POWERSECURE INTERNATIONAL, INC.
Form 10-Q
November 03, 2011

Table of Contents

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2011

or

o **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	84-1169358
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1609 Heritage Commerce Court Wake Forest, North Carolina	27587
(Address of principal executive offices)	(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 þ No o

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

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

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o	Smaller reporting company o

(Do not check if a smaller reporting company)

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

As of November 1, 2011, 18,965,612 shares of the issuer s Common Stock were outstanding.

POWERSECURE INTERNATIONAL, INC.
FORM 10-Q
For the Quarterly Period Ended September 30, 2011
TABLE OF CONTENTS

	Page
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements	
Unaudited Consolidated Balance Sheets September 30, 2011 and December 31, 2010	3
Unaudited Consolidated Statements of Operations For the Three and Nine Months Ended September 30, 2011 and September 30, 2010	5
Unaudited Consolidated Statements of Cash Flows For the Nine Months Ended September 30, 2011 and September 30, 2010	6
Notes to Unaudited Consolidated Financial Statements	7
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	29
Item 3. Quantitative and Qualitative Disclosures About Market Risk	62
Item 4. Controls and Procedures	63
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	65
Item 1A. Risk Factors	65
Item 6. Exhibits	66
Signatures	67

Exhibit 31.1
Exhibit 31.2
Exhibit 32.1
Exhibit 32.2
EX-101 INSTANCE DOCUMENT
EX-101 SCHEMA DOCUMENT
EX-101 CALCULATION LINKBASE DOCUMENT
EX-101 LABELS LINKBASE DOCUMENT
EX-101 PRESENTATION LINKBASE DOCUMENT
EX-101 DEFINITION LINKBASE DOCUMENT

Table of Contents

PART I.
FINANCIAL INFORMATION

Item 1. Financial Statements

POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (unaudited)
(in thousands, except share data)

	September 30, 2011	December 31, 2010
Assets		
Current Assets:		
Cash and cash equivalents	$ 32,692	$ 8,202
Trade receivables, net of allowance for doubtful accounts of $398 and $415, respectively	47,322	29,290
Assets of discontinued operations held for sale		12,183
Inventories	24,441	25,011
Current deferred income taxes	1,667	1,731
Prepaid expenses and other current assets	658	933
Total current assets	106,780	77,350
Property, plant and equipment:		
Equipment	35,660	24,946
Furniture and fixtures	281	280
Land, building and improvements	5,874	5,720
Total property, plant and equipment, at cost	41,815	30,946
Less accumulated depreciation and amortization	7,485	5,899
Property, plant and equipment, net	34,330	25,047
Other assets:		
Goodwill	7,970	7,970
Deferred income taxes, net of current portion	154	1,244
Restricted annuity contract	2,358	2,306
Intangible rights and capitalized software costs, net of accumulated amortization of $2,973 and $2,463, respectively	1,768	1,942
Investment in unconsolidated affiliate	195	4,346
Other assets	273	324
Total other assets	12,718	18,132

Total Assets	$	153,828	$	120,529

See accompanying notes to consolidated financial statements.

Table of Contents

POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (unaudited)
(in thousands, except share data)

	September 30, 2011	December 31, 2010
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 8,549	$ 8,438
Accrued and other liabilities	16,629	10,986
Liabilities of discontinued operations held for sale		1,411
Current income taxes payable	395	251
Current unrecognized tax benefit	287	954
Current portion of capital lease obligations	828	796
Total current liabilities	26,688	22,836
Long-term liabilites:		
Revolving line of credit	10,000	5,000
Capital lease obligations, net of current portion	3,022	3,647
Unrecognized tax benefit	731	749
Other long-term liabilities	2,236	1,053
Total long-term liabilities	15,989	10,449
Commitments and contingencies (Notes 8 and 10)		
Stockholders Equity:		
PowerSecure International stockholders equity:		
Preferred stock undesignated, $.01 par value; 2,000,000 shares authorized; none issued and outstanding		
Preferred stock Series C, $.01 par value; 500,000 shares authorized; none issued and outstanding		
Common stock, $.01 par value; 25,000,000 shares authorized; 18,965,612 and 18,701,614 shares issued and outstanding, respectively	190	187
Additional paid-in-capital	116,308	114,791
Accumulated deficit	(6,529)	(29,489)
Total PowerSecure International, Inc. stockholders equity	109,969	85,489
Noncontrolling interest	1,182	1,755
Total stockholders equity	111,151	87,244

Total Liabilities and Stockholders Equity	$ 153,828	$ 120,529

See accompanying notes to consolidated financial statements.

Table of Contents

POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Revenues	$ 38,229	$ 26,316	$ 92,159	$ 76,509
Cost of sales	26,582	17,747	65,183	50,098
Gross profit	11,647	8,569	26,976	26,411
Operating expenses:				
General and administrative	9,168	7,388	25,596	21,176
Selling, marketing and service	1,279	1,383	3,657	3,777
Depreciation and amortization	858	756	2,499	2,011
Total operating expenses	11,305	9,527	31,752	26,964
Operating income (loss)	342	(958)	(4,776)	(553)
Other income and (expenses):				
Gain on sale of unconsolidated affiliate	44		21,830	
Equity income from unconsolidated affiliate		598	1,559	2,435
Management fees		136	282	432
Interest income and other income	31	24	73	77
Interest expense	(168)	(177)	(454)	(457)
Income (loss) before income taxes	249	(377)	18,514	1,934
Income tax benefit (provision)	493	(42)	(1,763)	(475)
Income (loss) from continuing operations	742	(419)	16,751	1,459
Discontinued operations (Note 4):				
Income from operations, net of tax		777		1,587
Gain on disposal, net of tax			5,636	
Income from discontinued operations, net of tax		777	5,636	1,587
Net income	742	358	22,387	3,046
	230	132	573	(15)

Less: Net (income) loss attributable to noncontrolling interest				
Net income attributable to PowerSecure International, Inc.	$ 972	$ 490	$ 22,960	$ 3,031
Amounts attributable to PowerSecure International, Inc. common stockholders:				
Income (loss) from continuing operations, net of tax	$ 972	$ (287)	$ 17,324	$ 1,444
Income from discontinued operations, net of tax	0	777	5,636	1,587
Net income	$ 972	$ 490	$ 22,960	$ 3,031
Basic earnings per share attributable to PowerSecure International, Inc. common stockholders:				
Income (loss) from continuing operations	$ 0.05	$ (0.01)	$ 0.92	$ 0.08
Income from discontinued operations	.00	0.04	0.30	0.09
Net income attributable to PowerSecure International, Inc. common stockholders	$ 0.05	$ 0.03	$ 1.22	$ 0.17
Diluted earnings per share attributable to PowerSecure International, Inc. common stockholders:				
Income (loss) from continuing operations	$ 0.05	$ (0.01)	$ 0.91	$ 0.08
Income from discontinued operations	.00	0.04	0.29	0.08
Net income attributable to PowerSecure International, Inc. common stockholders	$ 0.05	$ 0.03	$ 1.20	$ 0.16

See accompanying notes to consolidated financial statements.

Table of Contents

POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)
(in thousands)

	Nine Months Ended September 30,	
	2011	**2010**
Cash flows from operating activities:		
Net income	$ 22,387	$ 3,046
Adjustments to reconcile net income to net cash used in operating activities:		
Gain on sale of unconsolidated affiliate	(21,830)	
Income from discontinued operations	(5,636)	(1,587)
Depreciation and amortization	2,499	2,011
Stock compensation expense	1,376	1,270
Distributions to noncontrolling shareholder		(877)
Loss on write-down or disposal of equipment	420	29
Deferred income taxes	1,154	
Equity in income of unconsolidated affiliate	(1,559)	(2,435)
Distributions from unconsolidated affiliate	1,537	2,225
Changes in operating assets and liabilities, net of effect of aquisiton:		
Trade receivables, net	(18,032)	(5,927)
Inventories	570	(2,249)
Other current assets and liabilities	(248)	402
Other noncurrent assets and liabilities	1,163	429
Accounts payable	111	169
Restructuring charges		(325)
Accrued and other liabilities	5,537	(2,938)
Net cash used by continuing operations	(10,551)	(6,757)
Net cash provided by discontinued operations		1,808
Net cash used in operating activities	(10,551)	(4,949)
Cash flows from investing activities:		
Acquisition		(4,413)
Purchases of property, plant and equipment	(13,743)	(3,695)
Additions to intangible rights and software development	(365)	(518)
Proceeds from sale of property, plant and equipment	12	21
Proceeds from sale of unconsolidated affiliate	25,974	
Proceeds from sale of discontinued operations	16,515	
Discontinued operations investing activities		(147)
Net cash provided by (used in) investing activities	28,393	(8,752)
Cash flows from financing activities:		
Borrowings (payments) on revolving line of credit	5,000	7,500

Proceeds from sale leaseback transactions	2,097	
Payments on capital lease obligations	(593)	(563)
Proceeds from stock option exercises, net of shares tendered	144	1,263
Net cash provided by financing activities	6,648	8,200
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	24,490	(5,501)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	8,202	20,169
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 32,692	$ 14,668

See accompanying notes to consolidated financial statements.

Table of Contents

POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements
As of September 30, 2011 and December 31, 2010 and
For the Three and Nine Month Periods Ended September 30, 2011 and 2010
(in thousands, except per share data)

1. Description of Business and Basis of Presentation

Description of Business

PowerSecure International, Inc., headquartered in Wake Forest, North Carolina, is a leading provider of Energy and Smart Grid Solutions to electric utilities, their commercial, institutional and industrial customers.

Our core business is our Energy and Smart Grid Solutions segment, operated through our largest wholly-owned subsidiary PowerSecure, Inc., which we refer to as our PowerSecure subsidiary . This segment includes our three core strategic business areas: Interactive Distributed Generation, Utility Infrastructure and Energy Efficiency. These three areas are focused on providing utilities and their commercial, institutional and industrial customers with products and services to help them generate, deliver, and utilize electricity more efficiently and are intended to deliver strong returns on investment. They share common or complementary utility relationships and customer types, common sales and overhead resources, and facilities. However, each business area in this segment possesses distinct technical disciplines and specific capabilities that are designed to provide a competitive advantage in the marketplace for its specific products and services, including personnel, technology, engineering, and intellectual capital. This segment operates primarily out of our Wake Forest, North Carolina headquarters office, and its operations also include several satellite offices and manufacturing facilities, the largest of which are in Raleigh, North Carolina, Randleman, North Carolina, McDonough, Georgia, and Anderson, South Carolina. The locations of our sales organization for this segment are generally in close proximity to the utilities and commercial, industrial, and institutional customers they serve.

Until recently, our Energy Services segment operated through our two other principal operating subsidiaries, Southern Flow Companies, Inc., which we refer to as Southern Flow , and WaterSecure Holdings, Inc., which we refer to as WaterSecure . WaterSecure holds a significant noncontrolling minority portion of the equity interests in an unconsolidated business, Marcum Midstream 1995-2 Business Trust, a Delaware statutory trust, which we refer to as MM 1995-2 or as our WaterSecure operations . Our WaterSecure operations provided water processing, recycling, and disposal services for oil and natural gas producers in northeastern Colorado utilizing environmentally responsible technologies and processes. In June 2011, substantially all of the assets and business of MM 1995-2 were sold. Accordingly, our WaterSecure subsidiary no longer has any on-going operating activity. See Note 5 for more information regarding the sale of MM 1995-2. Our Southern Flow business, which was sold in January 2011, provided oil and natural gas measurement services to customers involved in oil and natural gas production, transportation, and processing, with a focus on the natural gas market. Due to its sale, Southern Flow s operations are reflected as discontinued operations in the accompanying consolidated financial statements. See Note 4 for more information regarding the sale of Southern Flow. The sales of our WaterSecure and Southern Flow operations were the fulfillment of our strategy to monetize our non-core assets to focus on the businesses in our Energy and Smart Grid Solutions business segment. As a result of these sales, our Energy Services segment ceased on-going business activities in June 2011.

See Note 13 for more information concerning our reportable segments.

Table of Contents

Basis of Presentation

Organization The accompanying consolidated financial statements include the accounts of PowerSecure International, Inc. and its subsidiaries, primarily, PowerSecure, Inc. (our PowerSecure subsidiary) (and its majority-owned and wholly-owned subsidiaries, UtilityEngineering, Inc., PowerServices, Inc., EnergyLite, Inc., EfficientLights, LLC, Innovative Electronic Solutions Lighting, LLC (IES), Reid s Trailer, Inc. and PowerPackages, LLC), Southern Flow Companies, Inc. (Southern Flow), WaterSecure Holdings, Inc. (WaterSecure), and Marcum Gas Metering, Inc. (fka Metretek International, Inc. and Metretek, Incorporated) (Metretek Florida), collectively referred to as the Company or we or us or our .

These consolidated financial statements have been prepared pursuant to rules and regulations of the Securities and Exchange Commission. The accompanying consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2010.

In management s opinion, all adjustments (all of which are normal and recurring) have been made which are necessary for a fair presentation of the consolidated financial position of us and our subsidiaries as of September 30, 2011 and the consolidated results of our operations and cash flows for the three and nine months ended September 30, 2011 and September 30, 2010.

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

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

Until April 30, 2010, our PowerSecure subsidiary held a 67% controlling ownership interest in EfficientLights. On April 30, 2010, we acquired the 33% noncontrolling ownership interest in EfficientLights at which time EfficientLights became a wholly-owned subsidiary of our PowerSecure subsidiary. Also, on April 1, 2010, our PowerSecure subsidiary acquired a 67% controlling ownership interest in IES which is consolidated in our financial statements. Accordingly, the noncontrolling interest for the three and nine months ended September 30, 2011 and for the three months ended September 30, 2010, consists solely of the noncontrolling shareholders interest in the results of IES, whereas the noncontrolling interest for the nine months ended September 30, 2010 consists of the noncontrolling shareholders interest in the results of EfficientLights through April 30, 2010 and the noncontrolling shareholders interest in the results of IES commencing April 1, 2010. As a result, period-to-period comparisons of the aggregate amount of noncontrolling interests are not necessarily comparable.

Table of Contents

The following is a reconciliation of the amounts attributable to the noncontrolling interest for the nine months ended September 30, 2011:

	Noncontrolling Interest		
	EfficientLights	IES	Total
Balance, December 31, 2010	$	$ 1,755	$ 1,755
Income (loss)		(573)	(573)
Distributions			
Balance, September 30, 2011	$	$ 1,182	$ 1,182

The following is a reconciliation of the amounts attributable to the noncontrolling interest for the nine months ended September 30, 2010:

	Noncontrolling Interest		
	EfficientLights	IES	Total
Balance, December 31, 2009	$ 1,107	$	$ 1,107
Capital contributions		2,187	2,187
Income (loss)	280	(265)	15
Distributions	(877)		(877)
Acquisition of noncontrolling interest	(510)		(510)
Balance, September 30, 2010	$	$ 1,922	$ 1,922

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

Reclassifications During the fourth quarter of 2010, our board of directors approved a plan to sell our Southern Flow business (see Note 4). The operations of Southern Flow have been reclassified to discontinued operations for all periods presented in the accompanying consolidated financial statements. In addition, certain 2010 amounts have been reclassified to conform to current year presentation. Such reclassifications had no effect on net income or stockholders equity.

2. Summary of Significant Accounting Policies and Recent Accounting Standards

Revenue Recognition For our distributed generation turn-key project-based sales and our utility infrastructure projects, we recognize revenue and profit as work progresses using the percentage-of-completion method, which relies on various estimates. We believe the use of the percentage-of-completion method of accounting for our distributed generation and utility infrastructure projects is preferable to the completed contract method because our typical projects occurs over several accounting periods and the percentage-of-completion method is a better method to match the revenues and costs to the reporting period in which the construction services are performed. Nearly all of our distributed generation and utility infrastructure projects are fixed-price contracts.

9

Table of Contents

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

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

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

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

We recognize equipment and product revenue when persuasive evidence of a commercial arrangement exists, delivery has occurred and/or services have been rendered, the price is fixed or determinable, and collectability is reasonably assured. Equipment and product sales are generally made directly to end users of the product, who are responsible for payment for the product.

