

LIME ENERGY CO.  
Form 10-K  
March 31, 2014  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**Form 10-K**

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

**For the fiscal year ended: December 31, 2013**

**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 001-16265**

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**LIME ENERGY CO.**

(Exact name of registrant as specified in its charter)

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**Delaware**

**36-4197337**

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

**16810 Kenton Drive, Suite 240, Huntersville, NC**

**28078-4845**

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code **(704) 892-4442**

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

Title of each class	Name of each exchange on which registered
<b>Common Stock \$0.0001 par value</b>	<b>NASDAQ</b>

Securities registered pursuant to Section 12(g) of the Exchange Act: **None**

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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

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Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company (as defined in Rule 12b-2 of the Act).

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller reporting company

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

The aggregate market value of the registrant's common stock held by non-affiliates was \$8,596,386 based on the reported last sale price of common stock on June 29, 2013, which was the last business day of the registrant's most recently completed second fiscal quarter. For purposes of this computation, all executive officers, directors and 10% stockholders were deemed affiliates. Such a determination should not be construed as an admission that such executive officers, directors or 10% stockholders are affiliates.

As of March 28, 2014, there were 3,726,705 shares of common stock, \$0.0001 par value, of the registrant issued and outstanding.

### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive proxy statement relating to its 2014 Annual Meeting of Stockholders, to be filed within 120 days after registrant's fiscal year end of December 31, 2013, are incorporated by reference into Part III of this Annual Report on Form 10-K where indicated.

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**Cautionary Statement on Forward-Looking Information**

*This annual report contains forward-looking information within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, adopted pursuant to the Private Securities Litigation Reform Act of 1995, which reflect our current views with respect to, among other things, future events. Statements that are not purely historical may be forward-looking. You can identify these forward-looking statements by the use of words such as anticipate, believe, estimate, expect, hope, intend, may, project, plan, should, outlook, potential, continues, future and similar expressions, including when used in the negat*

*Forward-looking statements are subject to various risks and uncertainties. Accordingly, there are or will be important factors that could cause actual results to differ materially from those indicated in these statements, including but not limited to those described under Risk Factors, as well as, among others, the following:*

- *implementation of our operating and growth strategy;*
- *the loss, or renewal on less favorable terms, of utility contracts;*
- *the adequacy of our remediation of our disclosure controls and procedures;*
- *development of new, competitive energy efficiency services;*
- *changes in federal and state regulations including those affecting energy efficiency tax credits and the energy efficiency industry;*
- *a significant decrease in the cost of energy leading to a decrease in the demand for energy efficiency services; and*
- *availability, terms and employment of capital.*

*Although we believe that the expectations reflected in these forward-looking statements are reasonable and achievable, such statements involve risks and uncertainties and no assurance can be given that the actual results will be consistent with these forward-looking statements. Our actual results could differ materially from those anticipated in forward-looking statements as a result of various factors, including matters described in this annual report, including the sections titled Risk Factors, Management's Discussion and Analysis of Financial Condition and Results of Operations and our financial statements and notes thereto.*

*Except as otherwise required by federal securities laws, we do not undertake any obligation to publicly update, review or revise any forward-looking statements, whether as a result of new information, future events, changed circumstances or any other reason.*

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**Part I**

**Item 1. Business.**

We are a leader in designing and implementing demand-side energy efficiency programs that enable our utility clients to reach their underserved markets and achieve their energy reduction goals. Utility-sponsored energy efficiency programs help reduce customer demand for electricity. Using less electricity when demand is high (like on a hot summer day) can mean fewer new power plants and a smaller electric distribution system, which saves money and benefits the environment. We offer utilities energy efficiency program delivery services targeted to their small and medium-sized business customers. Our programs help these businesses use less energy through the upgrade of existing equipment with new, more energy efficient equipment. This service allows the utility to delay investments in transmission and distribution upgrades and new power plants, while at the same time providing benefits to their clients in the form of lower energy bills, improved equipment reliability, reduced maintenance costs and a better overall operating environment.

Our energy efficiency programs operate exclusively within the utility sector and our clients include two of the five largest investor-owned utilities in the country. We focus on deploying direct install energy efficiency solutions for small and mid-size commercial and industrial business programs that improve energy efficiency, reduce energy-related expenditures and lessen the impact of energy use on the environment. Currently, these solutions include energy efficient lighting upgrades and energy efficient mechanical (HVAC) upgrades. We also have expertise in water conservation, building controls, refrigeration and facility weatherization and we are prepared to offer these measures should they become eligible within a utility program. Our small business direct install (SBDI) programs provide a cost-effective avenue for our utility clients to offer products and services to a hard-to-reach customer base, while satisfying aggressive state-mandated energy reduction goals. Our direct install model is a turnkey solution under which we contract with our utility clients to design and market their small and mid-size energy efficiency programs within a defined territory, perform the technical audits, sell the solution to the end-use customer and oversee the implementation of the energy efficiency measures. This model makes it easy and affordable for small businesses to upgrade to new, more energy efficient equipment.

We believe the following factors drive demand for small business direct install energy efficiency programs within the utility marketplace:

- **Magnitude:** 93% of all commercial buildings in the U.S. are occupied by small commercial businesses whose annual energy demand is less than 200 kilowatts (kW).
- **Consumption:** These same businesses account for 43% of the electricity consumption and almost 49% of the electricity expenditures.
- **Opportunity:** The large majority of these customers have not yet participated in any demand-side management program and most are still using older, less efficient lighting and HVAC equipment.

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- SBDI Proliferation: U.S. customer-funded electric efficiency budgets totaled \$6.9 billion in 2012, comprised of programs promoting energy efficiency, load management/demand response and evaluation, measurement, and verification. This market is forecasted to grow to between \$9.5 and \$14.3 billion by 2025. Our research of this segment indicates that current SBDI spending is approximately 5% of all U.S. energy efficiency programs. Given the cost-effectiveness of SBDI programs and the associated benefits of customer engagement for the utilities, we believe that the SBDI market will grow to 10% of all customer funded spending by 2020. As we continue to add services to our utility offerings, we believe that we will increase the market opportunity across the customer-funded electric efficiency market.

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- Regulation: Increasing regulatory pressures on utilities to increase the amount of energy efficiency and renewable energy in their resource plans. Twenty seven states now have some form of Energy Efficiency Resource Standard (EERS) or Energy Efficiency Portfolio Standard (EEPS) in place that requires utilities to achieve a target level of energy sales reductions through energy efficiency.
- Politics: Increasing political pressure on utilities to help small businesses manage their energy costs in order to facilitate economic recovery and offset rate increases.
- Resources: Due to their size and lower consumption, utilities have not actively managed their small business customers in the past. They do not have the resources internally to effectively bring products and services to these customers as internal customer relationship personnel are typically focused on large industrial, municipal and commercial customers.

**History and Business Development**

On December 5, 1997, we were formed as Electric City LLC, a Delaware limited liability company. On June 5, 1998, we changed from a limited liability company into a corporation by merging Electric City LLC into Electric City Corp., a Delaware corporation. Trading in our common stock commenced on August 14, 1998, on the OTC Bulletin Board.

On September 13, 2006, we changed our name to Lime Energy Co. to reflect our new Energy Efficiency Services focus. Lime is an acronym for Less is More Efficient, which reflects our focus on reducing energy consumption.

On February 25, 2008, our stock began trading on the NASDAQ Capital Market under the trading symbol LIME.

In June 2008, we acquired Applied Energy Management, Inc. ( AEM ). AEM provided energy engineering and consulting services and energy efficiency services similar to our existing energy efficiency lighting solutions. In addition, it provided mechanical and electrical conservation services, water conservation services and renewable energy solutions primarily for government and municipal facilities through its Energy Service Company ( ESCO ) partners.

During 2009, we began serving utility services clients and in late 2009 we won our first contract to provide utility energy efficiency program services.

During 2011, we implemented a corporate restructuring to better integrate and streamline our operations and reduce costs. As part of this restructuring, we merged many of our subsidiaries, changed the name of Applied Energy Management, Inc., to Lime Energy Services Co. and moved our corporate headquarters to Huntersville, North Carolina.



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On February 28th, 2013, we divested certain assets of our wholly owned subsidiary, Lime Energy Service Company, constituting our energy service companies (ESCO) subcontracting business to PowerSecure, Inc., a subsidiary of PowerSecure International, Inc. (NASDAQ:POWR). We completed this sale to allow us to focus all our resources on utility direct install programs.

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**Products and Services**

*Utility Program Management Services*

As part of our Utility Program Management and Implementation services, we provide utilities with a single point solution for acquiring energy efficiency resources in their customers' facilities. Our wide range of services includes program design, program administration, marketing and sales, customer recruitment, auditing and implementation of energy efficiency projects. These services provide our utility clients a reliable and economically attractive means to meet state-mandated Energy Efficiency Resource Standards and provide targeted relief to overburdened distribution systems, while also stimulating local economies, creating local jobs and making significant reductions to the environmental impacts of their utility operations.

We typically provide our clients with these services in a bundled offering, although they have historically been provided in the industry as stand-alone services. These include:

*Program Design*

We design direct install programs that utilize our technology platform and historical energy efficiency program data, to enable utilities to more cost effectively utilize their demand-side management budgets to acquire energy efficiency resources in customer facilities. Our primary focus has been the small business customer segment, where we have a great deal of historical program data. We have invested heavily since 2009 in the tools and processes that make the implementation of these programs cost-effective in a customer segment that has been traditionally ignored due to the high fixed cost of acquiring each small project.

*Program Administration*

We provide administration of utility direct install programs, managing all aspects of program implementation. In this role we work closely with the utility on areas including customer data management, program data tracking, coordination with utility protocols and standards and program reporting. Our engagements typically include heavy involvement by our technology team with our utility client's IT team for data gathering and reporting, including end-use customer data security.

*Customer Recruitment - Marketing and Sales*

In support of recruiting customers to participate in our utility direct install programs, we design and implement marketing campaigns including telemarketing, brochures and mailers, traditional media, hosted events, social media and neighborhood canvassing. We have a sales force in each program that is responsible for identifying prospects, managing the audit and proposal process and obtaining signed contracts for energy

efficiency project implementation within our contracted territory.

*Auditing and Customer Project Implementation*

We have a technical team that provides audits of a customer's facilities in support of customer proposals. This technical staff is responsible for calculating projected customer energy savings, constructability review and equipment specification. Our construction management team manages our relationships with equipment vendors and installation subcontractors with the responsibility for turnkey project implementation through closeout and customer satisfaction.

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We have a national presence in key states that have instituted mandates and initiatives to support utility energy efficiency programs. We have approximately 125 employees in seven offices across seven states. Our offices are staffed with professionals who have significant expertise in utility energy efficiency program implementation, marketing, sales, energy auditing and construction. Each program team is supported by corporate resources from dedicated functional areas. The majority of our professionals are hired locally in the service territory for our applicable utility client. We are able to maintain a highly scalable business model that deploys our professional employees to both work on ongoing programs and quickly launch programs in new markets.

Our program delivery model is comprised of:

- *Program Startup:* We provide program design services that include development of a go-to market strategy, cost-benefit analysis, energy conservation measure selection and implementation plans. At this time, we also conduct in-depth territory analysis and put in place the resources and infrastructure needed to successfully operate the program.
- *Customer Engagement:* Our customer engagement services include creation of a comprehensive program marketing plan as well as development of a customer database, efficiency measure database, and customized cloud-based audit, proposal, job tracking and real-time reporting tools utilizing our proprietary technology platform.
- *Implementation Services:* We provide complete turnkey implementation services through a network of trade allies comprised of local contractors who have been thoroughly vetted based on experience, safety record and customer satisfaction. Energy efficiency measures offered under current programs include energy efficient lighting upgrades and energy efficient mechanical and electrical retrofit and upgrade. Our field teams of energy advisors consider factors such as current facility infrastructure, best available technologies, building environmental conditions, hours of operation, energy costs, available incentives and covered measures in selecting the best measure to implement at a customer's facility. Once a customer has signed a contract, we purchase the required equipment and supervise the installation performed by one of our trade allies.

**Technology**

Our collaborative, secure technology platform, Lime DirectInstall™, combines cloud-based computing technology with data analytics to provide real-time customer relationship management ( CRM ), field audit data and customer tracking. The platform is integrated throughout our direct install process, from marketing campaigns through purchase orders, material pick lists, waste management and reporting. Our utility clients have access to dashboard views and reporting, which enables them to track program process in real-time. We offer the following solutions as part of our technology suite:

- *Territory Analytics:* Targeted utility customers are analyzed and scored to create an energy reduction profile. We can then implement targeted marketing plans and identify sales opportunities by selected metrics such as behaviors, business type and available efficiency measures.

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- Program Auditing: Mobile technology allows energy auditors to access a utility program's full list of efficiency measures, select the correct measures for the application, produce a customer proposal and obtain a signature for approval, all in one step.
- Project Delivery: Once a proposal is signed, material and subcontractor purchase orders and scope of work documents are automatically generated. Document management, change order

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management and vendor management are all built into the project area of the technology platform.

- Real-time Reporting: We track all program activities on a daily basis to quickly identify problems and allocate resources as needed.

## **Sales and Marketing**

Our sales and marketing efforts are focused on three key areas:

- Developing and deploying direct install programs in states that are driving energy efficiency programs and regulations;
- Expanding existing programs into new territories with affiliates of existing utility clients; and
- Expanding product and service sets within existing programs and new program opportunities.

Our key competitive advantage involves a risk-mitigated offering to our utility clients whereby we bundle the costs of administering these programs and price the installed measures on a holistic basis. By integrating the costs of program administration, customer sales and marketing, project scoping and implementation and reporting into a single cost, we eliminate upfront costs for our utility clients and only charge for delivered savings. Our utility clients realize lower program costs and achieve a more attractive cost/benefit result with a higher level of outcome predictability.

Our primary core competencies and market differentiation include a deep expertise in customer identification and acquisition and project implementation for the small to medium-sized business segments. This involvement in all aspects of the program gives us a second competitive advantage of providing a uniform experience to the business customer on behalf of the utility. These deep customer touch points allow us to deliver additional services on behalf of our utility clients (e.g., multi-measure energy conservation measures, demand response, telemetry and distributed generation). By reducing the upfront sales acquisition costs for these products and services, we can deliver a lower cost to the utilities, which allows them to realize more favorable cost/benefit tests for bundled programs. Similarly, by delivering these products and services through a consistent and existing sales channel, we can realize higher margins.

We intend to leverage the advantages of our predictable delivery model by marketing these cost/benefit advantages to utilities and their regulatory commissions to drive new program funding and increase our likelihood of securing contracts for these programs. We expect these program funding sources to come from newly formed cost recovery mechanisms as well as the reallocation of funds from existing programs that fail to achieve the cost/benefit advantages of our small to medium sized business program model.

## **Clients**

During 2013 we had nine active direct install programs, seven of which are with utilities that are ranked as one of the 25 largest electric utilities in the country. We derived approximately 75% of our 2013 consolidated revenue from continuing operations from our four largest utility programs, with the New Jersey Board of Public Utilities, Niagara Mohawk (National Grid), Long Island Power , and Central Hudson Gas & Electric each responsible for 24%, 22%, 16% and 11% of our revenue, respectively. During 2012 our three largest utility clients, Niagara Mohawk (National Grid), the New Jersey Board of Public Utilities and Long Island Power, were responsible for 40%, 25% and 21% of our

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consolidated revenue, respectively. The following is a summary of our current contracts. Substantially all of our business is dependent on these contracts:

<b>Lime Program</b>	<b>Client</b>	<b>Eligible Customers</b>	<b>Contract Term</b>
National Grid SBDI	National Grid	60,000 Small Businesses	2014 - 2015
NJ Direct Install	TRC	50,000 Small Businesses	2011 - 2014
PSE&G Municipal DI	PSE&G	1,000 Municipalities and Non-profits	2012 - 2014
Long Island Power Authority SBDI	Long Island Power Authority	90,000 Small Businesses	2011 - 2015
Central Hudson Gas & Electric SBDI	Central Hudson Gas & Electric	50,000 Small & Medium Businesses	2012 - 2015
NSTAR SBDI	NSTAR	8,300 Small Businesses	2012 - 2014
Duke Energy Progress SBDI	Duke Energy Progress	180,000 Small Businesses	2012 - 2015
AEP Ohio SBDI	AEP Ohio	88,000 Small Businesses	2012 - 2014
Efficiency Maine SBDI	Efficiency Maine	3,000 Small Businesses	2013

#### ***National Grid, Small Business Direct Install Program***

We are providing program management and implementation services for National Grid's Small Business Energy Efficiency Program, one of the nation's most successful Demand Side Management (DSM) programs. We are the exclusive provider for the Western New York and Frontier regions of National Grid's New York State service territory. This program is designed for the hard to reach small commercial & industrial market, serving customers with demand of less than 100 kW. The program provides incentives of up to 70% of project costs for upgrades including energy efficient lighting, lighting controls and refrigeration measures, and gives customers the ability to finance the customer share of the cost on-bill for up to 24 months. We have been the top performer under this program every year since its inception in 2009. In late 2013 this contract was renewed and extended for an additional two years through the end of 2015.

#### ***Central Hudson Gas & Electric, Commercial Lighting Direct Install Program***

As the exclusive provider for this program, Lime Energy provides energy-efficient lighting facility upgrades for business customers throughout Central Hudson's service territory, located in the Mid-Hudson Valley region of New York State. Central Hudson's Direct Install Programs serve small-sized commercial customers, as well as municipalities with peak demand of 100 kW or less, and medium-sized businesses with peak demand of 100kW to 350 kW, providing incentives that cover up to 70 percent of the cost of implementing these energy efficiency projects. To date, Central Hudson has provided more than \$3 million in incentives to help nearly 1,000 businesses upgrade to energy-efficient lighting, resulting in lower energy usage and improved lighting quality. We began work under this contract in late spring 2012 and it will be up for renewal in 2015.

#### ***American Electric Power - Ohio, Express Small Business Direct Install Program***

We are the exclusive provider of comprehensive energy efficiency upgrades for the program. The AEP Ohio Express program serves small commercial customers with annual consumption of less than 200,000 kWh. As part of the program, AEP Ohio incentivizes these customers to reduce wasted energy and lower their monthly electric bills by paying up to 80% of the project cost to complete an energy retrofit. Our 3-year performance-based contract with AEP Ohio has the potential to save participating small business customers over 30,000 MWh of annual energy usage. We began operations under this contract in late 2012 and it will be up for renewal in 2015.





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***Public Service Electric & Gas, Energy Efficiency Direct Install Program***

We are providing comprehensive multi-measure efficiency retro-fits for municipalities, with territory exclusivity in forty-two Northern New Jersey towns under a two-year contract with Public Service Electric & Gas. PSE&G is one of the largest combined electric and gas companies in the United States and is also New Jersey's oldest and largest electric and gas utility. The Program serves municipalities and not-for-profits. The projects are funded in whole by PSE&G, with each municipality re-paying 20% of the project cost through on-bill financing. This 80% incentive allows municipalities to capitalize on PSE&G's commitment to satisfy increasing power needs through investments in efficiency in their customers' facilities. We began to generate revenue under this contract in late 2012 and it will be up for renewal in 2014.

***NSTAR Electric & Gas, Small Business Direct Install Program***

We have territory exclusivity in Newton, Dedham, Needham, and Westwood Massachusetts to provide comprehensive electric and gas energy efficiency upgrades to small and mid-size businesses. NSTAR, the largest Massachusetts-based, investor-owned gas and electric utility, has been a leader in providing customer focused energy efficiency programs for the last two decades in Massachusetts, a state which recently overtook California as the #1 energy efficiency state. We began operating under this contract in the spring of 2012 and it is currently scheduled to expire at the end of 2014, though we plan to withdraw from this contract during 2014 because it is small and marginally profitable.

***Duke Energy (Progress-Carolinas), Small Business Energy Saver Program***

Utilizing our experience with small-business direct install programs, we assisted Duke Energy Progress (formerly Progress Energy) in the design and execution of its first SBDI program. Among other things, we provided assistance with the creation of a cost benefit analysis, public utility commission (PUC) document preparation, selection of energy efficiency measures to be included in the program and design of the overall program delivery process. Once the program was approved by the PUC we began operation as the exclusive authorized contractor under the program, targeting small business customers in the Carolinas with peak demand of 100 kW or less. Under this program, Duke covers up to 80% of the customer's cost to implement an energy efficiency upgrade. We began generating revenue under this program during the first quarter of 2013. The contract will be up for renewal in 2015.

***New Jersey's Clean Energy Program, Small & Medium Business Direct Install Program***

Under this state run program, we have exclusive rights to offer incentives to offset up to 70% of the cost of upgrading lighting and HVAC equipment to small businesses and municipalities with peak demand of up to 200kW located in Bergen, Essex, Passaic, Hudson and Union counties in New Jersey. Projects we have implemented under this program have resulted in savings of over 29.5 million kilowatt hours of electricity and over 348,000 therms of natural gas for New Jersey businesses and municipalities. We have been the top performer under this program since being awarded our contract in early 2010. This contract will be up for renewal in mid-2014.

***Long Island Power Authority, Small Business Energy Efficiency Program***

We are the exclusive provider under this program which covers selected portions of Long Island Power s (LIPA) operating territory on Long Island, New York. This program has a particular focus on reducing demand in load pockets susceptible to brown-outs and/or black-outs on peak demand days. Under this program we are responsible for the program s implementation and management, including marketing, lead development, customer enrollment, auditing and installation management of energy- efficient lighting. The program offers qualifying small businesses with peak demand of up to 145 kW

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incentives of up to 70% toward the cost of implementing energy efficiency upgrades. The program is part of LIPA's \$900-plus million Efficiency Long Island strategy to defer distribution and generation system upgrade costs by reducing peak energy demand. We began operating under this contract during the fourth quarter of 2009 and this contract will be up for renewal in 2015.

***Efficiency Maine (Bangor Hydro & Maine Public Service), Commercial Small Business Direct Install Pilot Program***

We are assisting Bangor Hydro and Main Public Service in the evaluation of the benefits of small business direct install programs by operating this small pilot program in their territories. This pilot program which started in early 2013, targets small commercial businesses, municipalities and non-profit customers with peak demand of 100 kW or less. As part of this pilot program, Efficiency Maine provides incentives to qualifying customers to offset up to 70% of the cost of implementing energy efficient lighting upgrades within their facilities. This pilot program ended on December 31, 2013.

