POWERSECURE INTERNATIONAL, INC.
Form 10-Q
August 07, 2008

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2008

or

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

For the transition period from __________ to

Commission File Number 1-12014

POWERSECURE INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

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

(919) 556-3056

(Registrant s telephone number, including area code)

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

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

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o	Smaller reporting company o
		(Do not check if a smaller reporting company)	

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

As of August 1, 2008, 17,020,928 shares of the issuer s Common Stock were outstanding.

POWERSECURE INTERNATIONAL, INC.
FORM 10-Q
For the Quarterly Period Ended June 30, 2008
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PART I.
FINANCIAL INFORMATION

Item 1. Financial Statements

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

ASSETS	June 30, 2008	December 31, 2007
CURRENT ASSETS:		
Cash and cash equivalents	$ 10,259,877	$ 28,709,688
Trade receivables, net of allowance for doubtful accounts of $345,007 and $262,547, respectively	40,339,361	36,753,399
Other receivables	747,469	376,198
Inventories	20,286,059	20,785,549
Deferred income taxes	2,463,986	2,528,636
Prepaid expenses and other current assets	692,014	1,091,498
Assets of discontinued operations held for sale (Note 3)		2,399,589
Total current assets	74,788,766	92,644,557
PROPERTY, PLANT AND EQUIPMENT:		
Equipment	18,073,620	6,663,520
Furniture and fixtures	620,534	614,589
Land, building and improvements	4,529,133	1,013,022
Total property, plant and equipment, at cost	23,223,287	8,291,131
Less accumulated depreciation and amortization	3,227,278	2,640,424
Property, plant and equipment, net	19,996,009	5,650,707
OTHER ASSETS:		
Goodwill	7,255,710	7,255,710
Restricted annuity contract	2,071,416	2,001,204
Intangible rights and capitalized software costs, net of accumulated amortization of $1,300,938 and $947,550, respectively	1,374,653	1,660,676
Investment in unconsolidated affiliate (Note 2)	5,268,617	3,652,251
Other assets	96,760	158,363
Total other assets	16,067,156	14,728,204
TOTAL	$ 110,851,931	$ 113,023,468

See accompanying notes to consolidated financial statements.

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

LIABILITIES AND STOCKHOLDERS EQUITY	June 30, 2008	December 31, 2007
CURRENT LIABILITIES:		
Accounts payable	$ 12,927,708	$ 11,321,639
Accrued and other liabilities	24,273,736	35,156,946
Current income taxes payable	56,004	
Restructuring charges payable	1,718,851	4,047,849
Note payable (Note 4)	129,200	
Liabilities of discontinued operations held for sale (Note 3)		754,589
Current unrecognized tax benefit	83,987	83,987
Capital lease obligations	1,445	1,392
Total current liabilities	39,190,931	51,366,402
LONG-TERM NOTES PAYABLE (Note 4)	2,390,200	
NON-CURRENT UNRECOGNIZED TAX BENEFIT	674,173	674,173
NON-CURRENT RESTRUCTURING CHARGES	887,222	1,682,543
DEFERRED COMPENSATION OBLIGATION	221,760	55,440
NON-CURRENT CAPITAL LEASE OBLIGATIONS	4,590	5,326
COMMITMENTS AND CONTINGENCIES		
MINORITY INTEREST IN SUBSIDIARY		
STOCKHOLDERS EQUITY:		
Preferred stock undesignated, $.01 par value; 2,000,000 shares authorized; none issued and outstanding		
Preferred stock Series C, $.01 par value; 500,000 shares authorized; none issued and outstanding		
Common stock, $.01 par value; 25,000,000 shares authorized; 17,020,928 and 16,860,267 shares issued and outstanding, respectively	170,209	168,602
Additional paid-in-capital	106,899,288	105,472,838
Accumulated deficit	(39,586,442)	(46,401,856)

Total stockholders equity	67,483,055	59,239,584
TOTAL	$ 110,851,931	$ 113,023,468

See accompanying notes to consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
Revenues	$ 41,951,625	$ 22,591,119	$ 75,526,660	$ 48,007,146
Cost of sales	28,194,795	16,974,709	51,749,721	35,022,380
Gross profit	13,756,830	5,616,410	23,776,939	12,984,766
Operating expenses:				
General and administrative	7,509,972	4,912,858	14,752,887	10,354,040
Selling, marketing and service	1,888,865	697,847	3,213,524	1,316,465
Depreciation and amortization	527,432	365,323	984,676	697,864
Research and development	44,569	84,723	63,781	102,247
Restructuring charges		14,139,216		14,139,216
Total operating expenses	9,970,838	20,199,967	19,014,868	26,609,832
Operating income (loss)	3,785,992	(14,583,557)	4,762,071	(13,625,066)
Other income and (expenses):				
Management fees	163,875	101,636	313,208	203,282
Interest income	118,312	126,198	345,062	350,401
Interest and finance charges	(51,736)	(7,874)	(102,864)	(14,197)
Equity income	1,226,738	672,735	2,190,560	1,321,295
Other income				556,340
Minority interest				
Income (loss) before income taxes	5,243,181	(13,690,862)	7,508,037	(11,207,945)
Income tax provision	(303,169)	(170,140)	(614,455)	(476,277)
Income (loss) from continuing operations	4,940,012	(13,861,002)	6,893,582	(11,684,222)
Discontinued operations Metretek Florida				
Loss on disposal		(140,490)	(42,278)	(140,490)
Income (loss) from operations		146,288	(35,890)	202,864
Income (loss) from discontinued operations		5,798	(78,168)	62,374

Net income (loss)	$ 4,940,012	$ (13,855,204)	$ 6,815,414	$ (11,621,848)
PER SHARE AMOUNTS (NOTE 1):				
Income (loss) from continuing operations:				
Basic	$ 0.30	$ (0.87)	$ 0.42	$ (0.74)
Diluted	$ 0.29	$ (0.87)	$ 0.40	$ (0.74)
Net income (loss)				
Basic	$ 0.30	$ (0.87)	$ 0.42	$ (0.73)
Diluted	$ 0.29	$ (0.87)	$ 0.40	$ (0.73)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:				
Basic	16,337,808	15,935,336	16,327,493	15,883,210
Diluted	17,084,821	15,935,336	17,170,028	15,883,210

See accompanying notes to consolidated financial statements.