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

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

Table of Contents

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

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

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

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

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

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

Warranty Reserve We provide a standard warranty for our distributed generation equipment, switchgear equipment, utility infrastructure equipment, and our Energy Efficiency unit s lighting products, which range generally between one and five years. In addition, we offer extended warranty terms on our distributed generation turn-key and switchgear projects. We reserve for the estimated cost of product warranties when revenue is recognized, and we evaluate our reserve periodically by comparing our warranty repair experience by product. The purchase price for extended warranties or extended warranties included in the contract terms are deferred as a component of our warranty reserve. The balance of our warranty reserve included in accrued and other liabilities at September 30, 2011 and December 31, 2010 was $1,040 and $1,087, respectively.

Table of Contents

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

Pre-tax share-based compensation expense for our stock options and restricted stock awards recognized during the three months ended September 30, 2011 and 2010 was $450 and $282, respectively. Pre-tax share-based compensation expense for our stock options and restricted stock awards recognized during the nine months ended September 30, 2011 and 2010 was $1,376 and $1,270, respectively. All share-based compensation expense is included in general and administrative expense in the accompanying consolidated statements of operations.

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

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

Subsequent Events Subsequent events are events or transactions that occur after the balance sheet date but before the financial statements are issued or are available to be issued and are classified as either recognized subsequent events or non-recognized subsequent events. We recognize and include in our financial statements the effects of subsequent events that provide additional evidence about conditions that existed at the balance sheet date. We disclose non-recognized subsequent events that provide evidence about conditions that arise after the balance sheet date but are not yet reflected in our financial statements when such disclosure is required to prevent the financial statements from being misleading. See further information regarding subsequent events in Note 12.

Recent Accounting Pronouncements

Fair Value Measurements In May 2011, the FASB issued Accounting Standards Update (ASU) 2011-04, which amended Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This amendment is intended to result in convergence between U.S. GAAP and International Financial Reporting Standards (IFRS) requirements for measurement of and disclosures about fair value. This amended guidance clarifies the concepts applicable for fair value measurement of non-financial assets and also expands the disclosures for fair value measurements that are estimated using significant unobservable inputs used in a fair value measurement. This amended guidance will be effective for us on a prospective basis for reporting periods beginning after December 15, 2011. We do not expect the adoption of this standard to have a material effect on our financial position or results of operations.

Table of Contents

***Disclosures Relating To Comprehensive* Income** In June 2011, the FASB issued ASU 2011-05, which is an amendment and update to ASC No. 220, Presentation of Comprehensive Income. This amendment will require an entity to present the components of net income and other comprehensive income either in a single continuous statement of comprehensive income, or in two separate but consecutive statements. This amendment eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders equity. This amended guidance, which must be applied retroactively, will be effective for us for reporting periods beginning after December 15, 2011. We do not expect the adoption of this amended guidance to have a material effect on our financial position or results of operations or our financial statement presentation.

Testing Goodwill for Impairment In September 2011, the FASB issued ASU No. 2011-08, Intangibles-Goodwill and Other (Topic 350) Testing Goodwill for Impairment. This standard, which amends and updates guidance on the periodic testing of goodwill for impairment, provides companies with the option to first assess qualitative factors to determine whether it is more likely than not that that the fair value of a reporting unit is less than its carrying amount. If so, then it is necessary to perform the two-step quantitative goodwill impairment test. This standard will be effective for us for reporting periods beginning after December 15, 2011, with early adoption permitted. We do not expect the adoption of this standard to have a material effect on our financial position or results of operations or our financial statement presentation.

Revenue Recognition Milestone Method In April 2010, the FASB issued ASU No. 2010-17 Revenue Recognition Milestone Method (Topic 605): Milestone Method of Revenue Recognition. This standard provides guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for certain research and development transactions. Under this new standard, a company can recognize as revenue consideration that is contingent upon achievement of a milestone in the period in which it is achieved, only if the milestone meets all criteria to be considered substantive. This standard became effective for us on a prospective basis commencing January 1, 2011. The adoption of this standard had no effect on our financial position or results of operations.

Improving Disclosures about Fair Value Measurements In January 2010, the FASB issued ASU No. 2010-06 Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements. This standard amends the disclosure guidance with respect to fair value measurements for both interim and annual reporting periods. Specifically, this standard requires new disclosures for significant transfers of assets or liabilities between Level 1 and Level 2 in the fair value hierarchy; separate disclosures for purchases, sales, issuance and settlements of Level 3 fair value items on a gross, rather than net basis; and more robust disclosure of the valuation techniques and inputs used to measure Level 2 and Level 3 assets and liabilities. This standard became effective for us on a prospective basis commencing January 1, 2011. The adoption of this standard had no effect on our financial position or results of operations or financial statement disclosures.

Multiple Deliverable Revenue Arrangements In October 2009, the FASB issued ASU No. 2009-13 - Multiple Deliverable Revenue Arrangements A Consensus of the FASB Emerging Issues Task Force: (Topic 605) Revenue Recognition. ASU No. 2009-13 provides application guidance on whether multiple deliverables exist, how the deliverables should be separated and how the consideration should be allocated to one or more units of accounting. This update establishes a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence, if available, third-party evidence if vendor-specific objective evidence is not available, or estimated selling price if neither vendor-specific or third-party evidence is available. This standard became effective for us on a prospective basis commencing January 1, 2011. The adoption of this standard had no effect on our financial position or results of operations.

Table of Contents

3. Earnings per Share

Basic earnings per share is computed by dividing net income attributable to PowerSecure International, Inc. common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share attributable to PowerSecure International, Inc. common stockholders is computed using the weighted average number of common shares outstanding and, when dilutive, potential common shares from stock options and warrants using the treasury stock method. Diluted earnings per share excludes the impact of potential common shares related to stock options and warrants in periods in which we reported a loss from continuing operations or in which the option or warrant exercise price is greater than the average market price of our common stock during the period because the effect would be antidilutive. A total of 388,000 common shares issuable upon the exercise of in-the-money stock options were excluded from the diluted weighted average number of shares outstanding for the three months ended September 30, 2010 because their effect was antidilutive to our loss from continuing operations for that period.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Income (loss) from continuing operations	$ 972	$ (287)	$ 17,324	$ 1,444
Income from discontinued operations		777	5,636	1,587
Net income	$ 972	$ 490	$ 22,960	$ 3,031
Basic weighted-average common shares outstanding in period	18,966	18,640	18,848	17,942
Add dilutive effects of stock options and warrants	197		274	505
Diluted weighted-average common shares outstanding in period	19,163	18,640	19,122	18,447
Basic earnings per common share:				
Income from continuing operations	$ 0.05	$ (0.01)	$ 0.92	$ 0.08
Income from discontinued operations	0.00	0.04	0.30	0.09
Basic earnings per common share	$ 0.05	$ 0.03	$ 1.22	$ 0.17
Diluted earnings per common share:				
Income from continuing operations	$ 0.05	$ (0.01)	$ 0.91	$ 0.08
Income from discontinued operations	0.00	0.04	0.29	0.08
Diluted earnings per common share	$ 0.05	$ 0.03	$ 1.20	$ 0.16

Table of Contents

4. Discontinued Operations

On December 30, 2010, we entered into a purchase and sale agreement for the sale of Southern Flow which was part of our Energy Services segment. The sale closed on January 14, 2011, with an effective date of January 1, 2011. Pursuant to the terms of the purchase and sale agreement, Zedi, Inc., a Canadian corporation, through its wholly-owned subsidiary, purchased 100% of the stock of Southern Flow. Upon closing, we received cash proceeds of $16,515, consisting of a base purchase price of $15,550, and $965 for additional Southern Flow working capital conveyed in the transaction. We recorded a gain on the sale of Southern Flow, net of transaction costs and income tax benefit, in the amount of $5,636 during the nine months ended September 30, 2011. The sale of Southern Flow was made pursuant to our review of our strategic alternatives for our non-core businesses. The operations of Southern Flow have been included in our consolidated statements of operations as discontinued operations for all periods presented. Results of discontinued operations for the three and nine months ended September 30, 2011 and 2010 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Total revenues	$	$ 5,090	$	$ 13,885
Operating expenses		4,302		12,245
Income before income taxes		788		1,640
Income tax provision		(11)		(53)
Income from operations		777		1,587
Gain on disposal			5,538	
Income tax benefit on disposal			98	
Income from discontinued operations	$	$ 777	$ 5,636	$ 1,587

The following assets and liabilities of Southern Flow were segregated and included in Assets of discontinued operations held for sale and Liabilities of discontinued operations held for sale, as appropriate, in the consolidated balance sheet as of December 31, 2010, and represent the assets and liabilities of Southern Flow that were sold in January 2011:

	December 31, 2010
Cash and cash equivalents	$ 250
Trade receivables, net of allowance for doubtful accounts	3,427
Inventories	2,182
Prepaid expenses and other current assets	169
Property, Plant and equipment, net	922
Goodwill	5,231
Other assets	2
Assets of discontinued operations held for sale	$ 12,183
Accounts payable	519

Accrued and other liabilities		871
Current income taxes payable		19
Capital lease obligations		2
Liabilities of discontinued operations held for sale	$	1,411

Table of Contents

5. Investment in and Gain on Sale of Unconsolidated Affiliate

Through WaterSecure, we own a significant noncontrolling minority portion of the equity interests in MM 1995-2, which we account for under the equity method. In June 2011, MM 1995-2 sold substantially all of its assets and business for cash. Prior to the sale, MM 1995-2 owned and operated several water processing, recycling, and disposal facilities located in northeastern Colorado. In connection with the sale of the assets, MM 1995-2 paid off its long-term debt to facilitate the transfer of its assets to the buyer free and clear of any liens and retained its working capital. MM 1995-2 is in the process of collecting its remaining accounts receivable and paying off the remainder of its liabilities, including its accounts payable and other debts and obligations. MM 1995-2 made distributions of the sales proceeds and an initial distribution of cash proceeds from the liquidation of its working capital, subject to an appropriate reserve for its remaining debts and liabilities, to its shareholders, including the Company. An amount equal to $4.0 million of the cash purchase price owed to MM 1995-2 is being held in escrow for twelve months, subject to extension for claims relating to various representations and warranties by MM 1995-2 to the purchaser. MM 1995-2 intends to distribute to its shareholders any additional amounts of working capital that it collects as it deems appropriate and to distribute any amounts remaining in the escrow after the expiration of the one-year escrow period, on the same basis. As a result of the sale of the WaterSecure operations, we received $26.0 million as our share of the sales and liquidation proceeds. In addition, we may receive up to $1.4 million from the balance of the sales price which was placed into escrow for one year. This additional amount is subject to the purchaser s rights to these funds for contingencies that are outside of our control. At September 30, 2011, the receipt of any portion of the escrow amount is not certain and is therefore not included in the gain on the sale. We recognized a pretax gain in the amount of $21.8 million during the nine months ended September 30, 2011 for our share of the equity in the gain on the sale recorded by MM 1995-2. The amount of recognized pretax gain from the sale is subject to adjustment, pending the final liquidation of the remaining assets and liabilities retained by MM 1995-2, although we do not expect the adjustment amount, if any, to be significant.

As a Delaware statutory trust, MM 1995-2 is treated as a partnership for tax purposes. Accordingly, there is no tax provision associated with the income from operations or the gain on disposal recorded on the books of MM 1995-2. All tax attributes associated with the income generating activities of MM 1995-2 are passed on to the shareholders of MM 1995-2. The following table sets forth certain summarized financial information for MM 1995-2 at September 30, 2011 and December 31, 2010 and for the three and nine months ended September 30, 2011 and 2010:

	September 30, 2011	December 31, 2010
Total current assets	$ 4,667	$ 3,753
Property, plant and equipment, net		11,616
Total other assets		4
Total assets	$ 4,667	$ 15,373
Total current liabilities	$ 4,146	$ 2,462
Long-term note payable		4,100
Total shareholders equity	521	8,811
Total liabilities and shareholders equity	$ 4,667	$ 15,373

16

Table of Contents

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Total revenues	$	$ 4,221	$ 9,023	$ 13,552
Total costs and expenses		2,743	5,169	7,532
Income from operations		1,478	3,854	6,020
Gain on disposal	147		65,553	
Net income	$ 147	$ 1,478	$ 69,407	$ 6,020

MM 1995-2 has deferred that portion of the gain on disposal associated with the $4.0 million placed into escrow which will be recognized only if the contingencies associated with the indemnification obligations provided by MM 1995-2 to the purchaser and other contingencies have been eliminated after the one-year escrow period expires.

6. PowerPackages Exit Plan

On May 31, 2011, we adopted a plan to exit the business and sell the assets of PowerPackages, which operated a medium speed engine business in our Energy and Smart Grid Solutions segment that we started in 2009 through the acquisition of inventory and equipment necessary to enter the business. We adopted this plan of disposition after evaluating the prospects for the PowerPackages business, current market conditions and our opportunities to focus our time and resources in other areas which have a higher potential to deliver near and mid-term revenue and profit growth.

We have initiated actions to exit the PowerPackages business. Our targeted and currently estimated exit date is December 31, 2011. During the three months ended June 30, 2011, we recorded pre-tax charges related to the PowerPackages exit plan in the amount of $2,075, which included a $1,692 inventory charge included in our cost of sales and a $383 loss from the write-down of long-lived assets associated with the business included in our general and administrative expenses, as proceeds from the disposition of the business are expected to be less than its carrying value. During the three months ended September 30, 2011, we received $1,644 cash proceeds and gross margin of $435 from the sale of a portion of the inventory of PowerPackages and we recorded $537 of operating expenses related to the wind-down of the operations, including $363 of employee severance and related expenses associated with contractual obligations incurred in connection with our exit plan. During the remainder of 2011, we expect to receive additional proceeds from the sale of the remaining inventory and we expect to incur additional facility and related expenses, and potentially additional inventory adjustments, as we dispose of the remaining assets of PowerPackages.

The results of our PowerPackages operations, including the losses associated with the exit plan, will be reported in continuing operations in our consolidated financial statements until the dispositions of the business and assets is complete and operations cease, at which time it will be reclassified in to discontinued operations for all prior and subsequent periods.

Table of Contents

7. Debt

Line of Credit We have had a credit facility with Citibank, N.A. (Citibank), as administrative agent and lender, and other lenders since entering into a credit agreement in August 2007. At December 31, 2010, our credit agreement with Citibank along with SunTrust Bank and Branch Banking and Trust Company (BB&T) as additional lenders, provided for a $50.0 million senior, first-priority secured revolving and term credit facility. In January 2011, the credit facility was amended to facilitate the sale of Southern Flow (see Note 4), modify certain financial covenants to accommodate our financial profile after that sale and reflect a change in lenders. The credit facility, as amended, is now a $25.0 million senior, first-priority secured revolving credit facility with Citibank and BB&T as lenders. The credit facility is guaranteed by all of our active subsidiaries and secured by all of our assets and the assets of our active subsidiaries.

As amended, the credit facility, as a revolving credit facility, matures and terminates on November 12, 2013. However, we have the option prior to that maturity date to convert a portion of outstanding principal balance into a non-revolving term loan for a two year period expiring November 12, 2015, making quarterly payments based upon a four year fully amortized basis, with the remaining outstandings due as a balloon payment on November 12, 2015. We intend to continue to use the proceeds available under the credit facility to finance our PowerSecure subsidiary s recurring revenue projects as well as to finance capital expenditures, working capital, acquisitions, and general corporate purposes. Under the terms of the amended credit facility, we are required, at all times until April 1, 2012, to maintain cash balances of at least 65% of our outstanding borrowings under the revolving credit facility.

Outstanding balances under the credit facility bear interest, at our discretion, at either the London Interbank Offered Rate for the corresponding deposits of U. S. Dollars plus an applicable margin, which is on a sliding scale ranging from 200 basis points to 325 basis points based upon the our leverage ratio, or at Citibank s alternate base rate plus an applicable margin, on a sliding scale ranging from 25 basis points to 150 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 EBITDA as defined in the credit agreement for the four consecutive 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.