**Competition**

*Utility Program Administrators*

Utility demand-side management programs have existed for more than 20 years in the U.S., primarily in northeast and west coast states. Companies have been providing various forms of management services to utilities for these programs since their inception. Traditionally these suppliers have been large consulting firms that design demand-side management programs for the utility and/or provide program administration, with their fees often unrelated to actual performance of the program. In most cases they set up a network of trade ally contractors that are trained in the incentive program details, with these contractors responsible for marketing, developing and implementing the energy efficiency projects at utility customers' facilities. Typically there is no territorial exclusivity under these programs for trade allies.

*SBDI Firms*

As the effectiveness of traditional demand-side management programs has begun to decline or fail to keep up with the increasing requirements of EERS mandates, utilities have begun to focus on and expand funding to the largely underserved small business segment of their market to make up the shortfall. Utilities that have not historically utilized SBDI programs have begun to implement them and utilities that have used these programs in the past are looking to expand them. As the demand for these programs has grown, new players have entered the market to supply various forms of services to support the programs. These new competitors include vertically integrated providers like Lime as well as a proliferation of smaller regional engineering firms and local contractors. Some of these players have won multiple contracts, sometimes in different regions of the country; however we do not know of any competitor that has won as many contracts as we have.

We believe that our capabilities in marketing, engineering, energy auditing, project management and installation, in combination with the IT platform we have developed to support these activities, permits us to cost effectively deliver the energy efficiency goals of these utilities. We believe that these capabilities have been demonstrated by the success we have achieved on our contracts to date, where our performance in most cases has exceeded the goals given us by our utility customers and the performance of any competitor.



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We expect that competition in this market will continue to increase as the number and size of utility programs increases. However, we believe that we are well positioned to compete for and win additional utility contracts in the future as a result of our experience, capabilities, track record of success and proprietary IT platform.

**Compliance with Environmental Laws**

The sale of our products and services generally does not require compliance with federal, state or local environmental laws. We use licensed disposal firms to dispose of old lamps, lighting ballasts or other products that may contain heavy metals or other potential environmental hazards.

**Intellectual Property**

As of December 31, 2013, we had three registered trademarks or service marks and one copyright.

**Employees**

As of March 21, 2014 we had 122 full time employees and 3 part time or temporary employees, of which 16 were management and corporate staff, 6 were in information technology, 17 supported program administration, 60 were engaged in sales, sales support or marketing and 26 were engaged in project management, product installation, customer support and field service.

**Item 1A. Risk Factors.**

**Risks Related to our Business**

*Our business model has changed significantly several times since our inception in response to a constantly changing and evolving market, which may make it difficult to evaluate our business and prospects, and may expose us to increased risks and uncertainties.*

Our business has evolved substantially over time through organic growth and strategic acquisitions. We started operating in the energy efficiency services business in June 2006, when we launched our commercial and industrial energy efficiency services business. In 2008, we made an acquisition that gave us access to the public sector energy efficiency market. In late 2009, we won our first utility energy efficiency contract and began to build this new business. In 2011, we scaled back our original commercial and industrial business and combined it with our public sector business, and in February 2013 we sold the public sector business. Accordingly, we have only a limited history of generating

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revenues under our current business model, and the future revenue potential of our current business model in the rapidly evolving energy efficiency solutions market is uncertain. As a result of our short operating history under our current business model, we have limited financial data that can be used to evaluate our business, strategies, performance and prospects or an investment in our common stock. Any evaluation of our business and our prospects must be considered in light of our limited operating history under our current business model and the risks and uncertainties encountered by companies with new business models. To address these risks and uncertainties, among other things, we must do the following:

- maintain and expand our current utility relationships and develop new relationships;
- maintain, enhance and add to our existing energy efficiency solutions;
- execute our business and marketing strategies successfully;
- attract, integrate, retain and motivate qualified personnel; and
- respond to competitive developments.

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We may be unable to accomplish one or more of these objectives, which could cause our business to suffer and could have a material adverse effect on our business, results of operations and financial condition. In addition, accomplishing many of these goals might be very expensive, which could adversely impact our operating results and financial condition. Additionally, any predictions about our future operating results may not be as accurate as they could be if we had a longer operating history under our current business model.

***We have incurred significant operating losses since inception and may not achieve or sustain profitability in the future.***

We have experienced annual losses and negative cash flow from operations since our inception and we currently have an accumulated deficit. We must continue to increase sales while maintaining or improving our margins to operate profitably and sustain positive operating cash flows. We may be required to reduce the prices of our services in order to win new contracts or retain existing contracts. If we reduce prices, we may not be able to reduce costs sufficiently to achieve acceptable profit margins. As we strive to grow our business, we have spent and expect to continue to spend significant funds for general corporate purposes, including working capital, marketing, recruiting and hiring additional personnel. To the extent that our revenues do not increase as quickly as these costs and expenditures, our results of operations and liquidity will be adversely affected. If we experience slower than anticipated revenue growth or if the margins we earn on our sales are lower than expected or our operating expenses exceed our expectations, we may not achieve profitability in the future or if we achieve profitability in the future, we may not be able to sustain it.

***We may not be able to raise additional capital to fund future operating losses.***

Because of our negative cash flow, we have funded our operations through the issuance of common and preferred stock and debt. Our ability to continue to operate until our cash flow turns positive on a consistent basis may depend on our ability to continue to raise additional funds through the issuance of equity or debt. We may not be able to raise additional funds on terms that are acceptable to us or at all. If we are not successful in raising any needed additional funds, we might have to significantly scale back or delay our growth plans, seek to sell the Company or cease operations altogether. Any reduction or delay in our growth plans could materially adversely affect our ability to compete in the marketplace, take advantage of business opportunities and develop or enhance our services and technologies, which could have a material adverse effect on our business, results of operations and financial condition.

***Any award granted the plaintiffs under the current stockholder lawsuit, in combination with the cost of defending against the lawsuits, could exceed the limits of our director's and officer's insurance.***

Several stockholder lawsuits were filed against current and former members of our executive management shortly after we announced that investors should not rely on our historical financial statements. These lawsuits have been consolidated into one lawsuit, which we agreed to settle in January 2014. The settlement still needs final court approval, for which a hearing is scheduled for May 2014. In addition two derivative lawsuits were filed against current and former members of our Board of Directors, also in connection with the announcement, which have been consolidated. The Company is generally obligated to indemnify its executives and board members from claims related to their position with the Company, including paying defense costs. We have a Directors and Officers insurance policy to help offset the cost of that indemnification. Subject to any defenses to coverage that the insurance carrier successfully asserts, this policy will cover the cost of that indemnification, up to the aggregate limit of \$10 million, including our \$150,000 retention, which we must pay. The insurance carrier has not asserted any defenses to coverage, but has reserved its right to do so.





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Our motion to dismiss the derivative suit was granted on March 25, 2013. However, the plaintiffs have 30 days to appeal this decision. The plaintiffs on the derivative suit have not specified the amount of damages they are seeking, but if they successfully appeal the motion to dismiss and are ultimately awarded an amount that exceeds the limits of our D&O insurance policy after paying the settlement on the stockholders' suit and defense costs or if the insurance carrier successfully asserts any defenses to coverage, we will need to use our available cash to pay any defense costs or awards not covered by our D&O policy. Any such payments, if large enough, could have an adverse impact on our financial condition, possibly to the point that we would be unable to continue as a going concern.

***The Securities and Exchange Commission is investigating us and the results of that investigation could have a material adverse effect on our business, results of operations and financial condition.***

The Securities and Exchange Commission has not completed its investigation of our revenue recognition practices and financial reporting. If, as a result of that investigation, the SEC takes action against us or our officers, it could have a material adverse effect on our business, results of operations and financial condition.

***We have identified a material weakness in our internal control over financial reporting which could, if not sufficiently remediated, result in material misstatements in our financial statements.***

Our management is responsible for establishing and maintaining adequate internal control over our financial reporting, as defined in Rule 13a-15(f) under the Securities Exchange Act. As disclosed in Item 9A, our management identified a deficiency in our internal control over financial reporting related to revenue recognition that constitutes a material weakness.

A material weakness is defined as a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. As a result of this material weakness, our management concluded that our internal control over financial reporting was not effective based on criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control - An Integrated Framework. We have implemented a remediation plan designed to address this material weakness. If our remedial measures are insufficient to address the material weakness or if additional material weaknesses or significant deficiencies in our internal control are discovered or occur in the future, our consolidated financial statements may contain material misstatements and we could be required to restate our financial results in the future, which could cause investors and other users to lose confidence in our financial statements, limit our ability to raise capital and have a negative effect on the trading price of our common stock.

***Our customers and investors may lose confidence in us because of our restatement.***

During 2013, we restated our consolidated financial statements for certain prior periods to correct certain errors in those financial statements. The restatement may cause customers and investors to lose confidence in the accuracy of our financial disclosures, may raise reputational issues for our business and may result in a decline in share price or the loss of customers, each of which could have a material adverse effect on our business, results of operations and financial condition.

*It is difficult for us to estimate our future quarterly operating results.*

Despite the sale of our public sector business, our revenue remains somewhat seasonal. Historically, this seasonality has caused our revenue, operating income, net income and cash flow from operating activities to be lower in the first two quarters and higher in the last two quarters of each year. In

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In addition, utility contracts can be subject to changes in budget allocations for the programs. In the past we experienced a situation where funds allocated for a program we were operating under were diverted to other uses with no warning, reducing our expected revenue under the program. As a result, we may be unable to forecast our revenue accurately, and a failure to meet our revenue or expense forecasts could have an immediate and negative impact on the market price of our common stock.

***We operate in a highly competitive industry and if we are unable to compete successfully our revenue and profitability will be adversely affected.***

The energy efficiency solutions market is highly competitive, and we expect competition to increase and intensify as the energy efficiency solutions market continues to evolve. We face strong competition primarily from other providers of energy efficiency solutions, local electrical and mechanical contractors and engineering firms, lighting and lighting fixture manufacturers and lighting fixture distributors. We compete primarily on the basis of client service and support, quality and scope of services and products, including proprietary technology, cost of services and products, name recognition and our performance track record for services provided.

In addition to our existing competitors, new competitors such as large national or multinational engineering and/or construction companies could enter our markets. Many of these current and potential competitors are better capitalized than we are, have longer operating histories and strong existing client relationships, greater name recognition, and more extensive engineering, technology and sales and marketing capabilities. Competitors could focus their substantial resources on developing a competing business model or energy efficiency solutions that may be potentially more attractive to clients than our products or services. In addition, we may face competition from other products or technologies that reduce demand for electricity. Our competitors may also offer energy efficiency solutions at reduced prices in order to improve their competitive positions. Any of these competitive factors could make it more difficult for us to attract and retain clients, require us to lower our prices in order to remain competitive, and reduce our revenue and profitability, any of which could have a material adverse effect on our results of operations and financial condition.

***Our success is largely dependent upon the skills, experience and efforts of our senior management and our ability to attract and retain other skilled personnel, and the loss of their services or our inability to attract and retain such personnel could have a material adverse effect on our ability to expand our business or to maintain profitable operations.***

Our future success will depend largely on the skills, efforts, and motivation of our executive officers and other senior managers. The loss of the service of executive officers and other senior managers or our inability to attract or retain other qualified personnel could have a material adverse effect on our ability to expand our business, implement our strategy or maintain profitable operations.

In addition, to execute our growth strategy and maintain our margins, we must attract and retain other skilled personnel with an extensive understanding of the energy efficiency regulatory framework and an effective sales force that can accurately price and manage our clients' energy efficiency solution contracts. Competition for hiring these individuals is intense. If we fail to attract and retain highly qualified skilled personnel, our business and growth prospects could be materially adversely affected.

***We depend upon a limited number of utility contracts to generate substantially all of our revenue.***

With the sale of our public sector business, GES-Port Charlotte, our regional service budget and FRR contract, all of our revenue will be derived from seven utility contracts, with four of these contracts generating 80% to 90% of the total revenue. While these contracts are typically multi-year, the utilities are required to re-bid them at the end of their term, therefore our ability to retain these contracts is not

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assured. It is also possible that utilities could have a change of strategy for achieving their energy efficiency goals, de-emphasizing the small-business direct install programs under which we currently operate. A utility could also decide to reduce the incentives available to small businesses under our program, thereby reducing the effectiveness of our sales efforts. The loss of, or substantial reduction in sales to any of our utility clients could have a material adverse effect on our business, results of operations and financial condition.

***Failure of our subcontractors to properly and effectively perform their services in a timely manner could cause delays in the delivery of our energy efficiency solutions.***

Our success depends on our ability to provide quality, reliable energy efficiency solutions in a timely manner, which in part requires the proper removal and installation of lighting, mechanical and electrical systems and other products by the subcontractors upon which we depend. Almost all of our energy efficiency solutions are installed by contractors or subcontractors. Any delays, malfunctions, inefficiencies or interruptions in the installation of our energy efficiency solutions caused by our subcontractors could put us at risk of a utility terminating a contract pre-maturely, jeopardize our ability to retain a contract when it comes up for renewal, and harm our reputation in the marketplace. Such delays could also result in additional costs that could affect the profit margin of our projects.

***If our information technology systems fail, or if we experience operation interruptions, then our business, results of operations and financial condition could be materially adversely affected.***

The efficient operation of our business is dependent on our information technology systems. We rely on those systems generally to manage the day-to-day operation of our business, manage relationships with our clients and maintain our financial and accounting records. The failure of our information technology systems, our inability to successfully maintain and enhance our information technology systems, or any compromise of the integrity or security of the data we generate from our information technology systems, could have a material adverse effect on our results of operations, disrupt our business and make us unable, or severely limit our ability, to respond to client demands. In addition, our information technology systems are vulnerable to damage or interruption from:

- earthquake, fire, flood and other natural disasters;
- employee or other theft;
- attacks by computer viruses or hackers;
- power outages; and
- computer systems, Internet, telecommunications or data network failure.

Any interruption of our information technology systems could result in decreased revenue, increased expenses, increased capital expenditures, client dissatisfaction and lawsuits, any of which could have a material adverse effect on our results of operations or financial condition.

*Product liability and personal injury claims could have a material adverse effect on our business, results of operations and financial condition.*

We face exposure to product liability and personal injury claims in the event that our energy efficiency solutions cause bodily injury or property damage. Since the majority of our products use electricity, it is possible that the products we sell could result in injury, whether due to product malfunctions, defects, improper installation or other causes. Further, we face exposure to personal injury claims in the event that an individual is injured as a result of our negligence or the negligence of one of our subcontractors. Moreover, we may not have adequate resources in the event of a successful claim against us. A successful product liability or personal injury claim against us that is not covered by

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insurance or is in excess of our available insurance limits could require us to make significant payments of damages which could materially adversely affect our results of operations and financial condition.

*Our retrofitting process frequently involves responsibility for the removal and disposal of components containing hazardous materials and at times requires that our contractors or subcontractors work in hazardous conditions, either of which could give rise to a claim against us.*

When we retrofit a client's facility, we assume responsibility for removing and disposing of its existing lighting fixtures. Certain components of these fixtures contain trace amounts of mercury and other hazardous materials. Older components may also contain trace amounts of polychlorinated biphenyls, or PCBs. We utilize licensed and insured hazardous wastes disposal companies to remove and/or dispose of such components. Failure to properly handle, remove or dispose of the components containing these hazardous materials in a safe, effective and lawful manner could give rise to liability against us, or could expose our workers, our subcontractor's workers or other persons to these hazardous materials, which could result in claims against us. Further, our workers and subcontractor's workers are sometimes required to work in hazardous environments that present a risk of serious personal injury which could result in claims against us. A successful personal injury claim against us that is not covered by insurance or is in excess of our available insurance limits could require us to make significant payments of damages and could materially adversely affect our results of operations and financial condition.

*Our ability to use our net operating loss carry forwards will be subject to additional limitation, which could potentially result in increased future tax liability.*

Generally, a change of more than 50% in the ownership of a company's stock, by value, over a three-year period constitutes an ownership change for U.S. federal income tax purposes. An ownership change may limit a company's ability to use its net operating loss carry forwards attributable to the period prior to such change. We have sold or otherwise issued shares of our common stock in various transactions sufficient to constitute an ownership change, including our public offering in 2009 and the conversion of all of our outstanding preferred stock and the conversion of all of our outstanding convertible notes. As a result, if we earn net taxable income, our ability to use our pre-change net operating loss carry forwards, which amounted to \$147 million as of December 31, 2013, to offset U.S. federal taxable income will be subject to limitations, which will likely result in increased future tax liability. In addition, future shifts in our ownership, including transactions in which we may engage, may cause additional ownership changes, which could have the effect of imposing additional limitations on our ability to use our pre-change net operating loss carry forwards.

### **Risks Related to Ownership of Our Common Stock**

*The future trading market for our common stock may not be active on a consistent basis and the market price of our common stock could be subject to significant fluctuations.*

Trading in our common stock has been limited and, at times, volatile since our shares were listed on The NASDAQ Capital Market in February 2008. The trading volume of our common stock in the future depends in part on our ability to increase our revenue and reduce or eliminate our operating losses. If we are unable to achieve these goals, the trading market for our common stock may be negatively affected, which may make it difficult for you to sell your shares. An active trading market for our common stock may not develop or, if developed, be sustained, and the trading price of our common stock may fluctuate substantially.



The price of our common stock may also fluctuate as a result of:

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- variations in our operating results;
- announcements by us, our competitors or others of significant business developments, changes in client relationships, acquisitions or expansion plans;
- analysts' earnings estimates, ratings and research reports;
- the depth and liquidity of the market for our common stock;
- speculation in the press;
- strategic actions by us or our competitors, such as sales promotions or acquisitions;
- actions by institutional and other stockholders;
- recruitment or departure of key personnel; or
- domestic and international economic factors and trends, some of which may be unrelated to our performance.

The stock markets, in general, periodically experience volatility that is sometimes unrelated to the operating performance of particular companies. These broad market fluctuations may cause the trading price of our common stock to decline.

In the past, following a period of volatility in the market price of a company's securities, securities class action litigation has often been brought against a company. Because of the potential volatility of our common stock price, we may become the target of securities litigation in the future. Securities litigation could result in substantial costs and divert management's attention and resources from our business.

***We expect our quarterly revenue and operating results to fluctuate. If we fail to meet the expectations of market analysts or investors, the market price of our common stock could decline substantially, and we could become subject to securities litigation.***

Our business is somewhat seasonal and can be affected by cyclical factors outside of our control. Our quarterly revenue and operating results have fluctuated in the past and are likely to continue to vary from quarter to quarter in the future. You should not rely upon the results of one quarter as an indication of our future performance. Our revenue and operating results may fall below the expectations of market analysts or investors in some future quarter or quarters. Our failure to meet these expectations could have an adverse effect on the market price of our common stock. In addition, these fluctuations in our revenue may result in volatility in our results of operations and/or have an adverse effect on the market price of our common stock. If the price of our common stock falls significantly we may be the target of securities litigation. If we become involved in this type of litigation, regardless of the outcome, we could incur substantial legal costs, management's attention could be diverted from the operation of our business, and our reputation could be damaged, which could have a material adverse effect on our business, results of operations and/or financial condition.

*If securities analysts do not publish research or reports about our business or if they downgrade their evaluations of our stock, the price of our stock could decline.*

The trading market for our common stock depends in part on the research and reports that industry or financial analysts publish about us or our business. Since announcing the need to restate our historical results, all of the analysts that were following us have dropped or suspended coverage. If these analysts don't resume coverage or if we cannot find other analysts willing to pick up coverage of our stock the price of our stock could stagnate or decline. If one or more analysts do pick up coverage on us, but subsequently downgrades their estimates or evaluations of our stock, the price of our stock could decline.

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***Due to the concentration of holdings of our stock, a limited number of investors may be able to control matters requiring common stockholder approval or could cause our stock price to decline through future sales because they beneficially own a large percentage of our common stock.***

As of March 28, 2014, there were 3,726,705 shares of our common stock outstanding and shares of Series A and Series B Preferred Stock convertible into an additional 4,852,768 shares of common stock that vote on as converted basis, of which two investors own 50.6%. As a result of their significant ownership, these investors may have the ability to exercise a controlling influence over our business and corporate actions requiring stockholder approval, including the election of our directors, a sale of substantially all of our assets, a merger between us and another entity or an amendment to our certificate of incorporation. This concentration of ownership could delay, defer or prevent a change of control and could adversely affect the price investors might be willing to pay in the future for shares of our common stock. Also, in the event of a sale of our business, these investors could be able to seek to receive a control premium to the exclusion of other common stockholders.

A significant percentage of the outstanding shares of our common stock, including the shares beneficially owned by these holders, can be sold in the public market from time to time, subject to limitations imposed by federal securities laws. The market price of our common stock could decline as a result of sales of a large number of our presently outstanding shares of common stock by these investors or other stockholders in the public market or due to the perception that these sales could occur. This could also make it more difficult for us to raise funds through future offerings of our equity securities or for you to sell your shares if you choose to do so.

The large concentration of our shares held by these two stockholders could result in increased volatility in our stock price due to the limited number of shares available in the market.

***Raising additional capital or consummation of additional acquisitions through the issuance of equity or equity-linked securities could dilute your ownership interest.***

It is possible that we may find it necessary to raise capital again sometime in the future or to consummate additional acquisitions through the issuance of equity or equity-linked securities. If we raise additional funds in the future through the issuance of equity securities or convertible debt securities, our existing stockholders will likely experience dilution of their present equity ownership position and voting rights. Depending on the number of shares issued and the terms and conditions of the issuance, new equity securities could have rights, preferences, or privileges senior to those of our common stock. Depending on the terms, common stock holders may not have approval rights with respect to such issuances.

***Provisions of our charter and by-laws, in particular our blank check preferred stock, and in the Delaware General Corporation Law may prevent or discourage an acquisition of our Company that would benefit our stockholders.***

Provisions of our charter and by-laws may make it more difficult for a third party to acquire control of our Company, even if a change-in-control would benefit our stockholders. In particular, shares of our preferred stock may be issued in the future without further stockholder approval and upon those terms and conditions, and having those rights, privileges and preferences, as our Board of Directors may determine. In the past, we have issued preferred stock with dividend and liquidation preferences over our common stock, and with certain approval rights not accorded to our common stock, and which was convertible into shares of our common stock at a price lower than the market price of our common stock.

