

POWERSECURE INTERNATIONAL, INC.

Form 10-Q

November 06, 2007

Table of Contents

**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 September 30, 2007

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)

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No
As of November 1, 2007, 16,806,099 shares of the issuer's Common Stock were outstanding.

POWERSECURE INTERNATIONAL, INC.
FORM 10-Q
For the Quarterly Period Ended September 30, 2007
TABLE OF CONTENTS

| | Page |
|--|------|
| <u>PART I. FINANCIAL INFORMATION</u> | |
| <u>Item 1. Financial Statements</u> | |
| <u>Unaudited Consolidated Balance Sheets - September 30, 2007 and December 31, 2006</u> | 3 |
| <u>Unaudited Consolidated Statements of Operations - For the Three and Nine Months Ended September 30, 2007 and September 30, 2006</u> | 5 |
| <u>Unaudited Consolidated Statements of Cash Flows - For the Nine Months Ended September 30, 2007 and September 30, 2006</u> | 6 |
| <u>Notes to Unaudited Consolidated Financial Statements</u> | 7 |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 22 |
| <u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u> | 45 |
| <u>Item 4. Controls and Procedures</u> | 46 |
| <u>PART II. OTHER INFORMATION</u> | |
| <u>Item 1. Legal Proceedings</u> | 47 |
| <u>Item 1A. Risk Factors</u> | 47 |
| <u>Item 6. Exhibits</u> | 47 |
| <u>Signatures</u> | 49 |
| <u>EX-10.5</u> | |
| <u>EX-31.1</u> | |
| <u>EX-31.2</u> | |
| <u>EX-32.1</u> | |
| <u>EX-32.2</u> | |

Table of Contents

PART I.
FINANCIAL INFORMATION

Item 1. Financial Statements

POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(unaudited)

| | September 30, 2007 | December 31, 2006 |
|--|-----------------------------------|----------------------------------|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 26,593,838 | \$ 15,916,460 |
| Trade receivables, net of allowance for doubtful accounts of \$248,016 and \$225,004, respectively | 39,707,646 | 40,255,372 |
| Other receivables | 152,217 | 431,437 |
| Inventories | 20,455,786 | 12,882,167 |
| Deferred income taxes | 231,990 | 231,990 |
| Prepaid expenses and other current assets | 908,262 | 818,583 |
| | | |
| Total current assets | 88,049,739 | 70,536,009 |
| | | |
| PROPERTY, PLANT AND EQUIPMENT: | | |
| Equipment | 7,015,433 | 6,524,549 |
| Vehicles | 172,659 | 166,894 |
| Furniture and fixtures | 565,176 | 568,212 |
| Land, building and improvements | 1,130,809 | 1,073,625 |
| | | |
| Total property, plant and equipment, at cost | 8,884,077 | 8,333,280 |
| Less accumulated depreciation and amortization | 4,307,603 | 3,889,401 |
| | | |
| Property, plant and equipment, net | 4,576,474 | 4,443,879 |
| | | |
| OTHER ASSETS: | | |
| Goodwill | 9,146,409 | 9,146,409 |
| Intangible rights and capitalized software costs, net of accumulated amortization of \$1,998,834 and \$1,543,024, respectively | 1,761,102 | 1,763,970 |
| Investment in unconsolidated affiliate | 3,451,145 | 3,513,501 |
| Assets of discontinued operations | | 144,490 |
| Other assets | 126,708 | 151,177 |
| | | |
| Total other assets | 14,485,364 | 14,719,547 |
| | | |
| TOTAL | \$ 107,111,577 | \$ 89,699,435 |

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(unaudited)

| | September 30, 2007 | December 31, 2006 |
|--|-------------------------------|------------------------------|
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | \$ 5,274,902 | \$ 15,090,540 |
| Accrued and other liabilities | 39,876,431 | 16,026,867 |
| Restructuring charges payable | 8,327,864 | |
| Current income taxes payable | 391,484 | 570,217 |
| Current unrecognized tax benefit | 62,406 | |
| Capital lease obligations | 1,367 | 4,749 |
| | | |
| Total current liabilities | 53,934,454 | 31,692,373 |
| | | |
| LONG-TERM NOTES PAYABLE | | |
| | | |
| NON-CURRENT CAPITAL LEASE OBLIGATIONS | 5,684 | 7,431 |
| | | |
| NON-CURRENT UNRECOGNIZED TAX BENEFIT | 285,117 | |
| | | |
| NON-CURRENT RESTRUCTURING CHARGES | 2,127,110 | |
| | | |
| COMMITMENTS AND CONTINGENCIES | | |
| | | |
| MINORITY INTEREST IN SUBSIDIARY | 24,191 | |
| | | |
| 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; 25,000,000 shares authorized; 16,806,099 and 15,808,634 shares issued and outstanding, respectively | 168,061 | 158,086 |
| Additional paid-in-capital | 111,484,413 | 102,287,543 |
| Deferred stock compensation | (7,157,200) | |
| Accumulated deficit | (53,760,253) | (44,445,998) |
| | | |
| Total stockholders equity | 50,735,021 | 57,999,631 |

| | | |
|--------------|----------------|---------------|
| TOTAL | \$ 107,111,577 | \$ 89,699,435 |
|--------------|----------------|---------------|

See accompanying notes to unaudited consolidated financial statements.

4

Table of Contents

POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES
Consolidated Statements of Operations
(unaudited)

| | Three Months Ended | | Nine Months Ended | |
|---|---------------------------|---------------|--------------------------|---------------|
| | September 30, | | September 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| REVENUES: | | | | |
| Sales and services | \$ 27,742,594 | \$ 33,125,164 | \$ 77,944,689 | \$ 83,767,976 |
| Other | 268,712 | 319,969 | 1,111,656 | 752,897 |
| | | | | |
| Total revenues | 28,011,306 | 33,445,133 | 79,056,345 | 84,520,873 |
| | | | | |
| COSTS AND EXPENSES: | | | | |
| Cost of sales and services | 18,785,036 | 24,055,211 | 54,679,605 | 60,580,104 |
| General and administrative | 5,204,688 | 5,535,861 | 15,713,866 | 13,473,641 |
| Selling, marketing and service | 1,358,185 | 936,415 | 3,232,820 | 2,868,346 |
| Depreciation and amortization | 396,259 | 306,332 | 1,113,292 | 682,636 |
| Research and development | 199,088 | 163,411 | 698,450 | 536,095 |
| Restructuring charges | | | 14,139,216 | |
| Interest, finance charges and other | 19,908 | 13,898 | 35,664 | 148,609 |
| | | | | |
| Total costs and expenses | 25,963,164 | 31,011,128 | 89,612,913 | 78,289,431 |
| | | | | |
| Income (loss) from continuing operations before minority interest, income taxes, equity income and litigation settlements | 2,048,142 | 2,434,005 | (10,556,568) | 6,231,442 |
| Equity in income of unconsolidated affiliate | 656,186 | 627,020 | 1,977,481 | 1,878,462 |
| Income from litigation settlements, net | 107,100 | | 385,434 | |
| Minority interest | 5,809 | | 5,809 | (72,464) |
| Income taxes | (162,121) | (150,496) | (638,398) | (262,010) |
| | | | | |
| Income (loss) from continuing operations | 2,655,116 | 2,910,529 | (8,826,242) | 7,775,430 |
| | | | | |
| Loss from disposal of discontinued operations | | | (140,490) | |
| | | | | |
| Net income (loss) | \$ 2,655,116 | \$ 2,910,529 | \$ (8,966,732) | \$ 7,775,430 |

PER SHARE AMOUNTS (Note 1):

Income (loss) from continuing operations:

| | | | | | | | | |
|---------|----|------|----|------|----|--------|----|------|
| Basic | \$ | 0.16 | \$ | 0.19 | \$ | (0.55) | \$ | 0.52 |
| Diluted | \$ | 0.15 | \$ | 0.17 | \$ | (0.55) | \$ | 0.47 |

Net income (loss):

| | | | | | | | | |
|---------|----|------|----|------|----|--------|----|------|
| Basic | \$ | 0.16 | \$ | 0.19 | \$ | (0.56) | \$ | 0.52 |
| Diluted | \$ | 0.15 | \$ | 0.17 | \$ | (0.56) | \$ | 0.47 |

**WEIGHTED AVERAGE COMMON
SHARES OUTSTANDING:**

| | | | | |
|---------|------------|------------|------------|------------|
| Basic | 16,157,500 | 15,730,954 | 15,975,083 | 14,818,667 |
| Diluted | 17,153,155 | 17,250,856 | 15,975,083 | 16,507,783 |

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(unaudited)

| | Nine Months Ended | |
|--|--------------------------|--------------|
| | September 30, | |
| | 2007 | 2006 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income (loss) | \$ (8,966,732) | \$ 7,775,430 |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Loss on disposal of discontinued operations | 140,490 | |
| Restructuring charges | 14,139,216 | |
| Depreciation and amortization | 1,113,292 | 682,636 |
| Minority interest in subsidiary | (5,809) | 72,464 |
| Loss on disposal of property, plant and equipment | 73,963 | 33,294 |
| Equity in income of unconsolidated affiliate | (1,977,481) | (1,878,462) |
| Distributions from unconsolidated affiliate | 1,994,462 | 361,302 |
| Stock compensation expense | 1,027,486 | 578,141 |
| Changes in other assets and liabilities: | | |
| Trade receivables, net | 547,726 | (22,328,032) |
| Inventories | (7,573,619) | (8,194,027) |
| Other current assets | 191,541 | (277,138) |
| Other noncurrent assets | 24,469 | (118,257) |
| Accounts payable | (9,815,638) | 5,497,097 |
| Accrued restructuring charges | (3,685,611) | |
| Income taxes payable | (178,733) | |
| Accrued and other liabilities | 24,069,750 | 13,095,743 |
| Net cash provided by (used in) continuing operations | 11,118,772 | (4,699,809) |
| Net cash provided by discontinued operations of MCM | 2,000 | 48,331 |
| Net cash provided by (used in) operating activities | 11,120,772 | (4,651,478) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of property, plant and equipment | (779,457) | (1,117,194) |
| Additions to patents and software development | (462,481) | (1,590,690) |
| Investment in unconsolidated affiliate | | (1,260,360) |
| Proceeds from sale of property, plant and equipment | 1,700 | 16,375 |
| Net cash used in investing activities | (1,240,238) | (3,951,869) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from private placement, net | | 26,221,123 |
| Proceeds from stock warrant and option exercises | 1,022,159 | 2,973,254 |
| Net payments on line of credit | | (1,314,200) |
| Principal payments on long-term notes payable | | (3,375,494) |

Edgar Filing: POWERSECURE INTERNATIONAL, INC. - Form 10-Q

| | | |
|--|---------------|---------------|
| Cash distributions to minority interests | | (381) |
| Payments on preferred stock redemptions | (220,186) | (80,735) |
| Payments on capital lease obligations | (5,129) | (3,213) |
| Net cash provided by financing activities | 796,844 | 24,420,354 |
| | | |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 10,677,378 | 15,817,007 |
| | | |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 15,916,460 | 2,188,310 |
| | | |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$ 26,593,838 | \$ 18,005,317 |

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

As of September 30, 2007 and December 31, 2006 and

For the Three and Nine Month Periods Ended September 30, 2007 and 2006

1. Summary of Significant Accounting Policies

Organization and Name Change - The accompanying consolidated financial statements include the accounts of PowerSecure International, Inc. (formerly known as Metretek Technologies, Inc.) and its subsidiaries, primarily PowerSecure, Inc. (PowerSecure) (and its majority-owned and wholly-owned subsidiaries, UtilityEngineering, Inc., PowerServices, Inc., EnergyLite, Inc, EfficientLights LLC and Reid s Trailer, Inc.), Southern Flow Companies, Inc. (Southern Flow), Metretek, Incorporated (Metretek Florida) (and its majority-owned subsidiary, Metretek Contract Manufacturing Company, Inc. (MCM)), and Marcum Gas Transmission, Inc. (MGT) (and its majority-owned subsidiary, Conquest Acquisition Company LLC (CAC LLC)), collectively referred to as the Company or we or us our . In August 2007, the Company changed its name from Metretek Technologies, Inc. to PowerSecure International, Inc.

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 the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

In the opinion of the Company s management, 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 the Company and its subsidiaries as of September 30, 2007 and the consolidated results of their operations and cash flows for the three and nine month periods ended September 30, 2007 and September 30, 2006.