The credit facility is not subject to any borrowing base computations, but does contain certain financial covenants. Our minimum asset coverage must be in excess of 1.25, where our 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. In addition, we are required to maintain a minimum consolidated tangible net worth, computed on a quarterly basis, equal to approximately $62.0 million. Finally, our debt to worth ratio, which is the ratio of our total consolidated indebtedness to our consolidated tangible net worth, cannot exceed 1.5 to 1.0 at the end of any quarter. At September 30, 2011, we were in compliance with our financial covenant requirements. In addition, commencing March 31, 2012, our maximum leverage ratio cannot exceed 3.25 and our minimum fixed charge coverage ratio must be in excess of 1.25, where the fixed charge coverage ratio is defined as the ratio of the aggregate of our trailing 12 month consolidated EBITDA plus our lease or rent expense minus our taxes based on income and payable in cash, 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. Under the credit facility, our cumulative capital expenditures beginning in 2008 cannot exceed the sum of $5.0 million plus $1.25 million per quarter, on a cumulative basis, plus an allowance for our PowerSecure subsidiary recurring revenue projects generated after December 31, 2007. The credit facility contains other representations and warranties and affirmative and negative covenants, including restrictions with respect to liens, indebtedness, loans and investments, material changes in our business, asset sales or leases or transfers of assets, restricted payments such as distributions and dividends, mergers or consolidations and transactions with affiliates.

Table of Contents

Upon the sale of any of our assets or the assets of our subsidiaries other than in the ordinary course of business, or the public or private sale of any equity or debt other than equity issuances where the aggregate proceeds do not exceed $10.0 million, we are required to use the net proceeds thereof to repay any indebtedness then outstanding under the credit facility, except for certain reinvestment provisions.

Our obligations under the credit facility are secured by guarantees and security agreements by each of our active subsidiaries, including but not limited to our PowerSecure subsidiary and WaterSecure. The guarantees guaranty all of our obligations under the credit facility, and the security agreements grant to the lenders a first priority security interest in virtually all of the assets of each of the parties to the credit agreement.

The credit agreement also 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.

The maximum balance outstanding on our credit facility during the three and nine months ended September 30, 2011 was $10.0 million. The balance outstanding on our credit facility at September 30, 2011 and December 31, 2010 was $10.0 million and $5.0 million, respectively. At September 30, 2011, we had an additional $15.0 million available to borrow under the amended provisions of our credit facility. At November 3, 2011, no balance was outstanding and we had $25.0 million available to borrow under our credit facility. However, the availability of this capital under our credit facility includes restrictions on the use of proceeds, and is dependent upon our ability to satisfy certain financial and operating covenants, as described above.

8. Capital Lease Obligations

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

Proceeds of the lease financing were used to finance our PowerSecure subsidiary s recurring revenue projects. We account for the lease financing as a capital lease in our consolidated financial statements in accordance with generally accepted accounting principles.

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

Table of Contents

Under the lease guaranty, we have unconditionally guaranteed the obligations of our PowerSecure subsidiary under the lease for the benefit of the lessor. The balance of our capital lease obligations shown in the consolidated balance sheet at September 30, 2011 and December 31, 2010 consist entirely of our obligations under the equipment lease described above.

9. Share-Based Compensation

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

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

In March 2008, our board of directors adopted the PowerSecure International, Inc. 2008 Stock Incentive Plan (the 2008 Stock Plan), which was approved by our stockholders at the Annual Meeting of Stockholders held on June 9, 2008. The 2008 Stock Plan authorizes our board of directors to grant incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, performance awards and other stock-based awards to our officers, directors, employees, consultants and advisors for up to an aggregate of 600,000 shares of our common stock. Stock options granted under the 2008 Stock Plan must contain exercise prices not less than the fair market value of our common stock on the date of grant, and must contain a term not in excess of 10 years from the date of grant. The 2008 Stock Plan replaced our 1998 Stock Plan.

Stock Options Net income for the three months ended September 30, 2011 and 2010 includes $59 and $85, respectively, of pre-tax compensation costs related to outstanding stock options. Net income for the nine months ended September 30, 2011 and 2010 includes $205 and $292, respectively, of pre-tax compensation costs related to outstanding stock options. All of the stock option compensation expense is included in general and administrative expenses in the accompanying consolidated statements of operations.

Table of Contents

A summary of option activity for the nine months ended September 30, 2011 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Balance, December 31, 2010	1,247	$ 5.98		
Granted	20	5.45		
Exercised	(291)	1.98		
Expired	(33)	13.17		
Forfeited	(31)	6.29		
Balance, September 30, 2011	912	$ 6.98	5.26	n/m(1)
Exercisable, September 30, 2011	712	$ 7.27	4.50	n/m(1)

(1) The exercise price of option exceeds the fair value of underlying stock.

A summary of option activity for the nine months ended September 30, 2010 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Balance, December 31, 2009	1,627	$ 5.18		
Granted	71	9.64		
Exercised	(434)	3.35		
Expired	(5)	17.38		
Forfeited	(13)	9.55		
Balance, September 30, 2010	1,246	$ 5.97	5.14	$ 3.29
Exercisable, September 30, 2010	945	$ 5.87	4.15	$ 3.39

The weighted average grant date fair value of the options granted during the nine months ended September 30, 2011 and 2010 was $2.19 and $4.31, respectively. In each case, the fair value was measured using the Black-Scholes valuation model with the following assumptions:

	September 30,	
	2011	2010
Expected stock price volatilility	44.8%	49.2%

Risk Free interest rate		1.48%	2.02%
Annual dividends		$	$
Expected life	employee options	5 years	5 years
Expected life	director options	n/a	n/a

The fair value of stock option grants are amortized to expense over their respective service periods using the straight-line method and assuming a forfeiture rate of 5%. As of September 30, 2011 and December 31, 2010, there was $465 and $731, respectively, of total unrecognized compensation costs related to stock options. These costs at September 30, 2011 are expected to be recognized over a weighted average period of approximately 1.8 years.

Table of Contents

During the three months ended September 30, 2011 and 2010, the total intrinsic value of stock options exercised was $0 and $2,409, respectively. Cash received, net of shares tendered, from stock option exercises for the three months ended September 30, 2011 and 2010 was $0 and $1,203, respectively. The total grant date fair value of stock options vested during the three months ended September 30, 2011 and 2010 was $62 and $52, respectively.

During the nine months ended September 30, 2011 and 2010, the total intrinsic value of stock options exercised was $1,642 and $2,760, respectively. Cash received, net of shares tendered, from stock option exercises for the nine months ended September 30, 2011 and 2010 was $144 and $1,453, respectively. The total grant date fair value of stock options vested during the nine months ended September 30, 2011 and 2010 was $255 and $426, respectively.

Restricted Stock Awards Net income for the three months ended September 30, 2011 and 2010 includes $391 and $197, respectively, of pre-tax compensation costs related to outstanding restricted stock awards granted to directors, certain officers and our employees. Net income for the nine months ended September 30, 2011 and 2010 includes $1,171 and $978, respectively, of pre-tax compensation costs related to outstanding restricted stock awards granted to directors, certain officers and our employees. All of the restricted stock award compensation expense during the three and nine months ended September 30, 2011 and 2010 is included in general and administrative expenses in the accompanying consolidated statements of operations.

A summary of restricted stock award activity for the nine months ended September 30, 2011 is as follows:

	Unvested Restricted Shares	Weighted Average Grant Date Fair Value
Balance, December 31, 2010	478	$ 11.00
Granted	30	6.77
Vested	(87)	8.02
Forfeited		
Balance, September 30, 2011	421	$ 11.31

A summary of restricted stock award activity for the nine months ended September 30, 2010 is as follows:

	Unvested Restricted Shares	Weighted Average Grant Date Fair Value
Balance, December 31, 2009	561	$ 10.36
Granted	21	9.56
Vested	(95)	7.27
Forfeited		
Balance, September 30, 2010	487	$ 10.93

Table of Contents

Restricted shares are subject to forfeiture and cannot be sold or otherwise transferred until they vest. If the holder of the restricted shares leaves us before the restricted shares vest, other than due to termination by us without cause, then any unvested restricted shares will be forfeited and returned to us. The restricted shares granted to directors vest in equal amounts over a period of one or three years, depending on the nature of the grant. The restricted shares granted to employees other than officers vest in equal annual amounts over five years. A total of 322,500 unvested restricted shares issued to officers cliff vest in 2012, while the remaining 64,500 unvested performance-based restricted shares issued to officers vest in 2012, assuming certain performance conditions are achieved. All restricted and unvested shares will automatically vest upon a change in control.

The fair value of employee and director restricted shares along with the cliff vesting restricted shares granted to officers are being amortized on a straight-line basis over the vesting period. The fair value of the performance-based restricted shares is expensed as the achievement of the performance criteria becomes probable and the related service period conditions are met. At September 30, 2011, the balance of unrecognized compensation cost related to unvested restricted shares was $1,028, which, assuming all future performance criteria will be met, we expect will be recognized over a weighted average period of approximately 0.8 years.

10. Commitments and Contingencies

From time to time, we hire employees that are subject to restrictive covenants, such as non-competition agreements with their former employers. We comply, and require our employees to comply, with the terms of all known restrictive covenants. However, we have in the past and may in the future receive claims and demands by some former employers alleging actual or potential violations of these restrictive covenants. While we do not believe any pending claims have merit, we cannot provide any assurance of the outcome of these claims.

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

Table of Contents

We estimate that from time to time we have performance issues related to component parts which have a cost basis of approximately 5-20% of our estimated annual revenues, although not necessarily limited to this amount, which are installed in equipment we own and have sold to various customers across our business lines, and additional performance issues could arise in the future. In addition, the failure or inadequate performance of these components pose potential material and adverse effects on our business, operations, reputation and financial results, including reduced revenues for projects in process or future projects, reduced revenues for recurring revenue contracts which are dependent on the performance of the affected equipment, additional expenses and capital cost to repair or replace the affected equipment, inventory write-offs for defective components held in inventory, asset write-offs for company-owned systems which have been deployed, the cancellation or deferral of contracts by our customers, or claims made by our customers for damages as a result of performance issues.

We have experienced performance issues with two types of component parts, in particular, which we are in the process of revolving: 1) a supplier of a substantial distributed generation system component indicated its warranty does not cover performance issues related to a component from another supplier which has been installed in many of the distributed generation systems deployed for our customers, and 2) generators from a certain supplier have had performance issues in a distributed generation system we own, and for which we have a performance-based recurring revenue contract that is dependent on the system s positive operating performance. In both of these matters, we have been actively working to correct and resolve the performance issues and have made progress, although we have not eliminated the risk related to these issues.

Given that we are in the process of addressing these performance issues, and the inherent uncertainty in assessing and quantifying the costs and nature of the resolution of these types of technical issues, at present we are unable to estimate the potential negative impacts from these particular items, if any, in addition to other component part performance issues discussed above. In addition, at this time we have not recorded any adjustment to our warranty reserve for these particular performance issues, other than an immaterial amount for certain minor repairs, as the estimated cost, if any, of fulfilling our warranty obligations for these performance issues within a possible range of outcomes is not determinable as of this date.

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

11. Income Taxes

The income tax provision recorded at September 30, 2011 is our best estimate of our expected tax expense taking into consideration our current earnings, expectation of future earnings, federal alternative minimum tax, state income tax for state jurisdictions in which we expect taxable income, changes in our deferred tax assets and liabilities, potential effects of adverse outcomes on tax positions we have taken and the benefits of tax positions taken for which the applicable statute of limitations has expired, true-up effects of prior tax provision estimates compared to actual tax returns, and our net operating loss carryforwards and valuation allowance.

Table of Contents

At December 31, 2010, we had a net deferred tax asset in the amount of $2,975, due primarily to the expected benefit associated with our net operating loss carryforwards. The gain on the sale of the WaterSecure operations in June 2011 (see Note 5) utilized the majority of our net operating loss carryforwards. As a result, the balance of our net deferred tax asset has been reduced and we have eliminated the valuation allowance related to expected utilization of our net operating losses. The effect of the reduction of our net deferred tax asset and elimination of our valuation allowance is included as a component of our current period income tax provision for the nine month period ended September 30, 2011.

12. Subsequent Events

On November 1, 2011, our Board of Directors authorized a stock repurchase program of up to $5 million in shares of the Company s common stock, par value $.01 per share. Repurchases of shares can be made from time to time in open market purchases or in privately negotiated transactions. The timing and amount of any shares repurchased will be determined in the discretion of the Company s management based on its evaluation of market conditions and other factors. The stock repurchase program may continue for a period of up to 24 months, although it may be suspended from time to time or discontinued at any time, or it may be renewed or extended, in the discretion of the Board of Directors.

13. Segment Information

Our operating segments represent components of our business for which discrete financial information is available and is reviewed regularly by the chief operating decision-maker, or decision-making group, to evaluate performance and make operating decisions. We conduct our operations through two operating segments: Energy and Smart Grid Solutions, and Energy Services. Our reportable segments are strategic business units that offer different products and services and serve different customer bases. They are managed separately because each business requires different technology and marketing strategies. Our WaterSecure and Southern Flow businesses, which previously operated in our Energy Services segment, were sold in June 2011 and January 2011, respectively. As a result of these sales, we will no longer actively operate in the Energy Services segment in the future.

Energy and Smart Grid Solutions Through our PowerSecure subsidiary we serve utilities and commercial, institutional, and industrial customers in the areas of Interactive Distributed Generation, Utility Infrastructure and Energy Efficiency. Each of these PowerSecure subsidiary business units operates in a distinct market with distinct technical disciplines, but shares a common customer base, sales force, and administrative infrastructure with other PowerSecure subsidiary products and services and which we grow through shared resources and customer relationships. Accordingly, these units are included within our Energy and Smart Grid Solutions segment results; and

Energy Services Until June 2011, we served customers in the oil and natural gas production business with water processing and disposal services through our WaterSecure subsidiary, which holds an equity investment in MM 1995-2. In June 2011, substantially all of the assets and business of MM 1995-2 were sold. Accordingly, our WaterSecure subsidiary no longer has any on-going operations. Similarly, the operations of our Southern Flow subsidiary, which previously was included in this segment, were sold in January 2011 pursuant to the execution of a purchase agreement in December 2010. Accordingly, the Southern Flow business has been discontinued and the results of its operations are excluded from our Energy Services segment for all periods presented in the information below. The sales of our WaterSecure and Southern Flow operations were the fulfillment of our strategy to monetize our non-core assets to focus on the businesses in our Energy and Smart Grid Solutions business segment. As a result of these sales, our Energy Services segment ceased business activities in June 2011 and thus we no longer report ongoing operations in the Energy Services segment in financial periods after June 30, 2011.

Table of Contents

The accounting policies of the reportable segments are the same as those described in Note 1 of the Notes to Consolidated Financial Statements. We evaluate the performance of our operating segments based on income (loss) before income taxes. There are no intersegment sales.

Summarized financial information concerning our reportable segments is shown in the following table. Unallocated corporate cost amounts include corporate overhead, other income and interest expense which, for purposes of evaluating the operations of our segments, are not allocated to our segment activities. Total asset amounts exclude intercompany receivable balances eliminated in consolidation.