The rights of the holders of our common stock will be subject to, and may be adversely affected by, the

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rights of the holders of any preferred stock we may issue in the future. The issuance of our preferred stock, while providing desirable flexibility in pursuing possible additional equity financings and other corporate purposes, could have the effect of making it more difficult for a third party to acquire control of us. This could limit the price that certain investors might be willing to pay in the future for shares of our common stock and discourage these investors from acquiring a majority of our common stock. In addition, the price that future investors may be willing to pay for our common stock may be lower due to the conversion price and exercise price granted to investors in any such private financing.

In addition, as a Delaware corporation, we are subject to certain Delaware anti-takeover provisions, including the application of Section 203 of the Delaware General Corporation Law, which generally restricts our ability to engage in a business combination with any holder of 15% or more of our capital stock. Our Board of Directors could rely on Delaware law to prevent or delay an acquisition of us.

*Compliance with changing regulation of corporate governance and public disclosure may result in additional expenses.*

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes Oxley Act of 2002 and the Dodd-Frank Act, and rules subsequently implemented by the Securities and Exchange Commission, or SEC, and The NASDAQ Stock Market, have imposed substantial requirements on public companies, including with respect to public disclosure, internal control, corporate governance practices and other matters. Our management and other personnel are devoting substantial amounts of time and resources to comply with these evolving laws, regulations and standards. Moreover, these laws, regulations and standards have significantly increased our legal and financial compliance costs and have made some activities more time-consuming and costly. In addition, we could incur significant costs to remediate any material weaknesses we identify through these efforts. We currently are evaluating and monitoring development with respect to these evolving laws, regulations and standards, and cannot predict or estimate the amount of additional costs we may incur or the timing of such costs. These new regulatory requirements may result in increased general and administrative expenses and a diversion of management's time and attention from revenue generating activities to compliance activities, which could harm our business prospects and could have a negative effect on the trading price of our common stock.

**Item 2. Properties.**

Our headquarters are located at 16810 Kenton Drive, Suite 240, Huntersville, North Carolina. This office is approximately 13,145 square feet and our lease runs through February 2022.

Other properties that are used for sales and administration include:

<b>Location:</b>	<b>Square Feet</b>	<b>Lease Expiration</b>
Beacon, NY	4,800	December 2015
Farmingdale, NY	11,100	July 2016
Gahanna, OH	2,650	April 2015

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Newton, MA	4,594	May 2015
Williamsville, NY	5,824	November 2015
Woodbridge, NJ	11,500	February 2017

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We believe that the space and location of our current headquarters will be sufficient for the level of sales and production projected for the current year.

**Item 3. Legal Proceedings.**

*Satterfield v. Lime Energy Co. et al.*, Case No. 12-cv-5704 (N.D. Ill.): This is a putative class action on behalf of purchasers of our securities between May 14, 2008 and December 27, 2012, inclusive. Following an announcement by us dated July 17, 2012, four separate putative class actions were filed alleging violations of the federal securities laws and naming as Defendants the Company and three of its officers, John O'Rourke, Jeffrey Mistarz and David Asplund. The four cases were consolidated. Pursuant to the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), on October 26, 2012, the Court appointed Lead Plaintiffs. Lead Plaintiffs filed a Consolidated Amended Class Action Complaint on January 18, 2013, alleging that Defendants issued false and misleading statements concerning Lime's revenues during the class period and thereby artificially inflated our stock price. On January 21, 2014, following several months of arm's length negotiations, the Lead Plaintiffs and Defendants entered into a stipulation of settlement under which this matter would be fully and finally settled. As part of the settlement, Defendants agreed to cause \$2.5 million to be paid into a settlement fund, which \$2.5 million has been provided by the Company's directors and officers liability insurers. On January 28, 2014, Judge Sara Ellis entered an order granting preliminary approval of the class action settlement and notice to the settlement class in the matter. The settlement remains subject to final approval by the court. The final approval hearing has been set for May 13, 2014.

*Kuberski v. Lime Energy Co. et al.*, Case No. 12-cv-7993 (N.D. Ill.): This is a putative shareholder derivative action alleging that certain of our officers and directors breached their fiduciary duties to the Company from May 14, 2008 through the present by failing to maintain adequate internal controls and causing the Company to issue false and misleading statements concerning our revenues. An initial derivative complaint was filed on October 5, 2012. A second derivative action was filed on March 5, 2013. The two cases were consolidated and the Court appointed Lead Counsel for the Plaintiffs on April 9, 2013. On May 9, 2013, the Plaintiffs filed a Verified Consolidated Shareholder Derivative Complaint. On June 10, 2013, Defendants filed a motion to dismiss for failure to make a demand on the Board of Directors of the Company or to adequately plead why demand should be excused, as required by Rule 23.1 of the Federal Rules of Civil Procedure and Delaware law. Briefing on the motion to dismiss was completed as of July 22, 2013. On March 25, 2014, the Court granted Defendants' motion to dismiss and dismissed the case with prejudice. Plaintiffs have thirty days to file a notice of appeal.

*SEC Investigation.* The Securities and Exchange Commission is conducting an investigation of our revenue recognition practices and financial reporting. On September 11, 2012, the Commission issued a subpoena for documents. We are cooperating with the Commission's investigation.

**Item 4. Mine Safety Disclosures.**

Not applicable.



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Since February 25, 2008, our stock has traded on the NASDAQ Capital Market under the trading symbol LIME.

The following table sets forth the quarterly high and low selling prices for our common stock as reported on the Bulletin Board and NASDAQ since January 1, 2012.

	<b>High</b>	<b>Common Stock</b>	<b>Low</b>
<b>Fiscal Year Ended December 31, 2012:</b>			
Fiscal Quarter Ended March 31, 2012	\$ 25.06	\$	19.39
Fiscal Quarter Ended June 30, 2012	\$ 21.56	\$	15.40
Fiscal Quarter Ended September 30, 2012	\$ 16.38	\$	4.76
Fiscal Quarter Ended December 31, 2012	\$ 5.18	\$	3.29
<b>Fiscal Year Ended December 31, 2013:</b>			
Fiscal Quarter Ended March 31, 2013	\$ 6.09	\$	3.64
Fiscal Quarter Ended June 30, 2013	\$ 5.60	\$	4.62
Fiscal Quarter Ended September 30, 2013	\$ 6.65	\$	3.29
Fiscal Quarter Ended December 31, 2013	\$ 4.08	\$	2.71

**Holdings**

As of March 21, 2014 we had approximately 792 holders of record, approximately 3,537 beneficial owners of our common stock and 3,726,705 shares of common stock outstanding.

**Dividends**

No dividends were declared or paid on our common stock during the fiscal years ended December 31, 2012, and 2013.

We have never declared or paid any cash dividends on our common stock and we do not anticipate paying any cash dividends in the foreseeable future.

**Recent Sales of Unregistered Securities**

On February 4, 2014, we raised \$2.0 million from the sale of a package of securities to Greener Capital Fund II, L.P. consisting of 200,000 shares of series B preferred stock and a five-year warrant to purchase 282,686 shares of our common stock at \$2.83 per share. The series B preferred stock is convertible at the holder's election into shares of our common stock at \$2.83 per share (subject to adjustment). At the current conversion price these shares of series B preferred are convertible into 706,714 shares of our common stock.

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**Purchases of Equity Securities by the Issuer and Affiliated**

None.

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

*Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that are based on management's current expectation, estimates, and projections about our business and operations. Our actual results may differ materially from those currently anticipated and expressed in such forward-looking statements as a result of numerous factors, including those we discuss under Risk Factors and elsewhere in this report.*

**Overview**

**General**

We are a leader in designing and implementing demand-side energy efficiency programs that enable our utility clients to reach their underserved markets and achieve their energy reduction goals. We provide our energy efficiency program delivery services exclusively within the utility sector, and our clients include two of the five largest investor-owned utilities in the country. We focus on deploying direct install energy efficiency solutions for small and mid-size commercial and industrial business programs that improve energy efficiency, reduce energy-related expenditures and lessen the impact of energy use on the environment. Currently, these solutions include energy efficient lighting upgrades and energy efficient mechanical upgrades. Our small business direct install (SBDI) programs provide a cost-effective avenue for our utility clients to offer products and services to a hard-to-reach customer base while satisfying aggressive state-mandated energy reduction goals. The direct install model is a turnkey solution under which we contract with the utility clients to design and market their small and mid-sized efficiency programs within a defined territory, perform the technical audits, sell the solution to the end-use customer and oversee the implementation of the energy efficiency measures. The model makes it easy and affordable for small businesses to upgrade to energy efficiency equipment and is a dependable and cost effective way for our utility clients to achieve their energy efficiency goals.

**Revenue and Expense Components**

*Revenue*

We generate the majority of our revenue from the sale of our services and the products that we purchase and resell to our clients.

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We charge our utility clients based on an agreed to rate schedule based on the item installed or the savings generated. A typical project for a small business utility client can take anywhere from a few hours to a few weeks to complete. During 2013, we provided services to over 6,800 small business customers under our nine utility programs.

### *Revenue Recognition*

We recognize our revenue when all four of the following criteria are met: (i) persuasive evidence has been received that an arrangement exists; (ii) delivery of the products and/or services has occurred; (iii) the selling price is fixed or determinable; and (iv) collectability is reasonably assured. In addition, we follow the provisions of the SEC's Staff Accounting Bulletin No. 104, *Revenue Recognition*, which

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sets forth guidelines for the timing of revenue recognition based upon factors such as passage of title, installation, payments and client acceptance. Any amounts received prior to satisfying our revenue recognition criteria are recorded as billings in excess of costs and estimated earnings on uncompleted contracts.

We recognize the revenue utilizing the percentage of completion method of revenue recognition. Under the percentage of completion method we recognize revenue throughout the term of the project based on the percentage of costs incurred. Any anticipated losses on contracts are charged to operations as soon as they are determinable.

*Revenue Concentration*

During 2013, we derived approximately 75% of our consolidated revenue from continuing operations from our four largest utility programs, with the New Jersey Board of Public Utilities, Niagara Mohawk (National Grid), Long Island Power, and Central Hudson Gas & Electric each responsible for 24%, 22%, 16% and 11% of our revenue, respectively. During 2012 our three largest utility clients, Niagara Mohawk (National Grid), the New Jersey Board of Public Utilities and Long Island Power, were responsible for 40%, 25% and 21% of our consolidated revenue, respectively.

We expect revenue from programs we started last year with Duke Energy and AEP Ohio to become larger contributors to our consolidated revenue during 2014, which should reduce the portion of our revenue generated by other existing programs.

*Gross Profit*

Gross profit equals our revenue less cost of sales. Our cost of sales consists primarily of materials, our internal labor and the cost of subcontracted labor.

Gross profit is a key metric that we use to examine our performance. Gross profit depends in part on the volume and mix of products and services that we sell during any given period. We subcontract substantially all of our installation and construction work, therefore our cost of goods sold consists almost exclusively of variable costs. Accordingly, our cost of sales will vary directly with changes in revenue.

*Selling, General and Administrative Expense*

Selling, general and administrative expense includes the following components:

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- direct labor costs of our employees performing sales and marketing;
- expenses related to our management, supervisory and staff salaries and employee benefits, including the costs of stock-based compensation;
- costs related to insurance, travel and entertainment, office supplies and utilities;
- costs related to marketing and advertising our products;
- legal and accounting expenses; and
- costs related to administrative functions that serve to support our existing businesses, as well as to provide the infrastructure for future growth.

### *Amortization of Intangibles*

When we acquire other companies we are required to allocate the purchase price between identifiable tangible and intangible assets, with any remaining value allocated to goodwill. The value allocated to intangible assets is amortized over the estimated life of the related asset. The acquisitions we

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completed within 2006, 2007 and 2008 resulted in approximately \$8.3 million of intangible assets, the substantial majority of which has already been amortized or written off. The acquisition of the Zemel Road gas rights also resulted in the creation of an intangible asset of \$2.6 million. We were amortizing this asset over the 20 year term of the contract; however, during the fourth quarter of 2012 we determined that the fair-market value of our investment in the Zemel Road facility was less than our carrying value. Therefore, as part of reducing the carrying value to the fair-market value, we wrote-off the remaining value of this intangible asset. During 2013, our intangible assets became fully amortized, therefore absent any future acquisitions, we will not have any additional amortization expense related to intangible assets.

*Interest Expense, Net*

Net interest expense consists of interest expense net of interest income. Net interest expense represents the interest costs associated with our subordinated convertible term notes (including amortization of the related debt discount and issuance costs) and our line of credit. The subordinated convertible notes were converted to preferred stock in September 2013 and the line of credit expired in March 2013.

Interest income includes earnings on our invested cash balances and amortization of the discount on our long-term receivables.

**General Business Trends and Recent Developments**

The trends, events, and uncertainties set out in this section have been identified as those we believe are reasonably likely to materially affect the comparison of historical operating results reported in this report to either other past period results or to future operating results. These trends, events and uncertainties include:

*Business Divestitures*

During 2013, we sold or shut down five businesses: the ESCO business; Lime Energy Asset Development; GES-Port Charlotte; our contract with the Army Corps of Engineers; and our regional service business. Our remaining business is exclusively focused on providing energy efficiency to small and mid-sized commercial and industrial businesses under small-business direct install programs offered by utilities. The businesses we sold or shut down have been reported as discontinued operations in the accompanying financials statements. The disposition of these businesses will make it more difficult to compare our current and future operating results to the results from periods prior to the disposition of these businesses.

For additional information regarding discontinued operations please refer to Note 6 in the accompanying financial statements.

**Critical Accounting Policies and Estimates**

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions. Critical accounting policies are defined as those that involve significant judgments and uncertainties, and potentially result in materially different results under different assumptions and conditions. We believe that our most critical accounting policies are limited to those described below. For a detailed discussion on the application of these and other accounting policies, see Note 3 in the notes to our consolidated financial statements.



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*Use of Estimates*

Preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions affecting the reported amounts of assets, liabilities, revenues and expenses and related contingent liabilities. On an on-going basis, we evaluate our estimates, including those related to revenues, bad debts, warranty accrual, income taxes and contingencies and litigation. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

*Revenue and Profit Recognition*

We recognize our revenue using the percentage of completion method of revenue recognition. Under the percentage of completion method, we recognize revenue based on the percentage of costs incurred. Under this method of revenue recognition, any anticipated losses on contracts are charged to operations as soon as they are determinable.

*Allowance for Doubtful Accounts*

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our clients to make required payments. The allowance is based upon the payment history of specific clients and specific knowledge of clients from whom collection is determined to be doubtful. If the financial condition of our clients or the economic environment in which they operate were to deteriorate, resulting in an inability to make payments, or if our estimates of certain clients' ability to pay are incorrect, additional allowances may be required. Under certain of our utility contracts, we offer extended payment terms of 12 or 24 months to our small-business customers for the portion of the cost of the work we perform that is not covered by utility incentives. We require that most of these customers provide us with a credit card or e-check authorization that we can charge for their monthly payment. This reduces our administrative cost of invoicing and collecting many small monthly payments and also gives us an earlier indication of a potential collection issue. As these programs have expanded and we have gained additional experience dealing with them we have increased our allowance for doubtful accounts. During 2013 and 2012 we increased our allowance by \$886 thousand and \$814 thousand, respectively. As of December 31, 2013, our allowance for doubtful accounts was \$1.8 million, or approximately 16% of our outstanding accounts receivable. We will continue to monitor our collections experience with these small-business customers and adjust our allowance accordingly.

*Amortization of Intangibles*

We account for acquisitions of companies in accordance with ASC 805, Accounting for Business Combinations. We allocate the purchase price to tangible assets and intangible assets based on their fair values, with the excess of purchase price being allocated to goodwill. The determination of the fair values of these intangible assets is based on a number of significant assumptions as determined by us, including evaluations of the future income producing capabilities of these assets and related future expected cash flows or replacement cost of the asset. We also make estimates about the useful lives of the acquired intangible assets. Should different conditions result in the determination that the value of the acquired intangible assets has been impaired, we could incur write-downs of intangible assets, or changes in the estimation of useful lives of those intangible assets. In accordance with ASC 350, Goodwill and Other Intangible Assets, goodwill is not amortized, but is subject to annual impairment testing which is discussed in greater detail below.



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Intangible assets of our continuing business include acquired technology and software. This asset was initially recorded at its fair value based on the estimated after tax cost to replace the asset and was amortized over its estimated useful life on a straight-line basis. This technology and software intangible asset became fully amortized during the first half of 2013.

The intangible assets of the businesses we sold have included in discontinued operations in the accompanying financial statements. Utilizing the price we received in February 2013 for the sale of the ESCO business as an indicator of its fair value, we determined that our carrying value of this business exceeded the fair value as of the end of 2012. In adjusting the carrying value of this business to reflect its indicated fair value, we reduced the carrying value of the associated intangibles to \$0 during the fourth quarter of 2012, resulting in an impairment charge of \$1.6 million during the period. Also during the fourth quarter of 2012, we reduced the carrying value of the Zemel Road gas rights to \$0 as part of our decision to reduce the carrying value of the Zemel Road assets to their fair-market value which resulted in an impairment charge of \$2.5 million.

***Impairment Loss***

We evaluate all of our long-lived assets, including intangible assets other than goodwill and fixed assets, periodically for impairment in accordance with ASC 360-10-35, Accounting for the Impairment or Disposal of Long-Lived Assets. We record impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of those items. Our cash flow estimates are based on historical results adjusted to reflect our best estimate of future market and operating conditions. The net carrying value of assets not recoverable is reduced to fair value. Our estimates of fair value represent our best estimate based on industry trends and reference to market rates and transactions.

Utilizing the price we received in February 2013 for the sale of the ESCO business as an indicator of its fair value, we determined that our carrying value of this business exceeded the fair value as of the end of 2012. Accordingly, we reduced the carrying value to the estimated fair value during the fourth quarter of 2012, incurring a \$3.2 million impairment charge as a result. This charge included \$129 thousand related to the write-off of property, plant and equipment.

During early 2012, the quality and quantity of gas coming from the well field on the Zemel Road landfill began to deteriorate, in part due to a fire in the well field. During the fourth quarter of 2012, we updated our projections for future cash flows from the facility given the lower gas flow rates and higher anticipated operating expenses and determined that the fair value was less than our current carrying value. As a result, we recorded a \$3.5 million impairment charge during the fourth quarter to reduce the value of this asset to our estimate of fair-value. This charge included \$1.1 million related to the write-down of the carrying value of property, plant and equipment. During the third quarter of 2013, we recorded an additional \$27,000 impairment charge when we reduce the carrying value of the asset to the anticipated selling price based on negotiations to sell the facility. We sold the facility on November 1, 2013 at a price equal to our adjusted carrying value, resulting in no gain or loss on the sale.

***Goodwill***

We have made acquisitions in the past that included a significant amount of goodwill and other intangible assets. In accordance with ASC 350, goodwill is subject to an annual (or under certain circumstances more frequent) impairment test based on its estimated fair value. Estimated fair

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value is less than value based on undiscounted operating earnings because fair value estimates include a discount factor in valuing future cash flows. Many assumptions and estimates underlie the determination of an

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impairment loss, including economic and competitive conditions, operating costs and efficiencies. Another estimate using different, but still reasonable, assumptions could produce a significantly different result.

The price we received in February 2013 for the sale of the ESCO business indicated that the carrying value of the assets associated with this business was impaired. In adjusting the carrying value to the indicated fair value, we reduced the value of goodwill associated with this business by \$1.4 million during the fourth quarter of 2012.

Our utility business was established in 2009 utilizing resources we acquired as part of the acquisition of Applied Energy Management, Inc. With the decision to sell most of the original AEM business, while retaining the utility business, we allocated the goodwill associated with the AEM reporting unit between the public sector business and the utility business based on their relative fair values as of December 31, 2012. The portion of goodwill allocated to the public sector business has been included in discontinued operations in the accompanying financial statements.

During the fourth quarter of 2012, and again during the fourth quarter of 2013, we completed an impairment analysis of the goodwill associated with the utility reporting unit and found that based on the discounted current value of the estimated future cash flows, the implied fair value substantially exceeded the carrying value, indicating that goodwill was not impaired.

We considered various factors in determining the fair value of the testing units, including discounted cash flows from projected earnings, values for comparable companies and the market price of our common stock. We will continue to monitor for any impairment indicators such as underperformance of projected earnings, net book value compared to market capitalization, declining stock price and significant adverse economic and industry trends. In the event that either testing unit does not achieve projected results, or, as the result of changes in facts or circumstances, we could incur an additional goodwill impairment charge in a future period.

***Share-Based Compensation***

We have stock incentive plans that provide for stock-based employee and director compensation, including the granting of stock options and shares of restricted stock, to certain key employees and non-employee directors. These plans are more fully described in Notes 23 and 24 to our consolidated financial statements. Consistent with ASC 718, *Share-Based Payment*, we record stock compensation expense for equity-based awards granted, including stock options and restricted stock unit grants, over the service period of the equity-based award based on the fair value of the award at the date of grant. We recognized \$867 thousand and \$1.8 million of stock compensation related to employee options expense, employee stock purchase plan and restricted stock grants during 2013 and 2012, respectively.

**Results of Operations**

*Revenue*

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We generate the majority of our revenue from the sale of our services as well as the sale of the products that we purchase and resell to our clients. All of our revenue is earned in the United States.

We charge our utility customers utilizing an agreed to rate schedule based on the item installed or the savings generated. A typical project for a small business utility customer can take anywhere from a few hours to a few weeks to complete and we began work on over 6,800 new projects during 2013.

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*Gross Profit*

Gross profit equals our revenue less costs of sales. The cost of sales consists primarily of materials, our internal labor and the cost of subcontracted labor.

Gross profit is a key metric that we use to examine our performance. Gross profit depends in part on the volume and mix of products and services that we sell during any given period. Since we subcontract substantially all of our construction work to independent contractors, there is very little fixed cost included in our cost of sales. The gross margin earned from different utility programs between programs. The mix of business generated from our various programs will change throughout the year, due in part to varying activity levels under existing programs and the growth of new programs, which will affect our consolidated gross margin.

*Selling, General and Administrative Expenses*

Selling, general and administrative expenses ( SG&A ) include the following components:

- direct labor costs of our employees performing sales and marketing;
  
- costs of our management, supervisory and staff salaries and employee benefits, including the costs of stock-based compensation;
  
- costs related to insurance, travel and entertainment, office supplies and utilities;
  
- costs related to marketing and advertising our products;
  
- legal and accounting expenses; and
  
- costs related to administrative functions that serve to support our existing businesses, as well as to provide the infrastructure for future growth.