Principles of Consolidation The consolidated financial statements include the accounts of PowerSecure International, Inc. and its subsidiaries after elimination of intercompany accounts and transactions. The Company uses the equity method to account for its investment in unconsolidated affiliate.

Use of Estimates The preparation of the Company s consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include percentage-of-completion estimates, allowance for doubtful accounts receivable, inventory valuation reserves,

Table of Contents

and deferred tax valuation allowance.

Basic and Diluted Earnings (Loss) Per Share Earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of shares outstanding during the period on a basic and diluted basis. Diluted earnings (loss) per share reflects the potential dilution that would occur if stock options and warrants were exercised using the average market price for the Company's stock for the period. Diluted earnings (loss) per share excludes the impact of potential common shares related to stock options and warrants in periods in which the Company experienced a loss from continuing operations or in which the option or warrant exercise price is greater than the average market price of the Company's common stock during the period. The following table sets forth the calculation of basic and diluted earnings (loss) per share:

| | Three Months Ended | | Nine Months Ended | |
|--|---------------------------|--------------|--------------------------|--------------|
| | September 30, | | September 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| Income (loss) from continuing operations | \$ 2,655,116 | \$ 2,910,529 | \$ (8,826,242) | \$ 7,775,430 |
| Loss from discontinued operations | | | (140,490) | |
| Net income (loss) | \$ 2,655,116 | \$ 2,910,529 | \$ (8,966,732) | \$ 7,775,430 |
| Basic weighted-average common shares outstanding in period | 16,157,500 | 15,730,954 | 15,975,083 | 14,818,667 |
| Add dilutive effects of stock options, warrants, and restricted stock awards | 995,655 | 1,519,902 | | 1,689,116 |
| Diluted weighted-average common shares outstanding in period | 17,153,155 | 17,250,856 | 15,975,083 | 16,507,783 |
| Basic earnings (loss) per common share: | | | | |
| Income (loss) from continuing operations | \$ 0.16 | \$ 0.19 | \$ (0.55) | \$ 0.52 |
| Loss from discontinued operations | | | (0.01) | |
| Basic earnings (loss) per common share | \$ 0.16 | \$ 0.19 | \$ (0.56) | \$ 0.52 |
| Diluted earnings (loss) per common share: | | | | |
| Income (loss) from continuing operations | \$ 0.15 | \$ 0.17 | \$ (0.55) | \$ 0.47 |
| Loss from discontinued operations | | | (0.01) | |
| Diluted earnings (loss) per common share | \$ 0.15 | \$ 0.17 | \$ (0.56) | \$ 0.47 |

Statement of Cash Flows Cash and all highly liquid and unrestricted 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. The Company maintains its cash in bank deposit accounts, which, at times, may exceed federally insured limits. The Company has not experienced any losses

in such accounts. The Company does not believe it is exposed to any significant credit risk on cash and cash equivalents.

Minority Interest The minority shareholder's interest in the equity and the loss from

8

Table of Contents

EfficientLights for the nine months ended September 30, 2007 and the minority shareholder's interest in the equity and the income of CAC LLC for the nine months ended September 30, 2006, is included in minority interest in the accompanying consolidated financial statements. The minority shareholders' interest in CAC LLC was distributed in April 2006 and the separate operating activities of CAC LLC ceased at that time.

Financial Instruments Effective January 1, 2007, the Company adopted the provisions of Financial Accounting Standards (FAS) No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140 (FAS 155). FAS 155 eliminates the exemption from applying FAS 133, Accounting for Derivative Instruments and Hedging Activities, to interests in securitized financial assets. The adoption of FAS 155 had no effect on the Company's financial position or results of operations.

Reclassification Certain 2006 amounts have been reclassified to conform to current year presentation. Such reclassifications had no impact on the Company's net income or stockholders' equity.

2. Investment in Unconsolidated Affiliate

The Company owns a 36.26% equity interest in MM 1995-2, which the Company accounts for under the equity method. MM 1995-2 owns and operates five water disposal wells located at four facilities in northeastern Colorado. The Company's equity investment balance includes approximately \$734,000 and \$780,000 of unamortized purchase price premiums in interest acquired at September 30, 2007 and December 31, 2006, respectively. The purchase price premiums are being amortized over a period of 14 years, which represents the weighted average useful life of the underlying assets acquired.

Summarized financial information for MM 1995-2 at September 30, 2007 and December 31, 2006 and for the three and nine months ended September 30, 2007 and 2006, are as follows:

| | September 30, 2007 | December 31, 2006 |
|--|-----------------------------------|----------------------------------|
| Total current assets | \$ 3,907,256 | \$ 2,816,175 |
| Property, plant and equipment, net | 7,250,624 | 5,828,718 |
| Total other assets | 15,666 | 9,833 |
| | | |
| Total assets | \$ 11,173,546 | \$ 8,654,726 |
| | | |
| Total current liabilities | \$ 1,424,483 | \$ 1,081,382 |
| Long-term note payable | 2,563,688 | 341,142 |
| Total shareholders' equity | 7,185,375 | 7,232,202 |
| | | |
| Total liabilities and shareholders' equity | \$ 11,173,546 | \$ 8,654,726 |

Table of Contents

| | Three Months Ended | | Nine Months Ended | |
|--------------------------|---------------------------|--------------|--------------------------|--------------|
| | September 30, | | September 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| Total revenues | \$ 3,189,887 | \$ 2,866,781 | \$ 9,493,031 | \$ 8,357,557 |
| Total costs and expenses | 1,380,367 | 1,137,685 | 4,039,859 | 3,374,494 |
| Net income | \$ 1,809,520 | \$ 1,729,096 | \$ 5,453,172 | \$ 4,983,063 |

3. Long-Term Debt

On August 23, 2007, the Company entered into a Credit Agreement (the "Credit Agreement") with Citibank, N.A., as the administrative agent (the "Agent"), and the other lenders party thereto ("Lender"), providing for a \$25 million senior, first-priority secured revolving and term credit facility (the "Credit Facility"). The Credit Facility is guaranteed by all active subsidiaries of the Company and secured by the assets of the Company and its subsidiaries. The Credit Facility matures on August 23, 2010. The Credit Facility is a refinancing and expansion of the Company's prior credit facility with First National Bank of Colorado ("FNBC"). The Credit Facility is expected to be used primarily to fund the growth and expansion of PowerSecure, as well as the growth of Southern Flow.

While the Credit Facility primarily functions as a \$25 million revolving line of credit, the Company can carve out up to three term loans, in an aggregate amount of up to \$5 million, to fund acquisitions, with each term loan having the tenor and amortization of seven years and maturing on August 23, 2015 (if made before August 23, 2007) or August 23, 2016 (if made on or after August 23, 2008). Any amounts borrowed under any term loans reduce the aggregate amount of the revolving loan available for borrowing.

Outstanding balances under the Credit Facility bear interest, at the Company's 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 125 basis points to 200 basis points based upon the Company's leverage ratio, or at the Agent's alternate base rate plus an applicable margin, on a sliding scale ranging from minus 25 basis points to plus 50 basis points based upon the Company's leverage ratio. The Company's leverage ratio is the ratio of its funded indebtedness as of a given date to its consolidated earnings before interest, taxes, depreciation and amortization ("EBITDA") for the four consecutive fiscal quarters ending on such date. The Agent'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%, and the Agent's prime commercial lending rate. Through September 30, 2007, the Company had not borrowed any amounts under the Credit Facility.

The Credit Facility is not subject to any borrowing base computations or limitations, but does contain certain financial covenants that the Company must meet. The Company's maximum leverage ratio cannot exceed 2.75. The Company's minimum fixed charge coverage ratio must be in excess of 1.75, where fixed charge coverage ratio is defined as the ratio of the aggregate of the Company's trailing 12 month consolidated EBITDA plus its lease or rent expense minus its cash

Table of Contents

taxes, divided by the sum of the Company's consolidated interest charges plus its lease or rent expenses plus its scheduled principal payments and dividends, computed over the previous period. Also, the Company's minimum asset coverage must be in excess of 1.25, where asset coverage is defined as the summation of 80% of the book value of accounts receivable plus 60% of the book value of inventory plus 50% of the book value of net fixed assets, divided by total funded debt outstanding less any acquisition term debt. At September 30, 2007, the Company was in compliance with these financial covenants.

The Credit Agreement also contains customary representations and warranties and affirmative and negative covenants, including restrictions with respect to liens, indebtedness, loans and investments, material changes in the Company's business, asset sales or leases or transfers of assets, restricted payments such as distributions and dividends, mergers or consolidations and transactions with affiliates. Upon the sale of any of the assets of the Company or its subsidiaries other than in the ordinary course of business, or the sale of any capital stock or debt of the Company or its subsidiaries, the Company is required to use the net proceeds thereof to repay any indebtedness then outstanding under the Credit Facility.

The obligations of the Company under the Credit Facility are secured by guarantees (Guarantees) and security agreements (the Security Agreements) by each of the Company's active subsidiaries, including but not limited to PowerSecure and PowerSecure's subsidiaries, Southern Flow, Metrotek Florida, and MGT. The Guarantees guaranty all of the obligations of the Company 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.

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.

On August 23, 2007, in connection with entering the Credit Agreement described above, the Company terminated its credit facility with FNBC (the FNBC Credit Facility). The FNBC Credit Facility was a \$4.5 million secured revolving line of credit that previously constituted the Company's primary credit facility and was scheduled to expire on September 1, 2007. The Company did not have any outstanding balance under the FNBC Credit Facility as of the date of termination.

4. Restructuring Charges

On April 16, 2007, the Company's founders, W. Phillip Marcum, the former Chairman of the Board, President and Chief Executive Officer of the Company, and A. Bradley Gabbard, the former Executive Vice President and Chief Financial Officer of the Company, retired from and terminated their employment with the Company. In conjunction with those retirements, on April 16, 2007, the Board of Directors elected and appointed Sidney Hinton, the President and Chief Executive Officer of PowerSecure, Inc., as the President and Chief Executive Officer of the

Table of Contents

Company. Mr. Hinton has also retained his positions with PowerSecure.

In connection with their retirement, Messrs. Marcum and Gabbard each entered into a Separation Agreement and Release with the Company (the Separation Agreements). The Separation Agreements were approved by the Compensation Committee of the Company's Board of Directors. Under the Separation Agreements, the Company will pay Messrs. Marcum and Gabbard severance payments, for a period of three years for Mr. Marcum and two years for Mr. Gabbard, on regular payroll dates in aggregate amounts equal to \$2,810,990, for Mr. Marcum, and \$1,310,540 for Mr. Gabbard. The severance payments are payable as follows: \$468,498 plus interest thereon of \$11,712 to Mr. Marcum, and \$327,635 plus interest thereon of \$8,191 to Mr. Gabbard, was due on October 18, 2007 (the Initial Payment Date) and the remainder are due in equal installments over the severance period on the Company's regular payroll dates. These severance payments were required by, and were established in accordance with, the employment agreements of Messrs. Marcum and Gabbard (the Founder Employment Agreements).

The Company will also pay to Messrs. Marcum and Gabbard the Incentive Compensation (as such term is defined in the Founder Employment Agreements) payments required by the Founder Employment Agreements in an aggregate amount of \$4,400,000 to Mr. Marcum and \$3,600,000 to Mr. Gabbard. The Incentive Compensation to Messrs. Marcum and Gabbard are payable as follows: (i) \$3,382,500 to Mr. Marcum and \$2,767,500 to Mr. Gabbard (which amounts include interest at the simple rate of 5% per annum) on the Initial Payment Date, and (ii) the remaining \$1,100,000 to Mr. Marcum and the remaining \$900,000 to Mr. Gabbard on June 15, 2008, plus interest at the simple rate of five percent (5%) per annum.

These Incentive Compensation payments are required under the Founder Employment Agreements and were intended, when originally entered into in 1991, to provide incentives for Messrs. Marcum and Gabbard to align their interests with the interests of stockholders and to enhance stockholder value. The formula for these payments was ten percent (10%) of the excess of the fair market value of the Company's Common Stock upon termination over \$10.08, which was the Company's initial public offering price attributable to the Common Stock, as adjusted for the 1998 1-for-4 reverse stock split, multiplied by the number of Common Stock equivalents outstanding. Only Messrs. Marcum and Gabbard were entitled to payments under the Incentive Compensation Fund, which was triggered by their termination of employment.