	Three Months Ended September 30, 2011			
	Energy and Smart Grid Solutions	Energy Services	Unallocated Corporate Costs	Total
Revenues	$ 38,229	$	$	$ 38,229
Cost of sales	26,582			26,582
Gross profit	11,647			11,647
Operating expenses:				
General and administrative	7,862		1,306	9,168
Selling, marketing and service	1,279			1,279
Depreciation and amortization	858			858
Total operating expenses	9,999		1,306	11,305
Operating income (loss)	1,648		(1,306)	342
Other income and (expenses):				
Gain on sale of unconsolidated affiliate		44		44
Equity income				
Management fees				
Interest income and other income			31	31
Interest expense	(124)		(44)	(168)
Income (loss) before income taxes	$ 1,524	$ 44	$ (1,319)	$ 249
Total capital expenditures	$ 4,800	$ 0	$ 0	$ 4,800
Total investment in unconsolidated affiliate	$ 0	$ 195	$ 0	$ 195

Total goodwill	$ 7,970	$ 0	$ 0	$ 7,970
Total assets	$ 118,622	$ 195	$ 35,011	$ 153,828

Table of Contents

	Three Months Ended September 30, 2010			
	Energy and Smart Grid Solutions	Energy Services	Unallocated Corporate Costs	Total
Revenues	$ 26,316	$	$	$ 26,316
Cost of sales	17,747			17,747
Gross profit	8,569			8,569
Operating expenses:				
General and administrative	6,332		1,056	7,388
Selling, marketing and service	1,383			1,383
Depreciation and amortization	737	18	1	756
Total operating expenses	8,452	18	1,057	9,527
Operating income (loss)	117	(18)	(1,057)	(958)
Other income and (expenses):				
Equity income		598		598
Management fees		136		136
Interest income and other income			24	24
Interest expense	(111)		(66)	(177)
Income (loss) before income taxes	$ 6	$ 716	$ (1,099)	$ (377)
Total capital expenditures	$ 1,291	$ 0	$ 0	$ 1,291
Total investment in unconsolidated affiliate	$ 0	$ 4,129	$ 0	$ 4,129
Total goodwill	$ 7,970	$ 0	$ 0	$ 7,970

	Nine Months Ended September 30, 2011		
	Energy and Smart Grid	Energy	Unallocated Corporate

	Solutions	Services	Costs	Total
Revenues	$ 92,159	$	$	$ 92,159
Cost of sales	65,183			65,183
Gross profit	26,976			26,976
Operating expenses:				
General and administrative	21,823		3,773	25,596
Selling, marketing and service	3,657			3,657
Depreciation and amortization	2,468	30	1	2,499
Total operating expenses	27,948	30	3,774	31,752
Operating income (loss)	(972)	(30)	(3,774)	(4,776)
Other income and (expenses):				
Gain on sale of unconsolidated affiliate		21,830		21,830
Equity income		1,559		1,559
Management fees		282		282
Interest income and other income			73	73
Interest expense	(311)		(143)	(454)
Income (loss) before income taxes	$ (1,283)	$ 23,641	$ (3,844)	$ 18,514
Total capital expenditures	$ 14,108	$ 0	$ 0	$ 14,108

Table of Contents

	Nine Months Ended September 30, 2010			
	Energy and Smart Grid Solutions	Energy Services	Unallocated Corporate Costs	Total
Revenues	$ 76,509	$	$	$ 76,509
Cost of sales	50,098			50,098
Gross profit	26,411			26,411
Operating expenses:				
General and administrative	17,417		3,759	21,176
Selling, marketing and service	3,777			3,777
Depreciation and amortization	1,952	55	4	2,011
Total operating expenses	23,146	55	3,763	26,964
Operating income (loss)	3,265	(55)	(3,763)	(553)
Other income and (expenses):				
Equity income		2,435		2,435
Management fees		432		432
Interest income and other income			77	77
Interest expense	(248)		(209)	(457)
Income (loss) before income taxes	$ 3,017	$ 2,812	$ (3,895)	$ 1,934
Total capital expenditures	$ 4,212	$ 0	$ 1	$ 4,213

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Table of Contents

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

Introduction

The following discussion and analysis of our consolidated results of operations for the three and nine month periods ended September 30, 2011, which we refer to as the third quarter 2011 and nine month period 2011, respectively, and the three and nine month periods ended September 30, 2010, which we refer to as the third quarter 2010 and nine month period 2010, respectively, and of our consolidated financial condition as of September 30, 2011 should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this report.

Cautionary Note Regarding Forward-Looking Statements

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

- our prospects, including our future business, revenues, expenses, net income, margins, profitability, cash flow, cash position, liquidity, financial condition and results of operations, our targeted growth rate and our expectations about realizing the revenue in our backlog and in our sales pipeline;
- the effects on our business, financial condition and results of operations of current and future economic, business, market and regulatory conditions, including the current challenging economic and market conditions and their adverse effects on our customers and their capital spending and ability to finance purchases of our products, services, technologies and systems;
- the effects of fluctuations in sales on our business, revenues, expenses, net income, margins, profitability, cash flow, liquidity, financial condition and results of operations;
- our products, services, technologies and systems, including their quality and performance in absolute terms and as compared to competitive alternatives, their benefits to our customers and their ability to meet our customers requirements, and our ability to successfully develop and market new products, services, technologies and systems;
- our markets, including our market position and our market share;
- our ability to successfully develop, operate, grow and diversify our operations and businesses;
- our business plans, strategies, goals and objectives, and our ability to successfully achieve them;

Table of Contents

- the effects on our financial condition and results of operations of the loss of income from the sales of our Southern Flow business and our WaterSecure business and our ability to effectively and profitably redeploy the proceeds of these sales in our core business;
- the sufficiency of our capital resources, including our cash and cash equivalents, funds generated from operations, availability of borrowings under our credit and financing arrangements and other capital resources, to meet our future working capital, capital expenditure, lease and debt service and business growth needs;
- the value of our assets and businesses, including the revenues, profits and cash flow they are capable of delivering in the future;
- industry trends and customer preferences and the demand for our products, services, technologies and systems;
- the nature and intensity of our competition, and our ability to successfully compete in our markets;
- fluctuations in our effective tax rates, including the expectation that with the utilization of a significant portion of our tax net operating losses our tax expense will likely approximate statutory rates in the future;
- business acquisitions, combinations, sales, alliances, ventures and other similar business transactions and relationships; and
- the effects on our business, financial condition and results of operations of litigation, warranty claims and other claims and proceedings that arise from time to time.

Any forward-looking statements we make are based on our current plans, intentions, objectives, goals, strategies, hopes, beliefs, projections and expectations, as well as assumptions made by and information currently available to management. Forward-looking statements are not guarantees of future performance or events, but are subject to and qualified by substantial risks, uncertainties and other factors, which are difficult to predict and are often beyond our control. Forward-looking statements will be affected by assumptions and expectations we might make that do not materialize or that prove to be incorrect and by known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from those expressed, anticipated or implied by such forward-looking statements. These risks, uncertainties and other factors include, but are not limited to, those described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, as amended or supplemented in subsequently filed Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, as well as other risks, uncertainties and factors discussed elsewhere in this report, in documents that we include as exhibits to or incorporate by reference in this report, and in other reports and documents we from time to time file with or furnish to the Securities and Exchange Commission. In light of these risks and uncertainties, you are cautioned not to place undue reliance on any forward-looking statements that we make.

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

Table of Contents

Overview

PowerSecure International, Inc., headquartered in Wake Forest, North Carolina, is a leading provider of Energy and Smart Grid Solutions to electric utilities and their commercial, institutional and industrial customers.

Our core business is our Energy and Smart Grid Solutions segment, which we operate through our primary wholly-owned subsidiary PowerSecure, Inc., which we refer to as our PowerSecure subsidiary. In this business segment we conduct our operations through our three core strategic business areas: Interactive Distributed Generation, Utility Infrastructure and Energy Efficiency. These three business areas are focused on providing utilities and their commercial, institutional and industrial customers with products and services to help them generate, deliver and utilize electricity more efficiently and are intended to deliver strong returns on investment. They share common or complementary utility relationships and customer types, common sales and overhead resources, and use of the same facilities. However, each business area in this segment possesses distinct technical disciplines and specific capabilities that are designed to provide a competitive advantage in the marketplace for its specific products and services, including personnel, technology, engineering and intellectual capital.

We previously conducted our non-core business through our Energy Services segment. Until recently, our Energy Services segment operated through our two other principal operating subsidiaries, Southern Flow Companies, Inc., which we refer to as Southern Flow , and WaterSecure Holdings, Inc., which we refer to as WaterSecure . WaterSecure holds a significant noncontrolling minority portion of the equity interests in an unconsolidated business, Marcum Midstream 1995-2 Business Trust, a Delaware statutory trust, which we refer to as MM 1995-2 or as our WaterSecure operations . Our WaterSecure operations provided water processing, recycling, and disposal services for oil and natural gas producers in northeastern Colorado utilizing environmentally responsible technologies and processes. In June 2011, substantially all of the assets and business of MM 1995-2 were sold. Accordingly, our WaterSecure subsidiary no longer has any on-going operating activity. Our Southern Flow business, which was sold in January 2011, provided oil and natural gas measurement services to customers involved in oil and natural gas production, transportation, and processing, with a focus on the natural gas market. Due to its sale, Southern Flow s operations are now reflected as discontinued operations in the accompanying consolidated financial statements. The sales of our WaterSecure and Southern Flow operations were the fulfillment of our strategy to monetize our non-core assets to focus on the businesses in our Energy and Smart Grid Solutions business segment. As a result of these sales, our Energy Services segment ceased business activities in June 2011 and thus we no longer report ongoing operations in the Energy Services segment in financial periods after June 30, 2011.

Interactive Distributed Generation

Our Interactive Distributed Generation business involves manufacturing, installing, and operating electric generation systems on site at the facility where the power is used, including commercial, institutional, and industrial operations, generally on behalf of electric utilities. Our systems provide a dependable backup power supply during power outages, and provide a more efficient and environmentally friendly source of power during high cost periods of peak power demand.

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

Table of Contents

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

In our PowerSecure-owned model, where we pay for, install and maintain ownership of the system in exchange for the customer paying us smaller fees over a period of years, utilities and their customers receive access to our system and the related benefits of distributed generation without making a large up-front investment of capital. Under the PowerSecure-owned model, contracts can be structured between us and the utility, us and the customer, or all three parties.

In the nine month period 2011, 80.9% of our distributed generation revenues consisted of customer-owned sales, and 19.1% of our distributed generation revenues were derived from recurring revenue sales. Sales of customer-owned systems deliver revenues and profits that are recorded on our financial statements over the course of the project and thus are more proximate to the time of the sale and our expenses of that project and generally larger in dollar amount in any particular period than sales of PowerSecure-owned projects, which can cause our consolidated revenues and profits to be more inconsistent from period-to-period as sales fluctuate. By contrast, sales under the PowerSecure-owned system model generate revenues and profits that are generally more consistent from period-to-period and have higher gross margins, while at the same time generating revenues and profits over a longer time period although smaller in dollar amount in any particular period, because the revenues and profits are recognized over the life of the contract. The PowerSecure-owned recurring revenue model also requires us to invest our own capital in the project without any return on capital until after the project is completed, installed and successfully operating.

Utility Infrastructure

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

Table of Contents

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

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

Energy Efficiency

Our Energy Efficiency business is focused on providing energy solutions to utilities, municipalities, and commercial, institutional, and industrial customers that deliver strong returns on investment by reducing energy costs, improving their operations, and benefiting the environment. Our Energy Efficiency area includes our EfficientLights, IES and EnergyLite businesses and brands. Our EfficientLights business is focused on bringing our EfficientLights branded LED-based lighting products to grocery, drug, and convenience stores. These LED lighting products include our largest volume product, our EfficientLights fixture for reach-in refrigerated cases, as well as lighting for walk-in storage coolers and open refrigerated display cases. Additionally, our EfficientLights business is in the process of developing and marketing LED-based parking lot lights. Our IES business designs and manufactures new LED-based lighting products for commercial, industrial and consumer applications. The business of IES includes turn-key product development, engineering, and manufacturing of solid state LED-based lights, including street lights, area lights, landscape lights, and other specialty lighting applications. In addition, IES s product portfolio includes component parts, including power drivers, light engines, and thermal management solutions. IES provides its products directly to OEMs, electronics manufacturers, and retailers, either as component solutions or as turn-key products.

We generate revenues in our EfficientLights business through the sale of our proprietary LED lights. These lights are primarily sold as retrofits for existing traditional lighting, although they are also sold for initial lighting installations. From time to time we also provide installation services, although that is not a significant portion of our business. We also assist our customers in receiving utility incentives for LED lighting. Our customers are primarily large retail chains, and their installations of EfficientLights have been across various numerous stores within their store base over a diverse geographic scope. We also sell our LED lights to, and through, original equipment manufacturers, or OEMs, of refrigerator and freezer cases. We expect our customer base and sales channels to continue to grow and develop as LED technology continues to be more widely adopted. As we bring additional products to market, including our LED-based parking lot light, we expect to employ a similar business model.

Table of Contents

We also generate revenues in our IES business through the sale of proprietary LED lights, as well as the sale of LED-lighting components including power drivers, light engines, and thermal management solutions. Our IES business designs and manufactures these LED-based lighting products for commercial, industrial and consumer applications. IES provides its products directly to OEMs, electronics manufacturers, and retailers, either as component solutions or as turn-key products. We expect our IES business to bring additional LED lighting products and components to market, and employ a similar business and distribution model.

Additionally, through our EnergyLite business and brand we market our SecureLite and PowerLite family of area lights and street lights and expect to market other products in the future. We utilize the engineering and manufacturing capabilities of our IES team in the development of these products. These products are marketed to utilities and municipalities directly, and through third party distribution arrangements.

Energy Services Business

Until recently, we conducted our Energy Services operations through our WaterSecure business. Through WaterSecure, we own a significant noncontrolling minority portion of the equity interests of MM 1995-2, an unconsolidated business. Equity income at our Energy Services segment consists of our minority ownership interest in the earnings of the WaterSecure operations. In June 2011, MM 1995-2 sold substantially all of its assets and business for cash. Prior to the sale, MM 1995-2 owned and operated water processing, recycling, and disposal facilities in northeastern Colorado, and the business served oil and natural gas production companies in that area.

Our Energy Services operations previously included Southern Flow, which we sold effective January 1, 2011 pursuant to a purchase and sale agreement we entered into with the purchaser on December 30, 2010. Southern Flow provides a variety of oil and natural gas measurement services principally to customers involved in the business of oil and natural gas production, gathering, transportation and processing, with a focus on the natural gas market. As a result of the sale of Southern Flow, its results of operations are now reflected as discontinued operations in our consolidated statements of operations for all periods presented in this report.

The sales of our WaterSecure and Southern Flow operations were the fulfillment of our strategy to monetize our non-core assets to focus on the businesses in our Energy and Smart Grid Solutions business segment. As a result of these sales, our Energy Services segment ceased business activities in June 2011 and thus we no longer report ongoing operations in the Energy Services segment in financial periods after June 30, 2011.

Recent Developments

On November 3, 2011, we announced that our Board of Directors authorized a stock repurchase program of up to $5 million in shares of the Company s common stock, par value $.01 per share. Repurchases of shares can be made from time to time in open market purchases or in privately negotiated transactions. The timing and amount of any shares repurchased will be determined in the discretion of the Company s management based on its evaluation of market conditions and other factors. The stock repurchase program may continue for a period of up to 24 months, although it may be suspended from time to time or discontinued at any time, or it may be renewed or extended, in the discretion of the Board of Directors.

Table of Contents

On October 11, 2011, we announced that our PowerSecure subsidiary had received $15 million of new business awards, including $9 million of orders for Interactive Distributed Generation® (IDG®) smart grid power systems, and $6 million of orders for utility infrastructure projects. The new IDG projects include awards to provide smart grid power systems to industrial customers, hospitals, and military facilities, and the new utility infrastructure projects include awards to provide several large utilities with transmission and distribution maintenance and upgrade services. All of this $15 million of new business is turn-key, project-based revenue, which the Company expects to recognize primarily during the fourth quarter of 2011 through the third quarter of 2012.

Financial Results Highlights

Our consolidated revenues during the third quarter 2011 increased by $11.9 million, or 45.3%, compared to our consolidated revenues during the third quarter 2010. The drivers of this quarter-over-quarter revenue increase were a 118.1% increase in revenues from our Utility Infrastructure products and services and a 46.1% increase in revenues from our Interactive Distributed Generation products, partially offset by a 24.5% decrease in revenues from our Energy Efficiency business.

Our gross profit margin as a percentage of revenue was 30.5% during the third quarter 2011, a decrease of 2.1 percentage points compared to the third quarter 2010. The decline in gross profit margin was driven by $0.8 million, or 2.0 percentage points, of additional fuel costs incurred to operate a PowerSecure-owned distributed generation system which serves a Midwest utility, due to record heat and high demand on the utility system during the months of July and August. In addition, gross profit margin variances were realized from changes in the mix of projects and products completed in the third quarter 2011 compared to the third quarter 2010. Our operating expenses increased in the third quarter 2011 compared to the third quarter of 2010 due to investments we made in our Energy and Smart Grid Solutions Segment to drive and support our future growth, including expenses relating to new product development, engineering, facilities, personnel, selling expense, compensation expense in each of our Distributed Generation, Energy Efficiency, and Utility Infrastructure business areas, as well as additional depreciation expense resulting from capital deployed to support our growing recurring revenue business. As a result, our total operating expenses during the third quarter 2011 increased by $1.8 million, or 18.7%, compared to our operating expenses during the third quarter 2010. We expect our operating costs to grow to support the growth of our business, although at a lower growth rate than revenues over time, and that growth will be dependent in large part upon future economic and market conditions. Accordingly, the timing and the amount of future increases in operating expenses will depend on the timing and level of future improvements in economic and business conditions and the effects of such economic recovery on our revenues. We cannot provide any assurance as to if, when, how much or for how long economic conditions will improve, or the effects of future economic conditions on our revenues, expenses or net income. Over the long-term, we expect to continue to invest in operational infrastructure and sales and new business development to drive and support our growth.

