POWERSECURE INTERNATIONAL, INC.
Form 10-Q
November 07, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2012

or

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

For the transition period from to

Commission File Number 1-12014

POWERSECURE INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware	**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 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 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 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 Act). Yes ¨ No x

As of November 1, 2012, 18,308,652 shares of the issuer s Common Stock were outstanding.

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POWERSECURE INTERNATIONAL, INC.

FORM 10-Q

For the Quarterly Period Ended September 30, 2012

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PART I.

FINANCIAL INFORMATION

Item 1. Financial Statements

POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (unaudited)

(in thousands, except share data)

	September 30, 2012	December 31, 2011
Assets		
Current Assets:		
Cash and cash equivalents	$ 22,550	$ 24,606
Trade receivables, net of allowance for doubtful accounts of $136 and $174, respectively	46,583	46,163
Assets of discontinued operations held for sale		380
Inventories	21,294	20,290
Income taxes receivable	17	439
Current deferred income taxes	650	650
Prepaid expenses and other current assets	846	1,128
Total current assets	91,940	93,656
Property, plant and equipment:		
Equipment	42,588	38,441
Furniture and fixtures	348	283
Land, building and improvements	5,901	5,885
Total property, plant and equipment, at cost	48,837	44,609
Less accumulated depreciation and amortization	11,084	8,281
Property, plant and equipment, net	37,753	36,328
Other assets:		
Goodwill	12,884	7,970
Deferred income taxes, net of current portion	266	266
Restricted annuity contract	2,429	2,376
Intangible rights and capitalized software costs, net of accumulated amortization of $3,580 and $3,070, respectively	1,434	1,642
Investment in unconsolidated affiliate		6
Other assets	652	331
Total other assets	17,665	12,591
Total Assets	$ 147,358	$ 142,575

See accompanying notes to consolidated financial statements.

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POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (unaudited)

(in thousands, except share data)

	September 30, 2012	December 31, 2011
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 9,695	$ 6,894
Accrued and other liabilities	16,044	16,129
Accrued restructuring and cost reduction liabilities	1,318	
Liabilities of discontinued operations held for sale		125
Current unrecognized tax benefit	242	287
Current portion of term loan	160	
Current portion of capital lease obligations	874	840
Total current liabilities	28,333	24,275
Long-term liabilities:		
Revolving line of credit		
Term loan, net of current portion	2,120	
Capital lease obligations, net of current portion	2,147	2,807
Unrecognized tax benefit	640	731
Other long-term liabilities	2,464	2,300
Total long-term liabilities	7,371	5,838
Commitments and contingencies (Notes 5, 9 and 11)		
Stockholders Equity:		
PowerSecure International stockholders equity:		
Preferred stock undesignated, $.01 par value; 2,000,000 shares authorized; none issued and outstanding		
Preferred stock Series C, $.01 par value; 500,000 shares authorized; none issued and outstanding		
Common stock, $.01 par value; 50,000,000 and 25,000,000 shares authorized, respectively; 18,475,883 and 18,908,412 shares issued and outstanding, respectively	185	189
Additional paid-in-capital	114,801	116,803
Accumulated deficit	(3,917)	(5,439)
Total PowerSecure International, Inc. stockholders equity	111,069	111,553
Non-controlling interest	585	909
Total stockholders equity	111,654	112,462
Total Liabilities and Stockholders Equity	$ 147,358	$ 142,575

See accompanying notes to consolidated financial statements.

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POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenues	$ 44,236	$ 36,585	$ 115,288	$ 90,326
Cost of sales	30,360	25,372	79,653	62,078
Gross profit	13,876	11,213	35,635	28,248
Operating expenses:				
General and administrative	9,012	8,714	26,750	24,347
Selling, marketing and service	1,615	1,197	4,039	3,565
Depreciation and amortization	1,211	857	3,432	2,432
Restructuring and cost reduction charges	1,548		1,548	
Total operating expenses	13,386	10,768	35,769	30,344
Operating income (loss)	490	445	(134)	(2,096)
Other income and (expenses):				
Gain on sale of unconsolidated affiliate		44	1,439	21,830
Equity income from unconsolidated affiliate				1,559
Management fees				282
Interest income and other income	22	31	67	73
Interest expense	(114)	(168)	(338)	(454)
Income before income taxes	398	352	1,034	21,194
Income tax benefit (provision)	(119)	453	(347)	(2,777)
Income from continuing operations	279	805	687	18,417
Discontinued operations (Note 5):				
Income (loss) from operations, net of tax	11	(63)	78	(1,666)
Gain on disposal, net of tax				5,636
Income (loss) from discontinued operations, net of tax	11	(63)	78	3,970
Net income	290	742	765	22,387
Net loss attributable to non-controlling interest	192	230	757	573
Net income attributable to PowerSecure International, Inc.	$ 482	$ 972	$ 1,522	$ 22,960
Amounts attributable to PowerSecure International, Inc. common stockholders:				
Income from continuing operations, net of tax	$ 471	$ 1,035	$ 1,444	$ 18,990
Income (loss) from discontinued operations, net of tax	11	(63)	78	3,970
Net income	$ 482	$ 972	$ 1,522	$ 22,960