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

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ 6,815,414	$ (11,621,848)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	984,676	717,033
Minority interest in subsidiary		
Deferred income taxes	64,650	
Loss on disposal of miscellaneous assets	148,682	72,999
Equity in income of unconsolidated affiliate	(2,190,560)	(1,321,295)
Distributions from unconsolidated affiliate	543,944	1,414,254
Stock compensation expense	1,215,479	467,976
Changes in other assets and liabilities:		
Trade receivables, net	(3,585,962)	312,409
Inventories	499,490	(1,820,867)
Other current assets	84,217	57,236
Assets of discontinued operations held for sale	2,399,589	144,490
Other noncurrent assets	61,603	(11,490)
Accounts payable	1,606,069	(10,281,558)
Restructuring charges, net of cash payments	(3,124,319)	10,520,521
Accrued and other liabilities	(10,883,210)	2,892,579
Liabilites of discontinued operations held for sale	(754,589)	
Deferred compensation obligation	166,320	
Retirement annuity	(70,212)	
Net cash used in operating activities	(6,018,719)	(8,457,561)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property, plant and equipment	(15,052,851)	(557,421)
Additions to intangible rights and software development	(110,486)	(254,664)
Proceeds from sale of property, plant and equipment	950	
Net cash used in investing activities	(15,162,387)	(812,085)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from term loan	2,584,000	
Proceeds from stock option exercises, net of shares tendered	212,578	401,322
Principal payments on long-term notes payable	(64,600)	
Payments on preferred stock redemptions		(220,186)
Payments on capital lease obligations	(683)	(3,703)

Net cash provided by financing activities	2,731,295	177,433
NET DECREASE IN CASH AND CASH EQUIVALENTS	(18,449,811)	(9,092,213)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	28,709,688	15,916,460
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 10,259,877	$ 6,824,247

See accompanying notes to consolidated financial statements.

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POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements
As of June 30, 2008 and December 31, 2007 and
For the Three and Six Month Periods Ended June 30, 2008 and 2007

1. Summary of Significant Accounting Policies

Organization The accompanying consolidated financial statements include the accounts of PowerSecure International, Inc. and its subsidiaries, primarily, PowerSecure, Inc. (our PowerSecure subsidiary) and its majority-owned and wholly-owned subsidiaries, UtilityEngineering, Inc., PowerServices, Inc., EnergyLite, Inc., EfficientLights, LLC and Reid s Trailer, Inc. dba PowerFab (PowerFab); Southern Flow Companies, Inc. (Southern Flow); Metretek, Incorporated (Metretek Florida) and its majority-owned subsidiary, Metretek Contract Manufacturing Company, Inc. (MCM); and WaterSecure Holdings, Inc. (WaterSecure), collectively referred to as the Company or we or us or our .

These consolidated financial statements have been prepared pursuant to rules and regulations of the Securities and Exchange Commission. The accompanying consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2007.

In management s opinion, all adjustments (all of which are normal and recurring) have been made which are necessary for a fair presentation of the consolidated financial position of us and our subsidiaries as of June 30, 2008 and the consolidated results of our operations and cash flows for the three and six month periods ended June 30, 2008 and June 30, 2007.

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

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

Basic and Diluted Earnings (Loss) Per Share Earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of shares outstanding during the period on a basic and diluted basis. Diluted earnings per share reflects the potential dilution that would occur if stock options and warrants were exercised using the average market price for our stock for the period. Diluted earnings per share excludes the impact of potential common shares related to stock options and warrants in periods in which we report a loss from continuing operations or in which the option or warrant exercise price is greater than the average market price of our common stock during the period because the effect of including them in the calculation would be antidilutive. A total of 1,210,127 and 1,205,924 common shares underlying in-the-money stock options and warrants were excluded from diluted weighted average shares outstanding for the three and six months ended June 30, 2007, respectively, because their effect would be antidilutive.

The following table sets forth the calculation of basic and diluted earnings (loss) per share:

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2008	**2007**	**2008**	**2007**
Income (loss) from continuing operations	$ 4,940,012	$ (13,861,002)	$ 6,893,582	$ (11,684,222)
Income (loss) from discontinued operations		5,798	(78,168)	62,374
Net income (loss)	$ 4,940,012	$ (13,855,204)	$ 6,815,414	$ (11,621,848)
Basic weighted-average common shares outstanding in period	16,337,808	15,935,336	16,327,493	15,883,210
Add dilutive effects of stock options and warrants	747,013		842,535	
Diluted weighted-average common shares outstanding in period	17,084,821	15,935,336	17,170,028	15,883,210
Basic earnings (loss) per common share:				
Income (loss) from continuing operations	$ 0.30	$ (0.87)	$ 0.42	$ (0.74)
Income (loss) from discontinued operations				0.01
Basic earnings (loss) per common share	$ 0.30	$ (0.87)	$ 0.42	$ (0.73)
Diluted earnings (loss) per common share:				
Income (loss) from continuing operations	$ 0.29	$ (0.87)	$ 0.40	$ (0.74)
Income (loss) from discontinued operations				0.01
Diluted earnings (loss) per common share	$ 0.29	$ (0.87)	$ 0.40	$ (0.73)

Cash and Cash Equivalents Cash and all highly liquid and unrestricted investments with a maturity of three months or less from the date of purchase, including money market mutual funds, short-term time deposits, and government agency and corporate obligations, are classified as cash and cash equivalents. We maintain our cash in bank deposit accounts, which, at times, may exceed federally insured limits. We have not experienced any losses in such accounts. We do not believe we are exposed to any significant credit risk on cash and cash equivalents.

