POWERSECURE INTERNATIONAL, INC.
Form 10-K
March 08, 2012
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-K

**(Mark One)**

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the fiscal year ended December 31, 2011**

**OR**

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the transition period from to**

**Commission file number: 001-12014**

# 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, including zip code)**

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

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

| **Title of each class** | **Name of each exchange on which registered** |
|---|---|
| Common Stock, par value $.01 per share | The NASDAQ Stock Market LLC (The NASDAQ Global Select Market) |

**Securities registered pursuant to Section 12(g) of the Act:**

**None**

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ¨ No x

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act.

Yes ¨ No x

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 x 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 (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) 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. x

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

Large accelerated filer ¨ Accelerated filer x

Non-accelerated filer ¨ (Do not check if a smaller reporting company) Smaller reporting company ¨

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

As of June 30, 2011, the last business day of the Registrant s most recently completed second fiscal quarter, the aggregate market value of the shares of the Registrant s Common Stock held by non-affiliates of the Registrant was approximately $128,528,093.50, based upon the last sale price of the Common Stock on such date as reported on The NASDAQ Global Select Market.

As of March 1, 2012, 18,908,412 shares of the Registrant s Common Stock were outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant s definitive Proxy Statement for the 2012 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission not later than 120 days after the end of the Registrant s fiscal year ended December 31, 2011, are incorporated by reference in Part III of this Annual Report on Form 10-K to the extent stated herein.

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# POWERSECURE INTERNATIONAL, INC.

**Form 10-K**

**For the Fiscal Year Ended December 31, 2011**

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## CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

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

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

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

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

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

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

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

- the effects on our financial condition, results of operations and prospects of the sales of our non-core businesses and our ability to effectively and profitably redeploy the proceeds of those sales in our core business;

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

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

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

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

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

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

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

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Any forward-looking statements we make are based on our current plans, intentions, objectives, goals, strategies, hopes, beliefs, projections and expectations, as well as assumptions made by and information currently available to management. Forward-looking statements are not guarantees of future performance or events, but are subject to and qualified by substantial risks, uncertainties and other factors, which are difficult to predict and are often beyond our control. Forward-looking statements will be affected by assumptions and expectations we might make that do not materialize or that prove to be incorrect and by known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from those expressed, anticipated or implied by such forward-looking statements. These risks, uncertainties and other factors include, but are not limited to, those described in Item 1A. Risk Factors, as well as other risks, uncertainties and factors discussed elsewhere in this report, in documents that we include as exhibits to or incorporate by reference in this report, and in other reports and documents we from time to time file with or furnish to the Securities and Exchange Commission (the SEC ). In light of these risks and uncertainties, you are cautioned not to place undue reliance on any forward-looking statements that we make.

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

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**PART I**

**Item 1. Business**

**Company Overview**

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

We conduct our core operations through our Utility and Energy Technologies segment, which is the only segment that we have strategically focused on investing in and growing for the last several years. Our Energy Services segment contained our non-core business operations, which we have been opportunistically divesting in recent years, with the final divestitures completed in 2011.

Our Utility and Energy Technologies segment, which was formerly named our Energy and Smart Grid Solutions segment, consists of our three primary product and service areas: our Interactive Distributed Generation products and services, our Utility Infrastructure products and services, and our Energy Efficiency products. These three groups of products and services are commonly focused on serving the needs of utilities and their commercial, institutional and industrial customers to help them generate, deliver and utilize electricity more efficiently.

Our strategy is focused on growing these three product and service areas because they require unique knowledge and skills that utilize our core competencies, and because they address large market opportunities due to their strong customer value propositions. These three product and service areas share a number of common or complementary utility relationships and customer types, common sales and overhead resources, and common facilities. However, we discuss and distinguish our Utility and Energy Technologies business among the three product and service areas due to the unique market needs they are addressing, and the distinct technical disciplines and specific capabilities required for us to deliver them, including personnel, technology, engineering and intellectual capital.