Income from our Energy Services Segment, which consists of our management fees, equity income and gain from the sale of the WaterSecure operations, decreased $0.7 million during the third quarter 2011 compared to the third quarter 2010, due to the sale of our WaterSecure operations in June 2011 and the resulting discontinuance of management fees and equity income from those operations after the sale.

Our income from continuing operations attributable to PowerSecure International, Inc. shareholders for the third quarter 2011 was $1.0 million, or $0.05 per diluted share, compared to a loss from continuing operations attributable to PowerSecure International, Inc. shareholders of $0.3 million, or $(0.01) per diluted share, for the third quarter 2010.

Table of Contents

In total, our consolidated net income attributable to PowerSecure International, Inc. common stockholders for the third quarter 2011 was $1.0 million, or $0.05 per diluted share, which compared to net income attributable to PowerSecure International, Inc. common stockholders of $0.5 million, or $0.03 per diluted share, for the third quarter 2010, which included $0.8 million, or $0.04 per diluted share, of income from discontinued operations for which there was no comparable amount in the third quarter 2011.

Our consolidated revenues during the nine month period 2011 increased by $15.7 million, or 20.5%, compared to our consolidated revenues during the nine month period 2010. The drivers of this revenue increase were a 85.2% increase in revenues from our Utility Infrastructure products and services and a 5.2% increase in revenues from our Interactive Distributed Generation products, partially offset by a 8.3% decrease in revenues from our Energy Efficiency business.

Our gross profit margin as a percentage of revenue was 29.3% during the nine month period 2011, a decrease of 5.2 percentage points compared to the nine month period 2010. The decline in gross profit margin was driven by a $1.7 million inventory charge we recognized during the second quarter 2011 in cost of sales related to our planned exit from the PowerPackages business, $0.8 million of additional fuel costs incurred to operate a PowerSecure-owned distributed generation system which serves a Midwest utility, due to record heat and high demand on the utility system during the months of July and August, as well as changes in the mix of projects and products completed in the nine month period 2011 compared to the nine month period 2010. Our operating expenses increased in the nine month period 2011 compared to the nine month period of 2010 due to investments we made in our Energy and Smart Grid Solutions Segment to drive and support our future growth, including expenses relating to new product development, engineering, facilities, personnel, selling expense, compensation expense in each of our Distributed Generation, Energy Efficiency, and Utility Infrastructure business areas, as well as additional depreciation expense resulting from capital deployed to support our growing recurring revenue business. As a result, our total operating expenses during the nine month period 2011 increased by $4.8 million, or 17.8%, compared to our operating expenses during the nine month period 2010.

Income from our Energy Services Segment, which consists of our management fees, equity income and gain from the sale of the WaterSecure operations, increased $20.8 million during the nine month period 2011 compared to the nine month period 2010, driven primarily by the $21.8 million gain we recorded on the sale of our WaterSecure operations in June 2011.

Our income from continuing operations attributable to PowerSecure International, Inc. shareholders for the nine month period 2011 was $17.3 million, or $0.91 per diluted share, compared to income from continuing operations attributable to PowerSecure International, Inc. shareholders of $1.4 million, or $0.08 per diluted share, for the nine month period 2010.

Our income from discontinued operations for the nine month period 2011, consisting of the gain we recorded on the sale of Southern Flow, was $5.6 million, or $0.29 per diluted share. This compares to income from discontinued operations for the nine month period 2010 of $1.6 million, or $0.08 per diluted share, which consisted of the operating results of Southern Flow during the nine month period 2010.

In total, our consolidated net income attributable to PowerSecure International, Inc. common stockholders for the nine month period 2011 was $23.0 million, or $1.20 per diluted share, which compared to net income attributable to PowerSecure International, Inc. common stockholders of $3.0 million, or $0.16 per diluted share, for the nine month period 2010.

Table of Contents

As discussed below under Fluctuations, our financial results will fluctuate from quarter to quarter and year to year. Thus, there is no assurance that our past results, including the results of our year ended December 31, 2010 or our quarter ended September 30, 2011, will be indicative of our future results, especially in light of the current challenging conditions in the economy and in the credit and capital markets.

Backlog

As of the date of this report, our revenue backlog expected to be recognized after September 30, 2011 is $149 million. This includes revenue related to the new business announcement made by us on October 11, 2011, and approximately $14 million of additional new business which we were awarded in late October, and compares to $147 million of revenue backlog we reported on August 4, 2011 (the date we last reported our backlog). Our revenue backlog and the estimated timing of revenue recognition is outlined below, including project-based revenues expected to be recognized as projects are completed and recurring revenues expected to be recognized over the life of the contracts:

Revenue Backlog to be recognized after September 30, 2011

Description		Anticipated Revenue	Estimated Primary Recognition Period
Project-based Revenue	Near term	$ 59 Million	4Q11 through 2Q12
Project-based Revenue	Long term	$ 21 Million	3Q12 through 2013
Recurring Revenue		$ 69 Million	4Q11 through 2019
Revenue Backlog to be recognized after September 30, 2011		**$ 149 Million**	

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

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

Operating Segments

We conduct our operations through two operating segments: Energy and Smart Grid Solutions, and Energy Services. Our reportable segments are strategic business units that offer different products and services and serve different customer bases. They are managed separately because each business has a different customer base, requires different technology and personnel, and has different marketing strategies.

Energy and Smart Grid Solutions

Through our PowerSecure subsidiary we serve utilities and commercial, institutional, and industrial customers in the areas of Interactive Distributed Generation, Utility Infrastructure and Energy Efficiency. Each of these PowerSecure subsidiary business units operates in a distinct market with distinct technical disciplines, but share a common or complementary customer base with other PowerSecure subsidiary products and services and which we grow through shared resources and customer relationships. Accordingly, these units are included within our Energy and Smart Grid Solutions segment results.

Table of Contents

Energy Services

Until recently, our Energy Services segment operated through our WaterSecure and Southern Flow subsidiaries. Our Southern Flow subsidiary was sold in January 2011 and the WaterSecure operations, which consisted of our equity investment in MM 1995-2 was sold in June 2011. The results of Southern Flow s discontinued operations are excluded from our Energy Services segment for all periods presented in the information below. We continue to report our WaterSecure operations in our Energy Services segment, although we do not anticipate any on-going operating activity from our WaterSecure operations for financial periods after June 30, 2011.

Results of Operations

The following discussion regarding segment revenues, gross profit, costs and expenses, and other income and expenses for the third quarter 2011 and nine month period 2011 compared to the third quarter 2010 and nine month period 2010 excludes revenues, gross profit, and costs and expenses of our Southern Flow subsidiary, which we sold in January 2011 and is classified as a discontinued operation in our financial statements.

Third Quarter 2011 Compared to Third Quarter 2010

Revenues

Our consolidated revenues are generated entirely by sales and services provided by our PowerSecure subsidiary, which operates our Energy and Smart Grid Solutions segment. We currently provide a variety of Energy and Smart Grid Solutions products and services through three product categories: Interactive Distributed Generation, Utility Infrastructure, and Energy Efficiency. The following table summarizes our Energy and Smart Grid Solutions segment revenues for the periods indicated (dollars in thousands):

	Quarter Ended September 30,		Period-over-Period Difference	
	2011	2010	$	%
Energy and SmartGrid Solutions:				
Interactive Distributed Generation	$ 19,999	$ 13,690	$ 6,309	46.1%
Utility Infrastructure	13,300	6,097	7,203	118.1%
Energy Efficiency	4,930	6,529	(1,599)	-24.5%
Total	$ 38,229	$ 26,316	$ 11,913	45.3%

Our consolidated revenues for the third quarter 2011 increased $11.9 million, or 45.3%, compared to the third quarter 2010 due to an increase in sales in our Interactive Distributed Generation and Utility Infrastructure products and services categories, partially offset by a decrease in sales in our Energy Efficiency products and services category.

Table of Contents

Our Energy and Smart Grid Solutions segment distributed generation revenues are very heavily affected by the number, size and timing of our Interactive Distributed Generation projects as well as the percentage of completion of in-process projects, and the percentage of customer-owned as opposed to recurring revenue projects. Our Interactive Distributed Generation sales have fluctuated significantly in the past and are expected to continue to fluctuate significantly in the future. Our Energy and Smart Grid Solutions segment revenues increased by $11.9 million, or 45.3%, during the third quarter 2011 compared to the third quarter 2010. The increase in those revenues in the third quarter 2011 over the third quarter 2010 was primarily attributable to a $7.2 million, or 118.1%, increase in revenues from our Utility Infrastructure products and services and a $6.3 million, or 46.1%, increase in revenues from our Interactive Distributed Generation products and services, partially offset by a $1.6 million, or 24.5%, decrease in revenues from our Energy Efficiency products and services. The increase in our Interactive Distributed Generation product sales and services reflects an increase in both our PowerSecure-owned recurring revenue projects and customer-owned system sales from period-to-period. During the third quarter 2011, 20.3% of our distributed generation revenues were derived from recurring revenue sales, a substantial increase over the third quarter 2010 when 13.0% of our distributed generation revenues were derived from recurring revenue sales. The increase in our Utility Infrastructure product sales and services was due to an increase in the number of utilities that we service, and an increase in those customers spending levels on transmission and distribution system maintenance and construction. The decrease in our Energy Efficiency sales and services in the third quarter 2011 compared the third quarter 2010 reflects a decrease in revenues from both our EfficientLights and IES LED lighting business operations.

The future level of our revenues will depend on the timing and degree of the recovery of the domestic economy, the health of the credit markets and the return to pre-recession levels of customer spending for capital improvements and energy efficiency, as well as our ability to secure new significant purchase orders. The level and timing of our future revenues will also be affected by the amount and proportion of revenues coming from recurring revenue projects in the future, which results in revenue being recognized over a longer period. We are particularly susceptible to changes in economic conditions due to the fact that our product offerings are largely discretionary investment items for our customers, and this can therefore subject them to delay or deferment especially when economic conditions are not positive.

Gross Profit and Gross Profit Margin

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

	Quarter Ended September 30,		Period-over-Period Difference	
	2011	2010	$	%
Energy and Smart Grid Solutions:				
Cost of Sales	$ 26,582	$ 17,747	$ 8,835	49.8%
Gross Profit	$ 11,647	$ 8,569	$ 3,078	35.9%
Gross Profit Margin	30.5%	32.6%		

Cost of sales and services include materials, personnel and related overhead costs incurred to manufacture products and provide services. The 49.8% increase in our consolidated cost of sales and services for the third quarter 2011, compared to the third quarter 2010, was driven by the increase in costs associated with the 45.3% increase in sales, together with the factors discussed below leading to the decrease in our gross profit margin.

39

Table of Contents

Our Energy and Smart Grid Solutions segment gross profit increased $3.1 million, or 35.9%, in the third quarter 2011, compared to the third quarter 2010. As a percentage of revenue, our Energy and Smart Grid Solutions segment gross profit margin decreased by 2.1 percentage points in the third quarter 2011 compared to the third quarter 2010, to 30.5%. The decrease in our Energy and Smart Grid Solutions gross profit margin reflects the effects on costs of sales of $0.8 million of additional fuel costs incurred to operate a PowerSecure-owned distributed generation system which serves a Midwest utility, due to record heat and high demand on the utility system during the months of July and August , as well as changes in the mix of projects and products completed in the third quarter 2011 compared to the third quarter 2010. In the long-term, however, we expect that gross profit margins for this segment will increase because of anticipated greater productivity, operations and manufacturing efficiencies, improvements in technology, and growth in our higher-margin recurring revenue projects.

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

- The absolute level of revenue achieved in any particular period, given that portions of our cost of sales are relatively fixed over the near-term, the most significant of which is personnel and equipment costs;
- Our ability to improve our operating efficiency and benefit from economies of scale;
- Our level of investments in our businesses, particularly for anticipated or new or business awards;
- Improvements in technology and manufacturing methods and processes;
- The mix of higher and lower margin projects, products and services, and the impact of new products and technologies on our pricing and volumes;
- Our ability to manage our materials and labor costs, including any future inflationary pressures;
- The costs to maintain and operate distributed generation systems we own in conjunction with recurring revenue contracts, including the price of fuel and the amount of fuel utilized in their operation, as well as their operating performance;
- The geographic density of our projects;
- The selling price of products and services sold to customers, and the revenues we expect to generate from recurring revenue projects;
- The rate of growth of our new businesses, which tend to incur costs in excess of revenues in their earlier phases and then become profitable and more efficient over time if they are successful;
- Costs and expenses of business shutdowns, when they occur; and
- Other factors described below under Fluctuations.

Some of these factors are not within our control, and we cannot provide any assurance that we can continue to improve upon those factors that are within our control, especially given the current economic climate as well as our movement to an expected higher percentage of recurring revenue projects. Moreover, our gross revenues are likely are likely to fluctuate from quarter to quarter and from year to year, as discussed in Fluctuations below. Accordingly, there is no assurance that our future gross profit margins will improve or even remain at historic levels in the future, and will likely decrease if revenues decrease.

Table of Contents

*Operating Expense*s

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

	Quarter Ended September 30,		Period-over-Period Difference	
	2011	2010	$	%
Consolidated Operating Expenses:				
General and administrative	$ 9,168	$ 7,388	$ 1,780	24.1%
Selling, marketing and service	1,279	1,383	(104)	-7.5%
Depreciation and amortization	858	756	102	13.5%
Total	$ 11,305	$ 9,527	$ 1,778	18.7%

Costs related to personnel, including wages, stock compensation, bonuses and commissions, are the most significant component of our operating expenses. During the third quarter 2011, our operating expenses increased due to investments in new product development, engineering, facilities, and personnel, as well as increases in compensation expense and increases in depreciation from capital deployed to support our recurring revenue business. Our operating expense investments were in support of, and driven by, increasing levels of revenue and identified new business opportunities in 2010 and the first nine months of 2011. In the future, we expect to continue to make investments designed to support and drive our future business growth. We expect our operating costs to grow to support the growth of our business, although at a lower growth rate than revenues over time, and that growth will be dependent in large part upon future economic and market conditions. Accordingly, the timing and the amount of future increases in operating expenses will depend on the timing and level of future improvements in economic and business conditions and the effects of such economic recovery on our revenues. We cannot provide any assurance as to if, when, how much or for how long economic conditions will improve, or the effects of future economic conditions on our revenues, expenses or net income.

Table of Contents

General and Administrative Expenses. General and administrative expenses include personnel wages, benefits, stock compensation, and bonuses and related overhead costs for the support and administrative functions incurred primarily in our Energy and Smart Grid Solutions segment. The 24.1% increase in our consolidated general and administrative expenses in the third quarter 2011, as compared to the third quarter 2010, was due to investment in personnel and other administrative expenses to support our increasing levels of revenue and investments in new business opportunities. The following table provides further detail of our general and administrative expenses by segment (dollars in thousands):

	Quarter Ended September 30,		Period-over-Period Difference	
	2011	2010	$	%
Segment G&A Expenses:				
Energy and Smart Grid Solutions:				
Personnel costs	$ 5,331	$ 3,923	$ 1,408	35.9%
Vehicle lease and rental	647	491	156	31.8%
Equipment disposals and write-down	(8)	38	(46)	-121.1%
Insurance	198	268	(70)	-26.1%
Rent-office and equipment	220	248	(28)	-11.3%
Professional fees and consulting	156	241	(85)	-35.3%
Travel	276	282	(6)	-2.1%
Development costs	240	151	89	58.9%
Other	802	690	112	16.2%
Energy Services				n/m
Unallocated Corporate Costs	1,306	1,056	250	23.7%
Total	$ 9,168	$ 7,388	$ 1,780	24.1%

The increase in our Energy and Smart Grid Solutions segment personnel costs and vehicle lease and rental costs during the third quarter 2011, as compared to the third quarter 2010, was due to staffing increases to support growth in our Energy and Smart Grid Solutions Segment and investments in new business opportunities. Other general and administrative expenses including professional and consulting fees, travel and other expenses decreased as a result of cost control efforts undertaken earlier in 2011. In the near-term, we expect our Energy and Smart Grid Solutions general and administrative expenses levels to be similar to our quarterly level during the third quarter 2011. Over the long-term, we expect our expenses in these areas to further increase, although at lower growth rates than our revenues, at our Energy and Smart Grid Solutions segment as we continue to invest in and support long-term growth. Unallocated corporate general and administrative expenses include similar personnel costs as described above as well as costs incurred for the benefit of all of our business operations, such as legal, Sarbanes-Oxley, public company reporting, director expenses, accounting costs, and stock compensation expense on our stock options and restricted stock grants which we do not allocate to our operating segments. The increase in unallocated corporate costs during the third quarter 2011 as compared to the third quarter 2010 was due to increased stock compensation expense, personnel expense, incentive compensation costs and professional fees. We expect our quarterly unallocated corporate costs in the near-term to remain consistent with the level we incurred during the third quarter 2011.