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Minority Interest The minority shareholder s interest in the equity and losses of EfficientLights is included in minority interest in the accompanying consolidated financial statements. The minority shareholder s interest in accumulated losses of EfficientLights exceeded its basis in EfficientLights at December 31, 2007. Accordingly, we discontinued recording additional minority interest losses in EfficientLights effective January 1, 2008.

In December 2007, the Financial Accounting Standards Board (FASB) issued Financial Accounting Standards (FAS) No. 160, Noncontrolling Interests in Consolidated Financial Statements-an amendment of ARB No. 51 (FAS 160), which establishes accounting and reporting standards for the noncontrolling interest in a subsidiary (minority interest) and for the deconsolidation of a subsidiary. We will be required to adopt the provisions of FAS 160 beginning January 1, 2009. We are currently evaluating the impact that the adoption of FAS 160 will have on our financial position and results of operations.

Income Taxes - On January 1, 2007, we adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes by prescribing a minimum recognition threshold for a tax position taken or expected to be taken in a tax return that is required to be met before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition.

We account for income taxes in accordance with the provisions of FAS No. 109, Accounting for Income Taxes . Accordingly, we recognize deferred income tax assets and liabilities for the estimated future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. We have net operating loss carryforwards available in certain jurisdictions to reduce future taxable income. Future tax benefits for net operating loss carryforwards are recognized to the extent that realization of these benefits is considered more likely than not. To the extent that available evidence raises doubt about the realization of a deferred income tax asset, a valuation allowance is established.

Fair Value Measurements Effective January 1, 2008, we adopted the provisions of FAS No. 157, Fair Value Measurements (FAS 157). FAS 157 defines fair value to measure assets and liabilities, establishes a framework for measuring fair value, and requires additional disclosures about the use of fair value. FAS 157 is applicable whenever another accounting pronouncement requires or permits assets and liabilities to be measured at fair value. FAS 157 does not expand or require any new fair value measures. The adoption of FAS 157 had no effect on our financial position or results of operations.

Financial Assets and Financial Liabilities Effective January 1, 2008, we adopted the provisions of FAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (FAS 159), which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The adoption of FAS 159 had no effect on our financial position or results of operations.

Business Combinations In December 2007, the FASB issued FAS No. 141(R), Business Combinations-a replacement of FASB Statement No. 141 (FAS 141(R)), which significantly changes the principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. FAS 141(R) also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. FAS 141(R) is effective prospectively, except for certain retrospective adjustments to deferred tax balances, for fiscal years beginning after December 15, 2008 and will become effective for us on January 1, 2009. We are currently evaluating the impact that the adoption of FAS 141(R) will have on our financial position and results of operations.

Derivative Instruments and Hedging Activities In March 2008, the FASB issued FAS No. 161, Disclosures About Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (FAS 161). FAS 161 amends FAS No. 133 by requiring expanded disclosures about, but does not change the accounting for, derivative instruments and hedging activities, including increased qualitative, quantitative, and credit-risk disclosures. FAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008 and will become effective for us on January 1, 2009. We are currently evaluating the impact that the adoption of FAS 161 will have on our financial position and results of operations.

Reclassification In December 2007, our board of directors approved a plan to discontinue the operations of Metretek Florida and sell all of its assets (see Note 3). The operations of the discontinued segment have been reclassified to discontinued operations for all periods presented in the accompanying consolidated statements of operations. In addition, certain 2007 amounts have been reclassified to conform to current year presentation. Such reclassifications had no impact on our net income or stockholders equity.

2. Investment in Unconsolidated Affiliate

Through WaterSecure, we own a significant minority equity interest in Marcum Midstream 1995-2 Business Trust (MM 1995-2), which we account for under the equity method. MM 1995-2 owns and operates six water disposal wells located at five facilities in northeastern Colorado. The balance of our equity investment in MM 1995-2 includes approximately $689,000 and $719,000 of unamortized purchase premiums we paid on our acquired interests at June 30, 2008 and December 31, 2007, respectively. The premiums are being amortized over a period of 14 years, which represents the weighted average useful life of the underlying assets acquired.

On July 2, 2008, WaterSecure purchased additional equity interests in MM 1995-2 for an aggregate purchase price of $710,000. The additional equity interests acquired increased WaterSecure s ownership interest to 40.45% of MM 1995-2, an increase from 36.26% at June 30, 2008.

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The following table sets forth certain summarized financial information for MM 1995-2 at June 30, 2008 and December 31, 2007 and for the three and six months ended June 30, 2008 and 2007:

	June 30, 2008	December 31, 2007
Total current assets	$ 7,663,357	$ 3,136,735
Property, plant and equipment, net	8,149,286	8,366,745
Total other assets	9,075	13,469
Total assets	$ 15,821,718	$ 11,516,949
Total current liabilities	$ 1,416,141	$ 1,362,482
Long-term note payable	2,083,149	2,372,807
Total shareholders equity	12,322,428	7,781,660
Total liabilities and shareholders equity	$ 15,821,718	$ 11,516,949

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Total revenues	$ 5,477,900	$ 3,157,694	$ 10,367,221	$ 6,303,143
Total costs and expenses	2,095,003	1,302,534	4,326,453	2,659,491
Net income	$ 3,382,897	$ 1,855,160	$ 6,040,768	$ 3,643,652

3. Discontinued Operations

In December 2007, our board of directors approved a plan to sell substantially all of the assets of Metretek Florida, which operated our automated data collection and telemetry segment. The board of directors adopted this plan in conjunction with its review of our strategic alternatives for our non-core businesses. On March 14, 2008, Metretek Florida entered into an Asset Purchase Agreement with Mercury Instruments LLC (Mercury). Under the purchase agreement, Metretek Florida sold substantially all of its assets and business to Mercury for a total purchase price of $2,250,000. The sale was completed March 31, 2008. On April 1, 2008, we received proceeds from the sale in the amount of $1,800,000, and the remaining proceeds from the sale in the amount of $450,000 were deposited by the seller into an escrow account.