The Compensation Committee of the Board of Directors of the Company set \$15.00 as the fair market value of the Common Stock for purposes of determining the Incentive Compensation payable to Messrs. Marcum and Gabbard under their Founder Employment Agreements. In establishing the fair market value of the Common Stock, the Compensation Committee received and relied upon a written opinion by Harris Williams & Co., dated April 16, 2007 (the Harris Williams Opinion). Based on this opinion, the Compensation Committee set \$15.00 per share, which was the midpoint of the valuation range opined upon in the Harris

Table of Contents

Williams Opinion, as the fair market value of the Common Stock. The Compensation Committee then rounded the resulting Incentive Compensation amount down to the nearest million dollars (\$8 million).

Messrs. Marcum and Gabbard have also entered into consulting agreements with the Company, pursuant to which they have agreed to provide their consulting services to the Company, as requested by the Company, for up to 25 hours per month, cumulative up to 50 hours, for a total gross consulting fee of \$8,000 per month for Mr. Marcum and \$7,500 for Mr. Gabbard. The consulting period is three years for Mr. Marcum and two years for Mr. Gabbard. The consulting fee is payable as follows: \$49,200 to Mr. Marcum and \$46,125 to Mr. Gabbard on the Initial Payment Date, and the remaining consulting fee will be paid over the remainder of the consulting period on the Company's regular payroll dates.

On April 24, 2007, the Company deposited into an escrow account with Zions First National Bank, as escrow agent, the sum of \$1,630,272 for Mr. Marcum and \$1,303,880 for Mr. Gabbard pursuant to an escrow agreement. The amounts represent the amounts payable to Messrs. Marcum and Gabbard on the Initial Payment Date less required tax withholdings. The escrowed funds were released from escrow on the Initial Payment Date and paid over to Messrs. Marcum and Gabbard by the escrow agent.

The Separation Agreements also contain customary provisions regarding such matters as accelerated payments in the event of a change in control, interest and fees on late payments due, and similar matters.

In connection with the restructuring, the Company has relocated its headquarters to PowerSecure's offices in Wake Forest, North Carolina. The Company recorded a pre-tax non-recurring restructuring charge in the amount of \$14,139,000 during the nine months ended September 30, 2007, which includes all amounts payable under the Separation Agreements as well as certain related costs. The restructuring charge also includes amounts the Company is obligated to pay to certain employees who were not relocated to the new corporate headquarters in Wake Forest, North Carolina, as well as early lease termination penalties the Company is obligated to pay on its existing office lease in Denver, Colorado. The Company expects the restructuring and relocation will result in annual savings of approximately \$2.4 million, the effects of which will be recognized for accounting purposes as the savings is realized.

5. Employment and Non-Competition Agreement

On August 15, 2007, the Company entered into an Employment and Non-Competition Agreement (the Hinton Employment Agreement) with Sidney Hinton, the President and Chief Executive Officer of the Company. The key terms of Mr. Hinton's Employment Agreement include a five year term, with automatic one-year renewals, an increase in base salary, annual bonuses equal to 7% of PowerSecure's cash flow from operations, a grant of 600,000 restricted shares of Common Stock, a \$5 million life insurance policy, a disability insurance policy and an annuity upon his retirement. The Hinton Employment Agreement also provides for severance

Table of Contents

benefits equal to as much as three times the sum of his most recent base salary plus his average bonuses for the two years before and for the year of the date of termination, depending upon the circumstances of his termination.

The 600,000 restricted shares of Common Stock were granted to Mr. Hinton pursuant to a restricted stock agreement. These restricted shares vest as follows:

A total of 300,000 restricted shares will cliff vest in their entirety on August 8, 2012, five years after the grant date, provided Mr. Hinton remains employed with the Company on that date.

The other 300,000 restricted shares vest in five equal annual installments, after the end fiscal 2007 and the subsequent four fiscal years, based on the Company achieving a performance target each year relating to its income from continuing operations, excluding restructuring charges related to the second quarter 2007 retirement of the Company's founders and the relocation of the Company's principal executive offices to Wake Forest, North Carolina.

Upon a change in control of the Company, all restricted shares remaining to vest will automatically vest.

The fair value of the 600,000 restricted shares granted on August 15, 2007 was \$7,404,000 and was recorded as deferred stock compensation expense and a reduction of stockholders' equity. The fair value of the 300,000 cliff vesting shares is being amortized on a straight-line basis over the five year vesting period. The fair value of the performance vesting shares are amortized as the achievement of the performance criteria becomes probable. Stock compensation expense in the amount of \$246,800 has been reflected in the statement of operations for the three and nine month periods ended September 30, 2007.

6. Discontinued Operations

In June 2007, the Company determined that the recovery value of the remaining assets of its discontinued MCM operations was permanently impaired. Accordingly, the remaining balance of the assets of discontinued operations, net of cash received upon resolution of a disputed receivable, was written off resulting in a loss from disposal of discontinued operations during the nine months ended September 30, 2007, in the amount of \$140,490. There are no remaining assets or liabilities of the discontinued MCM operations recorded on the books of the Company at September 30, 2007.

7. Income Taxes

On January 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes by prescribing a minimum recognition threshold for a tax position taken or expected to be taken in a tax return

Table of Contents

that is required to be met before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. At January 1, 2007, the total amount of unrecognized tax benefits for open tax years dating back to 2003 was approximately \$3.4 million, nearly all of which, if recognized would affect our effective tax rate. The cumulative effect of adopting FIN 48 of \$348,000 was recorded as an increase to accumulated deficit, which includes interest and penalties of \$107,000. The Company recognizes interest and penalties related to our tax contingencies as income tax expense. The total liabilities for unrecognized tax benefits relate primarily to the allocation of costs among the Company's operating subsidiaries.

8. Share-Based Compensation

The Company accounts for share-based compensation in accordance with FAS No. 123 (Revised 2004),

Share-Based Payment (FAS 123(R)), which it adopted January 1, 2006, using the modified prospective transition method. Under FAS 123(R) compensation cost for all stock-based awards is measured at the fair value on date of grant and recognized over the service period for awards expected to vest, net of estimated forfeitures. The fair value of restricted stock is determined based on the number of shares granted and the closing price of the Company's common stock on the date of grant, and the fair value of stock options is determined using the Black-Scholes valuation model.

The Company maintains stock plans under which the Company may grant stock awards, incentive stock options, and nonqualified stock options to employees and officers, consultants, and non-employee directors. Nonqualified stock options have been granted in prior years to the Company's directors (which currently vest over two years) under both our 1991 Directors' Stock Plan and under the Company's 1998 Stock Plan. Nonqualified and incentive stock options have been granted in prior years to the Company's officers and employees (which generally vest over periods up to five years) under the Company's 1991 Stock Option Plan and the Company's 1998 Stock Plan. At September 30, 2007, there were 123,283 options available for grant under the Company's 1998 Stock Plan, while no options can be granted in the future under the Company's 1991 Stock Plans.

Pursuant to the requirements of FAS 123(R), net income for the three months ended September 30, 2007 and 2006 includes \$312,710 and \$209,921 of compensation costs, respectively, related to outstanding stock options and \$246,800 and \$16,500, respectively, of compensation costs related to restricted stock awards that vested during the period. Net income for the nine months ended September 30, 2007 and 2006 includes \$780,686 and \$340,628 of compensation costs, respectively, related to outstanding stock options and \$246,800 and \$33,000, respectively, of compensation costs related to restricted stock awards that vested during the period. There were no net income tax benefits related to the Company's stock-based compensation arrangements during the three and nine month periods ended September 30, 2007 and 2006 because a valuation allowance has been provided for 100% of the Company's net deferred tax assets. All of the stock-based compensation expense is included in general and administrative expenses for each reporting period.

Table of Contents

A summary of option activity for the nine months ended September 30, 2007 is as follows:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (years) | Aggregate Intrinsic Value |
|---------------------------------|-----------|--|--|---------------------------------|
| Balance, December 31, 2006 | 2,085,344 | \$ 4.61 | | |
| Granted Directors | 37,500 | 12.72 | | |
| Granted Employees | 25,000 | 12.29 | | |
| Exercised | (402,058) | 2.67 | | |
| Canceled | | | | |
| Forfeited | (13,750) | 8.26 | | |
| Balance, September 30, 2007 | 1,732,036 | \$ 5.30 | 6.20 | \$ 7.23 |
| Exercisable, September 30, 2007 | 1,321,911 | \$ 3.84 | 5.56 | \$ 8.71 |

A summary of option activity for the nine months ended September 30, 2006 is as follows:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (years) | Aggregate Intrinsic Value |
|---------------------------------|-----------|--|--|---------------------------------|
| Balance, December 31, 2005 | 2,289,143 | \$ 2.98 | | |
| Granted Directors | 22,500 | 14.78 | | |
| Granted Employees | 271,000 | 12.62 | | |
| Exercised | (473,669) | 2.53 | | |
| Canceled | | | | |
| Forfeited | (12,500) | 8.57 | | |
| Balance, September 30, 2006 | 2,096,474 | \$ 4.42 | 6.74 | \$ 7.52 |
| Exercisable, September 30, 2006 | 1,544,932 | \$ 3.00 | 5.90 | \$ 8.94 |

The weighted average grant date fair value of the 37,500 options granted to directors during the nine months ended September 30, 2007 was \$8.29. The weighted average grant date fair value of the 22,500 options granted to the Company's directors during the nine months ended September 30, 2006 was \$11.22. The weighted average grant date fair value of the 25,000 options granted to employees during the nine months ended September 30, 2007 was \$8.00. The weighted average grant date fair value of the 271,000 options granted to employees during the nine months ended

Table of Contents

September 30, 2006 was \$8.33. In each case, the fair value was measured using the Black-Scholes valuation model with the following assumptions:

| | September 30, 2007 | September 30, 2006 |
|---------------------------------|-----------------------------------|-----------------------------------|
| Expected stock price volatility | 75.7% | 88.0% |
| Risk Free interest rate | 5.09% | 4.68% |
| Annual dividends | \$ | \$ |
| Expected life employees | 5years | 4.1years |
| Expected life directors | 5years | 6years |

The fair value of the stock option grants are amortized over the applicable vesting period using the straight-line method and assuming a forfeiture rate of 5%.

At September 30, 2007 and December 31, 2006, there was \$2,172,000 and \$2,409,000, respectively, of total unrecognized compensation costs related to stock options. These costs at September 30, 2007 are expected to be recognized over a weighted average period of 1.68 years.

During the three months ended September 30, 2007 and 2006, the total intrinsic value of stock options exercised was \$2,398,000 and 520,000, respectively, and the total fair value of stock awards vested was \$164,000 and \$36,000, respectively. During the nine months ended September 30, 2007 and 2006, the total intrinsic value of stock options exercised was \$4,421,000 and 5,254,000, respectively, and the total fair value of stock awards vested was \$861,000 and \$245,000, respectively.

Cash received from stock option exercises for the three months ended September 30, 2007 and 2006 was \$621,000 and \$285,000, respectively. Cash received from stock option exercises for the nine months ended September 30, 2007 and 2006 was \$1,022,000 and \$1,198,000, respectively.

9. Commitments and Contingencies and Income from Litigation Settlements

Income from Litigation Settlements In January 2001, a class action was filed in the District Court for the City and County of Denver, Colorado against the Company and certain affiliates and parties unrelated to the Company. The class action alleged that the defendants violated certain provisions of the Colorado Securities Act in connection with the sale of interests in an energy program of which MGT was the managing trustee. A settlement to fully resolve all claims by the class against the Company and its affiliates was submitted and granted final approval by the district court on June 11, 2004. The loss that occurred as a result of the class action and settlement was recorded by the Company in the fourth quarter of 2002. All obligations of the Company under the settlement were extinguished during the second quarter of 2006.

After the settlement with the class was approved, the Company vigorously pursued cross-claims and third party claims (Other Party Claims), including claims against the prior owners of the assets and against attorneys, consultants and a brokerage firm (the Other Parties) involved in the transactions underlying the claims in the Class Action, seeking recovery of damages and

Table of Contents

contribution, among other things, from the Other Parties. Some of the Other Parties asserted counterclaims against the Company.

The Company agreed to settlements with four of the Other Parties during the fourth quarter of 2006 and with the remaining Other Parties in 2007. As a result of the settlements with the Other Parties, the Company recorded income in the amount of \$343,000 during 2006, and additional income in the amount of \$385,000 during the nine months ended September 30, 2007 (of which \$107,000 was recorded during the three months ended September 30, 2007). Through September 30, 2007, the Company has received \$737,000 in payment from the settlements and incurred \$9,000 in settlement related expenses. All of the Other Party Claims have been settled and no additional amounts are payable to the Company at September 30, 2007.