Table of Contents

Selling, Marketing and Service Expenses. Selling, marketing and service expenses consist of personnel and related overhead costs, including commissions for sales and marketing activities, together with travel, advertising and promotion costs incurred in our Energy and Smart Grid Solutions segment. The 7.5% decrease in selling, marketing and service expenses in the third quarter 2011, as compared to the third quarter 2010, was due to decreases in travel, advertising and promotion expense, partially offset by increases in sales compensation incurred to stimulate revenue growth and respond to an increasing level of sales opportunities for our Energy and Smart Grid Solutions segment. The following table provides further detail of our segment selling, marketing and service expenses (dollars in thousands):

	Quarter Ended September 30,		Period-over-Period Difference	
	2011	2010	$	%
Segment Selling, Marketing and Service:				
Energy and Smart Grid Solutions:				
Salaries	$ 530	$ 620	$ (90)	-14.5%
Commission	387	275	112	40.7%
Travel	144	228	(84)	-36.8%
Advertising and promotion	107	146	(39)	-26.7%
Bad debt and other expense	111	114	(3)	-2.6%
Energy Services				n/m
Total	$ 1,279	$ 1,383	$ (104)	-7.5%

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

Depreciation and Amortization Expenses. Depreciation and amortization expenses include the depreciation of property, plant and equipment and the amortization of certain intangible assets including capitalized software development costs and other intangible assets. The 13.5% increase in depreciation and amortization expenses in the third quarter 2011, as compared to the third quarter 2010, primarily reflects increased depreciation and amortization resulting from capital investments at our Energy and Smart Grid Solutions segment in the second half of 2010 and the first nine months of 2011. These capital investments are primarily investments in PowerSecure-owned distributed generation systems for projects deployed under our recurring revenue model.

Table of Contents

Other Income and Expenses

Our other income and expenses include the gain on the sale of our WaterSecure operations, management fees and equity income earned by our Energy Services segment as managing trustee of MM 1995-2 relating to the WaterSecure operations, interest income, interest expense and income taxes. The following table sets forth our other income and expenses for the periods indicated, by segment (dollars in thousands):

	Quarter Ended September 30,		Period-over-Period Difference	
	2011	2010	$	%
Other Segment Income and (Expenses):				
Energy and Smart Grid Solutions:				
Interest income and other income	$	$	$	n/m
Interest expense	(124)	(111)	(13)	-11.7%
Segment total	(124)	(111)	(13)	
Energy Services:				
Gain on sale of unconsolidated affiliate	44		44	n/m
Equity income		598	(598)	-100.0%
Management fees		136	(136)	-100.0%
Segment total	44	734	(690)	
Unallocated Corporate:				
Interest income and other income	31	24	7	29.2%
Interest expense	(44)	(66)	22	33.3%
Income tax benefit (provision)	493	(42)	535	1273.8%
Segment total	480	(84)	564	
Total	$ 400	$ 539	$ (139)	

Gain on Sale of Unconsolidated Affiliate. Gain on sale of unconsolidated affiliate at our Energy Services segment consists of our minority ownership share of the gain recognized by our WaterSecure operations related to the sale of substantially all of assets and business of MM 1995-2 in June 2011. The balance recognized in the third quarter 2011 represents our minority ownership share of favorable purchase price adjustments recognized by MM 1995-2 during the third quarter 2011. In addition, MM 1995-2 has deferred $4.0 million of gain which will be recognized only when certain contingencies associated with the sale have been eliminated in the second quarter of 2012. Accordingly, our WaterSecure operations may recognize an additional gain in the second quarter of 2012 in the amount of up to $1.4 million, depending on the outcome of the contingencies.

Equity Income. Equity income at our Energy Services segment consists of our minority ownership interest in the earnings of the WaterSecure operations. Our equity income is a direct function of the net income of the WaterSecure operations. We recorded no equity income during the third quarter 2011 due to the sale of the WaterSecure operations on June 1, 2011.

Management Fees. Management fees at our Energy Services segment consist entirely of fees we earn as the managing trustee of the WaterSecure operations. These fees, to a large extent, are based on a percentage of the revenues of the

WaterSecure operations. We recorded no management fees during the third quarter 2011 due to the sale of the WaterSecure operations on June 1, 2011.

Interest Income and Other Income. Interest income and other income for each segments consists primarily of interest we earn on the interest-bearing portion of our cash and cash equivalent balances. In total, interest income and other income increased slightly during the third quarter 2011, as compared to the third quarter 2010. This slight increase was attributable to interest earned on a higher level of cash and cash equivalents balances in the third quarter 2011 compared to the third quarter 2010, partially offset by declining interest rates. Our future interest income will depend on our cash and cash equivalent balances, which will increase and decrease depending upon our profit, capital expenditures, and our working capital needs, and future interest rates.

Table of Contents

Interest Expense. Interest expense for each segment consists of interest and finance charges on our credit facilities and capital leases. In total, interest expense decreased slightly during the third quarter 2011, as compared to the third quarter 2010. The decrease in our interest expense reflects the reduction in balances outstanding on our capital lease obligation due to regular payments made on our capital leases over the year, partially offset by the interest associated with our increased borrowings under our credit facility during the third quarter 2011. We expect our future interest and finance charges to increase over time as a result of anticipated borrowings under our credit facility to fund future working capital needs and recurring revenue projects at our Energy and Smart Grid Solutions segment.

Income Taxes. Historically, our current federal income tax expense has been modest, generally limited to federal alternative minimum tax, because of our consolidated net operating losses in prior years that are used to offset taxable income in current years. The income tax benefit or provision we record is the result of applying our expected annual effective tax rate by our net income or loss. Our effective tax rate and our income tax provision or benefit includes the effects of permanent differences between our book and taxable income, changes in our deferred tax assets and liabilities, changes in the valuation allowance for our net deferred tax asset, state income taxes in various state jurisdictions in which we have taxable activities, and expenses associated with uncertain tax positions that we have taken or expense reductions from uncertain tax positions as a result of a lapse of the applicable statute of limitations. The gain from the sale of our WaterSecure operations in June 2011 has utilized the majority of our federal net operation loss carryforwards and also resulted in a change in our valuation allowance on the net operating loss carryforwards. This resulted in an increase to our effective income tax rate in the current and future periods. The tax benefit recorded during the third quarter 2011 compared to the tax provision recorded in the third quarter 2010 was a result of a tax benefit recorded for the lapse of statute of limitations on uncertain tax positions taken in prior years partially offset by an increase in our effective income tax rate on current period earnings.

Noncontrolling Interest. The noncontrolling ownership interests in the income or losses of our majority-owned subsidiaries is included in our consolidated statements of operations as a reduction or addition to net income to derive income attributable to PowerSecure International stockholders. Until April 30, 2010, our PowerSecure subsidiary held a 67% controlling ownership interest in EfficientLights which is consolidated in our financial statements. On April 30, 2010, we acquired the 33% noncontrolling ownership interest in EfficientLights at which time EfficientLights became a wholly-owned subsidiary of our PowerSecure subsidiary. Also, on April 1, 2010, our PowerSecure subsidiary acquired a 67% controlling ownership interest in IES.

The increase in the addition for the noncontrolling interest in the loss of IES in the third quarter 2011 compared to the third quarter 2010 is a result of start up and development expenses of IES.

Table of Contents

Nine Month Period 2011 Compared to Nine Month Period 2010

Revenues

The following table summarizes our Energy and Smart Grid Solutions segment revenues for the periods indicated (dollars in thousands):

	Nine Months Ended September 30,		Period-over-Period Difference	
	2011	2010	$	%
Energy and SmartGrid Solutions:				
Interactive Distributed Generation	$ 44,058	$ 41,888	$ 2,170	5.2%
Utility Infrastructure	32,387	17,490	14,897	85.2%
Energy Efficiency	15,714	17,131	(1,417)	-8.3%
Total	$ 92,159	$ 76,509	$ 15,650	20.5%

Our consolidated revenues for the nine month period 2011 increased $15.7 million, or 20.5%, compared to the nine month period 2010 due to increases in sales in our Interactive Distributed Generation and Utility Infrastructure products and services categories, partially offset by a decrease in our Energy Efficiency products and services category.

Our Energy and Smart Grid Solutions segment distributed generation revenues are very heavily affected by the number, size and timing of our Interactive Distributed Generation projects as well as the percentage of completion of in-process projects, and the percentage of customer-owned as opposed to recurring revenue projects. Our Interactive Distributed Generation sales have fluctuated significantly in the past and are expected to continue to fluctuate significantly in the future. Our Energy and Smart Grid Solutions segment revenues increased by $15.7 million, or 20.5%, during the nine month period 2011 compared to the nine month period 2010. The increase in those revenues in the nine month period 2011 over the nine month period 2010 was primarily attributable to a $14.9 million, or 85.2%, increase in revenues from our Utility Infrastructure products and services and a $2.2 million, or 5.2%, increase in revenues from our Interactive Distributed Generation products and services, partially offset by a $1.4 million, or 8.3%, decrease in revenues from our Energy Efficiency products and services. The increase in our Interactive Distributed Generation product sales and services reflects an 88.9% increase in our PowerSecure-owned recurring revenue projects during the nine month period 2011 compared to the nine month period 2010. During the nine month period 2011, 19.1% of our distributed generation revenues were derived from recurring revenue sales, a substantial increase over the nine month period 2010 when 12.2% of our distributed generation revenues were derived from recurring revenue sales. The increase in our Utility Infrastructure product sales and services was due to an increase in the number of utilities that we service, and an increase in those customers spending levels on transmission and distribution system maintenance and construction. The decrease in our Energy Efficiency sales and services in the nine month period 2011 compared the nine month period 2010 reflects a decrease in sales from our EfficientLights subsidiary, partially offset by the inclusion of revenues from our IES LED lighting business operations for the full nine month period in 2011 versus just six months during 2010, due to its acquisition on April 1, 2010.

Table of Contents

Gross Profit and Gross Profit Margin

The following tables summarizes our Energy and Smart Grid Solutions segment cost of sales along with our segment gross profit and gross profit margin for the periods indicated (dollars in thousands):

	Nine Months Ended September 30,		Period-over-Period Difference	
	2011	2010	$	%
Energy and Smart Grid Solutions:				
Cost of Sales	$ 65,183	$ 50,098	$ 15,085	30.1%
Gross Profit	$ 26,976	$ 26,411	$ 565	2.1%
Gross Profit Margin	29.3%	34.5%		

The 30.1% increase in our consolidated cost of sales and services for the nine month period 2011, compared to the nine month period 2010, was driven by the increase in costs associated with the 20.5% increase in sales, together with the factors discussed below leading to the decrease in our gross profit margin.

Our Energy and Smart Grid Solutions segment gross profit increased $0.6 million, or 2.1%, in the nine month period 2011, compared to the nine month period 2010. As a percentage of revenue, our Energy and Smart Grid Solutions segment gross profit margin decreased by 5.2 percentage points in the nine month period 2011 compared to the nine month period 2010, to 29.3%. The decrease in our Energy and Smart Grid Solutions gross profit margin reflects the $1.7 million inventory charge we recognized in cost of sales related to our planned exit from the PowerPackages business, $0.8 million of additional fuel costs incurred to operate a PowerSecure-owned distributed generation system which serves a Midwest utility, due to record heat and high demand on the utility system during the months of July and August, as well as changes in the mix of projects and products completed in the nine month period 2011 compared to the nine month period 2010. In the long-term, however, we expect that gross profit margins for this segment will increase because of anticipated greater productivity, operations and manufacturing efficiencies, improvements in technology, and growth in our higher-margin recurring revenue projects.

*Operating Expense*s

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

	Nine Months Ended September 30,		Period-over-Period Difference	
	2011	2010	$	%
Consolidated Operating Expenses:				
General and administrative	$ 25,596	$ 21,176	$ 4,420	20.9%
Selling, marketing and service	3,657	3,777	(120)	-3.2%
Depreciation and amortization	2,499	2,011	488	24.3%
Total	$ 31,752	$ 26,964	$ 4,788	17.8%

During the nine month period 2011, our operating expenses increased due to investments in new product development, engineering, facilities, and personnel, as well as increases in compensation expense, and increases in depreciation from capital deployed to support our recurring revenue business. Our operating expense investments were in support of, and driven by, increasing levels of revenue and identified new business opportunities in 2010 and early 2011. In the future, we expect to continue to make investments designed to support and drive our future business growth, subject to the general economic conditions demonstrating sustained improvement and our continuing positive

expectations regarding our future growth opportunities.

Table of Contents

General and Administrative Expenses. The 20.9% increase in our consolidated general and administrative expenses in the nine month period 2011, as compared to the nine month period 2010, was due to investment in personnel and other administrative expenses to support our increasing levels of revenue and investments in new business opportunities. Our general and administrative expense in the nine month period 2011 also included the effects of the write-down of equipment in the amount of $383 as a result our plan to exit the PowerPackages business. The following table provides further detail of our general and administrative expenses by segment (dollars in thousands):

	Nine Months Ended September 30,		Period-over-Period Difference	
	2011	2010	$	%
Segment G&A Expenses:				
Energy and Smart Grid Solutions:				
Personnel costs	$ 14,559	$ 10,820	$ 3,739	34.6%
Vehicle lease and rental	1,740	1,354	386	28.5%
Equipment disposals and write-down	384	42	342	814.3%
Insurance	502	788	(286)	-36.3%
Rent-office and equipment	678	682	(4)	-0.6%
Professional fees and consulting	534	689	(155)	-22.5%
Travel	808	822	(14)	-1.7%
Development costs	542	235	307	130.6%
Other	2,076	1,985	91	4.6%
Energy Services				n/m
Unallocated Corporate Costs	3,773	3,759	14	0.4%
Total	$ 25,596	$ 21,176	$ 4,420	20.9%

The increase in our Energy and Smart Grid Solutions segment personnel costs, development costs and vehicle costs during the nine month period 2011, as compared to the nine month period 2010, were due to staffing increases to support growth in our Energy and Smart Grid Solutions Segment and investments in new business opportunities. Other general and administrative expenses including professional and consulting fees, travel and other expenses decreased as a result of cost control efforts undertaken in the nine month period 2011. In the near-term, we expect our Energy and Smart Grid Solutions general and administrative expenses levels to be similar to our level during the nine month period 2011. Over the long-term, we expect our expenses in these areas to further increase at our Energy and Smart Grid Solutions segment as we continue to invest in and support long-term growth.

Table of Contents

Selling, Marketing and Service Expenses. The 3.2% decrease in selling, marketing and service expenses in the nine month period 2011, as compared to the nine month period 2010, was due to reductions in travel, advertising and promotion and to bad debt expense partially offset by increases in sales compensation incurred to stimulate revenue growth and respond to an increasing level of sales opportunities for our Energy and Smart Grid Solutions segment. The following table provides further detail of our segment selling, marketing and service expenses (dollars in thousands):

	Nine Months Ended September 30,		Period-over-Period Difference	
	2011	2010	$	%
Segment Selling, Marketing and Service:				
Energy and Smart Grid Solutions:				
Salaries	$ 1,776	$ 1,703	$ 73	4.3%
Commission	1,031	870	161	18.5%
Travel	446	575	(129)	-22.4%
Advertising and promotion	251	439	(188)	-42.8%
Bad debt and other expense	153	190	(37)	-19.5%
Energy Services				n/m
Total	$ 3,657	$ 3,777	$ (120)	-3.2%

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

Depreciation and Amortization Expenses. The 24.3% increase in depreciation and amortization expenses in the nine month period 2011, as compared to the nine month period 2010, primarily reflects increased depreciation and amortization resulting from capital investments at our Energy and Smart Grid Solutions segment throughout the second half of 2010 and the nine month period 2011. These capital investments are primarily investments in PowerSecure-owned distributed generation systems for projects deployed under our recurring revenue model.