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

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

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The following chart summarizes our business segments, our products and service categories, and our solutions and major brands:

| Business Segment | Product and Service Category | Solutions and Major Brands |
|---|---|---|
| Utility and Energy Technologies | Interactive Distributed Generation | Interactive Distributed Generatio power systems, smart grid monitoring for electric utilities, peak shaving and demand response, standby power dispatch and control |
| (Our Core Business Segment) | | |
| | | NexGear\ brand switchgear products and systems |
| | Utility Infrastructure | UtilityServices utility infrastructure products and services, including transmission and distribution system construction and maintenance |
| | | UtilityEngineering and PowerServices engineering, regulatory consulting, and electric grid system design |
| | Energy Efficiency | EfficientLights LED lighting for grocery, drug, and convenience stores |
| | | IES LED lighting and lighting components for OEM s, electronics manufacturers, and commercial, industrial, and consumer lighting applications |
| | | EnergyLite LED lighting for utilities and commercial and industrial customers, including street lights and area lights, and overhead lighting |
| Energy Services | Natural Gas Measurement | Southern Flow oil and natural gas measurement products and services (This business was sold effective January 1, 2011) |
| (Non-core Operations have been Divested and Ceased in 2011) | | |
| | Water Processing and Disposal | WaterSecure water processing and disposal services for oil and natural gas producers (This business was sold effective June, 2011) |

In this report, references to PowerSecure, our company, we, us, and our mean PowerSecure International, Inc. together with its subsidiaries, references to PowerSecure, Inc. mean our wholly-owned subsidiary PowerSecure, Inc. along with its subsidiaries, unless we state otherwise or the context indicates otherwise.

PowerSecure, Interactive Distributed Generation, IDG, NexGear, UtilityServices, UtilityEngineering, PowerServices, EfficientLights, IES, EnergyLite, SecureLite, PowerLite, SuperTube and our other registered or common law trademarks, service marks and trade names appearing in this report are our property. Any trademarks, service marks or trade names appearing in this report owned by other companies are the property of their respective owners.

**Recent Developments**

***Significant Business Developments in 2011***

In 2011, we fulfilled our strategy to monetize our non-core Energy Services segment businesses, Southern Flow and WaterSecure, to focus on the businesses in our core Utility and Energy Technologies business segment. Effective January 1, 2011, we sold our Southern Flow business, pursuant to a purchase and sale agreement dated December 30, 2010. Under the terms of the purchase agreement, Zedi, Inc., a Canadian corporation, through its wholly-owned U.S. subsidiary, purchased 100% of the stock of Southern Flow for $16.5 million. In addition, we retained cash of approximately $0.7 million from excess working capital of Southern Flow. Under the purchase agreement, we agreed to certain customary indemnification obligations for a period of 18 months after the closing of the sale. The financial results of Southern Flow are reported as discontinued operations in our consolidated financial statements presented in this report. In addition, the $5.6 million gain on the sale of Southern Flow is presented in our consolidated financial statements for fiscal 2011 as discontinued operations.

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Through WaterSecure, we own a significant non-controlling minority equity interest in MM 1995-2, which we account for under the equity method. In June 2011, MM 1995-2 sold substantially all of its assets and business for cash. As a result of that sale, we received $26.2 million as our share of the sales and liquidation proceeds. In addition, we may receive up to $1.4 million from the balance of the sales price, which was placed into escrow for one year in connection with the indemnification obligations of MM 1995-2 in connection with various representations and warranties it made to the purchaser. We recorded a pre-tax gain in the amount of $21.9 million in 2011 for our share of the equity in the gain on the sale.

On May 31, 2011, we adopted a plan to exit the business and sell the assets of PowerPackages, LLC, which was our subsidiary that operated a medium speed engine business in our Utility and Energy Technologies segment. We adopted this plan of disposition after evaluating the prospects for the PowerPackages business, current market conditions and our opportunities to focus our time and resources in other areas which have a higher potential to deliver near and mid-term revenue and profit growth. As of December 31, 2011, the operating activities of PowerPackages had ceased, and its shutdown activities were substantially complete. We have reclassified the operations and remaining assets and liabilities of PowerPackages as discontinued operations in our consolidated financial statements. We recorded a loss from discontinued operations related to the PowerPackages exit plan in the amount of $1.5 million, net of tax benefit, for fiscal 2011.

On November 1, 2011, our Board of Directors authorized a stock repurchase program providing for the repurchase of up to $5 million in shares of our common stock. Repurchases of shares can be made from time to time in open market purchases or in privately negotiated transactions. The timing and amount of any shares repurchased are determined in the discretion of our management based on its evaluation of market conditions and other factors. The stock repurchase program may continue for a period of up to 24 months after authorization, although it may be suspended from time to time or discontinued at any time, or it may be renewed or extended, in the discretion of our Board of Directors. In November 2011, we amended our credit facility to permit us to proceed with the $5 million stock repurchase program.