*Amortization of Intangibles*

We incur expenses related to the amortization of identifiable assets that we have capitalized in connection with our acquisitions.

*Other Expense*

Other expense consists of interest expense, net of interest earned on our investments. Interest expense represents the interest costs and fees associated with our subordinated convertible term notes (including amortization of the related debt discount and issuance costs) and our lines of credit.

Interest income includes earnings on our invested cash balances and amortization of the discount on our long term receivables. We offer certain customers extended payment terms. When we record receivables with payments terms of more than 12 months we are required to discount them using a market rate of interest and amortize the discount over the term of the receivable. This amortization is recognized as interest income.



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**Twelve-Month Period Ended December 31, 2013**

**Compared With the**

**Twelve-Month Period Ended December 31, 2012**

*Consolidated Results*

	Twelve Months Ended		Change	
	12/31/2013	12/31/2012	\$	%
Revenue	\$ 51,565	\$ 35,447	\$ 16,118	45.5%
Cost of sales	37,758	28,109	9,649	34.3%
Gross profit	13,807	7,338	6,469	88.2%
Selling, general and administrative	22,933	22,938	(5)	0.0%
Amortization of intangibles	10	25	(15)	-60.0%
Operating loss	(9,136)	(15,625)	6,489	-41.5%
Total other (expense) income	(2,001)	(127)	(1,874)	1475.6%
Loss from continuing operations	(11,137)	(15,752)	4,615	-29.3%
Loss from operation of discontinued business	(4,499)	(16,060)	11,561	-72.0%
Net Loss	\$ (15,636)	\$ (31,812)	\$ 16,176	-50.8%
Preferred dividend	(2,875)		(2,875)	100.0%
Net loss available to common	\$ (18,511)	\$ (31,812)	\$ 13,301	-41.8%

The following table presents the percentage of certain items to revenue:

	Twelve Months Ended	
	12/31/2013	12/31/2012
Revenue	100.0%	100.0%
Cost of sales	73.2%	79.3%
Gross profit	26.8%	20.7%
Selling, general and administrative	44.5%	64.7%
Amortization of intangibles	0.0%	0.1%
Operating loss	-17.7%	-44.1%
Total other income	-3.9%	-0.4%
Loss from continuing operations	-21.6%	-44.4%

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Loss from operation of discontinued business	-8.7%	-45.3%
Net Loss	-30.3%	-89.7%
Preferred dividend	-5.6%	0.0%
Net loss available to common	-35.9%	-89.7%

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***Revenue***

Our consolidated revenue increased \$16.1 million, or 45.5%, to \$51.6 million during 2013, from \$35.4 million during 2012. Approximately \$12 million of this increase was from four new programs that started generating revenue for the first time during 2013. The five programs that were in existence during 2012, experienced a 12% increase in combined revenue, either as the result of the continued ramp-up of new programs or expansion of contract goals under the existing program.

We will be dropping our two smallest utility programs during 2014, one of which was a pilot program that ended on December 31, 2013, and the other of which we decided to terminate because it was marginally profitable due to its low level of revenue. We also have a contract under one of our largest programs that is up for renewal in mid-2014, for which we have not been informed as to whether it will be continued beyond the current contract term. We believe that we have been the top performer under this program, therefore, we believe that if the program is continued we are likely to receive a contract extension. If our contract is not extended, we believe that the reduction in 2014 revenue from this program will be modest due to the backlog of work we will have to complete. We are expecting strong growth during 2014 from our programs with Duke Energy and AEP Ohio, both of which were new program initiated during 2013. We also continue to work to secure contracts for new utility territories, which if we are successful at winning, could begin to contribute to revenue during the fourth quarter of 2014.

***Gross Profit***

Our gross profit increased \$6.5 million, or 88.2%, to \$13.8 million during 2013, from \$7.3 million in 2012. This increase was the result of higher revenue and an improvement in our gross profit margin, which increased from 20.7% in 2012, to 26.8% in 2013. The improvement in our gross profit margin is the result of increased contributions from new utility programs, which generally have higher gross profit margins than our older programs, and improvements in efficiency within existing programs. The improvements in operating efficiency are due to a combination of the continued development of our software platform, changes we have made to some of our processes and additional training and experience of the people working in these programs.

We expect to see continued, modest improvements in our gross profit margins during 2014, as our newer programs become a larger portion of our overall revenue and we continue to seek additional operating efficiencies across all of our programs.

***Selling General & Administrative Expense***

Our selling, general and administrative expense declined \$5 thousand during 2013. Our SG&A as a percentage of revenue declined from 64.7% in 2012 to 44.5% in 2013. Costs associated with the restatement of our financial statements and the defense of related stockholder lawsuits declined \$259 thousand, to \$2.6 million during 2013 from \$2.8 million during 2012. The 2013 SG&A expense also included \$327 thousand of share based compensation expense related to the accelerated vesting of options and restricted stock of terminated employees. Other SG&A expenses declined \$73 thousand during 2013 as a result of initiatives we undertook to reduce overhead costs. The restatement was completed in July 2013, in late January 2014 we agreed to terms of a settlement on the stockholder lawsuit and the derivative suit was dismissed in late March 2013, as a result we expect that costs related to the restatement and stockholder lawsuits will decline significantly during 2014. We also believe that the initiatives we took in 2013 to reduce overhead costs will further reduce our SG&A expense by an additional \$1 million to \$2 million during 2014, and that this, in combination with an expected increase in revenue, will contribute to reduce our SG&A as a percentage of

revenue during 2014.

Table of Contents*Amortization of Intangibles*

Amortization expense declined \$15 thousand, or 60%, to \$10 thousand during 2013 from \$25 thousand during 2012. The technology and software intangible created as part of the acquisition of Applied Energy Management Inc. in 2008 became fully amortized in May 2013. Since this was the only intangible asset in continuing operations, absent a future acquisition, there will be no further amortization expense in future periods.

*Other Expense*

Other expense increased \$1.9 million to \$2.0 million during 2013, from \$127 thousand during 2012. Interest expense, which is included in Other Expense, increased \$1.8 million to \$2.1 million in 2013, from \$215 thousand in 2012. The components of interest expense for 2013 and 2012 are as follows (in thousands):

Year ended December 31,	2013		2012	
Line of credit	\$	3	\$	21
Term Note		168		212
Subordinated convertible notes		575		137
Other		1		8
Change in value of interest rate swap		(12)		22
Amortization of deferred issuance costs and debt discount		1,689		103
Total Interest Expense	\$	2,424	\$	503
Less discontinued operations		372		288
Continuing operations	\$	2,052	\$	215

The line of credit expired in March 2013 and was not renewed, contributing to the decline in interest expense associated with this facility. We also repaid the term note in full upon the sale of GES-Port Charlotte in November 2013, which resulted in a decline in interest expense for this note.

We issued the subordinated convertible notes in October 2012, and the notes were exchanged for preferred stock in September 2013, as a result 2012 included two months of interest for these notes, while 2013 included nine months of interest. Upon the exchange of the notes, the unamortized balance of the debt discount of \$1.2 million and the unamortized balance of deferred financing costs of \$30 thousand were transferred to interest expense. The write-off of these items was the primary contributor to the increase in amortization expense during 2013. See note 14 in the accompanying financial statements for additional information regarding the debt discount and deferred financing costs.

As of December 31, 2013, we had no outstanding debt, therefore we anticipate no interest expense during 2014.

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Our interest income decreased \$37 thousand to \$51 thousand during 2013, from \$88 thousand during 2012. All of the interest income was amortization of the discount on our long-term receivables. The decline in amortization is due to a reduction in our long-term receivables balances.

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The loss from discontinued operations declined \$11.6 million, or 72.0%, to \$4.4 million during 2013, from \$16.1 million in 2012. Discontinued operations represents the results of our ESCO business, which we sold in February 2013, GES-Port Charlotte, which we sold in November 2013, our regional service business, which we also sold in November 2013 and our contract with the Army Corps. of Engineers, which we sold in December 2013. We are still working to close out a couple contracts that we did not sell with the ESCO business that we anticipate will be closed out in early 2014. These contracts are likely to generate a small loss during 2014.

*Dividend Expense*

The components of dividend expense are as follows (in thousands):

<b>Year ended December 31,</b>	<b>2013</b>	<b>2012</b>
Series A dividend	\$ 314	\$
Series B dividend	12	
Deemed dividend on Series A	1,219	
Deemed dividend on Series B	1,330	
Total dividend expense	\$ 2,875	\$

On September 23, 2013, the holders of our convertible subordinated notes converted their notes in shares of Series A Preferred Stock. At the same time we also raised \$2.5 million through the sale of additional shares of Series A Preferred Stock. In late December we raised an additional \$4 million through the sale of shares of our Series B Preferred Stock. The price at which the Series B Preferred Stock is convertible into shares of our common stock is lower than the price at which shares of the Series A Preferred Stock are convertible. An anti-dilution provision of the Series A Preferred Stock required us to adjust the conversion price of the Series A Preferred Stock from \$3.78 per share to \$3.58 per share, resulting in a \$389 thousand non-cash deemed dividend. The deemed dividend was calculated as the increase in the value of the shares into which the Series A would be convertible resulting from the adjustment to the conversion price, based on the market price of our common stock on the date of the adjustment. This deemed dividend was recorded to dividend expense, with an offset to the accumulated deficit.

In recording the sale of the Series A and Series B Preferred Stock, we allocated the value of the proceeds to the sale of the shares and the warrants based on their relative fair values. In doing so, we determined that the preferred shares contained beneficial conversion features of \$415 thousand on the Series A Preferred and \$655 thousand on the Series B Preferred. The value of the beneficial conversion feature, along with the value of the warrants, determined to be \$415 thousand for the Series A Warrants and \$665 thousand for the Series B Warrants, where both considered to be non-cash deemed dividends and were recorded to dividend expense, with an offsetting entry to additional-paid-in-capital.

Table of Contents**Liquidity and Capital Resources***Overview*

As of December 31, 2013, we had cash and cash equivalents of \$7.4 million, including \$500 thousand of restricted cash, compared to cash of \$2.5 million, including restricted cash of \$500 thousand as of December 31, 2012. Our contractual obligations as of December 31, 2013, totaled \$3.64 million in future lease obligations. Our contractual commitments for 2013 total approximately \$852 thousand, which we believe we will be able to satisfy through operating cash flows and our cash reserve.

Our principal cash requirements are for operating expenses, including employee costs, the cost of outside services including those providing accounting, legal and contracting services, and the funding of accounts receivable, and capital expenditures. We have financed our operations since inception primarily through the sale of our common and preferred stock, as well as through various forms of secured debt.

The following table summarizes, for the periods indicated, selected items in our consolidated statement of cash flows (in thousands):

<b>Year ended December 31</b>	<b>2013</b>	<b>2012</b>
Net cash used in operating activities	\$ (3,035)	\$ (13,957)
Net cash provided by (used in) investing activities	4,910	(761)
Net cash provided by financing activities	3,053	8,440
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>4,928</b>	<b>(6,278)</b>
Cash and Cash Equivalents, at beginning of period	2,012	8,290
Cash and Cash Equivalents, at end of period	\$ 6,940	\$ 2,012

**2013 Compared to 2012**

Net cash increased 4.9 million to \$6.9 million during 2013, compared to declining \$6.3 million, to \$2.0 million during 2012.

*Operating Activities*

Operating activities used \$3.0 million of cash during 2013, compared to using \$13.6 million during 2012.





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Whether cash is consumed or generated by operating activities is a function of the profitability of our operations and changes in working capital. To get a better understanding of cash sources and uses, management splits the cash used or provided by operating activities into two pieces: the cash consumed (or generated) by operating activities before changes in assets and liabilities; and the cash consumed (or generated) from changes in assets and liabilities. By splitting the cash used or provided by operating activities this way our management believes it gets a better understanding of how much of our operating cash flow is the result of the Company's current period cash earnings or loss and how much of our operating cash flow is due to changes in working capital. These two measures are calculated as follows (in thousands):

	Year ended December 31, 2013	Year ended December 31, 2012
Net Loss	\$ (15,636)	\$ (31,812)
Provision for bad debts	886	814
Share-based compensation	867	1,784
Depreciation and amortization	1,017	1,821
Amortization of original issue discount	1,439	50
Amortization of deferred financing costs	250	57
Issuance of stock and warrants in exchange for services received		20
PIK notes issued for interest	575	137
Preferred stock dividends	(326)	
Asset impairment	27	5,282
Loss (Gain) on disposition of fixed assets	59	(2)
Goodwill impairment		1,435
Cash consumed by operating activities before changes in assets and liabilities	\$ (10,842)	\$ (20,414)
Changes in assets and liabilities, net of business acquisitions and dispositions:		
Accounts receivable	\$ (555)	\$ 9,637
Inventories	17	(17)
Costs in excess uncompleted contracts	(3,298)	(2,418)
Prepaid expenses and other current assets	226	328
Assets of discontinued operations	2,236	6,739
Accounts payable	10,125	(4,003)
Accrued expenses	331	555
Billings in excess uncompleted contracts	205	(3,336)
Other liabilities	(2,003)	5,110
Liabilities of discontinued operations	523	(6,138)
Cash consumed from changes in assets and liabilities	\$ 7,807	\$ 6,457

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The reconciliation to net cash used in operating activities as reported on our Consolidated Statement of Cash Flows is as follows (in thousands):

	Year ended December 31, 2013	Year ended December 31, 2012
Cash consumed by operating activities before changes in assets and liabilities	\$ (10,842)	\$ (20,414)
Cash consumed from changes in assets and liabilities	7,807	6,457
Net cash used in operating activities	\$ (3,035)	\$ (13,957)

The cash consumed by operating activities before changes in assets and liabilities decreased \$9.6 million, or 46.9% to \$10.8 million during 2013, from \$20.4 million during 2012. The increase in revenue and improvement in gross profit margins in combination with a reduction in the cash loss from discontinued operations were responsible for the improvement in the cash consumed by operating activities before changes in assets and liabilities. We believe that if our revenue continues to grow and our gross profit margins increase as we expect they will, and we are successful in reducing our overhead costs and the loss from discontinued operations, that we will generate cash from operating activities before changes in assets and liabilities during 2014.

Cash generated from changes in assets and liabilities increased \$1.3 million, or 20.9%, to \$7.8 million during 2013, from \$6.5 million during 2012. Collections on receivables of discontinued operations and an increase in our accounts payable were the primary contributors to the cash generated from changes in assets and liabilities during 2013. Early in 2013, we reach agreements with many of our suppliers to extend their payment terms from net 30 days to net 60 days. As of the end of 2013, we had extended many vendors beyond these agreed terms. We are attempting to get these payables back to within terms, which means that during 2014 changes in assets and liabilities are likely to consume cash, rather than generate cash as they have the past two years.

*Investing Activities*

Investing activities generated cash of \$4.9 million during 2013, compared to consuming \$761 thousand during 2012. During 2013, we sold the ESCO business for \$2.0 million, GES-Port Charlotte for \$3.3 million and our regional service business for \$195 thousand. These sources of cash were partially offset by capital expenditures of \$573 thousand, of which approximately \$460 thousand was the cost of continuing to build-out the software platform used by our utility programs. During 2012, capital expenditures totaled \$986 thousand, of which \$345 thousand was related to the utility software platform. The balance was computers, software and office equipment, primarily for the expansion of our utility business.

We feel the utility software is critical to improving the efficiency of our business and differentiating us in the marketplace with our utility clients, therefore we expect we will continue to invest between \$300 thousand and \$500 thousand per year in this asset. We expect expenditures for other assets to decline to maintenance levels unless we win additional utility programs.



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*Financing Activities*

Financing activities generated \$3.0 million of cash during 2013, compared to generating \$8.4 million during 2012. During 2013, we raised \$6.5 million through the sale of shares of our Series A and Series B Preferred Stock and we used the proceeds of \$3.3 million from the sale of GES-Port Charlotte to pay-off the term loan used to construct its generating facility. We used an additional \$107 thousand for schedule loan payments. We incurred costs \$40 thousand in the issuance of the preferred stock.

In May 2012, we sold shares of our common stock, raising \$2.5 million and in October we raised \$6.1 million through the issuance of subordinated convertible notes. During the year we also raised \$171 thousand from the sale of stock to employees under our Employee Stock Purchase Plan. These 2012 sources of cash were partial offset by scheduled principal payments of \$234 thousand and \$37 thousand of costs incurred in the issuance of the subordinated notes and \$60 thousand incurred in the issuance of the common stock.

**Sources of Liquidity**

Our primary sources of liquidity are our available, unrestricted cash reserves, including the \$2 million we raised in February 2014 from the sale of additional shares of our Series B Preferred Stock.

Our ability to continue to expand the sales of our products and services will require the continued commitment of significant funds. The actual timing and amount of our future funding requirements will depend on many factors, including the amount, timing and profitability of future revenues, working capital requirements, the level and amount of product marketing and sales efforts, among other things.

We have raised a significant amount of capital since our formation through the issuance of shares of our common and preferred stock and notes, which has allowed us to continue to execute our business plan. Most of these funds have been consumed by operating activities, either to fund our losses or for working capital requirements.

We incurred a \$31.8 million loss during 2012 and consumed \$14.0 million of cash in operating activities during the 2012, as we dealt with the impact on the business of the announcement regarding our discovery of improper revenue recognition, the inability of our Asset Development business to secure the financing required to fund its projects and the start-up of five new utility programs. In late 2012 our management, in consultation with our Board of Directors, decided that we needed to shed businesses that we could not finance, narrow our focus to our most promising business and reduce overhead costs. Consistent with this strategy, we shut down the asset development business at the end of 2012, sold the ESCO and regional services businesses, sold GES-Port Charlotte and our FRR contract with the Army Corps. Of Engineers and made significant reductions in remaining headcount during 2013. This all contributed to improvements in our cash flow, though we still consumed cash during 2013.

We believe that if our revenue grows and our gross profit margin improves, as we believe they will, and we are successful in reducing our overhead costs and the loss from discontinued operations, that our cash flows will continue to improve to the point that they turn positive during 2014. In addition, we believe that the current assets of our discontinued operations will convert to cash during 2014 in an amount that will be

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sufficient to satisfy the current liabilities of discontinued operations. In the event that we are not able to improve profitability from the levels achieved in 2013, we believe that our current cash reserves should be adequate to operate the business without interruption for a year or two before we would have to attempt to raise additional capital. If we do determine it necessary to raise additional capital because profitability does not improve as we expect it to, there is no assurance we will be able to do so, or it may only be available on terms that are not favorable to the Company or our existing

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shareholders. In the event that we are required to raise additional capital in the future but are unable to do so, we may be required to scale back operations or cease operations altogether.

*The information set forth above represents certain expectations of our business over time based on our business model. We caution you that these expectations may not materialize and are not indicative of the actual results we will achieve. See Risk Factors and Cautionary Statement On Forward-Looking Information.*

**Off-Balance Sheet Arrangements**

None.

**Recent Accounting Pronouncements**

We do not believe any recently issued, but not yet effective, accounting standards will have a material effect on our consolidated financial position, results of operations, or cash flows.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

Not applicable.

**Item 8. Financial Statements and Supplementary Data.**

The consolidated financial statements and the report of BDO USA, LLP, Independent Registered Public Accounting Firm on such financial statements are filed as part of this report beginning on page F-1.

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

Not applicable.

**Item 9A. Controls and Procedures.**

**Evaluation of Disclosure Controls and Procedures**

We maintain disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act ), that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and, include controls and procedures designed to ensure that such information is accumulated and communicated to our management, including our Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ), as appropriate, to allow timely decisions regarding required disclosure.



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We carried out an evaluation, under the supervision and with the participation of our management, including our CEO and CFO, of the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of December 31, 2013. Based upon that evaluation, management concluded that our disclosure controls and procedures were not effective as of December 31, 2013, because of a deficiency in our internal control over financial reporting discussed below.

**Management's Report on Internal Control over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control over financial reporting is a process designed by, or under the supervision of, our CEO and CFO, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of our consolidated financial statements for external purposes in accordance with U.S. generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements. Because of its inherent limitations, our internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

As of December 31, 2013, our management (with the participation of our CEO and CFO) conducted an evaluation of the effectiveness of our internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) based on the framework in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) (COSO). Based on this evaluation, management concluded that our internal control over financial reporting was not effective as of December 31, 2013, based on criteria in *Internal Control - Integrated Framework* issued by the COSO.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.

Management concluded that we did not maintain effective internal control over financial reporting as of December 31, 2013, because of the deficiencies in our internal control over financial reporting discussed below.

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DEFICIENCY IN OUR INTERNAL CONTROL OVER FINANCIAL REPORTING

Under the direction of the Audit Committee and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, the Company carried out an evaluation of the effectiveness of the design and operation of its controls and procedures. Based on this evaluation, the Company has concluded that due to a material weakness, a control and procedure was not effective as of December 31, 2013.

We have identified the following deficiency in our controls:

- We did not have sufficient monitoring controls in place to limit access rights to the database underlying our accounting system.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. The control deficiency identified above should be considered material weaknesses in our internal control over financial reporting.

As set forth below, we have taken the following steps to remediate the control deficiency identified above. Notwithstanding the control deficiency described above, we have performed additional analyses and other procedures to enable management to conclude that our financial statements included in this Form 10-K fairly present, in all material respects, our financial condition and results of operations as of and for the quarter ended December 31, 2013.

REMEDIATION

To remediate the control deficiency identified above, we have taken the following measures to improve internal control over financial reporting:

- Working with the value-added reseller of our accounting system, we implemented new controls in early January 2014 to limit access to the database underlying our accounting system.

Management and our Audit Committee will continue to monitor these remedial measures and the effectiveness of our internal controls and procedures. Other than as described above, there were no changes in our internal controls over financial reporting during the quarter ended December 31, 2013, that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

**Item 9B. Other Information.**

Not applicable.

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**PART III**

Certain information required to be included in Part III is omitted from this report because we intend to file a definitive proxy statement relating to our 2014 Annual Meeting of Stockholders (the Proxy Statement ) no later than 120 days after the end of the fiscal year covered by this report, and certain information to be included therein is incorporated herein by reference.