Other Matters On June 28, 2007, the Company, issued a press release announcing that the Company had received a letter from the Securities and Exchange Commission (the SEC) advising the Company that the SEC's investigation has been completed and that the SEC does not intend to recommend any enforcement action. The letter concludes the SEC's informal, non-public inquiry commenced in May 2006 into certain events relating to announcements made by the Company in February and March 2006 of orders received by the Company's subsidiary PowerSecure, Inc. These events included events that had been the subject of a previous review by the National Association of Securities Dealers (NASD), on behalf of the American Stock Exchange. The Company had fully cooperated with the SEC inquiry and the earlier NASD review, which had been previously disclosed by the Company in its SEC filings. The initial letter of inquiry by the SEC and the initial letter of review by the NASD had each advised the Company that such inquiry and review should not be construed as an indication that any violation of law had occurred.

From time to time, the Company hires employees that are subject to restrictive covenants, such as non-competition agreements with their former employers. The Company complies, and requires our employees to comply, with the terms of all known restrictive covenants. However, the Company has 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. While the Company does not believe any pending claims have merit, the Company cannot provide any assurance of the outcome of these claims.

From time to time, the Company is involved in other disputes and legal actions arising in the ordinary course of business. The Company intends to vigorously defend all claims against us. Although the ultimate outcome of these claims 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 dispute is expected to have a material adverse effect on our business, financial condition or results of operations.

Preferred Stock Redemption During the nine months ended September 30, 2007, the Company retired an additional 150 shares of its Series B Preferred Stock at a redemption value of \$220,000. The balance of the unpaid redemption obligation at September 30, 2007 and December 31, 2006, was \$104,000 and \$324,000, respectively, and is included in accrued and other liabilities in the accompanying consolidated balance sheets.

Table of Contents

10. Segment Information

The Company's reportable segments are strategic business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. The Company's reportable business segments include: distributed generation; natural gas measurement services; and automated energy data collection and telemetry.

Distributed Generation The operations of the Company's distributed generation segment are conducted by PowerSecure. PowerSecure commenced operations in September 2000. The primary elements of PowerSecure's distributed generation products and services include project design and engineering, negotiation with utilities to establish tariff structures and power interconnects, generator acquisition and installation, process control and switchgear design and installation, and ongoing project monitoring and servicing. PowerSecure markets its distributed generation products and services directly to large end-users of electricity and through outsourcing partnerships with utilities. Through September 30, 2007, the majority of PowerSecure's revenues have been generated from sales of distributed generation systems on a turnkey basis, where the customer purchases the systems from PowerSecure.

Since 2005, PowerSecure has added several new business units designed to expand and complement its core distributed generation business and customers. UtilityEngineering provides fee-based, technical engineering services to PowerSecure's utility partners and customers. PowerServices provides rate analysis and other similar consulting services to PowerSecure's utility, commercial and industrial customers. EnergyLite assists customers in reducing their use of energy through investments in more energy-efficient technologies. PowerSecure's Federal business unit concentrates on marketing its products and services to federal customers, primarily in conjunction with our utility alliances. Reid's Trailer, Inc., builds trailers for the transportation of goods and equipment, an element in PowerSecure's mobile distributed generation equipment business strategy. Late in the third quarter 2007, PowerSecure launched a new majority-owned subsidiary, EfficientLights, that will design and manufacture lighting solutions specifically aimed at substantially reducing the energy consumed in lighting grocery stores.

Each of these new PowerSecure business units operates in a distinct market with distinct technical disciplines, but share a common customer base which PowerSecure services and grows through shared resources and customer leads. Accordingly, these units are included within PowerSecure's segment results.

Natural Gas Measurement Services The operations of the Company's natural gas measurement services segment are conducted by Southern Flow. Southern Flow's services include on-site field services, chart processing and analysis, laboratory analysis, and data management and reporting. These services are provided principally to customers involved in natural gas production, gathering, transportation, and processing.

Table of Contents

Automated Energy Data Collection and Telemetry The operations of our automated data collection and telemetry segment are conducted by Metrotek Florida. Metrotek Florida's manufactured products fall into the following categories: field devices, including data collection products and electronic gas flow computers; data collection software products (such as InvisiConnect™, DC2000 and PowerSpring); and communications solutions that can use public networks operated by commercial wireless carriers to provide real time IP-based wireless internet connectivity, traditional cellular radio, 900 MHz unlicensed radio or traditional wire-line phone service to provide connectivity between the field devices and the data collection software products. Metrotek Florida also provides data collection, M2M telemetry connectivity and post-sale support services for its manufactured products and turnkey solutions.

The accounting policies of the reportable segments are the same as those described in Note 1 of the Notes to Consolidated Financial Statements. The Company evaluates the performance of its operating segments based on operating income (loss) before income taxes, nonrecurring items and interest income and expense. Intersegment sales are not significant.

Summarized financial information concerning the Company's reportable segments is shown in the following table. The Other column includes corporate related items including restructuring charges, revenues and expenses from managing MM 1995-2, results of insignificant operations and, as it relates to segment profit or loss, income and expense (primarily interest and finance charges) and other non-recurring charges not allocated to reportable segments.

Table of Contents**Summarized Segment Financial Information**

(all amounts reported in thousands)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---------------------------------------|-------------------------------------|-----------|------------------------------------|-----------|
| | 2007 | 2006 | 2007 | 2006 |
| Revenues: | | | | |
| PowerSecure | \$ 22,128 | \$ 28,221 | \$ 62,257 | \$ 68,964 |
| Southern Flow | 4,101 | 3,941 | 11,979 | 12,255 |
| Metrotek Florida | 1,513 | 964 | 3,708 | 2,549 |
| Other | 269 | 320 | 1,112 | 753 |
| Total | \$ 28,011 | \$ 33,446 | \$ 79,056 | \$ 84,521 |
| Segment profit (loss): | | | | |
| PowerSecure | \$ 1,576 | \$ 2,767 | \$ 2,349 | \$ 6,563 |
| Southern Flow | 789 | 710 | 2,150 | 2,196 |
| Metrotek Florida | 292 | (5) | 485 | (134) |
| Other | (609) | (1,038) | (15,541) | (2,394) |
| Total | \$ 2,048 | \$ 2,434 | \$ (10,557) | \$ 6,231 |
| Capital expenditures: | | | | |
| PowerSecure | \$ 291 | \$ 1,759 | \$ 842 | \$ 2,587 |
| Southern Flow | 128 | 26 | 334 | 72 |
| Metrotek Florida | 11 | 20 | 66 | 21 |
| Other | | | | 28 |
| Total | \$ 430 | \$ 1,805 | \$ 1,242 | \$ 2,708 |
| Depreciation and amortization: | | | | |
| PowerSecure | \$ 332 | \$ 228 | \$ 927 | \$ 446 |
| Southern Flow | 37 | 30 | 104 | 90 |
| Metrotek Florida | 10 | 29 | 29 | 90 |
| Other | 17 | 19 | 53 | 57 |
| Total | \$ 396 | \$ 306 | \$ 1,113 | \$ 683 |
| Total assets: | | | | |
| | | | September 30, 2007 | 2006 |
| PowerSecure | | | \$ 82,343 | \$ 49,907 |
| Southern Flow | | | 12,704 | 11,564 |
| Metrotek Florida | | | 4,725 | 3,875 |
| Other | | | 7,340 | 19,028 |

| | | | |
|-------|--|------------|-----------|
| Total | | \$ 107,112 | \$ 84,374 |
|-------|--|------------|-----------|

21

Table of Contents

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

Introduction

The following discussion of our results of operations for the three and nine month periods ended September 30, 2007 (referred to herein as the third quarter 2007 and nine month period 2007, respectively) and 2006 (referred to herein as the third quarter 2006 and nine month period 2006, respectively) and of our financial condition as of September 30, 2007 should be read in conjunction with our consolidated financial statements and related notes thereto included elsewhere in this report.

Overview

We are a diversified provider of energy technology products, services and data management systems primarily to industrial and commercial users and suppliers of natural gas and electricity. As a holding company, we conduct our operations and derive our revenues through our three operating subsidiaries, each of which operates a separate business:

PowerSecure, which designs, sells and manages distributed generation systems;

Southern Flow, which provides natural gas measurement services; and

Metretek Florida, which designs, manufactures and sells data collection and energy measurement monitoring systems.

In addition to these operating subsidiaries, we own approximately 36% of the equity interests of an unconsolidated business, MM 1995-2, through our wholly-owned subsidiary MGT. MGT also is the managing trustee of MM 1995-2. MM 1995-2 owns and operates five oil field production water disposal wells located at four facilities in northeastern Colorado.

We commenced operations in 1991 as an energy services holding company, owning subsidiaries with businesses designed to exploit service opportunities primarily in the natural gas industry. Since then, our business has evolved and expanded through acquisitions and developments of companies, businesses and product lines that have allowed us to reach not only a broader portion of the energy market, including the electricity market, but also markets outside of the energy field. In recent years, we have focused our efforts on growing our businesses by offering new and enhanced products, services and technologies and by entering new markets, within a framework emphasizing the goal of achieving profitable operations on a sustained basis.

Our revenues and results of operations, on a quarterly, period and annual basis, are dependent upon, and are the consolidated result of, the revenues and results of operations of each of our operating subsidiaries, our equity income in MM 1995-2 and our corporate overhead. While we operate generally in the energy technology products, services and data

Table of Contents

management industry, our businesses are diversified and each of our business segments is operated independently of the others and influenced and affected by many factors that may apply only to that segment. Accordingly, our consolidated results of operations are an aggregation of different businesses and thus dependent upon a variety of factors applicable to each of these businesses.

PowerSecure is an expanding company that has developed a series of businesses centered around distributed generation, with a core turnkey distributed generation business. Since late 2005, PowerSecure has received several significant orders from its largest customer, Publix Super Markets, Inc., that have resulted in numerous projects in PowerSecure's core business generating a majority of PowerSecure's revenues in 2006 and to date in 2007.

In addition, since 2005, PowerSecure has added several new business units designed to expand and complement its core distributed generation business and customers. UtilityEngineering provides fee-based, technical engineering services to PowerSecure's utility partners and customers. PowerServices provides rate analysis and other similar consulting services to PowerSecure's utility, commercial and industrial customers. EnergyLite assists customers in reducing their use of energy through investments in more energy-efficient technologies. PowerSecure's Federal business unit concentrates on marketing its products and services to federal customers, primarily in conjunction with our utility alliances. Reid's Trailer, Inc., builds trailers for the transportation of goods and equipment, an element in PowerSecure's mobile distributed generation equipment business strategy. Late in the third quarter 2007, PowerSecure launched a new majority-owned subsidiary, EfficientLights, that will design and manufacture lighting solutions specifically aimed at substantially reducing the energy consumed in lighting grocery stores.

Even with the addition of these business units and acquisitions, PowerSecure is still in large part dependent upon the size and timing of the receipt of orders for, and of the completion of, its projects, and its results of operations can be significantly impacted by large, individual projects.

During the third quarter 2007, PowerSecure's revenues and segment profit declined compared to the third quarter 2006. As a rapidly growing business with several new business units, PowerSecure's revenues and financial results can fluctuate significantly on a quarter-to-quarter and period-to-period basis due to the number, size and timing of its projects and the percentage completion of its in-progress projects. PowerSecure's results of operations in the third quarter 2007 were due, in large part, to such fluctuation. During the third quarter 2007, PowerSecure's revenues were \$22,128,000 (of which \$13,035,000 was attributable to the Publix projects), a decrease of \$6,093,000, or 22%, compared to the third quarter 2006. While PowerSecure's backlog of work that it has been awarded continues to increase (currently in excess of \$100,000,000), the timing of the work performed and the effect of the percentage of completion of in-process projects during the third quarter 2007 resulted in the decrease in revenues and segment profit compared to the third quarter 2006.

Southern Flow is a well established, strong and expanding oil field services company

Table of Contents

that renders natural gas measurement and other services to oil and gas production companies. During the third quarter 2007, Southern Flow's revenues increased by \$160,000, or 4%, as compared to the third quarter 2006, due to the strength of the oil and gas industry.

Metrotek Florida has been in operation since 1977 with a core business of designing, manufacturing and selling data collection and energy measurement monitoring systems. Metrotek Florida's future results of operations will be largely dependent upon its ability to successfully address its core markets, as well as its ability to generate incremental sales from certain new markets into which it has recently introduced new telemetry products. Metrotek Florida's revenues increased by \$549,000, or 57%, during the third quarter 2007 as compared to the third quarter 2006, as a result of improved market success for its M2M business.