On December 21, 2011, our credit facility was amended and restated to reduce and simplify the covenant structure, extend the maturity, and reflect that we are carrying a large cash position due to the sale and monetization of non-core Energy Services businesses earlier in 2011. The credit facility is backed by a syndicate which includes Citibank, N.A., as administrative agent and lender, and Branch Banking and Trust Company, referred to as BB&T, as lender. The amended credit facility consists of a $20 million revolving credit facility and a $2.4 million term loan, compared to a $25 million revolving credit line before the amendment. As of March 8, 2012, we had no outstanding balance under the credit facility other than the $2.4 million term loan.

***Recent Significant Announcements Regarding Our Business Operations***

We have recently reported on the several new business awards and product introductions in our core Utility and Energy Technologies segment, including those listed below.

On March 5, 2012, we announced that we were awarded a new contract to build electrical transmission infrastructure to support a series of new oil and gas production sites. Our work under this new contract will be performed on behalf of a major energy company, in partnership with a prominent electric utility. The award is for several million dollars of electrical transmission design and construction, the majority of which is expected to be completed by mid-2012.

On February 6, 2012, we announced that we received orders for new light emitting diode, or LED, lights totaling $15 million from three major retailers. The new orders are for our EfficientLights LED lighting technology and include each of its in-store product lines, including reach-in case lights, walk-in freezer/cooler lights and shelf and canopy lights. We expect to complete all of these sales in 2012.

On January 25, 2012, we announced that our innovative, energy efficient LED-based SecureLite was adopted by a utility as its standard area light. On March 1, 2012, we further announced that our SecureLite was adopted by two more utilities as their standard fixture. These utilities placed orders for several hundred units, which will used as replacements are required for existing lighting, and for residential and commercial illumination projects. We expect additional orders will be placed in 2012 and beyond as these initial orders are depleted.

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On January 23, 2012, we announced that we expanded and enhanced our strategy to serve customers in the large and growing Data Center and Hospital markets with mission critical power systems and hired two industry executives to lead our sales and marketing efforts in each of the Data Center and Hospital categories. Additionally, we introduced a new industry-leading version of our PowerBlock proprietary generator system that runs on a combination of natural gas and diesel fuel, is Tier 4 Interim emissions compliant, and improves redundancy.

On January 5, 2012, we announced that we were awarded a new contract to serve two separate divisions of a major investor-owned utility with Utility Infrastructure services. The award includes transmission and distribution construction and maintenance services and is expected to generate $20 million of revenues over the two-year contract period. We expect to realize approximately one-third of the revenues from this contract in 2012, and the remaining two-thirds of the revenues in 2013, although these estimates could fluctuate depending on specific work assignments.

On December 19, 2011, we announced that we received $15 million of new business awards. The new awards include $10 million of orders for our Interactive Distributed Generation smart grid power systems and $5 million of Utility Infrastructure projects. The $10 million of new Interactive Distributed Generation projects includes awards to provide smart grid power systems to a wide range of customers, including hospital, pharmaceutical, industrial, military and retail facilities. Approximately $4 million of this new business is turn-key, project-based revenue, which we expect to recognize primarily in 2012, and approximately $6 million of this new business is for PowerSecure-owned recurring revenue contracts, which we expect to be recognized over the next five to seven years. The $5 million of new Utility Infrastructure awards include transmission and distribution construction and maintenance for utilities, including a contract to serve a new utility with these services. We expect the majority of the utility infrastructure work to be performed and recognized over 2013 and 2014.

On November 28, 2011, we announced the introduction of our new SuperTube, an energy efficient LED-based light that is designed to replace and upgrade commercial overhead T8 and T12 fluorescent lighting. The SuperTube is specifically designed for indoor T8 and T12 retrofit applications, and is expected to deliver strong returns on investment for customers installing the lights. These SuperTube lights are engineered to deliver up to 75% energy savings compared to traditional fluorescent lighting, improve the quality of light in the workplace and significantly reduce maintenance cost due to their longer light life.