Metretek Florida retained its cash, accounts receivables, accounts payable in excess of $182,700, and certain other liabilities, other than those liabilities expressly assumed by Mercury in the purchase agreement. Mercury assumed most of the customer orders of Metretek Florida and its facilities lease. The purchase agreement contains customary representations, warranties and indemnification obligations by Metretek Florida and Mercury to each other, and includes a one year escrow of 20% of the purchase price to support the indemnity obligations of Metretek Florida.

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As a result of the sale, we recorded an after-tax estimated loss on disposal of our discontinued operations of $1,120,000 during the fourth quarter of fiscal 2007. Upon closing of the sale, we recorded an additional loss on disposition in the amount of $42,278 to reflect changes in assets and liabilities sold from December 31, 2007 to the date of closing. This non-cash charge represents our current estimate of the actual losses incurred. Additional losses may be recorded to the extent indemnity obligations are incurred, receivables remain uncollected, or warranty and other obligations exceed amounts we have currently reserved.

The accompanying consolidated financial statements have been reclassified for all periods presented to reflect the operations of Metretek Florida as discontinued operations. We ceased recording depreciation upon classification of the assets as discontinued operations in January 2008. Depreciation and amortization expense of Metretek Florida during the three and six months ended June 30, 2007 was $8,786 and $19,169, respectively. The following table sets forth the results of discontinued operations for the three and six months ended June 30, 2008 and 2007:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
Total revenues	$	$ 1,242,232	$ 1,284,576	$ 2,194,949
Operating expenses		1,095,944	1,320,466	1,992,085
Income (loss) from operations		146,288	(35,890)	202,864
Loss on disposal		(140,490)	(42,278)	(140,490)
Income (loss) from discontinued operations	$	$ 5,798	$ (78,168)	$ 62,374

The following assets and liabilities were segregated and classified as held for sale or liquidation in the accompanying consolidated balance sheet at December 31, 2007:

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		December 31, 2007
Inventories	$	1,189,437
Prepaid expenses and other current assets		195,159
Property, plant and equipment, net		162,618
Goodwill		770,558
Intangible assets, less accumulated amortization		47,530
Other assets		34,287
Assets of discontinued operations held for sale or liquidation	$	2,399,589
Current liabilities	$	754,589
Other		
Liabilities of discontinued operations held for sale or liquidation	$	754,589

Net cash flows of our discontinued operations from the categories of investing and financing activities were not significant for the three and six months ended June 30, 2008 and 2007.

4. Debt

Line of Credit We have a Credit Agreement (the Credit Agreement) with Citibank, N.A., as the administrative agent (the Agent), and the other lenders party thereto (Lender), providing for a $25 million senior, first-priority secured revolving and term credit facility (the Credit Facility). The Credit Facility is guaranteed by our active subsidiaries and secured by the assets of the Company and those subsidiaries. The Credit Facility matures on August 23, 2010. We expect to use the Credit Facility primarily to fund the growth and expansion of our business.

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

Outstanding balances under the Credit Facility bear interest, at our discretion, at either the London Interbank Offered Rate (LIBOR) for the corresponding deposits of U. S. Dollars plus an applicable margin, which is on a sliding scale ranging from 125 basis points to 200 basis points based upon our leverage ratio, or at the Agent s alternate base rate plus an applicable margin, on a sliding scale ranging from minus 25 basis points to plus 50 basis points based upon our leverage ratio. Our leverage ratio is the ratio of our funded indebtedness as of a given date to our consolidated earnings before interest, taxes, deprecation and amortization (EBITDA) for the four consecutive fiscal quarters ending on such date. The Agent s alternate base rate is equal to the higher of the Federal Funds Rate as published by the Federal Reserve of New York plus 0.50%, and the Agent s prime commercial lending rate. Through June 30, 2008, we have not borrowed any amounts under the Credit Facility.

The Credit Facility is not subject to any borrowing base computations or limitations, but does contain certain financial covenants that we must meet. Our maximum leverage ratio cannot exceed 2.75. Our minimum fixed charge coverage ratio must be in excess of 1.75, where fixed charge coverage ratio is defined as the ratio of the aggregate of our trailing 12 month consolidated EBITDA plus our lease or rent expense minus our cash paid for taxes, divided by the sum of our consolidated interest charges plus our lease or rent expenses plus our scheduled principal payments and dividends, computed over the previous period. Also, our minimum asset coverage must be in excess of 1.25, where asset coverage is defined as the summation of 80% of the book value of accounts receivable plus 60% of the book value of inventory plus 50% of the book value of net fixed assets, divided by total funded debt outstanding less any acquisition term debt. At June 30, 2008, we were in compliance with these financial covenants.

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

Our obligations under the Credit Facility are secured by guarantees (Guarantees) and security agreements (the Security Agreements) by each of our active subsidiaries. The Guarantees guaranty all of our obligations under the Credit Facility, and the Security Agreements grant to the Lenders a first priority security interest in virtually all of the assets of each of the parties to the Credit Agreement.