Our cash and cash equivalents balance was \$26,594,000 at September 20, 2007 compared to \$6,824,000 at June 30, 2007. The improvement in the balance of our cash and cash equivalents reflects a number of factors, including substantial collections on our trade receivables during the third quarter 2007.

On August 15, 2007, we entered into an Employment and Non-Competition Agreement with Sidney Hinton, the President and Chief Executive Officer of the Company. The key terms of Mr. Hinton's Employment Agreement include a five year term, with automatic one-year renewals, an increase in base salary, annual bonuses equal to 7% of PowerSecure's cash flow from operations, a grant of 600,000 shares of restricted common stock, a \$5 million life insurance policy, a disability insurance policy, an annuity upon his retirement, and severance benefits. The fair value of the 600,000 shares granted on August 15, 2007 was \$7,404,000 and was recorded as deferred compensation expense and a reduction of stockholders' equity. The fair value of the 300,000 cliff vesting shares is being amortized on a straight-line basis over the five year vesting period. The fair value of the 300,000 performance vesting shares are amortized as the achievement of the performance criteria becomes probable. Stock compensation expense in the amount of \$246,800 has been reflected in the statement of operations for the three and nine month periods ended September 30, 2007.

On August 23, 2007, we entered into a credit agreement with Citibank, N.A., and other lenders, providing for a \$25 million senior, first-priority secured revolving and term credit facility. The credit facility is guaranteed by all of our subsidiaries and secured by all of our assets and the assets of our subsidiaries. The credit facility matures on August 23, 2010. The Credit Facility is a refinancing and expansion of our prior credit facility with First National Bank of Colorado. The credit facility is expected to be used primarily to fund the growth and expansion of PowerSecure, as well as the growth of Southern Flow. We have not borrowed any funds on the credit facility through September 30, 2007.

Due principally to a decrease in revenues at our PowerSecure operating segment, our consolidated revenues during the third quarter 2007 decreased by \$5,435,000, representing a 16% decline over third quarter 2006 consolidated revenues. We recorded net income of \$2,655,000 during the third quarter 2007. Our third quarter 2007 results also included equity in income from MM 1995-2 in the amount of \$656,000. This compares to net income of

Table of Contents

\$2,911,000 during the third quarter 2006, which included \$627,000 equity in income of MM 1995-2.

During the nine month period 2007, PowerSecure's revenues and segment profit decreased compared to the nine month period 2006 primarily due to factors discussed above in reference to the third quarter 2007. During the nine month period 2007, PowerSecure's revenues were \$62,257,000 (of which \$34,932,000 was attributable to the Publix projects), a decrease of \$6,707,000, or 10%, compared to the nine month period 2006.

During the nine month period 2007, Southern Flow's revenues decreased by \$276,000, or 2%, as compared to the nine month period 2006. While Southern Flow is benefiting from a strong oil and gas market, its nine month period 2007 results are below the nine month period 2006 results only because of strong, non-recurring equipment sales in the nine month period 2006 to customers repairing damage from Hurricanes Rita and Katrina in late 2005.

Metrotek Florida's revenues increased by \$1,159,000, or 45%, during the nine month period 2007 as compared to the nine month period 2006, as a result of improved market success for its M2M business.

During the nine month period 2007, we incurred nonrecurring restructuring charges in the amount of \$14,139,000 related to the retirement of the two founders of our Company, the severance, consulting and incentive compensation incurred in connection with their employment and separation agreements, and the relocation of our corporate offices from Denver to PowerSecure's offices in Wake Forest, North Carolina, including severance benefits payable to personnel who were not relocated. In connection with our severance obligations, in the second quarter 2007 we paid \$2,934,000 over to escrow accounts for the benefit of our retired founders, and we will be discharging our remaining payment obligations thereunder through 2009.

During the nine month period 2007, we recorded income from litigation settlements in the amount of \$385,000 (including \$107,000 during the third quarter 2007) representing our share of litigation claims settled in 2007. All of the claims subject to litigation in this matter have now been settled and we have received all of the proceeds from the settlements.

Due principally to a decrease in revenues at PowerSecure, our consolidated revenues during the nine month period 2007 decreased by \$5,465,000, or 6%, over the nine month period 2006 consolidated revenues. We recorded a net loss of \$8,967,000 during the nine month period 2007. This net loss was primarily attributable to the \$14,139,000 of nonrecurring restructuring charges we incurred during the nine month period 2007. Our nine month period 2007 results also included equity in income from MM95-2 in the amount of \$1,977,000 and a loss from the discontinued operations of MCM in the amount of \$140,000. This compares to net income of \$7,775,000 during the nine month period 2006, which included \$1,803,000 equity in income of MM 1995-2 (net of minority interests), no restructuring charges and no loss from discontinued operations.

Table of Contents

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 conformity 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 ongoing 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, 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 are believed to be 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, and it is possible that such changes could occur in the near term.

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 are described in our Annual Report on Form 10-K for the year ended December 31, 2006 in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Results of Operations

The following table sets forth selected information related to our primary business segments and is intended to assist in understanding our results of operations for the periods presented. The following table excludes revenues and costs and expenses of the discontinued MCM operations as well as equity income in our unconsolidated affiliate, minority interest and income taxes for all periods presented.

Table of Contents

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------------|-------------------------------------|------------------|------------------------------------|------------------|
| | 2007 | 2006 | 2007 | 2006 |
| | (all amounts reported in thousands) | | | |
| Revenues: | | | | |
| PowerSecure | \$ 22,128 | \$ 28,221 | \$ 62,257 | \$ 68,964 |
| Southern Flow | 4,101 | 3,941 | 11,979 | 12,255 |
| Metrotek Florida | 1,513 | 964 | 3,708 | 2,549 |
| Other | 269 | 320 | 1,112 | 753 |
| Total | \$ 28,011 | \$ 33,446 | \$ 79,056 | \$ 84,521 |
| Gross Profit: | | | | |
| PowerSecure | \$ 7,038 | \$ 7,468 | \$ 17,833 | \$ 18,337 |
| Southern Flow | 1,101 | \$ 1,092 | \$ 3,291 | \$ 3,377 |
| Metrotek Florida | 818 | 510 | 2,141 | 1,474 |
| Total | \$ 8,957 | \$ 9,070 | \$ 23,265 | \$ 23,188 |
| Segment Profit (Loss): | | | | |
| PowerSecure | \$ 1,576 | \$ 2,767 | \$ 2,349 | \$ 6,563 |
| Southern Flow | 789 | 710 | 2,150 | 2,196 |
| Metrotek Florida | 292 | (5) | 485 | (134) |
| Other | (609) | (1,038) | (15,541) | (2,394) |
| Total | \$ 2,048 | \$ 2,434 | \$ (10,557) | \$ 6,231 |

We have three reportable segments. Our reportable segments are strategic business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. Our reportable business segments are distributed generation, natural gas measurement services and automated energy data management.

The operations of our distributed generation segment are conducted by PowerSecure. The primary elements of PowerSecure's distributed generation products and services include project design and engineering, negotiation with utilities to establish tariff structures and power interconnects, generator acquisition and installation, process control and switchgear design and installation, and ongoing project monitoring and servicing. PowerSecure markets its distributed generation products and services directly to large end-users of electricity and through outsourcing partnerships with utilities. Through September 30, 2007, the majority of PowerSecure's revenues have been generated from sales of distributed generation systems on a turnkey basis, where the customer purchases the systems from PowerSecure.

PowerSecure is an expanding company that has developed a series of businesses centered around distributed generation, with a core turnkey distributed generation business. Since late 2005, PowerSecure has received several significant orders from its largest customer, Publix Super Markets, Inc., that have resulted in numerous projects in PowerSecure's core business generating a majority of PowerSecure's revenues in 2006 and to date in 2007.

Table of Contents

In addition, since 2005, PowerSecure has added several new business units designed to expand and complement its core distributed generation business and customers. UtilityEngineering provides fee-based, technical engineering services to PowerSecure's utility partners and customers. PowerServices provides rate analysis and other similar consulting services to PowerSecure's utility, commercial and industrial customers. EnergyLite assists customers in reducing their use of energy through investments in more energy-efficient technologies. PowerSecure's Federal business unit concentrates on marketing its products and services to federal customers, primarily in conjunction with our utility alliances. Reid's Trailer, Inc., builds trailers for the transportation of goods and equipment, an element in PowerSecure's mobile distributed generation equipment business strategy. Late in the third quarter 2007, PowerSecure launched a new majority-owned subsidiary, EfficientLights, that will design and manufacture lighting solutions specifically aimed at substantially reducing the energy consumed in lighting grocery stores.

Each of PowerSecure's business units operates in a separate market with distinct technical disciplines, but all of these business units share a common customer base which PowerSecure services and grows through shared resources and customer leads. Accordingly, these units are included within PowerSecure's segment results.

The operations of our natural gas measurement services segment are conducted by Southern Flow. Southern Flow's services include on-site field services, chart processing and analysis, laboratory analysis, and data management and reporting. These services are provided principally to customers involved in natural gas production, gathering, transportation and processing.

The operations of our automated data collection and telemetry segment are conducted by Metretek Florida. Metretek Florida's manufactured products fall into the following categories: field devices, including data collection products and electronic gas flow computers; data collection software products (such as InvisiConnect®, DC2000 and PowerSpring); and communications solutions that can use public networks operated by commercial wireless carriers to provide real time IP-based wireless internet connectivity, traditional cellular radio, 900 MHz unlicensed radio or traditional wire-line phone service to provide connectivity between the field devices and the data collection software products. Metretek Florida also provides data collection, M2M telemetry connectivity and post-sale support services for its manufactured products and turnkey solutions.

We evaluate the performance of our operating segments based on operating income (loss) before taxes, nonrecurring items and interest income and expense. Other profit (loss) amounts in the table above include corporate related items including restructuring charges, fees earned from managing our unconsolidated affiliate, results of insignificant operations, and income and expense (primarily interest income and expense) and other non-recurring charges not allocated to its operating segments. Intersegment sales are not significant.

Table of Contents

Third Quarter 2007 Compared to Third Quarter 2006

Revenues. Our revenues are derived almost entirely from the sales of products and services by our subsidiaries. Our consolidated revenues for the third quarter 2007 decreased \$5,435,000, or 16%, compared to the third quarter 2006 due primarily to a decrease in revenues at PowerSecure, partially offset by increases in revenues at Southern Flow and Metrotek Florida.

PowerSecure's revenues are influenced by the number, size and timing of various projects as well as the percentage completion on in-process projects. PowerSecure's revenues have fluctuated significantly in the past and are expected to continue to fluctuate significantly in the future. PowerSecure's revenues decreased \$6,093,000, or 22%, during the third quarter 2007 compared to the third quarter 2006. The decrease in PowerSecure's revenues during the third quarter 2007 compared to the third quarter 2006 was due to a \$4,102,000 decrease in its revenues from its largest customer, Publix, and a decrease of \$1,991,000 in revenues from other customers. While PowerSecure's backlog of work that it has been awarded continues to increase (currently in excess of \$100,000,000), the timing of the work performed and the effect of the percentage of completion of in-process projects during the third quarter 2007 resulted in the decrease in revenues compared to the third quarter 2006.

Southern Flow's revenues increased \$160,000, or 4%, during the third quarter 2007, as compared to the third quarter 2006, due to a \$239,000 increase in field and service related revenues, partially offset by a decline in equipment sales. The increase in field and other service related revenue in the third quarter 2007 is due to continued favorable market conditions in the oil and gas sector. The decline in equipment sales is due to third quarter 2006 sales activity related to customers repairing damage from Hurricanes Rita and Katrina in late 2005. There were no similar equipment sales for hurricane repairs in the third quarter 2007.

Metrotek Florida's revenues increased by \$549,000, or 57%, during the third quarter 2007 compared to the third quarter 2006 due to improved market success for its M2M business as well as normal fluctuations in its business as it continues to develop its M2M business and take advantage of new sales opportunities. As discussed below under

Quarterly Fluctuations, Metrotek Florida's revenues have fluctuated significantly in the past and are expected to continue to fluctuate significantly in the future as it continues to develop its M2M business.

Other revenues decreased \$51,000 during the third quarter 2007, as compared to the third quarter 2006. This decrease was comprised principally of a decline in interest earned on cash and cash equivalents balances, the average balance of which also declined during the third quarter 2007 compared to the third quarter 2006.