**The Industry, our Strategy and our Business Areas of Focus**

The U.S. electricity industry is large and has grown significantly over the last two decades. The U.S. electricity market totaled $370 billion in end-user revenue in 2010, with over 3,800 million megawatt hours consumed. Throughout this period, utilities have been constrained in their ability to invest to meet this growth by an evolving and uncertain regulatory process, the increased burden of environmental constraints, and long lead times to complete major capital infrastructure investments. As a result, utilities are challenged to meet demand by traditional means, both in the areas of large scale power production and in power transmission and distribution. This has increased the strain on the electric power grid and, combined with higher input costs to produce electricity, has caused the price of electricity to increase over time. High electricity prices and costs to generate and deliver electricity are particularly pronounced during peak power periods, when the demand for electricity is at its highest. The rising demand for energy, growing cost of energy, and increasing concerns about the environment, have combined to cause virtually every organization, public and private, including utilities and their end customers, to be focused on energy efficiency and energy productivity. Approximately 60% of U.S. electricity demand is driven by commercial and industrial electricity usage.

These factors have generated a significant need in the marketplace for products and services in our Utility and Energy Technologies segment, which contains our three primary product and service areas: Interactive Distributed Generation products and services, Utility Infrastructure products and services, and Energy Efficiency products. Our strategy is to serve utilities and their large commercial, institutional and industrial customers by providing products and services in these areas that have strong value propositions. Our business leaders and their teams have strong utility and customer relationships and a deep understanding of the markets we serve, and they are incentivized to grow these businesses profitably and prudently. Our company is highly entrepreneurial, and we encourage our business leaders to embrace a philosophy of service and disciplined innovation as a means to anticipate and fill customer needs. Our entrepreneurial culture is an asset that is fundamental to our growth and success. We are continually listening to our utility relationships, and to our existing and potential commercial, industrial and institutional customers, to identify energy-related products and services we can deliver to add value to their businesses. We seek to fill these customer needs in several ways, including by:

- offering our existing portfolio of products and services that have demonstrated their value in similar or complementary situations, usually customizing them for each particular application;

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offering new energy-related technologies and capabilities that are emerging or being developed by third parties, which we can either incorporate into our existing product lines or bring to market as new product offerings; and

developing new technologies and capabilities internally to serve existing and potential customers when options do not exist in the marketplace, that meet our quality, effectiveness, cost and financial return standards.

Over the near and mid-term, our strategic focus is to continue to grow our businesses and to expand and enhance our product and service offerings in our Utility and Energy Technologies segment, including our Interactive Distributed Generation, Utility Infrastructure and Energy Efficiency products and services. Over the longer term, we expect to identify additional areas of business expansion that are complementary to these areas. We have ceased the operations of, and do not intend to engage in any future activities in, our Energy Services segment.

**Our Interactive Distributed Generation Business**

***Overview***

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

Our Interactive Distributed Generation systems contain our proprietary electronic controls and software, which enable our systems to be monitored around the clock by our smart grid monitoring center, protecting our customers operations from power outages and their costs. Through our monitoring center, we also forecast utilities peak demand periods, and we electronically deploy our systems during these periods to power customers operations instead of drawing electricity from the utility grid. Our smart grid monitoring center ensures that our interactive distributed generation systems deliver power at optimal times and durations for maximum efficiency. This efficient peak demand power capacity benefits both the utility and the customer whose facility is being supported by the system. Our systems also enable utilities to delay new infrastructure investments for transmitting and distributing power, and minimize energy losses associated with moving electricity over long distances.

***Market***

The market for our Interactive Distributed Generation systems is driven by the multiple sources of value they provide. Both utilities and their large customers receive financial and operational benefits from our systems.

For utilities, our systems help them to:

manage constraints in their electric grid systems, particularly during times of peak demand;

minimize energy losses associated with moving electricity over long distances;

manage challenges with respect to bottlenecks that can occur in electric transmission and distribution systems;

perform localized system maintenance without interrupting large users of electricity in that particular area;

operate with demand levels that are less volatile, enhancing the efficiency of their overall system and invested capital; and

reduce carbon emissions compared to traditional sources of spinning power reserves.

For commercial, institutional and industrial customers, our systems help them by:

providing a dependable source of backup power to protect their operations from financial losses and other negative consequences of power outages, including utilizing our systems both for preventative measures, such as when a storm is approaching, and for emergency purposes, when utility power is interrupted; and

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providing electricity cost savings by utilizing the systems to provide power during periods of high cost peak electricity demand, instead of drawing power from the utility grid, which is referred to as peak shaving.