The Credit Agreement contains customary events of default, including payment defaults, breach of representations and warranties, covenant defaults, cross-defaults, certain bankruptcy or insolvency events, judgment defaults and certain ERISA-related events.

On January 17, 2008, we acquired the land and building constituting our principal executive offices and the offices of our PowerSecure subsidiary, located in Wake Forest, North Carolina for a purchase price of approximately $3.3 million. Previously, we had leased the facilities from the seller. We determined it was more financially favorable to us to acquire the facilities than to continue leasing them, and that the ownership of these facilities served the best interests of our stockholders.

The acquisition of the facilities was financed in large part through a $2,584,000 seven year term loan under a Term Credit Agreement (the Term Credit Agreement) with the Lender. The Term Credit Agreement is in addition to, and on substantially the same terms and conditions as, the Credit Facility, including nearly identical covenants (financial and operating), representations, warranties, collateral, security and events of default. The Term Credit Agreement, like the Credit Facility, is guaranteed by our active subsidiaries and secured by the assets of the Company and those subsidiaries.

The outstanding balance under the Term Credit Agreement is payable on a quarterly basis and bears interest, at our discretion, at either LIBOR for the corresponding deposits of U. S. Dollars plus an applicable margin, which is on a sliding scale ranging from 125 basis points to 200 basis points based upon our leverage ratio, or at the Lender s alternate base rate plus an applicable margin, on a sliding scale ranging from minus 25 basis points to plus 50 basis points based upon our leverage ratio, as under the Credit Facility.

Upon the sale of either our PowerSecure subsidiary or the facilities, we are required to use the net proceeds to repay the then outstanding balance on the Term Credit Agreement. Our obligations under the Term Credit Agreement are secured by a deed of trust by our PowerSecure subsidiary with respect to the facilities, and by the Guarantees and amendments to the existing Security Agreements by our active subsidiaries. The Guarantees guaranty all of our obligations under the Term Credit Agreement, and the Security Agreements, as amended, grant to the Lender a first priority security interest in virtually all of the assets of each of the parties to the Guarantees.

On January 17, 2008, we entered into a First Amendment to Credit Agreement with the Lender, modifying the Credit Agreement to incorporate and facilitate the Term Credit Agreement and to amend certain technical provisions of the Credit Agreement.

On May 5, 2008, we entered into a Second Amendment to Credit Agreement and First Amendment to Term Credit Agreement with the Lender, modifying the Credit Agreement and Term Credit Agreement to eliminate the restrictive covenants on annual capital expenditures.

Equipment Line On July 22, 2008, Caterpillar Financial Services Corporation (Caterpillar) renewed a line of credit to finance the purchase, from time to time, of Caterpillar generators to be used in our PowerSecure subsidiary s projects, primarily those projects sold under the recurring revenue model, pursuant to a letter by Caterpillar containing the terms of this credit line. The line of credit was increased from its previous $7,500,000 level to $10,000,000. Under this line of credit, our PowerSecure subsidiary may submit equipment purchases to Caterpillar for financing, and Caterpillar may provide such financing in its discretion at an interest rate, for a period of time between 12 and 60 months and upon such financing instruments, such as a promissory note or an installment sales contract, as are set by Caterpillar on a project by project basis. The line of credit expires on June 30, 2009 (subject to renewal, if requested by PowerSecure and accepted by Caterpillar in its sole discretion), or at an earlier date upon notice given by Caterpillar in its sole discretion. The letter setting forth the terms of the line of credit confirms the intent of Caterpillar to finance equipment purchases by our PowerSecure subsidiary, but is not an unconditional binding commitment to provide such financing. The line of credit contains various customary provisions and is contingent upon the continued credit-worthiness of our PowerSecure subsidiary in the sole discretion of Caterpillar.

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5. Share-Based Compensation

We account for share-based compensation in accordance with the provisions of FAS No. 123 (Revised 2004), Share-Based Payment (FAS 123(R)), which requires measurement of compensation cost for all stock-based awards at the fair value on date of grant and recognition of compensation over the service period for awards expected to vest. We measure the fair value of restricted stock awards based on the number of shares granted and the quoted price of our common stock on the date of the grant, and we measure the fair value of stock options using the Black-Scholes valuation model. These fair values are recognized as compensation expense over the service period, net of estimated forfeitures.

Stock Options Historically, we have granted stock options to employees, directors, advisors and consultants under three stock plans. Under our 1991 Stock Option Plan, as amended (the 1991 Stock Plan), we granted incentive stock options and non-qualified stock options to purchase common stock to officers, employees and consultants. Options that were granted under the 1991 Stock Plan contained exercise prices not less than the fair market value of our common stock on the date of grant and had a term of ten years, the vesting of which was determined on the date of the grant, but generally contained a 2-4 year vesting period. Under our Directors Stock Plan as amended (Directors Stock Plan), we granted non-qualified stock options to purchase common stock to our non-employee directors at an exercise price not less than the fair market value of our common stock on the date of grant. Options that were granted under the Director s Stock Plan generally had a term of ten years and vested on the date of grant. Certain options granted to officers and non-employee directors under the 1991 Stock Plan and the Directors Stock Plan contained limited rights for receipt of cash for appreciation in stock value in the event of certain changes in control. At June 30, 2008, there were no options outstanding under the 1991 Stock Plan or the Directors Stock Plan.