Costs and Expenses. The following table sets forth our costs and expenses during the periods indicated:

Table of Contents

| | Quarter Ended September | | Quarter-over-Quarter | |
|-------------------------------------|-------------------------|-----------|----------------------|------|
| | 30, | | Difference | |
| | 2007 | 2006 | \$ | % |
| Costs and Expenses: | | | | |
| Costs of Sales and Services | | | | |
| PowerSecure | \$ 15,090 | \$ 20,752 | \$ (5,662) | -27% |
| Southern Flow | 3,000 | 2,849 | 151 | 5% |
| Metrotek Florida | 695 | 454 | 241 | 53% |
| Total | 18,785 | 24,055 | (5,270) | -22% |
| General and administrative | 5,205 | 5,536 | (331) | -6% |
| Selling, marketing and service | 1,358 | 936 | 422 | 45% |
| Depreciation and amortization | 396 | 306 | 90 | 29% |
| Research and development | 199 | 163 | 36 | 22% |
| Interest, finance charges and other | 20 | 14 | 6 | 43% |
| Income taxes | 162 | 150 | 12 | 8% |

Costs of sales and services include materials, personnel and related overhead costs incurred to manufacture products and provide services. The 22% decrease in cost of sales and services for the third quarter 2007, compared to the third quarter 2006, was attributable almost entirely to the decrease in sales at PowerSecure.

The 27% decrease in PowerSecure's costs of sales and services in the third quarter 2007 is a result in part from the 22% decrease in PowerSecure's revenues as well as a result of the factors leading to the improvement in PowerSecure's gross profit margin. PowerSecure's gross profit margin increased to 31.8% during the third quarter 2007, as compared to 26.5% during the third quarter 2006. The favorable increase in PowerSecure's gross profit margin during the third quarter 2007 was due to improved efficiency in our operations, the geographic density of our projects which allowed us to better control and minimize expenses and labor costs, improved management of material costs, and an increase in sales of higher margin products and services.

The 5% increase in Southern Flow's costs of sales and services in the third quarter 2007 is the result of the 4% increase in its revenues. Southern Flow's gross profit margin decreased to 26.8% for the third quarter 2007, compared to 27.7% during the third quarter 2006, which is within the range of normal fluctuations for Southern Flow.

The 53% increase in Metrotek Florida's costs of sales and services in the third quarter 2007 is due to the 57% increase in its revenues. Metrotek Florida's gross profit margin increased to 54.1% for the third quarter 2007, compared to 52.9% during the third quarter 2006, which is within the range of normal fluctuations for Metrotek Florida.

General and administrative expenses include personnel and related overhead costs for the support and administrative functions. The 6% decrease in general and administrative expenses in the third quarter 2007, as compared to the third quarter 2006, was due to a decline in corporate overhead costs related to reduced personnel costs resulting from the recent corporate restructuring partially offset by increases in personnel and related overhead costs associated with the development and growth of PowerSecure's business.

Table of Contents

Selling, marketing and service expenses consist of personnel and related overhead costs, including commissions for sales and marketing activities, together with advertising and promotion costs. The 45% increase in selling, marketing and service expenses in the third quarter 2007, as compared to the third quarter 2006, was due primarily to increased personnel and commission costs at PowerSecure.

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 that do not have indefinite useful lives. The 29% increase in depreciation and amortization expenses in the third quarter 2007, as compared to the third quarter 2006, primarily reflects an increase in depreciable assets acquired by PowerSecure in the latter portions of fiscal 2006 as well as an increase in amortization expense associated with contract rights acquired by PowerSecure in the third quarter of 2006.

Research and development expenses, most of which relate to activities at Metrotek Florida, include payments to third parties, wages and related expenses for personnel, materials costs and related overhead costs related to product and service development, enhancements, upgrades, testing and quality assurance. Historically, our research and development expenses have been incurred primarily at Metrotek Florida. During the third quarter 2007, however, PowerSecure incurred approximately \$6,000 of development expenses for which there was no similar expenditure in the third quarter 2006. The 22% increase in research and development expenses in the third quarter 2007, as compared to the third quarter 2006, primarily reflects the product development costs incurred by PowerSecure together with increased personnel related expenses at Metrotek Florida.

Interest, finance charges and other expenses include interest and finance charges on our credit facility as well as other non-operating expenses. The 43% increase in interest, finance charges and other expenses in the third quarter 2007, as compared to the third quarter 2006, reflects the unused line fee and amortization of financing costs related to our new credit facility.

Income tax expenses include state income taxes in various state jurisdictions in which we have taxable activities as well as federal alternative minimum tax. Historically, we have incurred no federal income tax expense because of our consolidated net operating losses. Since the second half of fiscal 2006, however, we have incurred federal alternative minimum tax. The increase in income taxes in the third quarter 2007, as compared to the third quarter 2006, was due to increases in state income taxes incurred by PowerSecure and Southern Flow in states in which they generated taxable income as well as federal alternative minimum tax.

Equity in Income of Unconsolidated Affiliate. We record equity in income of unconsolidated affiliate due to our ownership of a minority interest in MM 1995-2. During the third quarter 2007, our equity in income of unconsolidated affiliate increased by \$29,000, or 5%, over the third quarter 2006. The performance of MM 1995-2, and our equity in the income of MM 1995-2, was favorably affected by strong market conditions in the oil and gas sector in the region in which it operates.

Table of Contents

Nine Month Period 2007 Compared to Nine Month Period 2006

Revenues. Our consolidated revenues for the nine month period 2007 decreased \$5,465,000, or 6%, compared to the nine month period 2006 due primarily to decreases in revenues at PowerSecure and Southern Flow, partially offset by an increases in Metretek Florida revenue and other revenues.

PowerSecure's revenues decreased \$6,707,000, or 10%, during the nine month period 2007 compared to the nine month period 2006. The decrease in PowerSecure's revenues during the nine month period 2007 compared to the nine month period 2006 was due to a decrease in Publix related revenues of \$3,509,000 and a decrease revenues from other customers of \$3,198,000. While PowerSecure's backlog of work that it has been awarded continues to increase (currently in excess of \$100,000,000), the timing of the work performed and the effect of the percentage of completion of in-process projects during the nine month period 2007 resulted in the decrease in revenues compared to the nine month period 2006.

Southern Flow's revenues decreased \$276,000, or 2%, during the nine month period 2007, as compared to the nine month period 2006, due to a \$930,000 decline in equipment sales, partially offset by an increase of \$655,000 in field and service related revenues. The decline in equipment sales is due to nine month period 2006 sales activity related to customers repairing damage from Hurricanes Rita and Katrina in late 2005. There were no similar equipment sales for hurricane repairs in the nine month period 2007. The increase in field and other service related revenue in the nine month period 2007 is due to continued favorable market conditions in the oil and gas sector.

Metretek Florida's revenues increased by \$1,159,000, or 45%, during the nine month period 2007 compared to the nine month period 2006 due to normal fluctuations in its business as it continues to develop its M2M business and take advantage of new sales opportunities. As discussed below under *Quarterly Fluctuations*, Metretek Florida's revenues have fluctuated significantly in the past and are expected to continue to fluctuate significantly in the future as it continues to develop its M2M business.

Other revenues increased \$359,000 during the nine month period 2007, as compared to the nine month period 2006. This increase was comprised principally of insurance proceeds from a fire claim at Southern Flow as well as interest earned on cash and cash equivalents balances which resulted from the net proceeds of our 2006 private placement which occurred in the second quarter 2006.

Costs and Expenses. The following table sets forth our costs and expenses during the periods indicated:

Table of Contents

| | Nine Months Ended September | | Period-over-Period | |
|-------------------------------------|-----------------------------|---------------|--------------------|-------------|
| | 30, | | Difference | |
| | 2007 | 2006 | \$ | % |
| | (In thousands) | | | |
| Costs and Expenses: | | | | |
| Costs of Sales and Services | | | | |
| PowerSecure | \$ 44,424 | \$ 50,627 | \$ (6,203) | -12% |
| Southern Flow | 8,688 | 8,878 | (190) | -2% |
| Metretek Florida | 1,567 | 1,075 | 492 | 46% |
| Total | 54,679 | 60,580 | (5,901) | -10% |
| General and administrative | 15,714 | 13,474 | 2,240 | 17% |
| Selling, marketing and service | 3,233 | 2,868 | 365 | 13% |
| Depreciation and amortization | 1,113 | 683 | 430 | 63% |
| Research and development | 698 | 536 | 162 | 30% |
| Restructuring charges | 14,139 | | 14,139 | na |
| Interest, finance charges and other | 36 | 149 | (113) | -76% |
| Income taxes | 638 | 262 | 376 | 144% |

The overall 10% decrease in cost of sales and services for the nine month period 2007, compared to the nine month period 2006, was attributable almost entirely to the decrease in sales at PowerSecure and Southern Flow.

The 12% decrease in PowerSecure's costs of sales and services in the nine month period 2007 is almost entirely a direct result of the 10% decrease in its revenues. PowerSecure's gross profit margin increased to 28.6% during the nine month period 2007, as compared to 26.6% during the nine month period 2006. The gross profit margins during both nine month periods are slightly lower than PowerSecure's normal gross profit margin reflecting some embedded margin reduction priced into the Publix projects to induce those large orders as well as higher than expected material costs during those periods. The improvement in PowerSecure's gross profit margin during the nine month period 2007 as compared to the nine month period 2006 was due to improved efficiency in our operations, the geographic density of our projects which allowed us to better control and minimize expenses and labor costs, improved management of material costs, and an increase in sales of higher margin products and services.

The 2% decrease in Southern Flow's costs of sales and services in the nine month period 2007 is the result of the 2% decrease in its revenues. Southern Flow's gross profit margin decreased slightly to 27.5% for the nine month period 2007, compared to 27.6% during the nine month period 2006, which is within the range of normal fluctuations for Southern Flow.

The 48% increase in Metretek Florida's costs of sales and services in the nine month period 2007 is due to the 45% increase in its revenues. Metretek Florida's gross profit margin decreased slightly to 57.7% for the nine month period 2007, compared to 57.8% during the nine month period 2006, which is within the range of normal fluctuations for Metretek Florida.

The 17% increase in general and administrative expenses in the nine month period 2007, as compared to the nine month period 2006, was due to increases in personnel and related overhead costs associated with the development and growth of PowerSecure's business.

Table of Contents

The 13% increase in selling, marketing and service expenses in the nine month period 2007, as compared to the nine month period 2006, was due primarily to increased personnel and commission costs at PowerSecure and at Metretek Florida.

The 63% increase in depreciation and amortization expenses in the nine month period 2007, as compared to the nine month period 2006, primarily reflects an increase in depreciable assets acquired by PowerSecure in the latter portions of fiscal 2006 as well as an increase in amortization expense associated with contract rights acquired by PowerSecure in the third quarter of 2006.

The 30% increase in research and development expenses in the nine month period 2007, as compared to the nine month period 2006, primarily reflects the product development costs incurred by PowerSecure together with increased personnel related expenses at Metretek Florida.

Restructuring charges of \$14,139,000 during the nine month period 2007, include the severance, consulting and incentive compensation incurred in connection with the employment and separation agreements related to the retirement of our two founders, and costs associated with the relocation of our corporate offices from Denver to PowerSecure's offices in Wake Forest, North Carolina, including severance benefits payable to personnel who were not relocated.

The 76% decrease in interest, finance charges and other expenses in the nine month period 2007, as compared to the nine month period 2006, reflects the repayment of all of our long-term debt obligations, during the second quarter 2006.

The 144% increase in income taxes in the nine month period 2007, as compared to the nine month period 2006, was due to increases in state income taxes incurred by PowerSecure and Southern Flow in states in which they generated taxable income as well as federal alternative minimum tax.

Equity in Income of Unconsolidated Affiliate. During the nine month period 2007, our equity in income of unconsolidated affiliate increased by \$171,000, or 9%, over the nine month period 2006, net of minority interests held by others in 2006. The performance of MM 1995-2, and our equity in the income of MM 1995-2, was favorably affected by strong market conditions in the oil and gas sector in the region in which it operates.

Income from Litigation Settlements. During the fourth quarter of fiscal 2006, we agreed to settlements of outstanding litigation claims against some of the other parties involved in a class action lawsuit that we had previously settled with the class. As a result of these settlements, we recorded income from litigation settlements in the amount of \$343,000 during fiscal 2006. During the nine month period 2007, we settled with all of the other remaining parties and we recorded additional income from litigation settlements in the amount of \$385,000. No additional claims are outstanding at September 30, 2007.