Because utilities realize operational and financial benefits when customers reduce the amount of power they draw from the electric grid during peak power periods, they generally provide incentives in their pricing, or tariff, structures to encourage this activity. These incentives are called demand response benefits and programs. Our systems are engineered to carry the full load required to operate the businesses they support, and our NexGear parallel switchgear technology enables power to be transferred between the grid, our distributed generation system, and the facility it supports, during peak shaving activities without any interruption. Therefore, customers who use our distributed generation systems can realize the financial benefits of utility demand response programs without the consequences, costs and inconveniences of having to interrupt or reduce the load of their operations.

***Our Systems and Technology***

We provide turn-key Interactive Distributed Generation systems and programs for our customers. The typical distributed generation system is installed and maintained at a utility s end customer s location and is designed to supply power only to that one particular site. The size of the distributed generation systems that we have designed and installed has ranged from 90 kilowatts, or kW, to 30,000 kW, most commonly ranging from 500 kW to 6,000 kW, and we have the ability to design and install even larger systems. Our proprietary distributed generation system, which is named the PowerBlock, has become our primary distributed generation system product, and it is largely standardized around 625 kW capacity building blocks. These standard building block units are combined, using our switchgear and control technology, to create systems for facilities with higher electric loads. We manufacture our PowerBlocks in our recently upgraded facility in Randleman, North Carolina. From time to time and in certain applications, we also utilize generators sourced from major global generator manufacturers as the power plants for our systems.

The primary elements of our turn-key Interactive Distributed Generation systems include:

designing and engineering the distributed generation system;

obtaining the required regulatory approvals and permits;

establishing the electricity inter-connect between the utility and the customer to take advantage of electricity rate savings;

manufacturing and packaging the generators for our proprietary PowerBlock systems using engines sourced from a major global engine manufacturer, and in other cases integrating a turn-key generator sourced from one of several major global generator manufacturers, depending on the application;

engineering and integrating the system components and controls;

designing, engineering, constructing and installing the switchgear and process controls; and

providing continuous 24 x 7 monitoring and servicing of the system.

One key component of a distributed generation system is its source of power generation, the generator, which is typically comprised of an alternator driven by a power source. While several types of distributed generation technologies are available, we currently utilize an internal combustion engine to power our distributed generation systems to provide maximum dependability as well as quick and efficient startup and shutdown. Typically these engines are fueled by diesel or a combination of natural gas and diesel, and they can also utilize methane or biodiesel as fuel. The types of generators, engines and alternators utilized in our systems are widely used and provide a dependable, cost-effective distributed generation technology, meaning that they are able to generate the power that is required with very short start-up times, with good efficiency at a reasonable cost. However, new power producing technologies are emerging, and we are continually evaluating the utilization of

new technologies and their ability to be a commercially viable and reliable power source. For example, we recently introduced a new version of our PowerBlock generator system that runs on a combination of natural gas and diesel fuel and is Tier 4 Interim emissions compliant.

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***Smart Grid Monitoring Center and NexGear Technology***

We build smart grid technology into our distributed generation systems. This technology is embedded into the design and manufacture of our proprietary switchgear and hardware and software controls systems, which are marketed under the name NexGear. Our NexGear technology controls the generator and the transfer of power, quickly shifting power between a customer s primary power source and our Interactive Distributed Generation system. We consider our switchgear designs to be a source of competitive advantage for us due to their quality and their ability to provide power from the generator in parallel with, meaning at the same time as, the customer s primary power source without disrupting the flow of electricity. This capability allows the customer to quickly substitute the power generated at the customer s site with the power supplied by the utility power plant during times of peak demand without business interruption. Our system controls are built to enable remote monitoring and control functions, allowing us to operate the Interactive Distributed Generation system 24 x 7 from our monitoring center.