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

Information required by this item regarding our directors and executive officers and compliance by our directors, executive officers and certain beneficial owners of our common stock with Section 16(a) of the Exchange Act is incorporated by reference to all information under the captions entitled Election of Directors, Executive Officers, and Section 16(a) Beneficial Ownership Reporting Compliance in the Proxy Statement. Information required by this item regarding our codes of ethics is incorporated by reference to all information under the caption Committees of the Board of Directors Codes of Conduct and Business Ethics in the Proxy Statement. Information required by this item regarding our separately designated standing Audit Committee and our Audit Committee Financial Expert is incorporated by reference to all information under the caption Committees of the Board of Directors Audit Committee in the Proxy Statement.

**Item 11. Executive Compensation.**

Information required by this item regarding compensation of our named executive officers is incorporated by reference to all information under the caption Executive Compensation in the Proxy Statement. Information required by this item regarding compensation of our directors is incorporated by reference to all information under the caption Compensation of Directors in the Proxy Statement.

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

Information required by this item regarding security ownership of certain beneficial owners, directors and executive officers is incorporated by reference to all information under the caption Security Ownership of Principal Stockholders and Management Beneficial Owners of Greater than 5% of Each Class of Our Common Stock and Directors and Executive Officers in the Proxy Statement.

Table of Contents**Securities Authorized for Issuance Under Equity Compensation Plans**

The following information reflects certain information about our equity compensation plans as of December 31, 2013:

Plan Category	Equity Compensation Plan Information		
	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders (1)	219,516	\$ 26.87	202,140
Equity compensation plans not approved by security holders (2)	228,548	\$ 46.32	
<b>Total</b>	<b>448,064</b>	<b>\$ 36.79</b>	<b>202,140</b>

(1) Includes warrants granted to a consultant to purchase 1,430 shares at an average price of \$26.95 per share.

(2) Prior to June 2010, we granted stock options to our non-employee directors pursuant to a Directors Stock Option Plan (See Compensation of Directors in our Proxy Statement), which grants are included in this category.

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

Information required by this item regarding certain relationships and related transactions is incorporated by reference to all information under the caption Transactions with Related Persons in the Proxy Statement. Information required by this item regarding the director independence is incorporated by reference to all information under the caption Election of Directors Independent Directors.

**Item 14. Principal Accountant Fees and Services.**

Information required by this item regarding principal auditor fees and services is incorporated by reference to all information under the caption Audit Committee Disclosure Independent Auditors Fees in the Proxy Statement. Information required by this item regarding our Audit Committee s pre-approval policies and procedures and the status of our auditors employees is incorporated by reference to all information under the captions Audit Committee Disclosure Procedures for Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of

Independent Auditor.

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**PART IV**

**Item 15. Exhibits and Financial Statement Schedules.**

**(a)(1) Financial Statements**

The following financial statements are filed as part of this annual report and set forth on the page indicated:

F-2 - F-3	Consolidated Balance Sheets as of December 31, 2013 and December 31, 2012
F-4	Consolidated Statements of Operations for the years ended December 31, 2013, and 2012
F-5	Statements of Stockholders' Equity for the years ended December 31, 2013 and 2012
F-6 - F-7	Statements of Consolidated Cash Flows for the years ended December 31, 2013, and 2012
F-8 - F-37	Notes to Consolidated Financial Statements

**(a)(3) Exhibits**

All exhibits incorporated herein by reference are located in SEC File No. 001-16265.

<b>Exhibit Number</b>	<b>Description of Exhibit</b>
2.1	Asset Purchase and Sale Agreement, dated as of February 28, 2013, among Lime Energy Services Co., Lime Energy Co. and PowerSecure, Inc. (Incorporated herein by reference to Exhibit 2.1 of our Current Report on Form 8-K filed March 1, 2013)
2.2	Membership Interest Purchase Agreement, dated as of November 1, 2013, among Lime Energy Asset development, LLC and Green Gas Americas, Inc. (Incorporated herein by reference to Exhibit 2.1 of our Current Report on Form 8-K filed November 6, 2013)
2.3	Promissory Note, dated November 1, 2013, by and among Lime Energy Asset development, LLC and Green Gas Americas, Inc. (Incorporated herein by reference to Exhibit 2.2 of our Current Report on Form 8-K filed November 6, 2013)
3.1	Amended and Restated Certificate of Incorporation (Incorporated herein by reference to Exhibit 3.1 of our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2013 and filed on November 14, 2013)
3.2	

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Amended and Restated Bylaws, as amended (Incorporated herein by reference to Exhibit 3.1 of our Current Report on Form 8-K filed June 11, 2007)

- 4.1 Certificate of Designation of Series A Preferred Stock (Incorporated herein by reference to Exhibit 3.1 of our Current Report on Form 8-K filed September 23, 2013)
- 4.2 Certificate of Designation of Series B Preferred Stock (Incorporated herein by reference to Exhibit 3.1 of our Current Report on Form 8-K filed December 31, 2013)



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<b>Exhibit Number</b>	<b>Description of Exhibit</b>
4.3	Form of Warrant to Purchase Common Stock dated September 23, 2013(Incorporated herein by reference to Exhibit 3.1 of our Current Report on Form 8-K filed September 23, 2013)
4.4	Form of Warrant to Purchase Common Stock dated December 30, 2013(Incorporated herein by reference to Exhibit 3.1 of our Current Report on Form 8-K filed December 31, 2013)
10.1.1 +	Employment Agreement, dated as of August 15, 2006, between Electric City Corp. and Jeffrey R. Mistarz (Incorporated herein by reference to Exhibit 10.1 of our Current Report on Form 8-K filed on August 18, 2006)
10.1.2 +	Amendment to Employment Agreement dated October 1, 2007 between Lime and Jeffrey R. Mistarz. (Incorporated herein by reference to Exhibit 10.3 of our Current Report on Form 8-K filed on October 2, 2007)
10.1.3 +	Employee Option Agreement dated August 15, 2006 between Lime and Jeffrey R. Mistarz (Incorporated herein by reference to Exhibit 10.2 of our Current Report on Form 8-K filed on August 18, 2006)
10.1.4 +	Employee Stock Option Agreement dated July 11, 2006 between Lime and Jeffrey R. Mistarz (Incorporated herein by reference to Exhibit 10.3 of our Current Report on Form 8-K filed on July 17, 2006)
10.1.5+	Second Amendment to Employment Agreement dated June 3, 2010 between Lime and Jeffrey R. Mistarz. (Incorporated herein by reference to Exhibit 10.4 of our Current Report on Form 8-K filed on June 7, 2010)
10.2.1+	Employment Agreement, dated as of June 10, 2008, between Applied Energy Management, Inc. and John O Rourke (Incorporated herein by reference to Exhibit 10.1 of our Current Report on Form 8-K filed on March 9, 2009)
10.2.2+	Assignment and First Amendment to Employment Agreement dated June 3, 2010 between John O Rourke, Applied Energy Management, Inc. and Lime Energy Co. (Incorporated herein by reference to Exhibit 10.3 of our Current Report on Form 8-K filed on June 7, 2010)
10.2.3+	Second Amendment to Employment Agreement dated June 3, 2011 between John O Rourke and Lime Energy Co. (Incorporated herein by reference to Exhibit 10.3 of our Current Report on Form 8-K filed on June 6, 2011)
10.2.4+	Employee Stock Option Agreement dated June 3, 2011 between John O Rourke and Lime Energy Co. (Incorporated herein by reference to Exhibit 10.4 of our Current Report on Form 8-K filed on June 6, 2011)
10.3+	Employment Agreement dated April 7, 2009, between Applied Energy Management Energy Consulting, LLC. and Adam Procell. (Incorporated herein by reference to Exhibit 10.1 of our Current Report on Form 8-K filed on September 27, 2013)
10.4 +	Lime Energy 2010 Non-Employee Directors Stock Plan (Incorporated herein by reference to Exhibit 99.1 of our Current Report on Form 8-K filed on June 8, 2010)
10.5 +	2009 Management Incentive Compensation Plan (Incorporated herein by reference to Exhibit 10.1 of our Current Report on Form 8-K filed on August 7, 2009)

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<b>Exhibit Number</b>	<b>Description of Exhibit</b>
10.6	Loan Agreement between GES-Port Charlotte, LLC and RBC Bank (USA) (Incorporated herein by reference to Exhibit 10.1 of our Current Report on Form 8-K filed on November 7, 2011)
10.7	Commercial Promissory Note between GES-Port Charlotte, LLC and RBC Bank (USA) (Incorporated herein by reference to Exhibit 10.2 of our Current Report on Form 8-K filed on November 7, 2011)
10.8	Continuing Guaranty Agreement between Lime Energy Co., Lime Energy Asset Development, LLC and RBC Bank (USA) (Incorporated herein by reference to Exhibit 10.3 of our Current Report on Form 8-K filed on November 7, 2011)
10.9	Security Agreement between GES-Port Charlotte, LLC and RBC Bank (USA) (Incorporated herein by reference to Exhibit 10.4 of our Current Report on Form 8-K filed on November 7, 2011)
10.10	Mortgage by GES-Port Charlotte, LLC (Incorporated herein by reference to Exhibit 10.5 of our Current Report on Form 8-K filed on November 7, 2011)
10.11	Collateral Assignment of Site Lease Agreement between GES-Port Charlotte, LLC and RBC Bank (USA) (Incorporated herein by reference to Exhibit 10.6 of our Current Report on Form 8-K filed on November 7, 2011)
10.12	Form of Collateral Assignment (Incorporated herein by reference to Exhibit 10.7 of our Current Report on Form 8-K filed on November 7, 2011)
10.13	Hazardous Substances Indemnity Agreement between GES-Port Charlotte, LLC and RBC Bank (USA) (Incorporated herein by reference to Exhibit 10.8 of our Current Report on Form 8-K filed on November 7, 2011)
10.14	Pledge, Assignment and Security Agreement between Lime Energy Asset Development, LLC and RBC Bank (USA) (Incorporated herein by reference to Exhibit 10.9 of our Current Report on Form 8-K filed on November 7, 2011)
10.15	Intercreditor Agreement by and among American Chartered Bank, RBC Bank (USA), GES-Port Charlotte, LLC, Lime Energy Co., and Lime Energy Asset Development, LLC (Incorporated herein by reference to Exhibit 10.10 of our Current Report on Form 8-K filed on November 7, 2011)
10.16	Convertible Note and Warrant Purchase Agreement dated October 22, 2012 (Incorporated herein by reference to Exhibit 10.1 of our Current Report on Form 8-K filed on October 22, 2012)
10.17	Form of Subordinated Secured Convertible Pay-In-Kind Note dated October 22, 2012 (Incorporated herein by reference to Exhibit 10.2 of our Current Report on Form 8-K filed on October 22, 2012)
10.18	Security Agreement dated October 22, 2012 (Incorporated herein by reference to Exhibit 10.3 of our Current Report on Form 8-K filed on October 22, 2012)
10.19	Collateral Agency Agreement dated October 22, 2012 (Incorporated herein by reference to Exhibit 10.4 of our Current Report on Form 8-K filed on October 22, 2012)

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<b>Exhibit Number</b>	<b>Description of Exhibit</b>
10.20	Stock Purchase and Warrant Purchase Agreement dated September 23, 2013 (Incorporated herein by reference to Exhibit 10.1 of our Current Report on Form 8-K filed on September 23, 2013)
10.21	Preferred Stock Purchase and Warrant Purchase Agreement dated December 30, 2013 (Incorporated herein by reference to Exhibit 10.1 of our Current Report on Form 8-K filed on December 31, 2013)
10.22	Preferred Stock Purchase and Warrant Purchase Agreement dated January 29, 2014 (Incorporated herein by reference to Exhibit 10.1 of our Current Report on Form 8-K filed on February 3, 2014)
10.23	Side Letter Agreement dated January 29, 2014 (Incorporated herein by reference to Exhibit 10.1 of our Current Report on Form 8-K filed on February 3, 2014)
21*	List of Subsidiaries
23*	Consent of BDO USA LLP
24.1*	Power of Attorney (included on signature page hereto)
31.1*	Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002
31.2*	Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002
32.1*	Certification of the Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002
32.2*	Certification of the Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema 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

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+ Management contract or compensation plan or arrangement

\* Filed herewith

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**SIGNATURES**

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

LIME ENERGY CO.

By: /s/ C. Adam Procell  
C. Adam Procell  
President and Chief Executive Officer  
March 31, 2014

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**Report of Independent Registered Public Accounting Firm**

Board of Directors and Stockholders

Lime Energy Co.

Huntersville, North Carolina

We have audited the accompanying consolidated balance sheets of Lime Energy Co. as of December 31, 2013 and 2012, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the two years in the period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over consolidated financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Lime Energy Co. at December 31, 2013 and 2012, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2013, in conformity with accounting principles generally accepted in the United States of America.

Chicago, Illinois  
March 31, 2014

/s/ BDO USA, LLP



Table of Contents**Lime Energy Co.****Consolidated Balance Sheets**

(\$ in thousands, except par value amounts)

<b>Liabilities and Stockholders' Equity</b>			
<b>Current liabilities</b>			
Accrued expenses (Note 10)		2,907	2,577
Customer deposits		72	41
Current liabilities of discontinued operations		3,245	15,978
<b>Other Long-Term Liabilities</b>			
Series A Preferred stock, \$0.01 par value; 2,000,000 shares authorized 957,624 and 0 shares issued and outstanding as of December 31, 2013 and 2012, respectively		9	
Common stock, \$.0001 par value; 50,000,000 shares authorized 3,667,295 and 3,576,855 issued and outstanding as of December 31, 2013 and 2012, respectively			
Accumulated deficit		(197,728)	(182,092)
<b>Total Stockholders' Equity</b>		<b>7,774</b>	<b>9,321</b>
		<b>\$ 34,780</b>	<b>\$ 45,156</b>

*See accompanying notes to consolidated financial statements.*

Table of Contents**Lime Energy Co.****Consolidated Statement of Operations**

(\$ in thousands, except per share amounts)

<b>Revenue</b>	<b>\$ 51,565</b>	<b>\$ 35,447</b>
Cost of sales	37,758	28,109
Gross Profit	13,807	7,338
Selling, general and administrative expense	22,933	22,938
Interest income	51	88
Loss from operation of discontinued business	(4,499)	(16,060)
<b>Net loss</b>	<b>\$ (15,636)</b>	<b>\$ (31,812)</b>
Preferred dividend	(2,875)	
Net loss available to common stockholders	(18,511)	(31,812)
Basic and diluted loss per common share from Continuing operations	\$ (3.90)	\$ (4.48)
Discontinued operations	(1.25)	(4.56)
<b>Basic and Diluted Loss Per Common Share</b>	<b>\$ (5.15)</b>	<b>\$ (9.04)</b>
<b>Weighted Average Common Shares Outstanding (Note 3)</b>	<b>3,595,379</b>	<b>3,520,045</b>

*See accompanying notes to consolidated financial statements.*



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## Lime Energy Co.

## Consolidated Statements of Stockholders' Equity

(in thousands)

	Common Shares	Common Stock	Series A Shares	Series A Preferred Stock	Series B Shares	Series B Preferred Stock	Additional Paid-in Capital	Accumulated Deficit	Total Stockholders Equity
<b>Balance, December 31, 2011</b>	<b>3,406</b>						<b>185,404</b>	<b>(150,280)</b>	<b>35,124</b>
Share-based compensation							1,784		1,784
Issuance of common stock	143						2,490		2,490
Shares issued for benefit plans and option exercises	27						171		171
Shares issued for services received	1						20		20
Value of beneficial conversion option							362		362
Warrant issued							1,182		1,182
Net loss								(31,812)	(31,812)
<b>Balance, December 31, 2012</b>	<b>3,577</b>	<b>\$</b>		<b>\$</b>		<b>\$</b>	<b>191,413</b>	<b>\$ (182,092)</b>	<b>9,321</b>
Conversion of subordinated notes			677	7			6,755		6,762
Issuance of preferred stock			250	2	400	4	6,494		6,500
Issuance costs							(40)		(40)
Preferred stock dividends							(326)		(326)
Satisfaction of accrued dividends through the issuance of preferred stock			31		1		326		326
Shares issued for benefit plans	90								
Share-based compensation							867		867
Net loss								(15,636)	(15,636)
<b>Balance, December 31, 2013</b>	<b>3,667</b>	<b>\$</b>	<b>958</b>	<b>\$ 9</b>	<b>401</b>	<b>\$ 4</b>	<b>205,489</b>	<b>\$ (197,728)</b>	<b>7,774</b>

See accompanying notes to consolidated financial statements.

Table of Contents**Lime Energy Co.****Statements of Cash Flows**

(\$ in thousands)

	Year ended December 31, 2013	Year ended December 31, 2012
<b>Cash Flows From Operating Activities</b>		
Net Loss	\$ (15,636)	\$ (31,812)
Adjustments to reconcile net loss to net cash used in operating activities, net of assets acquired and disposed of:		
Provision for bad debts	886	814
Share-based compensation	867	1,784
Depreciation and amortization	1,017	1,821
Amortization of original issue discount	1,439	50
Amortization of deferred financing costs	250	57
Issuance of stock and warrants in exchange for services received		20
PIK notes issued for interest	575	137
Preferred stock dividends	(326)	
Asset impairment	27	5,282
Loss (Gain) on disposition of fixed assets	59	(2)
Goodwill impairment		1,435
Changes in assets and liabilities, net of business acquisitions and dispositions		
Accounts receivable	(555)	9,637
Inventories	17	(17)
Costs and estimated earnings in excess of billings on uncompleted contracts	(3,298)	(2,418)
Prepaid expenses and other current assets	226	328
Assets of discontinued operations	2,236	6,739
Accounts payable	10,125	(4,003)
Accrued expenses	331	555
Billings in excess of costs and estimated earnings on uncompleted contracts	205	(3,336)
Customer deposits and other current liabilities	(2,003)	5,110
Liabilities of discontinued operations	523	(6,138)
Net cash used in operating activities	(3,035)	(13,957)
<b>Cash Flows From Investing Activities</b>		
Proceeds from sale of businesses	5,483	
Purchases of property and equipment	(573)	(986)
Decrease in restricted cash		225
Net cash provided by (used in) investing activities	4,910	(761)
<b>Cash Flows From Financing Activities</b>		
Proceeds from long-term debt		6,050
Payments of long-term debt	(3,407)	(234)
Debt issuance costs		(37)
Proceeds from issuance of common stock		2,550
Proceeds from issuance of preferred stock	6,500	
Costs related to stock issuances	(40)	(60)

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Proceeds from issuance of shares for benefit plans		171	
Net cash provided by financing activities	3,053		8,440
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	4,928		(6,278)
<b>Cash and Cash Equivalents, at beginning of period</b>	2,012		8,290
<b>Cash and Cash Equivalents, at end of period</b>	\$	6,940	\$ 2,012

*See accompanying notes to consolidated financial statements.*

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**Lime Energy Co.**

**Statements of Cash Flows**

**(\$ in thousands)**

	Year ended December 31, 2013	Year ended December 31, 2012
<b>Supplemental Disclosure of Cash Flow Information</b>		
Cash paid during the period for interest discontinued operations	\$ 168	\$ 215
Stock, warrants and options issued in exchange for services received		20
Value of subordinated notes and accrued interest converted to preferred stock	6,762	
Accrued dividends satisfied through issuance of preferred stock	326	

*See accompanying notes to consolidated financial statements.*

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Lime Energy Co.

Notes to Consolidated Financial Statements

***Note 1 Description of Business***

Lime Energy Co. (the Company), a Delaware corporation headquartered in Huntersville, North Carolina, is a provider of energy efficiency solutions for small businesses under utility demand side management programs.

As of December 31, 2012, the Company was in active discussions to sell its Public Sector business and ultimately came to terms with a buyer and closed on the sale of this business on February 28, 2013. It also shut down its Asset Development business (excluding GES-Port Charlotte) effective December 31, 2012, sold GES-Port Charlotte effective November 1, 2013, its regional HVAC service business effective November 6, 2013 and its rights under its contract with the Army Corps of Engineers effective December 31, 2013. The operating results and associated assets and liabilities of these businesses have been reported as discontinued operations in the accompanying financial statements.

***Note 2 Basis of Presentation***

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP).

The consolidated financial statements include the accounts of Lime Energy Co. and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

***Note 3 - Summary of Significant Accounting Policies***

***Use of Estimates***

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

***Concentration of Risk***

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The Company's customers are primarily utilities and their small business customers. During 2013, revenue generated under four utility programs represented 75% of the Company's consolidated revenue, whereas during 2012, three utility programs generated 86% of the Company's consolidated revenue.

The Company purchases its materials from a variety of suppliers and continues to seek out alternate suppliers for critical components so that it can be assured that its sales will not be interrupted by the inability of a single supplier to deliver product. During 2013, two suppliers were responsible for 41% and 12% of the Company's purchases, respectively, while during 2012 one supplier was responsible for 49% of the Company's purchases.

The Company maintains cash and cash equivalents in accounts with financial institutions in excess of the amount insured by the Federal Deposit Insurance Corporation. The Company monitors the financial stability of these institutions regularly and management does not believe there is significant credit risk associated with deposits in excess of federally insured amounts.

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## Lime Energy Co.

## Notes to Consolidated Financial Statements

*Allowance for Doubtful Accounts*

The Company records an allowance for doubtful accounts based on specifically identified amounts that it believes to be uncollectible. If actual collections experience changes, revisions to the allowance may be required. After all attempts to collect a receivable have failed, the receivable is written off against the allowance. Based on the information available to it, the Company believes its allowance for doubtful accounts is adequate. However, actual write-offs might exceed the recorded allowance.

The following is a summary of changes to the allowance for doubtful accounts (in thousands):

Year ended December 31,	2013	2012
Balance at the beginning of the period	\$ 960	\$ 279
Additions charged to costs and expenses	886	814
Amounts written-off	(22)	(133)
Balance at the end of the period	\$ 1,824	\$ 960

*Inventories*

Inventories are stated at the lower of cost or market. Cost is determined utilizing the first-in, first-out (FIFO) method.