Table of Contents

Quarterly Fluctuations

Our revenues, expenses, margins, net income 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. These factors include, without limitation, the following:

the size, timing and terms of sales and orders, including large customer orders, such as the recent significant orders at PowerSecure, as well as the effects of customers delaying, deferring or canceling purchase orders or making smaller purchases than expected;

the effects of severe weather conditions, such as hurricanes, on the demand requirements of our customers;

our ability to obtain adequate supplies of key components and materials for our products on a timely and cost-effective basis;

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

the pace of development of our new businesses, including PowerSecure's new businesses, and the growth of their markets;

the timing, pricing and market acceptance of our new products and services;

changes in our pricing policies and those of our competitors;

variations in the length of our product and service implementation process;

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

changes in the mix of international and domestic revenues;

the life cycles of our products and services;

budgeting cycles of utilities and other major customers;

general economic and political conditions;

the effects of litigation, claims and other proceedings;

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

economic conditions in the energy industry, especially in the natural gas and electricity sectors including the effect of cyclical changes in energy prices;

changes in the prices charged by our suppliers;

our ability to make and obtain the expected benefits from acquisitions of technology or businesses, and the costs related to such acquisitions;

changes in our operating expenses; and

the development and maintenance of business relationships with strategic partners.

Table of Contents

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

Our revenues and other operating results are heavily dependant upon the volume and timing of customer orders and payments and the date of product delivery. The timing of large individual sales is difficult for us to predict. Because our operating expenses are based on anticipated revenues and because a high percentage of these are relatively fixed, a shortfall or delay in recognizing revenue could cause our operating results to vary significantly from quarter-to-quarter and could result in significant operating losses in any particular quarter. If our revenues fall below our expectations in any particular quarter, we may not be able to reduce our expenses rapidly in response to the shortfall, which could result in us suffering significant operating losses in that quarter.

Over PowerSecure's seven year operating history, its revenues, costs, gross margins, cash flow, net income and other operating results have varied from quarter-to-quarter, period-to-period and year-to-year for a number of reasons, including the factors mentioned above, and we expect such fluctuations to continue in the future. PowerSecure's revenues depend in large part upon the timing and the size of projects awarded to PowerSecure, such as the recent significant orders received by PowerSecure, and the timing of the completion of those projects. As PowerSecure develops new related lines of business, its revenues and costs will fluctuate as it takes time for revenues to develop, but also requires start-up expenses. Another factor that could cause material fluctuations in PowerSecure's quarterly results is the amount of recurring, as opposed to non-recurring, sources of revenue. To date, the majority of PowerSecure's revenues have consisted of non-recurring revenues.

Southern Flow's operating results tend to vary, to some extent, with energy prices, especially the price of natural gas. For example, in recent years, the high price of natural gas has led to an increase in production activity by Southern Flow's customers, resulting in higher revenues and net income by Southern Flow. Since energy prices tend to be cyclical, rather than stable, future cyclical changes in energy prices are likely to affect Southern Flow's future revenues and net income. In addition, Southern Flow's Gulf Coast customers are exposed to the risks of hurricanes and tropical storms, which can adversely affect Southern Flow's results of operations during hurricane season, such as during fiscal 2005, and which can positively affect Southern Flow's revenues in subsequent periods, such as during fiscal 2006.

Metrotek Florida has historically derived most of its revenues from sales of its products and services to the utility industry. Metrotek Florida has experienced variability in its operating results on both an annual and a quarterly basis due primarily to utility purchasing patterns and delays of purchasing decisions as a result of mergers and acquisitions in the utility industry and changes or potential changes to the federal and state regulatory frameworks within which the utility industry operates. The utility industry, both domestic and foreign, is generally characterized by long budgeting, purchasing and regulatory process cycles that can take up to several years to complete. In addition, Metrotek Florida has only a limited operating history

Table of Contents

with its new M2M and telemetry business, and its operating results in this new business may fluctuate significantly as it develops this business.

Due to all of these factors and the other risks discussed in this Report and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006, you should not rely on quarter-to-quarter, period-to-period or year-to-year comparisons of our results of operations 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

Capital Requirements. We require capital primarily to finance our:

operations;

inventory;

accounts receivable;

research and development efforts;

property and equipment acquisitions, including investments in shared savings projects;

software development;

debt service requirements;

severance and incentive compensation obligations under separation agreements with our prior President and Chief Financial Officer; and

business and technology acquisitions and other growth transactions.

Cash Flow. We have historically financed our operations and growth primarily through a combination of cash on hand, cash generated from operations, borrowings under credit facilities, borrowings on other project or term loans, and proceeds from private and public sales of equity. At September 30, 2007, we had working capital of \$34,115,000, including \$26,594,000 in cash and cash equivalents, compared to working capital of \$38,844,000 on December 31, 2006, which included \$15,916,000 in cash and cash equivalents. At September 30, 2007, we had \$25,000,000 of additional borrowing capacity and at December 31, 2006, we had \$4,500,000 of additional borrowing capacity from our credit facilities available to support working capital needs.

Net cash provided by operating activities was \$11,121,000 in the nine month period 2007, consisting of approximately \$7,539,000 of cash provided by operations, before changes in assets and liabilities, approximately \$3,580,000 of cash provided by changes in working capital and other asset and liability accounts (including \$3,686,000 of cash used to fund a portion of the severance obligations of our retired founders) and approximately \$2,000 of cash provided by discontinued operations of MCM. This compares to net cash used in operating activities of \$4,651,000 in the nine month period 2006, consisting of approximately \$7,625,000 of cash provided by operations, before changes in assets and liabilities, approximately \$12,324,000 of cash used by changes in working capital and other asset and liability accounts, and approximately \$48,000 of cash provided by discontinued operations of MCM.

Net cash used in investing activities was \$1,240,000 in the nine month period 2007, as

Table of Contents

compared to net cash used in investing activities of \$3,952,000 in the nine month period 2006. The majority of the net cash used by investing activities during the nine month period 2007 was attributable to the purchase of equipment at PowerSecure and Southern Flow and the purchase of software at PowerSecure. The net cash used by investing activities during the nine month period 2006 was attributable to contract rights acquired by PowerSecure, the purchase of our additional investment in our unconsolidated affiliate, and the purchase of equipment and leasehold improvements at PowerSecure.

Net cash provided by financing activities was \$797,000 in the nine month period 2007, compared to net cash provided by financing activities of \$24,420,000 in the nine month period 2006. The majority of the net cash provided by financing activities during the nine month period 2007 was attributable to proceeds from the exercise of stock options, partially offset by cash payments on our preferred stock redemptions. The majority of the net cash provided by financing activities during the nine month period 2006 was attributable to cash proceeds from a private placement of 2,012,548 shares of our common stock at a price of \$14.00 per share, raising gross proceeds of \$28,176,000, partially offset by net payments on our line of credit and principal payments on our long-term notes payable.

Our research and development expenses totaled \$698,000 during the nine month period 2007 compared to \$536,000 during the nine month period 2006. The majority of our nine month period 2007 research and development expenses were directed toward the enhancement of Metretek Florida's business, including the development of its M2M communications products. During fiscal 2007, we plan to continue our research and development efforts to enhance our existing products and services and to develop new products and services. We anticipate that our research and development expenses in fiscal 2007 will total approximately \$890,000, the majority of which will be directed to Metretek Florida's business.

Our capital expenditures during the nine month period 2007 were approximately \$1,242,000, of which \$842,000 was incurred at PowerSecure. Our nine month period 2007 capital expenditures also included \$334,000 incurred at Southern Flow, largely to replace equipment items lost or damaged in a fire at its facility in Lafayette, Louisiana. During the nine month period 2006, our capital expenditures were approximately \$2,708,000, the vast majority of which was incurred for the purchase of contract rights, miscellaneous equipment items and leasehold improvements at PowerSecure. We anticipate capital expenditures in fiscal 2007 of approximately \$1.5 million, the vast majority of which will be for the benefit of the business of PowerSecure. In addition, we may incur up to an additional \$700,000 in capital expenditures for PowerSecure's shared savings distributed generation projects during fiscal 2007.

Restructuring Obligations. On April 16, 2007, our founders, W. Phillip Marcum, the former Chairman of the Board, President and Chief Executive Officer, and A. Bradley Gabbard, the former Executive Vice President and Chief Financial Officer, retired from and terminated their employment with us. In connection with their retirement, Messrs. Marcum and Gabbard each entered into separation agreements with us. The separation agreements were approved by the Compensation Committee of our Board of Directors. Under the separation agreements, we

Table of Contents

will pay Messrs. Marcum and Gabbard severance payments, for a period of three years for Mr. Marcum and two years for Mr. Gabbard, on regular payroll dates in aggregate amounts equal to \$2,810,990, for Mr. Marcum, and \$1,310,540 for Mr. Gabbard. The severance payments are payable as follows: \$468,498 plus interest thereon of \$11,712 to Mr. Marcum, and \$327,635 plus interest thereon of \$8,191 to Mr. Gabbard, are due on October 18, 2007, and the remainder are due in equal installments over the severance period on the Company's regular payroll dates. These severance payments were required by, and were established in accordance with, the employment agreements of Messrs. Marcum and Gabbard.

We will also pay incentive compensation to Messrs. Marcum and Gabbard, as required by their employment agreements, in an aggregate amount of \$4,400,000 to Mr. Marcum and \$3,600,000 to Mr. Gabbard. The incentive compensation to Messrs. Marcum and Gabbard is payable as follows: \$3,382,500 to Mr. Marcum and \$2,767,500 to Mr. Gabbard (including interest at the simple rate of 5% per annum) on October 18, 2007, and the remaining \$1,100,000 to Mr. Marcum and the remaining \$900,000 to Mr. Gabbard on June 15, 2008, plus interest at the simple rate of five percent (5%) per annum.

On April 24, 2007, we deposited into an escrow account with Zions First National Bank, as escrow agent, the sum of \$1,630,272 for Mr. Marcum and \$1,303,880 for Mr. Gabbard pursuant to an escrow agreement. The amounts represent the amounts payable to Messrs. Marcum and Gabbard on the Initial Payment Date less required tax withholdings. The escrowed funds were released from escrow on October 18, 2007 and paid over to Messrs. Marcum and Gabbard by the escrow agent.

In connection with the restructuring, we have relocated our headquarters to PowerSecure's offices in Wake Forest, North Carolina. We recorded a pre-tax non-recurring restructuring charge in the amount of \$14,139,000 during the nine months ended September 30, 2007, which includes all amounts payable under the various separation agreements as well as certain related costs. The restructuring charge also includes amounts we are obligated to pay to certain employees who were not relocated to the new corporate headquarters in Wake Forest, North Carolina, as well as early lease termination penalties and other charges we are obligated to pay as a result of our relocation. Through September 30, 2007, we have paid \$3,686,000 of our total severance obligations. We expect the restructuring and relocation will result in annual savings of approximately \$2.4 million, the effects of which will be recognized for accounting purposes as those savings are realized.

Equipment Line of Credit. On May 9, 2005, Caterpillar Financial Services Corporation offered PowerSecure a \$5,000,000 equipment line of credit, which was increased to \$7,500,000 on May 18, 2006, and which was renewed by Caterpillar on July 16, 2007, until July 31, 2008, or at an earlier date upon notice to PowerSecure in the sole discretion of Caterpillar. The equipment line is available to finance the purchase, from time to time, of Caterpillar generators used in PowerSecure projects, primarily in shared savings arrangements, pursuant to a letter by Caterpillar to PowerSecure containing the terms of this credit line.

Table of Contents

Under the Caterpillar equipment line, PowerSecure may submit equipment purchases to Caterpillar for financing, and Caterpillar may provide such financing in its discretion at an interest rate, for a period of time between 12 and 60 months and upon such financing instruments, such as a promissory note or an installment sales contract, as are set by Caterpillar on a project by project basis. The letter from Caterpillar provides that the equipment line is not an unconditional binding commitment to provide such financing and that the equipment line is contingent upon the continued credit-worthiness of PowerSecure in the sole discretion of Caterpillar.

With respect to any equipment financed by Caterpillar, PowerSecure must make a 10% cash down payment of the purchase price and grant to Caterpillar a first priority security interest in the equipment being financed as well as other equipment related to the project. At September 30, 2007, PowerSecure had the full \$7.5 million available for additional equipment purchases under the equipment line of credit.