We believe our combination of unique smart grid capabilities is unmatched in the industry. Through our monitoring center, we lead the industry in our ability to monitor the electric power grid, proactively predict peak power periods, and electronically dispatch our customers generation at the right time, and for the right duration, with the goal of optimizing our customers energy efficiency. Peak power periods vary by geography, time of day, utility infrastructure, utility customer mix and weather. Using our predictive capabilities, we coordinate the operation of our customers Interactive Distributed Generation systems during times of peak demand so that our customers can benefit from energy savings and beneficial electricity rates that are available from managing energy use during these periods of high electricity prices. Our ability to enable our customers to benefit from these savings is enhanced by our expertise in understanding complicated utility rate structures.

Our monitoring center is an integral part of our distributed generation solution. We monitor and maintain our distributed generation systems for our customers around the clock, with the goal of ensuring reliability and removing many of the burdens associated with ownership. Distributed generation systems must be operated periodically so that they function properly when called upon to supply power. We remotely start and operate the systems using sophisticated communication devices, and we continuously monitor their performance. In the event of a mechanical problem, technicians are immediately dispatched. Additionally, for customers who already have generators on-site, we offer management services, including fuel management services, preventive and emergency maintenance services, and monitoring and dispatching services, to upgrade the performance of their stand-alone generators.

***Business Models***

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

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

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

In 2011, 81.2% of our distributed generation revenues consisted of customer-owned sales, and 18.8% of our distributed generation revenues were derived from recurring revenue sales. Sales of customer-owned systems deliver revenues and profits that are recorded on our financial statements over the course of the project, which is generally over a three to eighteen month timeframe depending on the size of the project, and sales of PowerSecure-owned projects are recorded over a longer time frame of five to fifteen years depending on the life of the underlying contract. Therefore, changes in the sales of customer-owned systems have significant impacts on our near-term revenues and profits and cause them to fluctuate from period-to-period. By contrast, sales under the PowerSecure-owned system model generate revenues and profits that are more consistent from period-to-period and have higher gross margins, and generate revenues and profits over a longer time period, although smaller in dollar amount in any particular period because they are recognized over the life of the contract. Our PowerSecure-owned recurring revenue model also requires us to invest our own capital in the project without any return on capital until after the project is completed, commissioned and successfully operating.

**Our Utility Infrastructure Business**

***Overview***

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

***Market***

There are over 3,000 electric utilities in the U.S. In 2010, these utilities invested over $20 billion to maintain, upgrade and enhance the efficiency of their transmission and distribution infrastructure. Several industry trends suggest there will be additional growth in transmission and distribution investment over the coming years, including the need to upgrade and replace the utility grid s aging infrastructure to improve and ensure reliability, to respond to the expected long-term increase in demand for electric power, and to incorporate renewable energy and other new power sources into the grid. In addition, the megatrend toward improving the efficiency of our energy delivery and consumption is driving initiatives and innovations in smart grid technology which will also be a positive driver for overall transmission and distribution system infrastructure spending. The difficult economic cycle of the last several years caused utilities to reduce their spending in these areas, and it is likely that as electricity demand increases with an increase in economic activity, transmission and distribution system infrastructure spending will increase to accommodate increases in demand.

Utilities generally use a combination of internal and third-party outsource vendors to provide construction and maintenance services for their transmission and distribution infrastructure. Utilities also utilize third party engineering and consulting firms to supplement their internal engineering resources. We provide services in each of these areas for investor-owned utilities, referred to as IOUs, electric cooperatives, and municipal utilities of virtually every size. Historically, our geography was primarily concentrated in the Southeastern U.S. However, we have grown the geographic base of the utilities we serve over the last several years to include utilities in the Mid-Atlantic, Midwest, Gulf Coast and Western regions. We intend to continue to expand our utility relationships and the geography we serve as our business grows and develops.

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***Products and Services***

Our largest business within our Utility Infrastructure area is our UtilityServices business, which significantly expanded its scope of utility relationships, customers and geographic service areas in 2011. UtilityServices provides utilities with transmission and distribution construction and maintenance, including substation construction and maintenance, advanced metering and lighting installations, and storm restoration. In addition to providing these services directly to utilities, we also provide services on behalf of utilities for their large industrial and institutional customers. Similar to the products and services we provide for utilities, our work for large utility customers includes turn-key design, procurement and construction services for large transmission and distribution projects, including substations. Our resources include a fleet of owned and leased utility vehicles along with experienced field personnel and engineers, and we also utilize third party resources from time to time, as needed, to supplement our internal resources on particular projects.

