date, we have managed this risk by using alternative raw materials acceptable to our customers or we have been able to pass these cost increases to our customers. While we do not believe that changes in commodity prices have had a material impact on us in the past, commodity price fluctuations could have a material impact on us in the future, depending on the magnitude and timing of such fluctuations. The impact of these fluctuations could result in an increase in our operating costs and expenses and reduction in our gross margins and income due to increases in the price and costs of engines, generators, copper, aluminum, electrical components, labor, electricity, diesel fuel, gasoline, oil and natural gas. Movements in prices of these commodities can materially impact our results in this segment.

*Foreign Exchange Risk.* Since substantially all of our revenues, expenses and capital spending are transacted in U.S. dollars, we face minimal exposure to adverse movements in foreign currency exchange rates. However, if our international operations expand in the future, then our exposure to foreign currency risks could increase, which could materially affect our financial condition and results of operations. In addition, because our Energy Efficiency products utilize certain component parts manufactured in China, then to the extent the U.S. Dollar exchange rate with the Chinese Yuan changes significantly, our business and results of operations could be materially impacted.

### **Item 4. Controls and Procedures Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of June 30, 2013, the end of the period covered by this report. Based upon management's evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that, as of June 30, 2013, our disclosure controls and procedures were designed at the reasonable assurance level and were effective at the reasonable assurance level to provide reasonable assurance 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 the SEC's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

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

We regularly review our system of internal control over financial reporting and make changes to our processes and systems to improve controls and increase efficiency, while ensuring that we maintain an effective internal control environment. Changes may include such activities as implementing new, more efficient systems, consolidating activities and migrating processes. There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### **Limitations in Control Systems**

Our controls and procedures were designed at the reasonable assurance level. However, because of inherent limitations, any system of controls and procedures, no matter how well designed and operated, can provide only reasonable, not absolute, assurance of achieving the desired objectives of the control system. In addition, the design of a control system must reflect the fact that there are resource constraints, and management must apply its judgment in evaluating the benefits of controls relative to their costs. Further, no evaluation of controls and procedures can provide absolute assurance that all errors, control issues and instances of fraud will be prevented or detected. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls and procedures is also based in part on certain assumptions regarding 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.

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**PART II**

**OTHER INFORMATION**

**Item 1. Legal Proceedings**

From time to time, we are involved in disputes and legal proceedings. There has been no material change in our pending legal proceedings as described in Item 3. Legal Proceedings in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

**Item 1A. Risk Factors**

Our business and operating results are subject to many risks, uncertainties and other factors. If any of these risks were to occur, our business, affairs, assets, financial condition, results of operations, cash flows and prospects could be materially and adversely affected. These risks, uncertainties and other factors include the information discussed elsewhere in this report as well as the risk factors set forth in Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012, which have not materially changed as of the date of this report, except for the addition of the following risk factor:

*We may issue a substantial number of shares of our common stock in the future, and stockholders may be adversely affected by the issuance of those shares.*

We may raise additional capital by issuing shares of our common stock in the future, which would increase the number of shares outstanding and may result in dilution in the equity interest of our current stockholders and may adversely affect the market price of our common stock. We have filed a universal shelf registration statement on Form S-3 which is effective and allows us to issue up to \$70 million in any combination of common stock, preferred stock, warrants and units in offerings for cash. We have also filed an acquisition shelf registration statement on Form S-4 which is effective and allows us, in connection with acquisitions, to issue up to 2.5 million shares of common stock. Shares issued under either shelf registration statement would be freely tradable upon issuance. In addition, from time to time we have issued shares of our common stock pursuant to private placement exemptions from Securities Act registration requirements, including shares of common stock issued in connection with the acquisition of Solais which are being registered for resale on the Form S-3, and may do so in the future. The issuance, and the resale or potential resale, of shares of our common stock in connection with acquisitions or otherwise could adversely affect the market price of our common stock, and could be dilutive to our stockholders depending on the performance of the acquired business and other factors.

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

On November 1, 2011, our Board of Directors authorized a stock repurchase program providing for the repurchase of up to \$5.0 million in shares of our common stock. On December 3, 2012, our Board of Directors authorized an increase in the stock repurchase program to provide for the repurchase of up to an additional \$5.0 million in shares of our common stock. Our Board of Directors' authorization specifies the maximum dollar amount but not the maximum number of shares to be repurchased. Repurchases of shares can be made from time to time in open market purchases or in privately negotiated transactions. The timing and amount of any shares repurchased are determined in the discretion of our management based on its evaluation of market conditions and other factors. On December 3, 2012, in connection with the increase in the size of the stock repurchase plan, our Board of Directors extended the plan to continue for a period of up to 24 months thereafter, although the plan may be suspended from time to time or discontinued at any time, or the plan may be renewed or further extended, in the discretion of our Board of Directors.

During the quarter ended June 30, 2013, we did not repurchase any shares of our common stock under our stock repurchase program, and as of the end of the quarter we had \$5.1 million remaining on our authorization.

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**Item 6. Exhibits**

- (2.1) Agreement and Plan of Merger, dated as of April 12, 2013, among Solais Lighting, Inc., the stockholders of Solais Lighting, Inc., PowerSecure International, Inc. and Brite Idela, Inc. (Incorporated by reference to Exhibit 2.1 to Registrant's Current Report on Form 8-K, filed April 15, 2013.)
- (10.1) Second Amendment to Amended and Restated Credit Agreement, dated as of June 19, 2013 among PowerSecure International, Inc., as borrower, Citibank, N.A., as administrative agent and lender, and Branch Banking and Trust Company, as lender. (Incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed June 20, 2013).
- (10.2) Amended and Restated Credit Agreement, dated as of December 21, 2011, as amended through June 19, 2013, among PowerSecure International, Inc., as borrower, Citibank, N.A., as administrative agent and lender, and Branch Banking and Trust Company, as lender. (Incorporated by reference to Exhibit 10.2 to Registrant's Current Report on Form 8-K, filed June 20, 2013).
- (31.1) Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (Filed herewith.)
- (31.2) Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (Filed herewith.)
- (32.1) Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 and Rule 13a-14(b) or 15d-14(b) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (Filed herewith.)
- (32.2) Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 and Rule 13a-14(b) or 15d-14(b) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (Filed herewith.)
- (101.INS)\* XBRL Instance Document
- (101.SCH)\* XBRL Taxonomy Extension Schema Document
- (101.CAL)\* XBRL Taxonomy Extension Calculation Linkbase Document
- (101.DEF)\* XBRL Taxonomy Extension Definition Linkbase Document
- (101.LAB)\* XBRL Taxonomy Extension Label Linkbase Document
- (101.PRE)\* XBRL Taxonomy Extension Presentation Linkbase Document

\* XBRL (Extensible Business Reporting Language) information is furnished herewith and not filed for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, and Section 18 of the Securities Exchange Act of 1934, as amended, is not subject to liability under these sections, and is not part of, incorporated or deemed to be incorporated by reference into any registration statement, prospectus or other document.

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**SIGNATURES**

Pursuant to the requirements 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.

POWERSECURE INTERNATIONAL, INC.

Date: August 7, 2013

By: /s/ Sidney Hinton  
Sidney Hinton  
President and Chief Executive Officer

Date: August 7, 2013

By: /s/ Christopher T. Hutter  
Christopher T. Hutter  
Executive Vice President, Chief Financial Officer,  
  
Treasurer and Secretary