Working Capital Credit Facility. On August 23, 2007, we entered into a Credit Agreement (the "Credit Agreement") with Citibank, N.A., as the administrative agent, and the other lenders party thereto, providing for a \$25 million senior, first-priority secured revolving and term credit facility. The credit facility is guaranteed by all of our active subsidiaries and secured by our assets and the assets of our subsidiaries. The credit facility matures on August 23, 2010. The Credit Facility is a refinancing and expansion of the Company's prior credit facility with First National Bank of Colorado ("FNBC"). The Credit Facility is expected to be used primarily to fund the growth and expansion of PowerSecure, as well as the growth of Southern Flow.

While the credit facility primarily functions as a \$25 million revolving line of credit, we can carve out up to three term loans, in an aggregate amount of up to \$5 million, to fund acquisitions, with each term loan having the tenor and amortization of seven years and maturing on August 23, 2015 (if made before August 23, 2007) or August 23, 2016 (if made on or after August 23, 2008). Any amounts borrowed under any term loans reduce the aggregate amount of the revolving loan available for borrowing.

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 125 basis points to 200 basis points based upon our leverage ratio, or at Citibank's alternate base rate plus an applicable margin, on a sliding scale ranging from minus 25 basis points to plus 50 basis points based upon our leverage ratio. Our leverage ratio is the ratio of our funded indebtedness as of a given date to our consolidated earnings before interest, taxes, depreciation and amortization ("EBITDA") 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%, and Citibank's prime commercial lending rate. Through September 30, 2007, we had not borrowed any amounts under the credit facility.

The credit facility is not subject to any borrowing base computations or limitations, but

Table of Contents

does contain certain financial covenants that we must meet. Our maximum leverage ratio cannot exceed 2.75. Our minimum fixed charge coverage ratio must be in excess of 1.75, where fixed charge coverage ratio is defined as the ratio of the aggregate of our trailing 12 month consolidated EBITDA plus our lease or rent expense minus our cash taxes, divided by the sum of our consolidated interest charges plus our lease or rent expenses plus our scheduled principal payments and dividends, computed over the previous period. Also, our minimum asset coverage must be in excess of 1.25, where asset coverage is defined as the summation of 80% of the book value of accounts receivable plus 60% of the book value of inventory plus 50% of the book value of net fixed assets, divided by total funded debt outstanding less any acquisition term debt. At September 30, 2007, we were in compliance with these financial covenants.

Prior to August 23, 2007, we had a credit facility with First National Bank of Colorado that provided for a \$4.5 million revolving credit facility. Southern Flow and PowerSecure were the borrowers under the credit facility. Amounts, if any, borrowed under the credit facility bore interest at the lender's prime rate. The credit facility had been used primarily to fund the operations and growth of PowerSecure, as well as the operations of Southern Flow and Metrotek Florida. In April 2006, upon completion of the 2006 private placement, we paid down our credit facility balances to \$0 and had not borrowed on the credit facility since that time.

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 \$1,000 per share plus accumulated and unpaid dividends. Our remaining redemption obligation at September 30, 2007, to holders of outstanding shares of Series B preferred stock that have not been redeemed, is approximately \$104,000.

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. To the extent we borrow under our credit facility or under the Caterpillar equipment line, we are obligated to make future payments under those facilities. Also, as discussed in Note 7, *Income Taxes* of the Notes to the Consolidated Financial Statements, we adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* an interpretation of FASB Statement No. 109 as of January 1, 2007. At September 30, 2007, we had a liability for unrecognized tax benefits and payment of related interest and penalties totaling \$348,000. 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 when cash settlement with a taxing authority will occur. Accordingly, the table information below, which is as of September 30, 2007, does not include the liability for unrecognized tax benefits:

Table of Contents

| | Total | Payments Due by Period (1) | | | |
|---------------------------------------|----------------------|----------------------------|---------------------|---------------------|---------------------|
| | | Remainder of 2007 | Years 2008-2009 | Years 2010-2011 | After 2011 |
| <u>Contractual Obligations</u> | | | | | |
| Credit Facility (2) | \$ | \$ | \$ | \$ | \$ |
| Restructuring Obligations | 10,455,000 | 4,805,000 | 5,295,000 | 355,000 | |
| Capital Lease Obligations | 9,000 | 1,000 | 4,000 | 4,000 | |
| Operating Leases | 4,276,000 | 255,000 | 1,725,000 | 880,000 | 1,416,000 |
| Series B Preferred Stock | 104,000 | 104,000 | | | |
| Caterpillar Equipment Line (2) | | | | | |
| Total | \$ 14,844,000 | \$ 5,165,000 | \$ 7,024,000 | \$ 1,239,000 | \$ 1,416,000 |

(1) Does not include interest that may become due and payable on such obligations in any future period.

(2) Total repayments are based upon borrowings outstanding as of September 30, 2007, not projected borrowings.

Off-Balance Sheet Arrangements. During the nine month period 2007, 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.

Liquidity. Based upon our plans and assumptions as of the date of this report, we currently 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, research and development, capital expenditures, severance and incentive compensation obligations, 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 below in this Item and Part II, Item 1A Risk Factors below. 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 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.

Recent Accounting Pronouncements

In February 2006, the Financial Accounting Standards Board (FASB) issued FAS No. 155, Accounting for Certain Hybrid Financial Instruments-an amendment of FASB Statements No. 133 and 140 (FAS 155). FAS 155 eliminates the exemption from applying FASB

Table of Contents

Statement No. 133 to interests in securitized financial assets. FAS 155 became effective for us on January 1, 2007. The adoption of FAS 155 had no effect on our financial position or results of operations.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* an Interpretation of FASB Statement No. 109 (*FIN 48*). FIN 48 clarifies the accounting for uncertainty in income taxes by prescribing a minimum recognition threshold for a tax position taken or expected to be taken in a tax return that is required to be met before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The cumulative effect of adopting FIN 48 of \$348,000 was recorded as an increase to our accumulated deficit, which would otherwise have increased our income tax expense in prior periods.

In September 2006, the FASB issued FAS No. 157, *Fair Value Measurements* (*FAS 157*). FAS 157 defines fair value to measure assets and liabilities, establishes a framework for measuring fair value, and requires additional disclosures about the use of fair value. FAS 157 is applicable whenever another accounting pronouncement requires or permits assets and liabilities to be measured at fair value. FAS 157 does not expand or require any new fair value measures. FAS 157 will become effective for us on January 1, 2008. We are currently evaluating the impact that the adoption of FAS 157 will have on our financial position and results of operations.

In February 2007, the FASB issued FAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (*FAS 159*), which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. FAS 159 will be effective for us on January 1, 2008. We are currently evaluating the impact that the adoption of FAS 159 will have on our financial position and results of operations.

In September 2006, the FASB ratified the consensus on the guidance provided by Emerging Issues Task Force (*EITF*) No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*. The guidance is applicable to endorsement split-dollar life insurance arrangements, whereby the employer owns and controls the insurance policy, that are associated with a postretirement benefit. EITF No. 06-4 requires that for a split-dollar life insurance arrangement within the scope of the issue, an employer should recognize a liability for future benefits in accordance with SFAS No. 106 (if, in substance, a postretirement benefit plan exists) or Accounting Principles Board Opinion No. 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. EITF No. 06-4 is effective for fiscal years beginning after December 15, 2007. We are currently evaluating the impact the adoption of the standard will have on our financial position and results of operations.

In March 2007, the FASB ratified the consensus reached by the EITF on Issue No. 06-10, *Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements*. EITF

Table of Contents

No. 06-10 provides guidance on an employers' recognition of a liability and related compensation costs for collateral assignment split-dollar life insurance arrangements that provide a benefit to an employee that extends into postretirement periods and the asset in collateral assignment split-dollar life insurance arrangements. The effective date of EITF No. 06-10 is for fiscal years beginning after December 15, 2007. We are currently evaluating the impact that the adoption of the standard will have on our financial condition and results of operations.

Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q (this Report) contains forward-looking statements within the meaning of and made under the safe harbor provisions of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). 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, expect, plan, potential, opportunity and scheduled, variations of such words, and other comparable terminology 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 revenues, expenses, net income, margins, profitability, cash flow, liquidity, financial condition and results of operations;

our products and services and our markets, including market position, market share, market demand and benefits to customers;

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

our business plans, strategies, goals and objectives;

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

industry trends and customer preferences;

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

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

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

future economic, business, market and regulatory conditions.

Any forward-looking statements we make are based on our current plans, intentions,

Table of Contents

objectives, goals, strategies, hopes, beliefs, projections and expectations, as well as assumptions made by and information currently available to management. You are cautioned not to place undue reliance on any forward-looking statements, any or all of which could turn out to be wrong. 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 we might make that do not materialize or 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 identified in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006, 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 other factors discussed elsewhere in this Report and in our other reports and documents filed from time to time with the SEC.

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 speaks only as of the date it is made. We undertake no duty or obligation to update or revise any forward-looking statement for any reason, whether as a result of changes in our expectations or the underlying assumptions, the receipt of new information, occurrence of future or unanticipated events, circumstances or conditions or otherwise.

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 are primarily due to changes in interest rates, foreign exchange rates and commodity prices, which may adversely affect our financial condition, results of operations and cash flow.

Our exposure to market risk resulting from changes in interest rates relates primarily to income from our investments in short-term interest-bearing marketable securities, which is dependent upon the interest rate of the securities held, and to interest expenses attributable to our credit facility, which is based on floating interest rates as described in Item 2. Management's Discussion and Analysis of Financial Conditions and Results of Operations of this report.

At September 30, 2007, our cash and cash equivalent balance was approximately \$26.6 million and our credit facility had a zero balance. All of our cash equivalents are currently invested in money market mutual funds, short-term time deposits, and government agency and corporate obligations, the income of which generally increases or decreases in proportion to increases or decreases, respectively, in interest rates. 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, a change of 1% (100 basis points) in the interest rate on either our investments or any future reasonably likely borrowings would not have a material impact on our financial condition, results of operations or cash flow.

Table of Contents

Since substantially all of our revenues, expenses and capital spending are transacted in U.S. dollars, we are not exposed to significant foreign exchange risk. However, from time to time we are subject to market risk from fluctuating commodity prices in certain raw materials we use.

We do not use derivative financial instruments to manage or hedge our exposure to interest rate changes or other market risks, or for trading or other speculative purposes.

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 our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of September 30, 2007, the end of the period covered by this Report. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the 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

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Limitations in Control Systems

Because of its inherent limitations, any control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered 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. 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.

Table of Contents

**PART II
OTHER INFORMATION**

Item 1. Legal Proceedings

From time to time, we are involved in disputes and legal proceedings. Our material legal proceedings are described in note 9 to our consolidated financial statements, Commitments and Contingencies and Income from Litigation Settlements, which is set forth in Item 1 of Part I of this Report and incorporated in this item by reference.

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, 2006, which have not materially changed as of the date of this Report.

Item 6. Exhibits

- 3.1 Certificate of Ownership and Merger, as filed with the Secretary of State of the State of Delaware on August 22, 2007, merging PowerSecure International, Inc. into Metrotek Technologies, Inc. and amending Registrant's Second Amended and Restated Certificate of Incorporation to change the Registrant's name to PowerSecure International, Inc. (Incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on August 22, 2007.)
- 3.2 Amended and Restated By-Laws of PowerSecure International, Inc., as of August 22, 2007 (Incorporated by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K filed on August 22, 2007.)
- 10.1 Credit Agreement, dated as of August 23, 2007, among PowerSecure International, Inc., the financial institutions from time to time parties thereto as lenders, and Citibank, N.A., as administrative agent (Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on August 24, 2007.)
- 10.2 Form of Security Agreement, dated as of August 23, 2007, by each of PowerSecure International, Inc. and its active subsidiaries in favor of Citibank, N.A., as administrative agent, as secured party (Incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on August 24, 2007.)

Table of Contents

- 10.3 Form of Guaranty, dated as of August 23, 2007, by each active subsidiary of PowerSecure International, Inc. in favor of Citibank, N.A., as administrative agent (Incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on August 24, 2007.)
- 10.4 Employment and Non-Competition Agreement, dated as of August 15, 2007, by and between Metrotek Technologies, Inc. and Sidney Hinton (Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on August 15, 2007.)
- 10.5 Restricted Stock Agreement, dated as of August 15, 2007, by and between Metrotek Technologies, Inc. and Sidney Hinton (Filed herewith.)
- 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.)

Table of Contents

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: November 6, 2007

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

Date: November 6, 2007

By: /s/ Gary Zuiderveen
Gary Zuiderveen
Vice President and Chief Financial
Officer

49