Under our 1998 Stock Incentive Plan, as amended (the 1998 Stock Plan), we granted incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, performance awards and other stock-based awards to our officers, directors, employees, consultants and advisors for shares of our common stock. Stock options granted under the 1998 Stock Plan contained exercise prices not less than the fair market value of our common stock on the date of grant, and had a term of 10 years from the date of grant. Nonqualified stock option grants to our Directors under the 1998 Stock Plan generally vested over periods up to two years. Qualified stock option grants to our employees under the 1998 Stock Plan generally vested over periods up to five years. The 1998 Stock Plan replaced our 1991 Stock Plan and Directors Stock Plan. The 1998 Stock Plan expired on June 12, 2008, so no additional awards can be made under that plan after such date, although awards granted prior to such date will remain outstanding and subject to the terms and conditions of those awards.

In March 2008, our board of directors adopted the PowerSecure International, Inc. 2008 Stock Incentive Plan (the 2008 Stock Plan), which was approved by our stockholders at the Annual Meeting of Stockholders held on June 9, 2008. The 2008 Stock Plan authorizes our board of directors to grant incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, performance awards and other stock-based awards to our officers, directors, employees, consultants and advisors for up to an aggregate of 600,000 shares of our common stock. Stock options granted under the 2008 Stock Plan must contain exercise prices not less than the fair market value of our common stock on the date of grant, and must contain a term not in excess of 10 years from the date of grant. There have been no stock options granted under the 2008 Stock Plan through June 30, 2008. The 2008 Stock Plan replaced our 1998 Stock Plan.

Net income for the three months ended June 30, 2008 and 2007 includes $198,000 and $259,000, respectively, of pre-tax compensation costs related to outstanding stock options. Net income for the six months ended June 30, 2008 and 2007 includes $410,000 and $468,000 of pretax compensation costs, respectively, related to outstanding stock options. The after-tax compensation cost of outstanding stock options for the three and six months ended June 30, 2008 was $121,000 and $250,000, respectively. There were no net income tax benefits related to our stock-based compensation arrangements during the three and six months ended June 30, 2007 because a valuation allowance was provided for nearly all of our net deferred tax assets. All of the stock option compensation expense is included in general and administrative expenses in the accompanying consolidated statements of operations.

A summary of option activity for the six months ended June 30, 2008 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Balance, December 31, 2007	1,727,868	$ 5.34		
Granted-Directors				
Granted-Employees	30,000	12.14		
Exercised	(141,983)	3.15		
Canceled				
Forfeited	(5,000)	13.55		
Balance, June 30, 2008	1,610,885	$ 5.63	5.72	$ 1.63
Exercisable, June 30, 2008	1,305,135	$ 4.44	5.25	$ 2.82

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

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	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Balance, December 31, 2006	2,085,344	$ 4.61		
Granted-Directors	22,500	13.02		
Granted-Employees				
Exercised	(200,066)	2.25		
Canceled				
Forfeited	(2,500)	3.06		
Balance, June 30, 2007	1,905,278	$ 4.96	6.31	$ 10.48
Exercisable, June 30, 2007	1,496,278	$ 5.00	5.74	$ 11.79

The weighted average grant date fair value of the 30,000 options granted to employees during the six months ended June 30, 2008 was $6.51. There were no stock options granted to directors during the six months ended June 30, 2008. The weighted average grant date fair value of the 22,500 options granted to directors during the six month ended June 30, 2007 was $12.90. There were no stock options granted to employees during the six months ended June 30, 2007. In each case, the fair value was measured using the Black-Scholes valuation model with the following assumptions:

	June 30, 2008	June 30, 2007
Expected stock price volatilility	60.3%	75.7%
Risk Free interest rate	2.96%	5.09%
Annual dividends	$	$
Expected life employee options	5 years	na
Expected life director options	na	5 years

We amortize the fair value of stock option grants over the applicable vesting period using the straight-line method and assuming a forfeiture rate of 5%. As of June 30, 2008 and December 31 2007, there was $1,687,000 and $1,979,000, respectively, of total unrecognized compensation costs related to all of our outstanding stock options. These costs at June 30, 2008 are expected to be recognized over a weighted average period of 1.45 years.

During the three months ended June 30, 2008 and 2007, the total intrinsic value of stock options exercised was $452,000 and $1,072,000, respectively, and the total fair value of stock options vested was $395,000 and $435,000, respectively. During the six months ended June 30, 2008 and 2007, the total intrinsic value of stock options exercised was $944,000 and $2,023,000, respectively, and the total fair value of stock options vested was $627,000 and $697,000, respectively.

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Cash received from stock option exercises for the three months ended June 30, 2008 and 2007 was $362,000 and $198,000, respectively. Cash received from stock option exercises for the six months ended June 30, 2008 and 2007 was $448,000 and $401,000, respectively.

Restricted Stock Awards We have granted restricted stock awards under our 1998 Stock Plan and under our 2008 Stock Plan. A total of 38,148 restricted shares were granted under the 2008 Stock Plan during the six months ended June 30, 2008. Net income for the three and six months ended June 30, 2008 includes $403,000 and $806,000, respectively, of pre-tax compensation costs related to outstanding restricted stock awards granted to directors, certain officers and our employees. There were no unvested restricted stock awards outstanding during the three or six months ended June 30, 2007. All of the restricted stock award compensation expense during the three and six months ended June 30, 2008 is included in general and administrative expenses in the accompanying consolidated statements of operations.

A summary of unvested restricted stock award activity for the six months ended June 30, 2008 is as follows:

	Unvested Restricted Shares	Weighted Average Grant Date Fair Value
Balance, December 31, 2007	640,500	$ 12.48
Granted-Directors	23,148	8.64
Granted-Officers		
Granted-Employees	15,000	8.50
Vested	(60,000)	12.34
Forfeited		
Balance, June 30, 2008	618,648	$ 12.25

Restricted shares are subject to forfeiture and cannot be sold or otherwise transferred until they vest. If the holder of the restricted shares leaves us before the restricted shares vest, other than due to termination by us without cause, then any unvested restricted shares will be forfeited and returned to us. The restricted shares granted to directors vest in equal quarterly amounts over one year. The restricted shares granted to employees vest in equal annual amounts over five years. The restricted shares previously granted to officers vest as follows:

A total of 300,000 restricted shares will cliff vest in their entirety on August 15, 2012, provided the officer holding those shares remains employed by us on that date.