Other Income and Expenses

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

	Nine Months Ended September 30,		Period-over-Period Difference	
	2011	2010	$	%
Other Segment Income and (Expenses):				
Energy and Smart Grid Solutions:				
Interest income and other income	$	$	$	n/m
Interest expense	(311)	(248)	(63)	-25.4%
Segment total	(311)	(248)	(63)	
Energy Services:				
Gain on sale of unconsolidated affiliate	21,830		21,830	n/m
Equity income	1,559	2,435	(876)	-36.0%

Management fees	282	432	(150)	-34.7%
Segment total	23,671	2,867	20,804	
Unallocated Corporate:				
Interest income and other income	73	77	(4)	-5.2%
Interest expense	(143)	(209)	66	31.6%
Income tax benefit (provision)	(1,763)	(475)	(1,288)	-271.2%
Segment total	(1,833)	(607)	(1,226)	
Total	$ 21,527	$ 2,012	$ 19,515	

Table of Contents

Gain on Sale of Unconsolidated Affiliate. Gain on sale of unconsolidated affiliate at our Energy Services segment consists of our minority ownership share of the gain recognized by our WaterSecure operations related to the sale of substantially all of assets and business of MM 1995-2 in June 2011. MM 1995-2 has deferred $4.0 million of gain which will be recognized only when certain contingencies associated with the sale have been eliminated in the second quarter of 2012. Accordingly, our WaterSecure operations may recognize an additional gain in the second quarter of 2012 in the amount of up to $1.4 million, depending on the outcome of the contingencies.

Equity Income. During the nine month period 2011, our equity income decreased by $876, or 36.0%, compared to the nine month period 2010 due to the sale of the WaterSecure operations on June 1, 2011. We do not expect to record any additional equity income from our ownership interest in the earnings of the WaterSecure operations in financial periods after June 30, 2011.

Management Fees. Our Energy Services segment management fees decreased in the nine month period 2011 by $150, or 34.7%, compared to the nine month period 2010 due to the sale of the WaterSecure operations on June 1, 2011. We do not expect to record any additional management fees in financial periods after June 30, 2011.

Interest Income and Other Income. In total, interest income and other income decreased slightly during the nine month period 2011, as compared to the nine month period 2010. This decrease was attributable to a decline in our interest income resulting from declining interest rates earned on our cash and cash equivalent balances in the nine month period 2011 compared to the nine month period 2010. Our future interest income will depend on our cash and cash equivalent balances, which will increase and decrease depending upon our profit, capital expenditures, and our working capital needs, and future interest rates.

Interest Expense. In total, interest expense decreased slightly during the nine month period 2011, as compared to the nine month period 2010. The decrease in our interest expense reflects the reduction in balances outstanding on our capital lease obligation due to regular payments made on our capital leases over the year, partially offset by the interest associated with our increased borrowings under our credit facility during the nine month period 2011. We expect our future interest and finance charges to increase over time as a result of anticipated borrowings under our credit facility to fund future working capital needs and recurring revenue projects at our Energy and Smart Grid Solutions segment.

Income Taxes. The increase in our nine month period 2011 income tax provision compared to the nine month period 2010 income tax provision was due to state income taxes on the sale of our WaterSecure operations together with the reduction of our deferred tax asset and the elimination of our valuation allowance associated with utilizing our net operating loss carryforwards. The gain from the sale of our WaterSecure operations has utilized the majority of our federal net operation loss carryforwards and also resulted in a change in our valuation allowance on the net operating loss carryforwards. This resulted in an increase to our effective income tax rate in the current and future periods. The increase in our income tax provision during the nine month period 2011 compared to the nine month period 2010 was a result of the increase in our effective income tax rate.

Noncontrolling Interest. The addition for the noncontrolling interest in the loss of IES in the nine month period 2011 is a result of start up and development expenses of IES, which we acquired on April 1, 2010. The reduction for the noncontrolling interest in the nine month period 2010 is a result of income related to the EfficientLights noncontrolling interest prior to the exercise of our option to acquire the minority interest position in EfficientLights on April 30, 2010, partially offset by the losses related to the IES noncontrolling interest subsequent to our acquisition of IES on April 1, 2010.

Table of Contents

Fluctuations

Our revenues, expenses, margins, net income, cash flow, cash, working capital debt, balance sheet positions, and other operating results have fluctuated significantly from quarter-to-quarter, period-to-period and year-to-year in the past and are expected to continue to fluctuate significantly in the future due to a variety of factors, many of which are outside of our control. These factors include, without limitation, the following:

- the effects of general economic and financial conditions, including the ongoing challenges in the economy and the difficult capital and credit markets, and the potential for such economic and market challenges to continue or recur in the future, negatively impacting our business operations and our revenues and net income, including the negative impact these conditions could have on the timing of and amounts of orders from our customers, and the potential these factors have to negatively impact our access to capital to finance our business;
- the size, timing and terms of sales and orders, including large customer orders, as well as the effects of the timing of project phases of completion, and customers delaying, deferring or canceling purchase orders or making smaller purchases than expected;
- our ability to increase our revenues through long-term recurring revenue projects, recognizing that increasing revenues from recurring revenue projects will require significant up-front capital expenditures and will protract revenue and profit recognition, while increasing our gross margins over the long-term, as well as our ability to sell, complete, and recognize satisfactory levels of quarterly revenue and profits related to our project-based sales and product and service revenue, in order to maintain current profits, cash flow, and to satisfy our financial covenants in our debt facilities and successfully finance the recurring portion of our business model;
- our ability to maintain and grow our utility infrastructure revenues, and maintain and increase pricing, utilization rates, and productivity rates, given the significant levels of vehicles, tools, and labor in which we have invested and is required to serve utilities in this business area;
- the recent sales of our Southern Flow business and our WaterSecure business, and the associated loss of revenues, cash flow and income from those businesses, and our ability to redeploy the proceeds from the sales productively and profitably into our core business;
- our ability to obtain adequate supplies of key components and materials of suitable quality for our products on a timely and cost-effective basis, including the impact of potential supply line constraints, substandard parts, and fluctuations in the cost of raw materials and commodity prices, including without limitation with respect to our Energy Efficiency business unit in relation to third party manufacturing arrangements we have with vendors in China, and other component parts which have their origins in Japan;
- the performance of our products, services and technologies, and the ability of our systems to meet the performance standards they are designed and built to deliver to our customers, including but not limited to our recurring revenue projects for which we retain the on-going risks associated with the performance and ownership of the systems;
- our ability to access significant capital resources on a timely basis in order to fund working capital requirements, fulfill large customer orders, and finance capital required for recurring revenue projects and equipment for our utility infrastructure business;

Table of Contents

- our ability to implement our business plans and strategies and the development of new products and services the timing of such implementation;
- the pace of revenue and profit realization from our new businesses and the development and growth of their markets, including the timing, pricing and market acceptance of our new products and services;
- changes in our pricing policies and those of our competitors, including the introduction of lower cost competing technologies and the potential for them to impact our pricing and our profit margins;
- variations in the length of our sales cycle and product and service delivery and construction process;
- changes in the mix of products and services having differing margins;
- changes in our operating expenses, including prices for materials including but not limited to copper, aluminum, and other raw materials, labor costs, and other components of our products and services, fuel prices and volumes of fuel utilized in our operations including diesel, natural gas, oil and gasoline, and our ability or inability to hedge or otherwise manage these prices to protect our costs and revenues, minimize the impact of volatile exchange rates and mitigate unforeseen or unanticipated expenses;
- changes in our valuation allowance for our net deferred tax asset, and the resulting impact on current tax expense, future tax expense, and balance sheet account balances;
- the effects of severe weather conditions, such as hurricanes, on the business operations of our customers, and the potential effect of such conditions on our results of operations;
- the life cycles of our products and services, and competitive alternatives in the marketplace;
- budgeting cycles of utilities and other industrial, commercial, and institutional customers, including impacts of the current downturn in the economy and difficult capital market conditions on capital projects and other spending items;
- changes and uncertainties in the lead times required to obtain the necessary permits and other governmental and regulatory approvals for projects;
- the development and maintenance of business relationships with strategic partners such as utilities and large customers;
- economic conditions and regulations in the energy industry, especially in the electricity, natural gas and oil sectors, including the effects of changes in energy prices and electricity pricing and utility tariffs;
- changes in the prices charged by our suppliers;
- the effects of governmental regulations and regulatory changes in our markets;
- the effects of litigation, claims and other proceedings; and
- our ability to make and obtain the expected benefits from the development of or acquisition of technology or businesses, and the costs related to such development or acquisitions.

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.

Table of Contents

Our revenues and other operating results are heavily dependent upon the size and timing of customer orders, payments, and the timing of the completion of those projects. The timing of large individual sales, and of project completion, 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 can cause our operating results to vary significantly from quarter-to-quarter and can result in significant operating losses or declines in profit margins in any particular quarter. If our revenues fall below our expectations in any particular quarter, we may not be able to or it may not be prudent to reduce our expenses rapidly in response to the shortfall, which can result in us suffering significant operating losses or declines in profit margins in that quarter.

As we develop new related lines of business, our revenues and costs will fluctuate because generally new businesses require start-up expenses but take time for revenues to develop. Another factor that could cause material fluctuations in our quarterly results is the amount of recurring, as opposed to project-based, sources of revenue for our distributed generation and utility infrastructure projects. To date, the majority of our Energy and Smart Grid Solutions segment revenues have consisted of project-based distributed generation revenues, which are recognized as the project is completed. However, we have marketing efforts focused on developing more sales under our recurring revenue model, for which the costs and capital is invested initially and the related revenue and profit is recognized over the life of the contract, generally five to fifteen years. Recurring revenue projects, compared to project-based sales, are generally more profitable, but result in delayed recognition of revenue and net income, especially in the short-term, as we implement an increased number of these recurring revenue projects.

Due to all of these factors and the other risks, uncertainties and other factors discussed in this report and in our Annual Report on Form 10-K for the year ended December 31, 2010, quarter-to-quarter, period-to-period or year-to-year comparisons of our results of operations should not be relied on as an indication of our future performance. Quarterly, period or annual comparisons of our operating results are not necessarily meaningful or indicative of future performance.

Liquidity and Capital Resources

Overview

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

- operations;
- inventory;
- accounts receivable;
- property and equipment expenditures, including capital expenditures related to recurring revenue projects;
- software purchases or development;
- debt service requirements;
- lease obligations;
- deferred compensation obligations; and
- business and technology acquisitions and other growth transactions.

Table of Contents

Working Capital

At September 30, 2011, we had working capital of $80.1 million, including $32.7 million in cash and cash equivalents, compared to working capital of $54.5 million, including $8.2 million in cash and cash equivalents at December 31, 2010. Changes in the components of our working capital from December 31, 2010 to September 30, 2011 and from December 31, 2009 to September 30, 2010 are explained in greater detail below. At September 30, 2011 and December 31, 2010, we had $15.0 million and $20.0 million, respectively, of additional borrowing capacity from our credit facility. However, the availability of this capacity under our credit facility includes restrictions on the use of proceeds, and is dependent upon our ability to satisfy certain financial and operating covenants including financial ratios and a minimum cash balance, as discussed below.

Cash Flows

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

	Nine Months Ended September 30,	
	2011	**2010**
Net cash flows used in operating activities	$ (10,551)	$ (4,949)
Net cash flows provided by (used in) investing activities	28,393	(8,752)
Net cash provided by financing activities	6,648	8,200
Net increase (decrease) in cash and cash equivalents	$ 24,490	$ (5,501)

Cash Used in Operating Activities

Cash used in operating activities consists primarily of net income adjusted for certain non-cash items including the gain on the sale of our unconsolidated affiliate, depreciation and amortization, stock-based compensation expenses and equity income. Cash used in operating activities also include operating cash distributions from our unconsolidated affiliate, cash distributions to the EfficientLights noncontrolling member, and the effect of changes in working capital and other activities.

Cash used in operating activities of $10.6 million for the nine month period 2011 included the effects of the following:

- our income from continuing operations of $16.8 million;
- gain on sale of unconsolidated affiliate of $21.8 million;
- non-cash charges of $2.5 million in depreciation and amortization;
- stock-based compensation expense of $1.4 million;
- non-cash deferred income tax expense of $1.2 million;
- non-cash equity income from our WaterSecure operations of $1.6 million partially offset by cash distributions from those operations of $1.5 million;
- non-cash loss on the write down of our PowerPackages equipment of $0.4 million;
- an increase of $18.0 million in accounts receivable;
- a decrease of $0.6 million in inventories;
- a net decrease of $0.9 million in other assets and liabilities
- an increase of $0.1 million of accounts payable; and
- an increase of $5.5 million of accrued expenses.

Table of Contents

Cash used in operating activities of $4.9 million for the nine month period 2010 included the effects of the following:

- our income from continuing operations of $1.5 million;
- non-cash charges of $2.0 million in depreciation and amortization;
- stock-based compensation expense of $1.3 million;
- cash distributions to the noncontrolling member of EfficientLights of $0.9 million;
- non-cash equity income from our WaterSecure operations of $2.4 million partially offset by cash distributions from those operations of $2.2 million;
- an increase of $5.9 million in accounts receivable;
- an increase of $2.2 million in inventories;
- a net decrease of $0.8 million in other assets and liabilities
- an increase of $0.2 million of accounts payable;
- a decrease of $2.9 million of accrued expenses;
- cash payments of $0.3 million on our restructuring obligations; and
- cash provided by our discontinued operations of $1.8 million.

Cash Provided by (Used in) Investing Activities

Cash provided by investing activities was $28.4 million in the nine month period 2011 and cash used by investing activities was $8.8 million in the nine month period 2010. Historically, our principal cash investments have related to the purchase of equipment used in our production facilities, the acquisitions of certain contract rights, the acquisition and installation of equipment related to our recurring revenue sales, and the acquisition of businesses or technologies. During the nine month period 2011, we received $26.0 million from the sale of our WaterSecure operations, we received $16.5 million from the sale of our Southern Flow business, we used $11.4 million to purchase and install equipment at our recurring revenue distributed generation sites, and we used $2.7 million at our PowerSecure subsidiary principally to acquire operational assets. During the nine month period 2010, we used $4.4 million to acquire a 67% ownership interest in IES, $1.7 million to purchase and install equipment at our recurring revenue distributed generation sites and $2.5 million at our PowerSecure subsidiary principally to acquire operational assets.

Cash Provided by Financing Activities

Cash provided by financing activities was $6.6 million in the nine month period 2011 and cash provided by financing activities was $8.2 million in the nine month period 2010. During the nine month period 2011, we received $5.0 million from borrowings on our credit facility, we received $2.1 million from sale leaseback transactions, we received $0.1 million from the exercise of stock options and we used $0.6 million to repay our capital lease obligations. During the nine month period 2010, we received $7.5 million from borrowings on our credit facility, we received $1.3 million from the exercise of stock options and we used $0.6 million to repay our capital lease obligations.

Capital Spending

Our capital expenditures during the nine month period 2011 were approximately $14.1 million, of which we used $11.4 million to purchase and install equipment at our recurring revenue distributed generation sites, and $2.7 million to purchase equipment and other capital items at our PowerSecure subsidiary. Our capital expenditures from our continuing operations during the nine month period 2010 were approximately $4.2 million, of which we used $1.7 million to purchase and install equipment at our recurring revenue distributed generation sites, and $2.5 million to purchase equipment and other capital items at our PowerSecure subsidiary.

Table of Contents

We anticipate making capital expenditures of approximately $15-16 million in 2011, although customer demand for our Interactive Distributed Generation systems under recurring revenue contract arrangements, and economic and financial conditions could cause us to reduce or increase those capital expenditures. The vast majority of our capital spending has to date been and will continue to be used for investments in assets related to our recurring revenue projects as well as equipment to support the growth of our Energy and Smart Grid Solutions segment.

Indebtedness

Line of Credit. We have had a credit facility with Citibank, N.A. (Citibank), as administrative agent and lender, and other lenders since entering into a credit agreement in August 2007. At December 31, 2010, our credit agreement with Citibank along with SunTrust Bank and Branch Banking and Trust Company (BB&T) as additional lenders, provided for a $50.0 million senior, first-priority secured revolving and term credit facility. In January 2011, the credit facility was amended to facilitate the sale of Southern Flow, modify certain financial covenants to accommodate our financial profile after that sale and reflect a change in lenders. The credit facility, as amended, is now a $25.0 million senior, first-priority secured revolving credit facility with Citibank and BB&T as lenders. The credit facility is guaranteed by all of our active subsidiaries and secured by all of our assets and the assets of our active subsidiaries.