*Properties & Equipment*

Property and equipment are stated at cost. For financial reporting purposes depreciation is computed using the straight-line method over the following estimated useful lives:

Buildings	39 years
Office equipment	3 - 5 years
Furniture	5 - 10 years

Transportation equipment

3 - 5 years

***Goodwill***

Goodwill represents the purchase price in excess of the fair value of assets acquired in business combinations. Accounting Standards Codification ( ASC ) 350, Goodwill and Other Intangible Assets, requires the Company to assess goodwill and other indefinite-lived intangible assets for impairment at least annually in the absence of an indicator of possible impairment and immediately upon an indicator of possible impairment. During the fourth quarter of 2013, the Company undertook an assessment of its goodwill for possible impairment and concluded that the fair value of the continuing business, based on the discounted current value of the estimated future cash flows, exceeded the carrying value, indicating that the goodwill was not impaired. As explained further in Note 4, the Company sold its ESCO business on February 28, 2013. Utilizing the sales price of this business as an indicator of its fair market value, it concluded that the goodwill associated with this business was partially impaired. As a result, it reduced the carrying value of the goodwill by \$1.4 million, to \$5.3 million and recorded a \$1.4 million impairment loss during the fourth quarter of 2012.

The Company considered various factors in determining the fair value of its business, including discounted cash flows from projected earnings, values for comparable companies and the market price of its common stock. It will continue to monitor for any impairment indicators such as underperformance of



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Lime Energy Co.

Notes to Consolidated Financial Statements

projected earnings, net book value compared to market capitalization, declining stock price and significant adverse economic and industry trends. In the event that the business does not achieve projected results, or, as the result of changes in facts of circumstances, the Company could incur an additional goodwill impairment charge in a future period.

***Impairment of Long-Lived Assets***

The Company records impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of those items. The Company's cash flow estimates are based on historical results adjusted to reflect its best estimate of future market and operating conditions. The net carrying value of assets not recoverable is reduced to fair value.

These estimates of fair value represent management's best estimate based on industry trends and reference to market rates and transactions. During the fourth quarter of 2012, the Company determined that the future cash flows of its Zemel Road generating facility were likely to be less than initially anticipated, due to lower than projected gas flow rates and higher than expected operating costs. As a result, the fair market value was determined to be less than the Company's current carrying value, indicating an impairment of this asset's value.

On February 28, 2013, the Company sold its ESCO business. The sales price received upon the sale of this business was less than the Company's carrying value as of December 31, 2012, indicating that the asset was partially impaired. The Company therefore reduced the carrying value of the assets associated with this business during the fourth quarter of 2012, recording a \$3.2 million impairment loss in the process.

***Intangible Assets***

The Company's finite life intangible assets are comprised of technology and software. Finite life intangible assets are amortized based on the timing of expected economic benefits associated with the asset over their estimated useful lives. The Company estimated that the useful life of its technology and software to be between five to seven years.

For all amortizable intangible assets, if any events or changes in circumstances occur that indicate possible impairment, the Company will perform an impairment review based on an undiscounted cash flow analysis. Impairment occurs when the carrying value of the assets exceeds the future undiscounted cash flows. When impairment is indicated, the estimated future cash flows are then discounted to determine the estimated fair value of the asset and an impairment charge is recorded for the difference between the carrying value and the net present value of estimated future cash flows. The Company also evaluates the remaining useful life during each reporting period to determine whether events and circumstances warrant a revision to the remaining period of amortization. If the estimate of an intangible asset's remaining useful life is changed, the remaining carrying amount of the intangible asset is amortized prospectively over that revised remaining useful life.

On February 28, 2013, the Company sold its ESCO business. The sales price received upon the sale of this business was less than the Company's carrying value as of December 31, 2012, indicating that the asset was partially impaired. As part of the adjustment to reduce the carrying value of the assets of this business to the implied fair value, it wrote off all of the intangibles assets associated with the business in the fourth quarter of 2012.

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Lime Energy Co.

Notes to Consolidated Financial Statements

***Revenue Recognition***

The Company recognizes revenue when all four of the following criteria are met: (i) persuasive evidence has been received that an arrangement exists; (ii) delivery of the products and/or services has occurred; (iii) the selling price is fixed or determinable; and (iv) collectibility is reasonably assured. In addition, the Company follows the provisions of the Securities and Exchange Commission's Staff Accounting Bulletin No. 104, Revenue Recognition, which sets forth guidelines in the timing of revenue recognition based upon factors such as passage of title, installation, payments and customer acceptance. Any amounts billed prior to satisfying the Company's revenue recognition criteria is recorded as Billings in Excess of Costs and Estimated Earnings on Uncompleted Contracts ( Billings in Excess ) in the accompanying consolidated balance sheets. Billings in Excess totaled \$1.7 million and \$1.5 million as of December 31, 2013 and 2012, respectively.

The Company utilizes the percentage of completion method to recognize revenue in conjunction with the cost-to-cost method of measuring the extent of progress toward completion, consistent with ASC 605-35, Construction Type and Production Type Contracts and the AICPA's Statement of Position 81-1 (SOP 81-1). Any anticipated losses on contracts are charged to operations as soon as they are determinable.

***Costs and Estimated Earnings in Excess of Billings on Uncompleted Contracts***

As of December 31, 2013, the Company had customer projects underway for which it had recognized revenue but not yet invoiced the customer. The Company records this unbilled revenue as a current asset titled Costs and Estimated Earnings in Excess of Billings on Uncompleted Contracts. The Company had Costs and Estimated Earnings in Excess of Billings on Uncompleted Contracts of \$6.6 million and \$3.3 million at December 31, 2013 and 2012, respectively.

***Other Liabilities***

In December 2012, one of the Company's major suppliers agreed to allow it to pay for approximately \$5.3 million worth of purchases over a 23 month period. The balance of this liability was \$3.2 million and \$5.3 million as of December 31, 2013 and 2012, respectively and has been included in other current liabilities and other long-term liabilities in the accompanying consolidated financial statements.

***Advertising, Marketing and Promotional Costs***

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Expenditures on advertising, marketing and promotions are charged to operations in the period incurred and totaled \$152,000 and \$212,000 for the periods ended December 31, 2013 and 2012, respectively.

### *Income Taxes*

Income taxes are accounted for under the asset and liability method. Deferred income taxes are recognized for the tax consequences in future years of the differences between the tax basis of assets and liabilities and their financial reporting amounts at each period end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable earnings. Valuation allowances are established when necessary to reduce deferred tax assets to the amount more likely than not to be realized.

### *Net Loss Per Share*

The Company computes loss per share under ASC 260-10, Earnings Per Share. This statement requires presentation of two amounts; basic and diluted loss per share. Basic loss per share is computed by dividing the loss available to common stockholders by the weighted average common shares outstanding. Diluted earnings per share would include all common stock equivalents unless anti-dilutive. For periods when such inclusion would not be anti-dilutive, the Company uses the treasury method to

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## Lime Energy Co.

## Notes to Consolidated Financial Statements

calculate the diluted earnings per share. The treasury stock method assumes that the Company uses the proceeds from the exercise of in-the-money options and warrants to repurchase common stock at the average market price for the period. Options and warrants are only dilutive when the average market price of the underlying common stock exceeds the exercise price of the options or warrants.

The Company has not included the outstanding options, warrants, preferred stock or convertible debt as common stock equivalents when calculating the diluted loss per share for the years ended December 31, 2013 or 2012, because the effect would be anti-dilutive.

The following table sets forth the weighted average shares issuable upon exercise of outstanding options and warrants and convertible debt that is not included in the basic and diluted loss per share available to common stockholders:

<b>December 31,</b>	<b>2013</b>	<b>2012</b>
Weighted average shares issuable upon exercise of outstanding options	<b>469,625</b>	<b>624,588</b>
Weighted average shares issuable upon exercise of outstanding warrants	<b>767,643</b>	<b>145,695</b>
Weighted average shares issuable upon conversion of convertible preferred	<b>655,599</b>	
Weighted average shares issuable upon conversion of convertible debt	<b>897,041</b>	<b>211,217</b>
<b>Total</b>	<b>2,789,908</b>	<b>981,500</b>

*Fair Value of Financial Instruments*

The carrying amounts reported in the consolidated balance sheets for cash, accounts receivable, accounts payable and accrued expenses approximate fair value because of the short-term nature of these amounts.

*Share-based Compensation*

The Company has a stock incentive plan that provides for stock-based employee compensation, including the granting of stock options and shares of restricted stock, to certain key employees. The Company follows the guidance of ASC 718, Compensation Stock Compensation, which requires companies to record stock compensation expense for equity-based awards granted, including stock options and restricted stock unit grants, over the service period of the equity-based award based on the fair value of the award at the date of grant.



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## Lime Energy Co.

## Notes to Consolidated Financial Statements

The following are the components of the Company's stock compensation expense during the years ended December 31, 2013 and 2012, respectively:

	2013	2012
Stock Options	\$ 698	\$ 1,322
Restricted Stock	169	481
Employee Stock Purchase Plan (1)		(19)
Total Stock Compensation Expense	\$ 867	\$ 1,784

(1) The Employee Stock Purchase Plan was terminated before its planned expiration during 2012 due to the Company's inability to maintain a current registration statement for the shares. Upon the termination of the Plan, the Company reversed previously recorded compensation expense associated with employee's rights to purchase shares under the Plan.

Please refer to Notes 23, 24 and 25 for additional information regarding share-based compensation expense.

***Recent Accounting Pronouncements***

The Company does not believe any recently issued, but not yet effective, accounting standards will have a material effect on the Company's consolidated financial position, results of operations, or cash flows.

***Note 4 Sale of ESCO Business***

On February 28, 2013, the Company sold its ESCO business to Powersecure, Inc., a wholly-owned subsidiary of PowerSecure International, Inc. (Powersecure). The ESCO business, which represented the largest portion of the Company's public sector business, designed, installed and maintained energy conservation measures, primarily as a subcontractor to large energy service company providers (ESCOs), for the benefit of public sector, commercial, industrial and institutional customers as end users. The sale was structured as an asset sale. The total purchase price for the assets sold was \$4.0 million in cash, subject to a working capital adjustment, and the assumption of approximately \$9.8 million of liabilities, comprising certain other debts, liabilities and obligations relating to the acquired business and assumed contracts. After application of the working capital adjustment in accordance with the Purchase Agreement, the cash purchase price was approximately \$1.9 million, subject to post-closing confirmation of the working capital adjustment, resulting in an effective purchase price, including the assumption of liabilities, of

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approximately \$11.7 million. In connection with the acquisition of the ESCO business, PowerSecure assumed certain unfinished contracts and projects in the acquired business, along with the accounts receivables and accounts payables associated with those projects.

During the fourth quarter of 2012, utilizing the purchase price received for the sale of the ESCO business as an indication of its fair market value, the Company determined that its carrying value associated with the business exceeded the fair market value by approximately \$3.2 million. Accordingly, it reduced the carrying value to the fair market value, recording a \$3.2 million impairment loss in the process.



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## Lime Energy Co.

## Notes to Consolidated Financial Statements

The value of assets and liabilities sold to Powersecure on February 28, 2013, were as follows (in thousands):

Accounts receivable	\$	4,680
Costs and estimated earnings in excess of billings on uncompleted contracts		591
Goodwill		5,337
<b>Total Assets</b>	<b>\$</b>	<b>11,664</b>
Accounts payable	\$	1,226
Billings in excess of costs and estimated earnings on uncompleted contracts		8,432
Other liabilities		1
<b>Total Liabilities</b>	<b>\$</b>	<b>9,803</b>

After adjusting the carrying value of the assets during the fourth quarter of 2012, the net carrying value of the assets and liabilities of the ESCO business was equal to the proceeds received for the sale of the business on February 28, 2013, therefore there was no gain or loss resulting from the sale recorded during 2013. However, the Asset Purchase Agreement provided that within 90 days of the closing the seller provide the buyer a final calculation of the Closing Net Working Capital as of February 28, 2013. To the extent that this calculation showed an increase in the Closing Net Working Capital from the amount estimated on the closing date, the buyer would owe the seller an amount equal to the increase and to the extent the Closing Net Working Capital was less than the amount estimated on the closing date, the seller would owe the buyer an amount equal to the reduction. The calculation of the final Closing Net Working Capital was completed in August 2013 and it was determined that the buyer owed the seller an additional \$128 thousand. This additional consideration has been included in income from discontinued operations during the quarter ended September 30, 2013.

**Note 5 GES-Port Charlotte**

During 2010, the Company established Lime Energy Asset Development, LLC ( LEAD ), to develop, construct, operate and in certain situations own energy producing assets. In October 2010, LEAD paid \$2.65 million to acquire GES-Port Charlotte, an entity that held the gas rights to the Zemel Road landfill in Punta Gorda, Florida. Shortly thereafter GES-Port Charlotte entered into a 20-year power purchase agreement with a utility for the sale of electricity and certain environmental attributes to be generated from the landfill gas. In October 2011, it completed construction of a 2.8 megawatt landfill-gas to electricity facility on the site and began delivery of electricity under the power purchase agreement. The cost to construct the facility was approximately \$4.7 million, net of a \$1.8 million U.S. Treasury Grant received for the project in December 2011. The Company financed a portion of the construction costs with a \$3.6 million term loan.



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Lime Energy Co.

Notes to Consolidated Financial Statements

The Company evaluates all of its long-lived assets, including intangible assets other than goodwill and fixed assets, periodically for impairment in accordance with ASC 360-10-35, Accounting for the Impairment or Disposal of Long-Lived Assets. It records impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of those items. Its cash flow estimates are based on historical results adjusted to reflect its best estimate of future market and operating conditions. The net carrying value of assets not recoverable is reduced to fair value. During the fourth quarter of 2012, its estimates regarding future cash flows indicated that the fair-market value of the Zemel Road landfill-gas to electricity generating facilities was less than its current carrying value. Accordingly, it recorded a \$3.5 million impairment charge for impairment to both the intangible asset and the associated PP&E to reduce the recorded value of these assets to their estimate of fair market value during the fourth quarter of 2012.

On November 1, 2013, the Company sold GES-Port Charlotte to Green Gas Americas, Inc. ( Green Gas or the Buyer ). The sale was consummated pursuant to a Membership Interest Purchase Agreement (the Purchase Agreement ), dated November 1, 2013, by and between LEAD, as the seller, and Green Gas, as the purchaser. The total purchase price paid for the membership interest was \$3.3 million, less a \$152,300 contribution on the part of the Seller toward the cost of wellfield improvements. The agreement also provides for a 5%, or \$165,000, hold-back of the purchase price (the Hold-Back ) to be held in escrow to cover the indemnification obligations of the seller and any additional pre-closing liabilities. The Hold-Back will be reduced by \$60,000 on February 2, 2014; \$40,000 on July 2, 2014; and \$65,000 on November 2, 2014, to the extent it has not been applied by the Buyer to any obligations of the Seller. The Company provided typical indemnifications to the Buyer, including for breach of representations, third party claims, pre-closing liabilities, etc., all of which are capped at the total purchase price paid by the Buyer.

As part of the Purchase Agreement, Lime agreed to assume GESPC's obligation to Florida Power and Light ( FP&L ) for the cost of completing an interconnect between GESPC's facility and the FP&L's transmission system. This obligation totaled \$400,000 as of November 1, 2013, and requires monthly payments of \$50,000 to FP&L.

The Company recognized a \$27,000 loss on the sale of GESPC. In recognition of this, it reduced the carrying value of GESPC's assets by this amount during the third quarter of 2013, incurring a \$27,000 impairment charge as a result.

Upon the closing of the transaction, the Company repaid in full the term loan it used to fund the construction of the Zemel Road facility.

**Note 6 Discontinued Operations**

As of December 31, 2012, the Company was in active discussions to sell its Public Sector business and ultimately came to terms with a buyer and closed on the sale of this business on February 28, 2013. It also shut down its Asset Development business (excluding GES-Port Charlotte) effective December 31, 2012, sold GES-Port Charlotte effective November 1, 2013, its regional HVAC service business effective November 6, 2013 and its rights under its contract with the Army Corps of Engineers effective December 31, 2013. The operating results and associated

assets and liabilities of these businesses have been reported as discontinued operations in the accompanying consolidated financial statements for all periods presented.

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Lime Energy Co.

Notes to Consolidated Financial Statements

The revenue and loss related to discontinued operations were as follows (in thousands):

Year ended December 31,	2013	2012
Revenue	\$ 6,805	\$ 44,133
Operating Loss	\$ (4,499)	\$ (16,060)

The assets and liabilities related to discontinued operations were as follows (in thousands):

December 31,	2013	2012
Cash	\$	\$ 380
Accounts Receivable	2,423	10,017
Costs and estimated earnings in excess of billings on uncompleted contracts	1,019	1,567
Prepaid expenses and other		41
Total current assets	3,442	12,005
Deferred financing costs		228
Net Property and Equipment, net		3,732
Goodwill		5,337
Total long-term assets		9,297
Total Assets	\$ 3,442	\$ 21,302
Current portion of long-term debt	\$	\$ 3,413
Accounts Payable	2,240	1,568
Accrued Expense	504	3,447
Billings in excess of costs and estimated earnings on uncompleted contracts	460	7,550
Customer Deposits	41	
Total current liabilities	3,245	15,978
Long-Term Debt, less current portion		5
Total Liabilities	\$ 3,245	\$ 15,983

**Note 7 Impairment Loss**

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During the fourth quarter of 2012, the Company completed a review of the assets of its GES-Port Charlotte subsidiary, which holds the Zemel Road landfill gas to electricity generating facility, and determined that based on its discounted projected future operating cash flows, that the fair market value of the assets was less than the Company's current carrying value. The \$2.5 million carrying amount of the intangible asset associated with the facility (Level 3 asset) was written-down to its fair value of \$0, resulting in an impairment charge of \$2.5 million, which is included in the loss from operation of the discontinued business in the accompanying consolidated financial statements. The \$4.6 million carrying

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## Lime Energy Co.

## Notes to Consolidated Financial Statements

amount of the generating assets (Level 3 assets) were written-down to their fair value of \$3.5 million, resulting in an impairment charge of \$1.1 million, which is also included in the loss from operation of the discontinued business during the fourth quarter of 2012. The Company recorded an additional impairment loss of \$27,000 during the third quarter of 2013, when it closed on the sale of GES-Port Charlotte (see Note 5 for additional information regarding the sale transaction).

On February 28, 2013, the Company sold its ESCO business, which comprised the majority of its public sector business. The sales price received for this business was less than the Company's carrying value, indicating that the assets were impaired. Accordingly, the Company reduced the carrying value of the property, plant and equipment and intangible assets to \$0 and reduced the value of the goodwill associated with the business by \$1.4 million. The total impairment loss recorded during the fourth quarter of 2012 as a result of these adjustments was \$3.2 million. The impairment loss has been included in the loss from operation of the discontinued business in the accompanying consolidated financial statements.

**Note 8 Property and Equipment**

Property and equipment consist of the following (in thousands):

December 31,	2013	2012
Buildings & improvements	\$ 41	\$ 37
Construction equipment	21	21
Furniture	338	337
Office equipment	3,565	2,998
Transportation equipment	329	338
	4,294	3,731
Less accumulated depreciation	(2,732)	(2,046)
	\$ 1,562	\$ 1,685

Total depreciation expense was \$1.0 million and \$1.1 million for the years ended December 31, 2013 and 2012, respectively. Included in this expense was depreciation from discontinued operations of \$203 thousand and \$412 thousand for the years ended December 31, 2013 and 2012, respectively.

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Lime Energy Co.

Notes to Consolidated Financial Statements

**Note 9 Goodwill and Other Intangible Assets**

Goodwill represents the purchase price in excess of the fair value of net assets acquired in business combinations. ASC 350, Goodwill and Other Intangible Assets, requires the Company to assess goodwill for impairment at least annually in the absence of an indicator of possible impairment and immediately upon an indicator of possible impairment. The following is a summary of the Company's goodwill (in thousands):

	Continuing Operations		Discontinued Operations		
	AEM		AEM	C&I	Total
Balance at December 31, 2011	\$ 6,009	\$	\$ 5,849	\$ 923	\$ 12,781
Corporate reorganization			923	(923)	
Goodwill impairment			(1,435)		(1,435)
Balance at December 31, 2012	\$ 6,009	\$	\$ 5,337	\$	\$ 11,346
Sale of public sector			(5,337)		(5,337)
Balance at December 31, 2013	\$ 6,009	\$	\$	\$	\$ 6,009

The components of intangible assets as of December 31, 2013 and 2012 are as follows (in thousands):

	Weighted Average Remaining Life (months)	Gross Book Value	Accumulated Amortization	Impairment	Net Book Value
<b>As of December 31, 2013</b>					
Amortized intangible assets:					
Technology and software		125	125		
Total		\$ 125	\$ 125	\$	\$
<b>As of December 31, 2012</b>					
Amortized intangible assets:					
Technology and software	3.0	125	115		10
Total		\$ 125	\$ 115	\$	\$ 10

The aggregate amortization expense from continuing operations was \$10,000 and \$25,000 for the years ended December 31, 2013 and 2012, respectively. The aggregate amortization expense from discontinued operations was \$0 and \$668,000 for the years ended December 31, 2013 and 2012, respectively.





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## Lime Energy Co.

## Notes to Consolidated Financial Statements

**Note 10 Accrued Expenses**

Accrued expenses are comprised of the following (in thousands):

December 31,	2013	2012
Compensation	\$ 1,423	\$ 644
Interest		2
Job costs	73	214
Rent	151	507
Sales tax payable	1,184	1,159
Taxes	71	27
Other	5	24
	\$ 2,907	\$ 2,577

**Note 11 Revolving Line of Credit**

On March 9, 2011, the Company entered into a \$7 million revolving line of credit agreement with American Chartered Bank. Availability under the line of credit was tied to eligible receivables and borrowings were secured by all the Company's assets. Borrowings were to incur interest at the Prime Rate, plus 0.625%, with a minimum rate of 4.675%, and had an unused fee of 0.30% per annum. The line contained covenants that required the Company to maintain a minimum current ratio of 1.55 to 1.0 or greater and a maximum tangible leverage ratio of 1.30 to 1.0. While the Company was not in compliance with these covenants at the end of December 31, 2012, the Company never drew on the line. The line expired on March 9, 2013.