A total of 22,500 restricted shares will cliff vest in their entirety on December 10, 2012, provided the officers holding those shares remain employed by us on that date.

The remaining 258,000 restricted shares vest in four equal annual installments, commencing when our annual report on Form 10-K for the year ended December 31, 2008 is filed, based upon the achievement of performance targets each year relating to our income from continuing operations for fiscal years 2008 through 2012.

All restricted and unvested shares will automatically vest upon a change in control.

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The fair value of the restricted shares that vest over time is being amortized on a straight-line basis over the vesting period. The fair value of the performance vesting shares are expensed as the achievement of the performance criteria becomes probable and the related service period conditions are met. The current period expense amortization amount above includes both the restricted shares that vest over time as well as the 2008 performance vesting shares based on our current assessment of achieving the 2008 performance criteria. At June 30, 2008, the balance of unrecognized compensation cost related to unvested restricted shares was $6,459,000, which, assuming all future performance criteria will be met, we expect will be recognized over a weighted average period of approximately 4.4 years.

6. Commitments and Contingencies

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

From time to time, in the ordinary course of business we encounter performance issues with key component parts we utilize in our distributed generation systems, switchgear systems, and lighting products, such as engines, generators, breakers, fuel systems, LED and other lighting technologies, and other complex electrical components. While we strive to utilize high quality component parts from reputable suppliers, and to back-up their quality and performance with manufacturers warranties, even the best parts and components have performance issues from time to time, and these performance issues create significant financial and operating risks to our business, operations and financial results. These risks include the expense, time, focus and resources involved in repairing, replacing or modifying distributed generation systems, switchgear systems and lighting systems for component part malfunctions, whether or not covered under manufacturers warranties and the burden and costs we would incur due to manufacturers disputing or failing to timely and fully honor their warranty obligations for quality and performance issues. These risks also include the potential material and adverse effects on our business, operations, reputation and financial results due to the cancellation or deferral of projects by our customers, or claims made by our customers for damages, as a result of performance issues. Although we believe our suppliers warranties generally cover these performance issues, from time to time we face disputes with our suppliers with respect to those performance issues and their warranty obligations, and our customers may claim to incur damages as a result of those performance issues. In those cases, we vigorously defend our position and rights, including our warranty rights, and we take all commercially practical actions to ensure our customers are fully satisfied with the quality of our products and services and do not incur any damages. In the opinion of management, there are currently no disputes pending that we expect to have a material adverse affect on our business or financial results. However, the outcome of warranty claims and performance issues are inherently difficult to predict due to the uncertainty of technical solutions, cost, customer requirements, and the uncertainty inherent in litigation and disputes generally, and thus there is no assurance we will not be adversely affected by performance issues with key parts and components. In addition, the mere existence of performance issues, even if finally resolved with our suppliers, can have an adverse effect on our reputation for quality, which could adversely affect our business.

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

7. Segment Information

In accordance with FAS No. 131, Disclosures about Segments of an Enterprise and Related Information, we define our operating segments as components of an enterprise for which discrete financial information is available and is reviewed regularly by the chief operating decision-maker, or decision-making group, to evaluate performance and make operating decisions. Our reportable segments are strategic business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. Our two reportable business segments include: Distributed generation and energy efficiency; and natural gas measurement services. Previously we had been engaged in a third business segment, automated energy data collection and telemetry. That segment of our business has been discontinued and the results of its operations reported as discontinued operations (see Note 3).

Distributed Generation and Energy Efficiency The operations of our distributed generation and energy efficiency segment are conducted by our PowerSecure subsidiary. Our PowerSecure subsidiary commenced operations in September 2000. Our PowerSecure subsidiary s operating segment activities include products and services related to distributed generation, utility infrastructure, and energy efficiency. Our PowerSecure subsidiary provides products and services to utilities and their commercial, institutional, and industrial customers. Our PowerSecure subsidiary s distributed generation products and services involve the deployment of electric generation equipment that supplements the electric power grid, enabling utilities to avoid new investments in infrastructure for transmitting and distributing power, and providing their customers with dependable backup power with a strong return on investment. The distributed generation equipment is generally located at the utilities end-customer s business sites. Our PowerSecure subsidiary has sophisticated monitoring systems and electrical switching technologies, which work in tandem to reduce customers costs by managing load curtailment during peak power periods, and also ensure backup power is available during power outages. In addition to its core distributed generation products and services, our PowerSecure subsidiary provides utilities with regulatory consulting, energy system engineering and construction, and energy conservation services. Our PowerSecure subsidiary also provides commercial and industrial customers with the identification, design and installation of cost effective energy improvement systems for lighting, building controls, and other facility

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upgrades. Through June 30, 2008, the majority of our PowerSecure subsidiary s revenues have been generated from sales of distributed generation systems on a turn-key basis, where the customer purchases the systems from our PowerSecure subsidiary. Our PowerSecure subsidiary also markets its distributed generation products and services in a recurring revenue model that is expected to generate an increasing proportion of our PowerSecure subsidiary s revenues in future years.