Our Utility Infrastructure services involve the use of equipment and exposure to conditions that can be dangerous. We strive to ensure we are operating safely and prudently. However, from time to time we are subject to claims by employees, customers and third parties for property damage and personal injuries. Our Utility Infrastructure business strives to ensure that our operations are conducted in a safe and prudent manner.

Through our UtilityEngineering and PowerServices businesses, we serve the engineering and consulting needs of our utility clients, broadening our offerings to our utility partners. The scope of services that we offer through UtilityEngineering includes technical engineering services for our utility partners and their customers, including design and engineering services relating to virtually every element of their transmission and distribution systems, substations and utility lighting. Through PowerServices, we provide management consulting services to utilities and commercial and industrial customers, including planning and quality improvement, technical studies involving reliability analysis and rate analysis, acquisition studies, accident investigations, and power supply contracts and negotiations. Our team of engineers operates out of its principal offices in Raleigh, North Carolina.

***Business Model***

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

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

**Our Energy Efficiency Business**

***Overview***

Our Energy Efficiency business is focused on providing energy solutions to utilities, municipalities, and commercial, institutional, and industrial customers with strong value propositions that are designed to reduce their energy costs, improve their operations, and benefit the environment. Our Energy Efficiency area includes our EfficientLights, IES and EnergyLite businesses and brands, all of which are focused on bringing LED lighting solutions to the marketplace.

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Our EfficientLights business is focused on developing LED-based lighting products for grocery, drug and convenience stores. These LED lighting products include our largest volume product, our EfficientLights fixture for reach-in refrigerated cases, as well as lighting for walk-in storage coolers and open refrigerated shelves. Additionally, our EfficientLights business is in the process of developing and marketing LED-based parking lot lights for retail stores.

Our IES business designs and manufactures new LED-based lighting products for commercial, industrial and consumer applications. The business of IES includes turn-key product development, engineering and manufacturing of solid state LED-based lights, including street lights, area lights, landscape lights, and other specialty lighting applications. In addition, IES s product portfolio includes component parts, such as power drivers, light engines and thermal management solutions. IES provides its products directly to original equipment manufacturers, or OEMs, and to electronics manufacturers and retailers, either as component solutions or as turn-key products.

Additionally, through our EnergyLite business and brand we market our SecureLite and PowerLite family of area lights and street lights, as well as our SuperTube LED light replacement for fluorescent tubes. These products are marketed to utilities and municipalities directly, and through third party distribution arrangements.

***Market***

The market for LED-based lighting is large and expected to grow rapidly over the next decade. This market growth is driven by the many benefits LED lights provide over traditional lighting, including superior energy efficiency, improved quality of the light emitted, superior heat characteristics, smaller size, relatively low cost over time, and longer life. Because of these factors, LED lighting is also better for the environment than traditional lighting. LED lighting can be utilized in a large range of broad general commercial and industrial lighting applications, as well as used effectively in very specialized applications. In our markets, many of our customers have concluded that LED lighting is the superior choice over traditional lighting, both for new facility installations and for investments to retrofit existing facilities, due to the financial and environmental benefits and its superior lighting quality. Utilities can also benefit from this technology due to the availability of renewable energy portfolio credits for the energy efficiencies our lights deliver, as well as the direct financial and environmental benefits available from investments in LED street lights.

The general LED lighting industry and market is served by companies in the areas of LED chip technology and manufacturing, and in LED lighting application development and manufacturing, the latter area being the one in which we participate and serve. The market for LED-based lighting applications, and the pace at which LED lighting is being and will be adopted, is driven by the return on investment available when an LED-based light is utilized instead of or as a replacement for traditional lighting. In particular, the size and growth of the LED-based lighting market is driven by the return on investment available to retrofit existing traditional lighting installations with LED-based lighting, given the significant size of the installed base of traditional lighting. To a large extent, this return on investment is influenced and driven by the cost of the LED itself, because the LED is the largest single component of cost in the LED lighting application. Over the past two years, the cost of LEDs has decreased significantly, which has been a catalyst driving the growth and expansion in the market for general LED lighting applications. Additionally, LED lighting application and manufacturing companies, such as us, have improved the efficiency and effectiveness of application designs. The combination of these factors has increased the return on investment for LED lighting applications in general, and for LED retrofit opportunities in particular. We believe these factors will continue to cause the market for LED-based general lighting to continue to grow and expand over the next five to ten years.

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