**Note 12 Notes Payable**

On November 3, 2011, GES-Port Charlotte, LLC (GES), entered into a Loan Agreement with RBC Bank (USA) (RBC Bank was subsequently acquired by PNC Bank) (PNC) under which GES borrowed \$3.6 million (the Loan Agreement). The Loan Agreement was to mature on, and all outstanding balances were due and payable on, October 31, 2016. The Loan Agreement required the monthly payment of interest and principal based on a 20-year amortization and a mandatory pre-payment at the end of each calendar year, commencing with the calendar year ending December 31, 2012, equal to 50% of GES's Excess Cash Flow. Excess Cash Flow was defined in the Loan Agreement as earnings before interest, taxes, depreciation and amortization (EBITDA) less cash taxes paid, less Debt Service, and less up to \$10,000 in capital expenditures. Debt Service was defined to equal the sum of (a) the total of principal and interest payments on funded debt (excluding excess cash flow mandatory prepayments), plus (b) any cash dividends or distributions (excluding the permitted distribution of the US Treasury Grant). No Excess Cash Flow payment was due for 2012. The loan carried an interest rate equal to 30-day LIBOR plus 500 basis points.

Borrowings pursuant to the Loan Agreement were secured by all of the assets of GES and guaranteed by Lime. The Loan Agreement contained customary events of default, including the failure to make required payments, borrower's failure to comply with certain covenants or other agreements, borrower's breach of the representations and covenants contained in the agreement, the filing or attachment of a lien to the collateral, the occurrence of a material adverse change, borrower's default of other certain

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indebtedness and certain events of bankruptcy or insolvency. Upon the occurrence and continuation of an event of default, amounts due under the Loan Agreement could have been accelerated.

The Loan Agreement contained a covenant that required GES to maintain a minimum Debt Service Coverage Ratio to 1.35 to 1.0. The Debt Service Ratio is defined as the ratio of (a) EBITDA, less cash taxes and unfunded capital expenditures to (b) Debt Service. As of December 31, 2012, the company was not in compliance with the debt Service Coverage Ratio. On January 4, 2013, PNC notified the Company that the loan was in default as a result of the failure to meet the minimum Debt Coverage Ratio, but that it has chosen not to exercise its rights, but reserved the right to do so in the future. On July 2, 2013, PNC notified the Company that it was requiring the Company to start paying interest at the default rate of LIBOR plus 9.00% per annum. The Company remained current with all scheduled loan payments and repaid the loan in full upon the sale of GES-Port Charlotte on November 1, 2013. The entire balance of the note has been included in current liabilities of discontinued operations in the accompanying consolidated financial statements as of December 31, 2012, due to the fact that the default was on-going at that time and had not been waived by the bank.

The Company entered into an interest rate swap to fix the interest rate on \$1.9 million of the principal amount of the term loan at 6.56% through October 2016. This interest rate swap was being carried at fair-market value on the Company's books, with changes in value included in interest expense. The mark-to-market value of the swap was a liability of \$66,000 of December 31, 2012, which has been included in current liabilities of discontinued operations in the accompanying consolidated financial statements. The interest rate swap was settled on November 1, 2013.

***Note 13 Conversion of Subordinated Debt and Sale of Series A Preferred Stock***

On September 23, 2013, the Company entered into a Preferred Stock and Warrant Purchase Agreement (the Series A Purchase Agreement) with a group of investors including Mr. Richard Kiphart, the Company's Chairman and largest individual stockholder, and Mr. Christopher Capps, a member of its Board of Directors (collectively with the other investors, the Investors). Pursuant to the terms of the Series A Purchase Agreement, the Investors purchased 926,223 shares of the Company's Series A Preferred Stock (the Series A Preferred Shares) at a price per Preferred Share of \$10.00. The purchase price was paid with (a) \$2,500,000 in cash and (b) the exchange of \$6,779,950 (principal amount and accrued interest) of the Company's Subordinated Secured Convertible Pay-In-Kind Note (the Notes), representing all of the outstanding Notes.

The Series A Preferred Shares are entitled to an accruing dividend of 12.5% per annum of their original issue price (subject to adjustment for stock splits, combinations and similar recapitalizations), payable semi-annually in arrears. Such dividends shall be paid in additional shares of Series A Preferred Stock at the original issue price (subject to adjustment for stock splits, combinations and similar recapitalizations) or, at the sole discretion of the Company's board of directors, in cash.

The Series A Preferred Shares may be converted at the election of the holder of such shares, into shares of the Company's common stock at a conversion price which was initially equal to \$3.78 per share (the Conversion Price). The Conversion Price is to be proportionately adjusted for stock splits, combinations and similar recapitalizations, and, subject to a floor of \$3.50, shall be adjusted for future issuances of common stock

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(excluding certain issuances) at a price per share less than the Conversion Price on a broad based, weighted average basis. The Company can require conversion of the Series A Preferred Shares if the weighted average price for its common stock is at least two hundred percent (200%) of the Conversion Price for at least 20 trading days during a 30 trading day period ending within 5

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Notes to Consolidated Financial Statements

trading days prior to the Company sending a notice of forced conversion to the holders of the Series A Preferred Shares. On December 30, 2013, as the result of the issuance of shares of series B convertible preferred stock, the Conversion Price of the Series A Preferred Shares was reduced to \$3.58 per share. The Conversion Price was further reduced to \$3.51 per share on February 4, 2014, when the Company issued additional shares of series B convertible preferred stock.

The Company may redeem all or a portion of the Series A Preferred Shares at its option at any time unless prohibited by Delaware law governing distributions to stockholders. The redemption price for each Series A Preferred Share shall be its original issue price (subject to adjustment for stock splits, combinations and similar recapitalizations) plus any accrued but unpaid dividends multiplied by a factor based on the date the notice of such redemption is sent to holders of the Series A Preferred Shares. If such notice is sent before the first anniversary of the issuance of the Series A Preferred Shares, the factor shall be 103%, if thereafter but before the second such anniversary, the factor shall be 102%, if thereafter but before the third such anniversary, the factor shall be 101% and thereafter, the factor shall be 100%.

In connection with the entry into the Purchase Agreement, the Company issued the Investors warrants to purchase 264,551 shares of its common stock at \$3.78 per share (the Series A Warrants ). These warrants expire on the fifth anniversary of their issuance and contain a cashless exercise option. In recording the transaction, the Company allocated the value of the proceeds to the Series A Preferred Shares and the Series A Warrants based on their relative fair values. In doing so, it determined that the Series A Preferred Shares contained a beneficial conversion feature worth \$415 thousand. The value of the beneficial conversion feature, along with the value of the warrants, also determined to be \$415 thousand, where both considered to be non-cash deemed dividends and were recorded to dividend expense, with an offsetting entry to additional paid in capital.

The Series A Purchase Agreement requires that the Company seek stockholder approval of the conversion of the Series A Preferred Shares and the exercise of the Series A Warrants on or before December 31, 2013. The Company did seek such approval at its annual meeting of stockholders held on December 3, 2013, at which time stockholders approved the issuance of shares of the Company s common stock upon the conversion of the Series A Preferred Stock and the exercise of the Series A Warrants.

The Company intends to use the cash proceeds from the sale of the Series A Preferred Shares for general corporate purposes.

**Note 14 Subordinated Convertible Term Notes**

On October 22, 2012, the Company entered into a Convertible Note and Warrant Purchase Agreement (the Sub Debt Purchase Agreement ) with a group of investors including Mr. Richard Kiphart, the Company s Chairman and largest individual stockholder, and Mr. Christopher Capps, a member of its Board of Directors (collectively with the other investors, the Holders ). Pursuant to the terms of the Sub Debt Purchase Agreement, the Holders lent the Company \$6,050,000 under a Subordinated Secured Convertible Pay-In-Kind Note (the Notes ). The Notes had a term of five years, accrued interest at the rate of 12-1/2% per year, payable semi-annually at the Company s election in cash or additional Notes. On September 23, 2013, the Notes and all accrued interest were converted to shares of Series A Preferred Stock (see Note 13 for

additional information regarding the Series A Preferred Stock).

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In connection with the entry into the Sub Debt Purchase Agreement, the Company issued the Holders warrants to purchase 644,991 shares of its common stock at \$4.69 per share (the Sub Debt Warrants ). These warrants expire on the fifth anniversary of their issuance and contain a cashless exercise option. The Company determined the value of the Sub Debt Warrants to be \$1.4 million using a trinomial option pricing model.

In recording the transaction, the Company allocated the value of the proceeds to the Notes and Sub Debt Warrants based on their relative fair values. In doing so, it determined that the Notes contained a beneficial conversion feature since the fair market value of the common stock issuable upon conversion of the Notes (determined on the Note issuance date) exceeded the value allocated to the Notes of \$4,924,000. The Notes were convertible into 1,179,912 shares of common stock, which at the market price of \$4.48 per share on date of issuance of the Notes was worth \$5,286,000. The difference of \$362,000 between the market value of the shares issuable upon conversion and the value allocated to the Notes was considered to be the value of the beneficial conversion feature.

The value of the beneficial conversion feature and the value of the warrants were recorded as a discount to the Notes, which was being amortized over the term of the Notes using the effective interest method. Amortization of the discount of \$200,000 and \$50,000 was included in interest expense during the years ended December 31, 2013 and 2012, respectively. Upon the conversion of the Notes to preferred stock in September 2013, the remaining unamortized discount of \$1.2 million was recorded to interest expense.

The Company incurred costs of approximately \$37,000 to issue the Notes. These costs were capitalized and were also being amortized over the term of the Notes using the effective interest method. Amortization of the deferred issuance costs of \$5,000 and \$2,000 was included in interest expense during the years ended December 31, 2013 and 2012, respectively. Upon the conversion of the Notes to preferred stock in September 2013, the balance of the deferred issuance costs of \$30,000 was recorded to interest expense.

The Company elected to pay the interest accrued through September 23, 2013, of \$712,000 in additional Notes. The Notes issued in satisfaction of the accrued interest were also converted to shares of preferred stock on September 23, 2013.

***Note 15 Sale of Series B Preferred Stock***

On December 30, 2013, the Company entered into a Preferred Stock and Warrant Purchase Agreement (the Series B Purchase Agreement ) with a group of Series B Investors including Mr. Richard Kiphart, the Company's Chairman and largest individual stockholder (collectively with the other investors, the Series B Investors ). Pursuant to the terms of the Series B Purchase Agreement, the Series B Investors purchased 400,000 shares of the Company's Series B Preferred Stock (the Series B Preferred Shares ) at a price per Series B Preferred Share of \$10.00.



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The Series B Preferred Shares are entitled to an accruing dividend of 12.5% per annum of their original issue price (subject to adjustment for stock splits, combinations and similar recapitalizations), payable semi-annually in arrears. Such dividends shall be paid in additional shares of Series B Preferred Stock at the original issue price (subject to adjustment for stock splits, combinations and similar recapitalizations) or, at the sole discretion of the Company's board of directors, in cash.

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Notes to Consolidated Financial Statements

The Series B Preferred Shares may be converted, at any time following the approval of such conversion by the Company's stockholders, at the election of the holder of such shares, into shares of the Company's common stock at a conversion price which was initially equal to \$2.83 per share (the Conversion Price). The Conversion Price shall be proportionately adjusted for stock splits, combinations and similar recapitalizations, and, subject to a floor of \$2.50, shall be adjusted for future issuances of common stock (excluding certain issuances) at a price per share less than the Conversion Price on a broad based, weighted average basis. The Company can require conversion of the Series B Preferred Shares if the weighted average price for its common stock is at least two hundred percent (200%) of the Conversion Price for at least 20 trading days during a 30 trading day period ending within 5 trading days prior to the Company sending a notice of forced conversion to the holders of the Series B Preferred Shares.

The Company may redeem all or a portion of the Series B Preferred Shares at its option at any time, unless prohibited by Delaware law governing distributions to stockholders. The redemption price for each Series B Preferred Share shall be its original issue price (subject to adjustment for stock splits, combinations and similar recapitalizations) plus any accrued but unpaid dividends multiplied by a factor based on the date the notice of such redemption is sent to holders of the Series B Preferred Shares. If such notice is sent before the first anniversary of the issuance of the Series B Preferred Shares, the factor shall be 103%, if thereafter but before the second such anniversary, the factor shall be 102%, if thereafter but before the third such anniversary, the factor shall be 101% and thereafter, the factor shall be 100%.

In connection with the entry into the Series B Purchase Agreement, the Company issued the Series B Investors warrants to purchase 565,372 shares of its common stock at \$2.83 per share (the Series B Warrants). These warrants expire on the fifth anniversary of their issuance and contain a cashless exercise option. The Warrants may not be exercised until the Company's common stockholders approve the exercise of the Warrants.

In recording the transaction, the Company allocated the value of the proceeds to the Series B Preferred Shares and the Series B Warrants based on their relative fair values. In doing so, it determined that the Series B Preferred Shares contained a beneficial conversion feature worth \$665 thousand. The value of the beneficial conversion feature, along with the value of the warrants, also determined to be \$665 thousand, where both considered to be non-cash deemed dividends and were recorded to dividend expense, with an offsetting entry to additional paid in capital.

The Series B Purchase Agreement requires that the Company seek stockholder approval of the conversion of the Series B Preferred Shares and the exercise of the Series B Warrants on or before July 31, 2014. The Company expects to seek such approval at its next annual meeting of stockholders.

The Company intends to use the cash proceeds from the sale of the Series B Preferred Shares for general corporate purposes.

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## Lime Energy Co.

## Notes to Consolidated Financial Statements

**Note 16 Letter of Credit Agreement**

On December 7, 2012, the Company entered into a Letter of Credit Agreement (the "Agreement") with Richard P. Kiphart, the Company's Chairman and largest individual stockholder. Pursuant to the Agreement, Mr. Kiphart agreed to cause the issuance of one or more Letters of Credit (collectively, the "Letter of Credit") for the benefit of a surety at the Company's request, up to an aggregate amount of \$1,000,000. The Letter of Credit is being used to support the issuance of performance bonds required by certain of the Company's contracts with Public Sector customers. Mr. Kiphart's obligation to cause the issuance of, or leave in place, the Letter of Credit was to terminate on December 7, 2013, however he has agreed to extend his support for outstanding Letters of Credit until the projects they are associated with are completed sometime in 2014.

The Company has agreed to indemnify Mr. Kiphart for any liability in connection with any payment or disbursement made under the Letter of Credit. The Company will also pay all of Mr. Kiphart's fees and out-of-pocket expenses incurred in connection with the Letter of Credit. All such indemnification, fees and expenses will be payable by the Company within ten business days of the Company's receipt of Mr. Kiphart's written demand.

The Company issued Mr. Kiphart a warrant (the "Warrant") to purchase 39,286 shares of its common stock at an exercise price of \$3.57 as consideration for his obligations under the Agreement. The Warrant has a three year term and may be exercised on a cashless basis at Mr. Kiphart's election. The Company determined the value of the Warrant to be \$56,000 using a trinomial option pricing model. The value of the Warrant was recorded to deferred financing costs and is being amortized on a straight-line basis over the term of the agreement, with the amortization included in the loss from operation of discontinued business.

**Note 17 Long Term Debt**

The Company's long term debt consists of the following (in thousands):

December 31,	2013	2012 (1)
Subordinated convertible term notes (less debt discount of \$1.4 million as of December 31, 2012), 12-1/2% due on October 22, 2017. Exchanged for Series A Preferred Stock on September 23, 2013.		4,748
Total debt		8,153
Less current portion		3,405

Long-term debt, less current maturities	\$	\$	<b>4,748</b>
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(1) Excludes \$3,405 due to PNC Bank which is included in current liabilities of discontinued operations. Please see Note 12 for additional information regarding this note.

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## Notes to Consolidated Financial Statements

**Note 18 Interest Expense**

Interest expense is comprised of the following (in thousands):

Year ended December 31,	2013	2012
Line of credit (1) (Note 11)	\$ 3	\$ 21
Term Note (Note 12)	168	212
Subordinated convertible notes (Note 13)	575	137
Other	1	8
Change in value of interest rate swap (Note 12)	(12)	22
Amortization of deferred issuance costs and debt discount (Notes 14)	1,689	103
Total Interest Expense	\$ 2,424	\$ 503
Continuing operations	2,052	215
Discontinued operations	\$ 372	\$ 288

(1) Expense represents unused line fees.

**Note 19 Lease Commitments**

The Company leased offices in California, Hawaii, Massachusetts, New Jersey, New York, North Carolina, Ohio, Pennsylvania and Texas at various times during 2012 and 2013 from unrelated third parties under leases expiring through 2022, for which it paid a total of \$739,000 and \$733,000 during 2013 and 2012, respectively.

Future annual minimum rentals to be paid by the Company under these non-cancellable operating leases as of December 31, 2013 are as follows (in thousands):

Year ending December 31,	Total
2014	763
2015	649
2016	443
2017	290

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2018		<b>281</b>
2019		<b>286</b>
2020		<b>287</b>
2021		<b>290</b>
2022		<b>47</b>
Total	\$	<b>3,336</b>

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## Lime Energy Co.

## Notes to Consolidated Financial Statements

**Note 20 Income Taxes**

The composition of income tax expense (benefit) is as follows (in thousands):

Year ended December 31	2013	2012
Deferred		
Federal	\$ (6,245)	\$ (12,200)
State	(1,511)	(2,943)
Change in valuation allowance	7,756	15,143
Total	\$	\$

Significant components of the Company's net deferred tax asset are as follows (in thousands):

December 31	2013	2012
<b>Deferred Tax Assets:</b>		
Federal and state net operating loss carryforwards	\$ 53,862	\$ 47,020
Stock-based compensation	6,242	6,242
Allowance for doubtful accounts	1,190	938
Goodwill	151	239
Property & equipment	56	681
Other	643	870
Amortization of intangibles	1,129	
Valuation allowance	(63,273)	(55,517)
Total deferred tax assets	\$	\$ 473
<b>Deferred Tax Liabilities:</b>		
Amortization of intangibles		(473)
Net deferred tax asset (liability)	\$	\$

The Company has recorded a valuation allowance equaling the net deferred tax assets due to the uncertainty of its realization in the future. At December 31, 2013, the Company had U.S. federal net operating loss carryforwards available to offset future taxable income of approximately \$147 million, which expire in the years 2018 through 2033. Under Section 382 of the Internal Revenue Code (IRC) of 1986, as amended, the utilization of U.S. net operating loss carryforwards may be limited under the change in stock ownership rules of the IRC. As a result of ownership changes as defined by Section 382, which have occurred at various points in the Company's history, utilization of its net operating loss carryforwards will be significantly limited under certain circumstances. Based on an analysis of ownership changes prior to 2008, approximately \$8.5 million of the net operating losses will expire unused due to Section 382 limitations.





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## Notes to Consolidated Financial Statements

A reconciliation of the statutory federal rate of 34% and the effective income tax rate for continuing operations for the years-ended December 31, 2013 and 2012 is as follows:

Year ended December 31,	2013	2012
Federal income tax at statutory rate	34.0%	34.0%
State and local taxes, net of federal benefit	6.0%	5.0%
Other	9.0%	1.0%
Valuation Reserve	(49.0)%	(40.0)%
Effective income tax rate	0.0%	0.0%

The Company has recorded a valuation allowance of \$63.2 million due to the uncertainty of future utilization of the deferred tax assets.

The effects of a tax position taken or expected to be taken in a tax return are to be recognized in the financial statements when it is more likely than not, based on the technical merits, that the position will be sustained upon examination. No uncertain tax positions have been identified through December 31, 2013. If we did identify any uncertain tax positions, any accrued interest related to unrecognized tax expenses and penalties would be recorded in income tax expense. The statute of limitations is normally three years from the extended due date of the return for federal and state tax purposes. However, for taxpayer s with NOLs, the statute is effectively open to any year in which an NOL was generated. The statute of limitations for the Company is therefore effectively open for the years 1998 through 2013. The Company s federal returns have been audited for the 2008 and 2009 tax years.

**Note 21 Commitments and Contingencies**

The Company carries Directors and Officers insurance with an aggregate limit of \$10 million, which it anticipates will cover the cost of defending an existing class action suit and derivative action and any related awards or settlements, up to the limit of the policy. At this point in the legal process, the Company estimates that its reasonably possible costs, over and above the amounts covered by insurance, of responding to these lawsuits, responding to the SEC investigation and completing its internal investigation and restatement will be between \$5.5 million and \$6.0 million, of which \$5.4 million had been incurred through December 31, 2013. There are many factors that could cause the actual costs to exceed or be less than this estimate, therefore the Company has not accrued for these potential future costs.

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**Note 22 Equity Transactions**

*2011 Transactions*

a) During 2011, the holders of options to purchase 7,707 shares of the Company's common stock exercised their options. Of these, options to purchase 5,197 were exercised on a cashless basis whereby the holder exchanged 4,027 shares they were entitled to purchase pursuant to the options to cover the exercise price. The total shares issued as a result of the exercise of the options exercised on a cash and cashless basis were 3,680 shares.

b) During 2011, the Company granted 6,644 shares of its common stock to seven of its outside directors pursuant to the 2010 Non-Employee Directors' Stock Plan as compensation for their service on the Board and various Board committees. These shares vest 50% upon grant and 50% on the first anniversary of the grant date if the director is still serving on the Company's board of directors on the vesting date.

c) During the first quarter of 2011, the Company issued 15,435 shares of restricted stock to eight senior employees. These shares vest equally on December 31, 2011, 2012 and 2013 if the holder is still employed by the Company on the vesting date.

d) During 2011, the Company issued 35 shares of its common stock to ten employees as part of its Employee Recognition Program.

*2012 Transactions*

e) In January 2012, the Company issued 877 shares of its common stock to a consultant as compensation for services.

f) In January 2012, the Company issued 8,543 shares of restricted stock to nine senior employees. These shares vest equally on December 31, 2012, 2013 and 2014 if the holder is still employed by the Company on the vesting date.

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g) On May 15, 2012, the Company sold 142,858 shares of its common stock to Richard Kiphart, the Company's Chairman, at the prior day closing bid price of \$17.85 per share.

h) During 2012, the Company issued 10,946 shares of its common stock in exchange for \$170,599 received from employees who participated in its Employee Stock Purchase Plan.

i) During 2012, the Company granted 8,733 shares of restricted stock to five of its outside directors pursuant to the 2010 Non-Employee Directors' Stock Plan as compensation for their service on the Board. These shares vest 50% upon grant and 50% on the first anniversary of the grant date if the director is still serving on the Company's board of directors on the vesting date.

j) During 2012, the Company issued 14 shares of its common stock to two employees as part of its Employee Recognition Program.

k) On December 7, 2012, the Company issued a warrant to purchase 39,286 shares of its common stock at \$3.57 per share to Richard Kiphart, its Chairman, in exchange for his agreement to cause the issuance of a letter of credit in the amount of \$1 million to support the issuance of surety bonds for use by the Company.