Since 2005, our PowerSecure subsidiary has added several new business units designed to expand and complement its core distributed generation business and customers. UtilityEngineering provides fee-based, technical engineering services to our PowerSecure subsidiary s utility partners and customers. PowerServices provides rate analysis and other similar consulting services to our PowerSecure subsidiary s utility, commercial and industrial customers. EnergyLite assists customers in reducing their use of energy through investments in more energy-efficient technologies. Our PowerSecure subsidiary s UtilityServices business unit provides turnkey services to utilities for the construction and maintenance of utility infrastructure, and the Federal business unit also works in conjunction with our utility partners to provide infrastructure development services, focusing on federal projects. PowerFab builds trailers for the transportation of goods and equipment, an element of our PowerSecure subsidiary s mobile distributed generation equipment business strategy, as well as other fabrication services for our PowerSecure subsidiary s product line. Late in the third quarter 2007, our PowerSecure subsidiary launched a new majority-owned subsidiary, EfficientLights, that designs and manufactures lighting solutions specifically aimed at substantially reducing the energy consumed in lighting freezer and refrigeration cases in grocery stores.

Each of these PowerSecure subsidiary business units operates in a distinct market with distinct technical disciplines, but share a common customer base which our PowerSecure subsidiary intends to service and grow through shared resources and customer leads. Accordingly, these units are included within Our PowerSecure subsidiary s distributed generation and energy efficiency segment results.

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

The accounting policies of the reportable segments are the same as those described in Note 1 above. We evaluate the performance of our operating segments based on operating income (loss) before income taxes, nonrecurring items and interest income and expense. Intersegment sales are not significant.

Summarized financial information concerning our reportable segments is shown in the following table. The Other amounts include corporate overhead and related items including restructuring charges and net assets of discontinued operations. The table information excludes the revenues, depreciation, and income or losses of the discontinued Metretek Florida operations for all periods presented.

Summarized Segment Financial Information
(all amounts reported in thousands)

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Revenues:				
PowerSecure	$ 37,058	$ 18,614	$ 66,164	$ 40,129
Southern Flow	4,894	3,978	9,363	7,878
Total	$ 41,952	$ 22,592	$ 75,527	$ 48,007
Gross profit:				
PowerSecure	$ 12,247	$ 4,478	$ 21,050	$ 10,795
Southern Flow	1,510	1,138	2,727	2,190
Total	$ 13,757	$ 5,616	$ 23,777	$ 12,985
Segment profit (loss) (1):				
PowerSecure	$ 4,080	$ (517)	$ 5,679	$ 773
Southern Flow	962	718	1,712	1,339
Other	(1,256)	(14,785)	(2,629)	(15,737)
Total	$ 3,786	$ (14,584)	$ 4,762	$ (13,625)
Capital expenditures:				
PowerSecure	$ 7,635	$ 215	$ 15,084	$ 551
Southern Flow	37	40	79	207
Other		35		54
Total	$ 7,672	$ 290	$ 15,163	$ 812
Depreciation and amortization:				
PowerSecure	$ 468	$ 313	$ 867	$ 595
Southern Flow	42	35	84	67
Other	17	17	34	36
Total	$ 527	$ 365	$ 985	$ 698

	June 30, 2008	June 30, 2007
Total assets:		
PowerSecure	$ 83,919	$ 57,367
Southern Flow	10,929	11,804

Other	16,004	12,345
Total	$ 110,852	$ 81,516

(1) Segment profit (loss) represents operating income (loss).

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

Introduction

The following discussion and analysis of our consolidated results of operations for the three and six month period ended June 30, 2008, which we refer to as the second quarter 2008 and six month period 2008, respectively, and the three and six month period ended June 30, 2007, which we refer to as the second quarter 2007 and six month period 2007, respectively, and of our consolidated financial condition as of June 30, 2008 should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this report.

Overview

We are a leading provider of energy management and efficiency solutions to utilities and their commercial, institutional and industrial customers. Our operations are currently focused on distributed generation, utility infrastructure, energy conservation and efficiency and energy services products and services. Our core distributed generation products and services involve the deployment of electric generation equipment that supplements the electric power grid, enabling utilities to avoid new investments in infrastructure for transmitting and distributing power, and providing their customers with dependable backup power with a strong return on investment. The distributed generation equipment is generally located at the utilities end-customer s business sites. We have sophisticated monitoring systems and electrical switching technologies, which work in tandem to reduce customers costs by managing load curtailment during peak power periods, and also ensure backup power is available during power outages. In addition to our core distributed generation products and services, we provide utilities with regulatory consulting, energy system engineering and construction, and energy conservation services. We also provide commercial and industrial customers with the identification, design and installation of cost effective energy improvement systems for lighting, building controls, and other facility upgrades.

We also conduct other business operations through other wholly-owned subsidiaries. Southern Flow conducts our natural gas measurement services operating segment. Southern Flow provides a wide variety of natural gas measurement services principally to producers and operators of natural gas production facilities. Previously, we had been engaged in a third business segment, automated energy data collection and telemetry which was conducted by our Metretek Florida subsidiary. That segment of our business has been discontinued and the results of its operations reported as discontinued operations.

In addition to our operating segments, WaterSecure owns a significant minority interest in MM 1995-2, which we refer to as the WaterSecure operations. On July 2, 2008, WaterSecure purchased additional equity interests in MM 1995-2 for an aggregate purchase price of $710,000. The additional equity interests acquired increased WaterSecure s ownership interest to 40.45% of MM 1995-2 from 36.26% at June 30, 2008. We record management fees from our services as managing trustee and equity in the income of the WaterSecure operations, which operates production water disposal facilities located in northeastern Colorado.

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We commenced operations in 1991 as an energy services holding company, owning businesses designed to exploit service opportunities primarily in the natural gas industry. Since then, our business has evolved and expanded through acquisitions and formations of companies, businesses and product lines that have allowed us to reach a broader portion of the energy market, including the electricity market. In recent years, we have focused our efforts on growing our businesses by offering new and enhanced products, services and technologies and by entering new markets,