As amended, the credit facility, as a revolving credit facility, matures and terminates on November 12, 2013. However, we have the option prior to that maturity date to convert a portion of outstanding principal balance into a non-revolving term loan for a two year period expiring November 12, 2015, making quarterly payments based upon a four year fully amortized basis, with the remaining outstandings due as a balloon payment on November 12, 2015. We intend to continue to use the proceeds available under the credit facility to finance our PowerSecure subsidiary s recurring revenue projects as well as to finance capital expenditures, working capital, acquisitions, and general corporate purposes. Under the terms of the amended credit facility, we are required, at all times until April 1, 2012, to maintain cash balances of at least 65% of our outstanding borrowings under the revolving credit facility.

Outstanding balances under the credit facility bear interest, at our discretion, at either the London Interbank Offered Rate for the corresponding deposits of U. S. Dollars plus an applicable margin, which is on a sliding scale ranging from 200 basis points to 325 basis points based upon the our leverage ratio, or at Citibank s alternate base rate plus an applicable margin, on a sliding scale ranging from 25 basis points to 150 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 EBITDA as defined in the credit agreement for the four consecutive 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.

Table of Contents

The credit facility is not subject to any borrowing base computations, but does contain certain financial covenants. Our minimum asset coverage must be in excess of 1.25, where our 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. In addition, we are required to maintain a minimum consolidated tangible net worth, computed on a quarterly basis, equal to approximately $62.0 million. Finally, our debt to worth ratio, which is the ratio of our total consolidated indebtedness to our consolidated tangible net worth, cannot exceed 1.5 to 1.0 at the end of any quarter. At September 30, 2011, we were in compliance with our financial covenant requirements. In addition, commencing March 31, 2012, our maximum leverage ratio cannot exceed 3.25 and our minimum fixed charge coverage ratio must be in excess of 1.25, where the fixed charge coverage ratio is defined as the ratio of the aggregate of our trailing 12 month consolidated EBITDA plus our lease or rent expense minus our taxes based on income and payable in cash, 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.

Under the credit facility, our cumulative capital expenditures beginning in 2008 cannot exceed the sum of $5.0 million plus $1.25 million per quarter, on a cumulative basis, plus an allowance for our PowerSecure subsidiary recurring revenue projects generated after December 31, 2007. The credit facility contains other representations and warranties and affirmative and negative covenants, including restrictions with respect to liens, indebtedness, loans and investments, material changes in our 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 our assets or the assets of our subsidiaries other than in the ordinary course of business, or the public or private sale of any equity or debt other than equity issuances where the aggregate proceeds do not exceed $10.0 million, we are required to use the net proceeds thereof to repay any indebtedness then outstanding under the credit facility, except for certain reinvestment provisions.

Our obligations under the credit facility are secured by guarantees and security agreements by each of our active subsidiaries, including but not limited to our PowerSecure subsidiary and WaterSecure. The guarantees guaranty all of our obligations under the credit facility, and the security agreements grant to the lenders a first priority security interest in virtually all of the assets of each of the parties to the credit agreement.

The credit agreement also 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.

The maximum balance outstanding on our credit facility during the three and nine months ended September 30, 2011 was $10.0 million. The balance outstanding on our credit facility at September 30, 2011 and December 31, 2010 was $10.0 million and $5.0 million, respectively. At September 30, 2011, we had an additional $15.0 million available to borrow under the amended provisions of our credit facility. At November 3, 2011, no balance was outstanding and we had $25.0 million available to borrow under our credit facility. However, the availability of this capital under our credit facility includes restrictions on the use of proceeds, and is dependent upon our ability to satisfy certain financial and operating covenants, as described above.

Table of Contents

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

Proceeds of the lease financing were used to finance our PowerSecure subsidiary s recurring revenue projects. We account for the lease financing as a capital lease in our consolidated financial statements in accordance with generally accepted accounting principles.

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

Under the lease guaranty, we have unconditionally guaranteed the obligations of our PowerSecure subsidiary under the lease for the benefit of the lessor. Our capital lease obligation at September 30, 2011 and December 31, 2010 was $3.9 million and $4.4 million, respectively, and consists entirely of our obligations under the equipment lease described above.

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, 2011, to holders of outstanding shares of Series B preferred stock that have not been redeemed, is $0.1 million.

Table of Contents

Contractual Obligations and Commercial Commitments

We incur various contractual obligations and commercial commitments in our normal course of business. We lease certain office space, operating facilities and equipment under long-term lease agreements; to the extent we borrow under our credit facility, we are obligated to make future payments under that facility; we have a deferred compensation obligation; and in 2009 we entered into a non-compete agreement providing for on-going payments. At September 30, 2011, we also had a liability for unrecognized tax benefits and related interest and penalties totaling $1.0 million. We do not expect a significant payment related to these obligations within the next year and we are unable to make a reasonably reliable estimate if and when cash settlement with a taxing authority would occur. Accordingly, the information in the table below, which is as of September 30, 2011, does not include the liability for unrecognized tax benefits (dollars in thousands):

	Payments Due by Period				
	Total	Remainder of 2011	1 - 3 Years	4 - 5 Years	More than 5 Years
Contractual Obligations					
Credit facility (1)	$ 10,000	$	$ 10,000	$	$
Capital lease obligations (2)	4,315	254	2,031	2,030	
Operating leases	8,539	473	3,434	2,362	2,270
Deferred compensation (3)	2,661				2,661
Non-compete agreement	400		200	200	
Series B preferred stock	104	104			
Total	$ 26,019	$ 831	$ 15,665	$ 4,592	$ 4,931

(1) Total repayments are based upon borrowings outstanding as of September 30, 2011, not actual or projected borrowings after such date. Repayments do not include interest that may become due and payable in any future period.

(2) Repayment amounts include interest on the capital lease obligation.

(3) Total amount represents our expected obligation on the deferred compensation arrangement and does not include the value of the restricted annuity contract, or interest earnings thereon, that we purchased to fund our obligation.

Off-Balance Sheet Arrangements

During the third quarter 2011, 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 believe that our capital resources, including our cash and cash equivalents, amounts available under our credit facility, along with funds expected to be generated from our operations, will be sufficient to meet our anticipated cash needs, including for working capital, capital spending and debt service commitments, for at least the next 12 months. However, any projections of future cash needs and cash flows are subject to substantial risks and uncertainties. See Cautionary Note Regarding Forward-Looking Statements above in this item and Part II, Item 1A. Risk Factors below. Although we believe that we have sufficient capital to fund our activities and commitments for at least the next 12 months, our future cash resources and capital requirements may vary materially from those now planned. Our ability to meet our capital needs in the future will

depend on many factors, including the effects of the current economic and financial crisis, the timing of sales, the mix of products, the amount of recurring revenue projects, our ability to meet our financial covenants under our credit facility, unanticipated events over which we have no control increasing our operating costs or reducing our revenues beyond our current expectations, and other factors listed under Fluctuations above. For these reasons, we cannot provide any assurance that our actual cash requirements will not be greater than we currently expect or that these sources of liquidity will be available when needed.

Table of Contents

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

Critical Accounting Policies

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

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

- revenue recognition;
- allowance for doubtful accounts;

Table of Contents

inventories;
warranty reserve;
impairment of long-lived assets;
deferred tax valuation allowance;
uncertain tax positions;
costs of exit or disposal activities and similar nonrecurring charges; and
stock-based compensation.

These accounting policies are described in our Annual Report on Form 10-K for the year ended December 31, 2010 in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

Recent Accounting Pronouncements

Fair Value Measurements In May 2011, the FASB issued Accounting Standards Update (ASU) 2011-04, which amended Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This amendment is intended to result in convergence between U.S. GAAP and International Financial Reporting Standards (IFRS) requirements for measurement of and disclosures about fair value. This amended guidance clarifies the concepts applicable for fair value measurement of non-financial assets and also expands the disclosures for fair value measurements that are estimated using significant unobservable inputs used in a fair value measurement. This amended guidance will be effective for us on a prospective basis for reporting periods beginning after December 15, 2011. We do not expect the adoption of this standard to have a material effect on our financial position or results of operations.

Disclosures Relating To Comprehensive **Income** In June 2011, the FASB issued ASU 2011-05, which is an amendment and update to ASC No. 220, Presentation of Comprehensive Income. This amendment will require an entity to present the components of net income and other comprehensive income either in a single continuous statement of comprehensive income, or in two separate but consecutive statements. This amendment eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders equity. This amended guidance, which must be applied retroactively, will be effective for us for reporting periods beginning after December 15, 2011. We do not expect the adoption of this amended guidance to have a material effect on our financial position or results of operations or our financial statement presentation.

Testing Goodwill for Impairment In September 2011, the FASB issued ASU No. 2011-08, Intangibles-Goodwill and Other (Topic 350) Testing Goodwill for Impairment. This standard, which amends and updates guidance on the periodic testing of goodwill for impairment, provides companies with the option to first assess qualitative factors to determine whether it is more likely than not that that the fair value of a reporting unit is less than its carrying amount. If so, then it is necessary to perform the two-step quantitative goodwill impairment test. This standard will be effective for us for reporting periods beginning after December 15, 2011, with early adoption permitted. We do not expect the adoption of this standard to have a material effect on our financial position or results of operations or our financial statement presentation.

Table of Contents

Revenue Recognition Milestone Method In April 2010, the FASB issued ASU No. 2010-17 Revenue Recognition Milestone Method (Topic 605): Milestone Method of Revenue Recognition. This standard provides guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for certain research and development transactions. Under this new standard, a company can recognize as revenue consideration that is contingent upon achievement of a milestone in the period in which it is achieved, only if the milestone meets all criteria to be considered substantive. This standard became effective for us on a prospective basis commencing January 1, 2011. The adoption of this standard had no effect on our financial position or results of operations.

Improving Disclosures about Fair Value Measurements In January 2010, the FASB issued ASU No. 2010-06 Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements. This standard amends the disclosure guidance with respect to fair value measurements for both interim and annual reporting periods. Specifically, this standard requires new disclosures for significant transfers of assets or liabilities between Level 1 and Level 2 in the fair value hierarchy; separate disclosures for purchases, sales, issuance and settlements of Level 3 fair value items on a gross, rather than net basis; and more robust disclosure of the valuation techniques and inputs used to measure Level 2 and Level 3 assets and liabilities. This standard became effective for us on a prospective basis commencing January 1, 2011. The adoption of this standard had no effect on our financial position or results of operations or financial statement disclosures.

Multiple Deliverable Revenue Arrangements In October 2009, the FASB issued ASU No. 2009-13 - Multiple Deliverable Revenue Arrangements A Consensus of the FASB Emerging Issues Task Force: (Topic 605) Revenue Recognition. ASU No. 2009-13 provides application guidance on whether multiple deliverables exist, how the deliverables should be separated and how the consideration should be allocated to one or more units of accounting. This update establishes a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence, if available, third-party evidence if vendor-specific objective evidence is not available, or estimated selling price if neither vendor-specific or third-party evidence is available. This standard became effective for us on a prospective basis commencing January 1, 2011. The adoption of this standard had no effect on our financial position or results of operations.

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 and commodity prices, which may adversely affect our financial condition, results of operations and cash flow.

Interest Rate Risk. 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 Condition and Results of Operations of this report. Our lease with SunTrust is at a fixed interest rate and thus not impacted by changes in interest rates.

Table of Contents

At September 30, 2011, our cash and cash equivalent balance was approximately $32.7 million and we had an outstanding balance on our credit facility of $10.0 million. Our cash equivalents are invested in a combination of bank deposits, money market or U.S. government mutual funds, short-term time deposits, and government agency and corporate obligations, or similar kinds of instruments, the income of which generally increases or decreases in proportion to increases or decreases, respectively, in interest rates. 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 our borrowings would not have a material impact on our financial condition, results of operations or cash flow. While we believe we have our cash and cash equivalents invested in relatively risk-free investments, the current capital market crisis make it difficult to accurately assess the risk of each of our holdings. This risk includes, but is not limited to, bank deposits in excess of FDIC insurance limits.

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

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

We do not use derivative financial instruments to manage or hedge our exposure to interest rate changes, foreign currency exchange risks 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 the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of September 30, 2011, the end of the period covered by this report. Based upon management s evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that, as of September 30, 2011, our disclosure controls and procedures were designed at the reasonable assurance level and were effective at the reasonable assurance level to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Table of Contents

Changes in Internal Control Over Financial Reporting

We regularly review our system of internal control over financial reporting and make changes to our processes and systems to improve controls and increase efficiency, while ensuring that we maintain an effective internal control environment. Changes may include such activities as implementing new, more efficient systems, consolidating activities and migrating processes. There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended September 30, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Limitations in Control Systems

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

Table of Contents

PART II
OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are involved in disputes and legal proceedings. There has been no material change in our pending legal proceedings as described in Item 3. Legal Proceedings in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

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, 2010, which have not materially changed as of the date of this report, except for the modification of the following risk factors, which update and supersede the similar risk factors in our Annual Report on Form 10-K:

The recent sale of our non-core WaterSecure and Southern Flow businesses will reduce our revenues and profits in the near term and could adversely affect our financial results in the longer term.

The recent sales of our non-core WaterSecure and Southern Flow businesses in 2011 represent the completion of our strategy to monetize our non-core assets where beneficial in order to focus on our core Energy and Smart Grid Solutions businesses. We received net cash proceeds of approximately $26.0 million to date in connection with the sale of WaterSecure and $16.5 million in connection with the sale of Southern Flow. However, we will no longer receive the equity income and management fees from the WaterSecure business or the revenues, positive cash flows and positive earnings generated by the Southern Flow business. In 2010, for example, WaterSecure generated a combined $3.8 million in equity income and management fees and Southern Flow generated $19.4 million in revenues, $2.8 million in operating cash flow, and $2.5 million in operating income. We intend to deploy the cash proceeds from these sales into core business investments, with the goal of generating even higher revenues, cash flow and operating income from this capital in future periods than we believe those non-core businesses would have realized. However, there is no assurance that we will be able to find the appropriate business opportunities to invest such cash proceeds, or when those opportunities will arise, or how long it will take them to be financially successfully or how successful the financial results of those opportunities will be. Our failure to timely and successfully deploy the capital received from the monetization of our non-core businesses could have a material adverse impact on our financial condition and results of operations.

Our prior management of the water processing business, which we referred to as our WaterSecure operations, will continue to present risks to us even though it was sold in June 2011.

WaterSecure is our subsidiary that manages and holds a significant minority ownership interest in the private business that owned and conducted the WaterSecure operations until they were sold in June 2011. While there are no further WaterSecure operations being conducted and our primary responsibility as manager is the completion of the liquidation and dissolution of the underlying assets and business, our prior management of this business and our ongoing management of its winding up present risks to us inherent in the management of private enterprises. While there are no currently pending or overtly threatened claims or actions and we are unaware of any basis therefore, if any were to be made and if we were to fail to successfully defend against them, our financial condition and results of operations could be materially and adversely affected. Additionally, we have $1.4 million of purchase price proceeds that are in escrow and subject to claims by the purchaser for a twelve month period ending June 1, 2012.

Table of Contents

Item 6. Exhibits

(31.1)	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Filed herewith.)
(31.2)	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Filed herewith.)
(32.1)	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 and Rule 13a-14(b) or 15d-14(b) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Filed herewith.)
(32.2)	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 and Rule 13a-14(b) or 15d-14(b) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Filed herewith.)
(101.INS)*	XBRL Instance Document
(101.SCH)*	XBRL Taxonomy Extension Schema Document
(101.CAL)*	XBRL Taxonomy Extension Calculation Linkbase Document
(101.DEF)*	XBRL Taxonomy Extension Definition Linkbase Document
(101.LAB)*	XBRL Taxonomy Extension Label Linkbase Document
(101.PRE)*	XBRL Taxonomy Extension Presentation Linkbase Document

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

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 3, 2011

By: /s/ Sidney Hinton

Sidney Hinton
President and Chief Executive Officer

Date: November 3, 2011

By: /s/ Christopher T. Hutter

Christopher T. Hutter
Executive Vice President, Chief Financial Officer,
Treasurer and Assistant Secretary