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2013 Transactions

l) During 2013, the Company granted 43,489 shares of restricted stock to five of its outside directors pursuant to the 2010 Non-Employee Directors Stock Plan as compensation for their service on the Board. These shares vest 50% upon grant and 50% on the first anniversary of the grant date if the director is still serving on the Company's board of directors on the vesting date.

m) During 2013, the Company granted 49,951 shares of restricted stock to five senior employees. These shares vest in equal amounts on each of December 31, 2014, 2015 and 2016, if the employee still works for the Company on the vesting date.

n) On September 23, 2013, the Company issued 926,223 shares of Series A Preferred Stock and warrants to purchase 264,551 shares of its common stock as part of a transaction in which it converted all of its outstanding Subordinated Convertible Notes and raised \$2.5 million of cash. Please see Note 13, for additional information regarding this transaction.

o) On December 30, 2013, the Company sold 400,000 shares of its Series B Preferred Stock and warrants to purchase 565,372 shares of its common stock to two investors for \$4 million. Please see Note 14, for additional information regarding this transaction.

p) The Company had outstanding warrants to purchase 1,515,698 and 697,205 shares of its common stock as of December 31, 2013 and 2012, respectively. Outstanding warrants can be exercised at any time prior to their expiration dates which range between December 2014 and December 2018. The following table summarizes information about warrants outstanding as of December 31, 2013:

Exercise Price	Number Outstanding at December 31, 2013	Warrants Outstanding	
		Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
\$2.83 - \$4.00	869,209	4.8 years	\$ 3.15
\$4.01 - \$10.00	644,991	3.8 years	4.69
\$10.01 - \$25.00	715	2.0 years	22.40
\$25.01 - \$735.00	783	1.0 years	92.60
	1,515,698	4.4 years	\$ 3.86

*Note 23 Stock Options*

On June 4, 2008, the Company's stockholders approved the adoption of the 2008 Stock Incentive Plan (the 2008 Plan), which replaced the 2001 Stock Incentive Plan, as amended. The 2008 Plan provided that up to 40,000 shares of the Company's common stock could be delivered under the Plan to certain employees of the Company or any of its subsidiaries and to consultants and directors who are not employees. In addition, the 2008 Plan originally provided for an additional number of shares of the Company's common stock to be reserved for issuance under the plan on January 1st of each succeeding year, beginning January 1, 2009, in an amount equal to 14,286 shares. On November 26, 2008, the Company's Compensation Committee approved amendments the 2008 Plan to i) increase the maximum number of shares of Common Stock authorized for issuance under the 2008 Plan by 50,000 shares, from

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40,000 shares to 90,000 shares, and (ii) raise the automatic increases in the number of shares available for awards by 21,429 shares, from 14,286 to 35,715, each year beginning in 2009. The holders of a majority of the Company's outstanding capital stock approved the Plan Amendment pursuant to a consent dated November 26, 2008. On March 25, 2010, the Compensation Committee approved a second amendment to the 2008 Plan to increase the shares available under the plan by an additional 245,714 shares, from 161,429 shares to 407,143 shares. The second amendment was approved by the Company's stockholders on June 3, 2010.

Awards granted under the 2008 Plan may be incentive stock options or non-qualified stock options. The exercise price for any incentive stock option ( ISO ) may not be less than 100% of the fair market value of the stock on the date the option is granted, except that with respect to a participant who owns more than 10% of the common stock the exercise price must be not less than 110% of fair market value. The exercise price of any non-qualified option shall be in the sole discretion of the Compensation Committee or the Board. To qualify as an ISO the aggregate fair market value of the shares (determined on the grant date) under options granted to any participant may not exceed \$100,000 in the first year that they can be exercised. There is no comparable limitation with respect to non-qualified stock options. The term of all options granted under the 2008 Plan will be determined by the Compensation Committee or the Board in their sole discretion, provided, however, that the term of each ISO shall not exceed 10 years from the date of grant thereof.

In addition to the ISOs and non-qualified options, the 2008 Plan permits the Compensation Committee, consistent with the purposes of the Plan, to grant stock appreciation rights and/or shares of Common Stock to non-employee directors and such employees (including officers and directors who are employees) of, or consultants to, the Company or any of its Subsidiaries, as the Committee may determine, in its sole discretion. Under applicable tax laws, however, ISO's may only be granted to employees.

The 2008 Plan is administered by the Board, which is authorized to interpret the 2008 Plan, to prescribe, amend and rescind rules and regulations relating to the 2008 Plan and to determine the individuals to whom, and the time, terms and conditions under which, options and awards are granted. The Board may also amend, suspend or terminate the 2008 Plan in any respect at any time. However, no amendment may (i) adversely affect the rights of a participant under an award theretofore granted without the consent of such participant, (ii) increase the number of shares reserved under the 2008 Plan, (iii) modify the requirements for participation in the 2008 Plan, or (iv) modify the 2008 Plan in any way that would require stockholder approval under the rules and regulations under the Exchange Act or the rules of any stock exchange or market on which the Common Stock is listed (unless such stockholder approval is obtained).

As of December 31, 2013, there were approximately 123 employees of the Company eligible to participate in the 2008 Plan, and 201,425 shares of common stock reserved for issuance under the 2008 Plan.

Effective April 1, 2000, the Company adopted a stock option plan for all independent directors, which is separate and distinct from the 2008 Stock Incentive Plan described above. The Directors' Plan was replaced during 2010 by the 2010 Non-Employee Directors' Stock Plan, which is described in Note 24.



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The following table summarizes the options granted, exercised, forfeited and outstanding through December 31, 2013:

	Shares	Exercise Price Per Share	Weighted Average Exercise Price
Outstanding at December 31, 2011	591,718	\$21.28 - \$1,844.85	\$ 40.84
Granted	82,341	\$3.64 - \$24.78	\$ 18.04
Exercised			
Forfeited	(165,423)	\$21.28 - \$984.90	\$ 41.42
Outstanding at December 31, 2012	508,636	\$3.64 - \$1,844.85	\$ 37.00
Granted	2,859	\$4.27	\$ 4.27
Exercised			
Forfeited	(64,861)	\$22.82 - \$1,844.85	\$ 36.76
Outstanding at December 31, 2013	446,634	\$3.64 - \$1,675.80	\$ 36.82
Options exercisable at December 31, 2013	340,557	\$3.64	\$ 39.84
Options exercisable at December 31, 2012	351,949	\$22.82	\$ 42.00
Options exercisable at December 31, 2011	364,134	\$21.28	\$ 47.32

The following table summarizes information about stock options outstanding at December 31, 2013:

Exercise Price	Options Outstanding			Options Exercisable		
	Number Outstanding at December 31, 2013	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable at December 31, 2013	Weighted Average Exercise Price	
\$3.64 - \$4.00	14,286	8.9 years	\$ 3.64	14,286	\$ 3.64	
\$4.01 - \$5.00	2,859	9.7 years	\$ 4.27		\$ 0.00	
\$5.01 - \$6.00	7,143	8.7 years	\$ 5.25	2,381	\$ 5.25	
\$6.01 - \$20.00						
\$20.01 - \$50.00	365,098	5.7 years	\$ 32.56	266,642	\$ 33.92	
\$50.01 - \$100.00	57,056	3.2 years	\$ 73.47	57,056	\$ 73.47	
\$100.01 - \$1,675.80	192	.3 years	\$ 1,384.19	192	\$ 1,384.19	
\$3.64 - \$1,675.80	446,634	5.5 years	\$ 36.82	340,557	\$ 39.84	





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The aggregate intrinsic value of the outstanding options (the difference between the closing stock price on the last trading day of 2013 of \$2.89 per share and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2012 was \$0. The aggregate intrinsic value of the exercisable options as of December 31, 2013 was \$0. These amounts will change based on changes in the fair market value of the Company's common stock.

The Company uses an Enhanced Hull-White Trinomial model to value its employee options. The weighted-average, grant-date fair value of stock options granted to employees during the year, and the weighted-average significant assumptions used to determine those fair values, using the Enhanced Hull-White Trinomial model for stock options under ASC 718, are as follows:

Year ended December 31,	2013	2012
Weighted average fair value per options granted	\$ 1.98	\$ 1.60
Significant assumptions (weighted average):		
Risk-free interest rate at grant date	0.02%	0.02%
Expected stock price volatility	62%	71%
Expected dividend payout		
Expected option life (years) (1)	5.7	6.0
Expected turn-over rate	4.8%	5.0%
Expected exercise multiple	2.2	2.2

(1) The Company continues to use the simplified method to estimate expected term due to the historical structural changes to its business such that historical exercise data may no longer provide a reasonable basis on which to estimate expected term.

The risk-free interest rate is based on the U.S. Treasury Bill rates at the time of grant. The dividend reflects the fact that the Company has never paid a dividend on its common stock and does not expect to in the foreseeable future. The Company estimated the volatility of its common stock at the date of grant based on the historical volatility of its stock. The expected term of the options is based on the simplified method as described in a Staff Accounting Bulletin. The expected turn-over rate represents the expected forfeitures due to employee turnover and is based on historical rates experienced by the Company. The expected exercise multiple represents the mean ratio of the stock price to the exercise price at which employees are expected to exercise their options and is based on an empirical study completed by S. Huddart and M. Lang (1996).

The Company recognizes compensation expense for stock options on a straight-line basis over the requisite service period, which is generally equal to the vesting period of the option. The subject stock options expire ten years after the date of grant. The Company recognized stock compensation expense for stock options of \$698,000 and \$1,322,000 during the years ended December 31, 2013, and 2012, respectively.



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As of December 31, 2013, \$30,000 of total unrecognized compensation cost related to outstanding stock options, unadjusted for potential forfeitures, is expected to be recognized as follows:

<b>Year ending December 31,</b>		
2014	\$	<b>28,000</b>
2015		<b>2,000</b>
Total	\$	<b>30,000</b>

In addition, there was approximately \$538 thousand of unrecognized expense related to the Cliff Options that vest based on the occurrence of certain events which may be recognized over the next 1.3 years if the requirements for vesting are met.

**Note 24 Restricted Stock**

On June 3, 2010, stockholders approved the 2010 Non-Employee Directors Stock Plan (the 2010 Directors Plan), which replaced the 2006 Directors Plan. The 2010 Directors Plan provides for the granting of stock to Non-Employee directors to compensate them for their services to the Company. The use of the shares available under the 2010 Directors Plan is administered by the Company's Board of Directors, which has delegated its powers to the Compensation Committee of the Board of Directors. The Compensation Committee has designed a plan that grants non-employee directors restricted shares of stock with the following market values on the date of grant:

**For Board Service:**

Each director upon initial election:	\$	40,000
Annual grant to each director:	\$	20,000

**Annual Grants for Committee Service:**

<u><b>Audit Committee:</b></u>		
Chairman	\$	15,000
Members	\$	10,000

<u><b>Compensation Committee:</b></u>		
Chairman	\$	10,000

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Members	\$	5,000
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Nominating Committee:

Chairman	\$	5,000
Members	\$	2,500

Half of the shares received pursuant to this plan vest immediately and the remaining shares vest on the one year anniversary of the initial grant. Shares for board service are granted on the first business day of the year and shares for committee service are granted upon appointment to the committee following the annual meeting of stockholders. Newly appointed directors receive their initial grant on their date of appointment.

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The Company has also granted shares of restricted stock to certain senior managers under its 2009 Management Incentive Compensation Plan as a form of long-term incentive. Grants under this plan typically vest over a three year period if the grantee is still an employee on the vesting date.

The following table summarizes the shares of restricted stock granted, vested, forfeited and outstanding as of December 31, 2013:

	Restricted Shares	Weighted Average Grant-Date Fair Value
Unvested Shares at December 31, 2011	15,286	\$ 28.99
Granted	18,582	\$ 21.16
Vested	(18,375)	\$ 25.39
Forfeited	(2,622)	\$ 16.24
Unvested Shares at December 31, 2012	12,871	\$ 25.43
Granted	92,812	\$ 3.22
Vested	(40,732)	\$ 8.50
Forfeited	(2,367)	\$ 6.83
Unvested Shares at December 31, 2013	62,584	\$ 4.22

The Company accounts for grants of restricted stock in accordance with ASC 718. This pronouncement requires companies to measure the cost of the service received in exchange for a share-based award based on the fair value of the award at the date of grant, with expense recognized over the requisite service period, which is generally equal to the vesting period of the grant. The Company recognized \$169,000 and \$481,000 of stock compensation expense related to the issuances of restricted stock in the years ended December 31, 2013 and 2012, respectively. As of December 31, 2013, there was approximately \$165,000 of unrecognized expense related to these restricted stock issuances which will be recognized over a weighted-average period of 10.4 months.

**Note 25 - Employee Stock Purchase Plan**

The Company's stockholders authorized the 2011 Employee Stock Purchase Plan at the 2011 annual stockholders meeting. The 2011 Plan has six-month offering periods during which employees set aside after-tax contributions from their paychecks to purchase shares of the Company's common stock at a 15% discount to the closing market price on the first day of the offering period or the last day of the offering period, whichever is lower. The Plan was scheduled to continue until June 30, 2013, or until the 300,000 shares allocated to the plan were exhausted, however, the Company terminated the plan effective July 1, 2012 because the registration statement for the shares issuable under the plan went

stale when the Company was unable to file its quarterly report for the second quarter of 2012 due to the ongoing restatement process.

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The Company issued 25,905 shares of its stock to participants in the Plan in January 2012 for contributions made during the first offering period which ended on December 31, 2011. The Company received \$80,000 for the shares sold during the first offering period. It issued an additional 47,067 shares in July 2012 for contributions made during the second offering period, which ended on June 30, 2012. It received a total of \$91,000 for the shares received during the second offering period.

For accounting purposes, each employee participating in the Employee Stock Purchase Plan is considered to have received a series of options for current and future offering periods to purchase shares at a price equal to the closing price on the first day of the offering period, less 15%. The Company calculates the value of these options using a trinomial option pricing model and amortizes the values as share-based compensation expense over the term of option, which is considered to extend through the end of the related offering period. The Company recorded net share-based compensation expense during 2012 of (\$19,000), as the previously recognized cost associated with future offering periods was reversed due to the early cancellation of the Plan.

The Company's stockholders authorized the 2013 Employee Stock Purchase Plan at the 2013 annual stockholders meeting held on December 3, 2013. The 2013 Plan provides for two six-month offering periods with the first offering period commencing on January 1, 2014. The 2013 Plan provides for the issuance of up to 42,858 shares of common stock.

**Note 26 Reverse Stock Split**

Holders of a majority of the Company's outstanding common stock, acting by written consent, approved amending the Company's certificate of incorporation to effect a one-for seven reverse split of the Company's stock in order for the Company to continue to meet the NASDAQ Stock Exchange's requirement that it maintain a \$1.00 minimum closing bid price for continued listing on the exchange. The reverse stock split was effective October 10, 2013. All share amounts presented in these consolidated financial statements have been adjusted to reflect the reverse stock split.

**Note 27 Legal Matters**

*Satterfield v. Lime Energy Co. et al.*, Case No. 12-cv-5704 (N.D. Ill.): This is a putative class action on behalf of purchasers of the Company's securities between May 14, 2008 and December 27, 2012, inclusive. Following an announcement by the Company dated July 17, 2012, four separate putative class actions were filed alleging violations of the federal securities laws and naming as Defendants the Company and three of its officers, John O'Rourke, Jeffrey Mistarz and David Asplund. The four cases were consolidated. Pursuant to the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), on October 26, 2012, the Court appointed Lead Plaintiffs. Lead Plaintiffs filed a Consolidated Amended Class Action Complaint on January 18, 2013, alleging that Defendants issued false and misleading statements concerning the Company's revenues during the class period and thereby artificially inflated its stock price. On January 21, 2014, following several months of arm's length negotiations, the Lead Plaintiffs and Defendants entered into a stipulation of settlement under which this matter would be fully and finally settled. As part of the settlement, Defendants agreed to cause \$2.5 million to be paid into a settlement fund, which \$2.5 million has been



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provided by the Company's directors and officers liability insurers. On January 28, 2014, Judge Sara Ellis entered an order granting preliminary approval of the class action settlement and notice to the settlement class in the matter. The settlement remains subject to final approval by the court. The final approval hearing has been set for May 13, 2014.

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*Kuberski v. Lime Energy Co. et al.*, Case No. 12-cv-7993 (N.D. Ill.): This is a putative shareholder derivative action alleging that certain of the Company's officers and directors breached their fiduciary duties to the Company from May 14, 2008 through the present by failing to maintain adequate internal controls and causing the Company to issue false and misleading statements concerning our revenues. An initial derivative complaint was filed on October 5, 2012. A second derivative action was filed on March 5, 2013. The two cases were consolidated and the Court appointed Lead Counsel for the Plaintiffs on April 9, 2013. On May 9, 2013, the Plaintiffs filed a Verified Consolidated Shareholder Derivative Complaint. On June 10, 2013, Defendants filed a motion to dismiss for failure to make a demand on the Board of Directors of the Company or to adequately plead why demand should be excused, as required by Rule 23.1 of the Federal Rules of Civil Procedure and Delaware law. Briefing on the motion to dismiss was completed as of July 22, 2013. On March 25, 2014, the Court granted Defendants' motion to dismiss and dismissed the case with prejudice. Plaintiffs have thirty days to file a notice of appeal.

SEC Investigation. The Securities and Exchange Commission is conducting an investigation of, among other things, the Company's revenue recognition practices and financial reporting. On September 11, 2012, the Commission issued a subpoena for documents. We are cooperating with the Commission's investigation.

**Note 28 Related Parties**

On October 22, 2012, the Company entered into a Convertible Note and Warrant Purchase Agreement with a group of investors that included Richard Kiphart, the Company's Chairman and largest individual stockholder, and Christopher Capps, one of its directors. Please see Note 14 for additional information regarding this transaction.

On December 7, 2012, the Company entered into a Letter of Credit Agreement with Richard Kiphart, the Company's Chairman and largest individual stockholder, pursuant to which Mr. Kiphart agreed to provide collateral in connection with the issuance of letters of credit to support the issuance of surety bonds required under construction contracts won by the Company. Please see Note 16 for additional information regarding this transaction.

On September 23, 2013, the Company entered into a Preferred Stock and Warrant Purchase Agreement with a group of investors that included Richard Kiphart, the Company's Chairman and largest individual stockholder, and Christopher Capps, one of its directors. Please see Note 13 for additional information regarding this transaction.

On December 30, 2013, the Company entered into a Preferred Stock and Warrant Purchase Agreement with two investors, including Richard Kiphart, the Company's Chairman and largest individual stockholder. Please see Note 15 for additional information regarding this transaction.

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The Company does not have a written policy concerning transactions between the Company or a subsidiary of the Company and any director or executive officer, nominee for director, 5% stockholder or member of the immediate family of any such person. However, the Company's practice is that such transactions shall be reviewed by the Company's Board of Directors and found to be fair to the Company prior to the Company (or a subsidiary) entering into any such transaction, except for (i) executive officers' participation in employee benefits which are available to all employees generally; (ii) transactions involving routine goods or services which are purchased or sold by the Company (or a subsidiary) on the same terms as are generally available in arm's length transactions with unrelated parties (however, such transactions are still subject to approval by an authorized representative of the

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## Lime Energy Co.

## Notes to Consolidated Financial Statements

Company in accordance with internal policies and procedures applicable to such transactions with unrelated third parties); and (iii) compensation decisions with respect to executive officers other than the CEO, which are made by the Compensation Committee pursuant to recommendations of the CEO.

**Note 29 Business Segment Information**

With the sale of the public sector business and renewable energy business during 2013, the Company considers all of its remaining operations to be in one business segment, its energy efficiency segment.

**Note 30 Selected Quarterly Financial Data (unaudited)**

The following presents the Company's unaudited quarterly results for fiscal 2013 and fiscal 2012. These quarterly results were prepared in accordance with U.S. generally accepted accounting principles and reflect all adjustments (consisting solely of normal recurring adjustments) which, in the opinion of management, are necessary for a fair statement of the results. All amounts, except per share data are presented in thousands.

	Fiscal 2013 Quarters Ended,					Total
	March 31	June 30	September 30	December 31		
Revenue	\$ 11,216	\$ 12,943	\$ 13,354	\$ 14,052	\$ 51,565	
Gross profit	2,626	3,751	3,703	3,727	13,807	
Loss from continuing operations	(3,656)	(1,918)	(3,511)	(2,052)	(11,137)	
Loss from discontinued operations	(3,050)	(128)	(329)	(992)	(4,499)	
Net loss	(6,706)	(2,046)	(3,840)	(3,044)	(15,636)	
Preferred dividends			(23)	(2,852)	(2,875)	
Net loss available to common stockholders	(6,706)	(2,046)	(3,863)	(5,896)	(18,511)	
Basic and diluted loss per common share from:						
Continuing operations	\$ (1.02)	\$ (0.53)	\$ (0.98)	\$ (1.36)	\$ (3.90)	
Discontinued operations	\$ (0.85)	\$ (0.04)	\$ (0.09)	\$ (0.28)	\$ (1.25)	
Weighted averages shares	3,595	3,593	3,593	3,600	3,595	

	Fiscal 2012 Quarters Ended,					Total
	March 31	June 30	September 30	December 31		
Revenue	\$ 8,539	\$ 8,012	\$ 8,622	\$ 10,274	\$ 35,447	
Gross profit	1,874	1,678	1,644	2,142	7,338	
Loss from continuing operations	(2,511)	(3,888)	(4,805)	(4,548)	(15,752)	
Loss from discontinued operations	(1,677)	(773)	(1,793)	(11,817)	(16,060)	

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Net loss	(4,188)	(4,661)	(6,598)	(16,365)	(31,812)
Basic and diluted loss per common share from:					
Continuing operations	\$ (0.73)	\$ (1.11)	\$ (1.34)	\$ (1.27)	\$ (4.48)
Discontinued operations	\$ (0.49)	\$ (0.22)	\$ (0.50)	\$ (3.30)	\$ (4.56)
Weighted averages shares	3,425	3,498	3,578	3,577	3,520

**Note 31 Subsequent Events**

On February 4, 2014, the Company raised \$2 million through the sale of a package of securities that included 200,000 shares of its Series B Preferred Stock and a warrant to purchase 282,686 shares of its common stock at \$2.83 per share. The terms of transaction were substantially the same as the terms described in Note 15 above.