Basic earnings per share attributable to PowerSecure International, Inc. common stockholders:				
Income from continuing operations	$ 0.03	$ 0.05	$ 0.08	$ 1.01
Income (loss) from discontinued operations				0.21
Net income attributable to PowerSecure International, Inc. common stockholders	$ 0.03	$ 0.05	$ 0.08	$ 1.22
Diluted earnings per share attributable to PowerSecure International, Inc. common stockholders:				
Income from continuing operations	$ 0.03	$ 0.05	$ 0.08	$ 0.99
Income (loss) from discontinued operations				0.21
Net income attributable to PowerSecure International, Inc. common stockholders	$ 0.03	$ 0.05	$ 0.08	$ 1.20

See accompanying notes to consolidated financial statements.

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POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

(in thousands)

	Nine Months Ended September 30,	
	2012	2011
Cash flows from operating activities:		
Net income	$ 765	$ 22,387
Adjustments to reconcile net income to net cash used in operating activities:		
Gain on sale of unconsolidated affiliate	(1,439)	(21,830)
Income from discontinued operations	(78)	(3,970)
Depreciation and amortization	3,432	2,432
Stock compensation expense	755	1,376
Loss on disposal of miscellaneous assets	68	36
Equity in income of unconsolidated affiliate		(1,559)
Distributions from unconsolidated affiliate		1,537
Changes in operating assets and liabilities, net of effect of acquisition:		
Trade receivables, net	900	(18,032)
Inventories	(903)	570
Deferred income taxes		1,154
Other current assets and liabilities	659	(248)
Other noncurrent assets and liabilities	(302)	1,163
Accounts payable	2,125	111
Accrued and other liabilities	(1,884)	5,537
Accrued restructuring and cost reduction liabilities	1,318	
Net cash provided by (used in) continuing operations	5,416	(9,336)
Net cash provided by (used in) discontinued operations	334	(1,215)
Net cash provided by (used in) operating activities	5,750	(10,551)
Cash flows from investing activities:		
Acquisition	(3,523)	
Purchases of property, plant and equipment	(4,367)	(13,740)
Additions to intangible rights and software development	(267)	(365)
Proceeds from sale of property, plant and equipment	15	12
Proceeds from sale of unconsolidated affiliate	1,445	25,974
Proceeds from sale of discontinued operations		16,515
Discontinued operations investing activities		(3)
Net cash provided by (used in) investing activities	(6,697)	28,393
Cash flows from financing activities:		
Borrowings (payments) on revolving line of credit		5,000
Proceeds from term loan borrowings	2,400	
Proceeds from sale leaseback transactions		2,097
Payments on term loan	(120)	
Payments on capital lease obligations	(626)	(593)
Repurchases of common stock	(2,786)	(166)
Proceeds from stock option exercises	23	310

Net cash provided by (used in) financing activities	(1,109)	6,648
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(2,056)	24,490
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	24,606	8,202
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 22,550	$ 32,692

See accompanying notes to consolidated financial statements.

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POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

As of September 30, 2012 and December 31, 2011 and

For the Three and Nine Month Periods Ended September 30, 2012 and 2011

(all amounts in thousands unless otherwise designated, except per share data)

1. Description of Business and Basis of Presentation

Description of Business

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

Our Utility and Energy Technologies segment includes our core business operations. It is the only segment that we have been strategically focused on investing in and growing for the last several years. Conversely, our Energy Services segment contains our non-core business operations. We divested the operations of our Energy Services segment over the last several years, with the final divestitures completed in 2011.

Our Utility and Energy Technologies segment includes our three primary product and service offerings: 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 common or complementary utility relationships and customer types, common sales and overhead resources, and 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, North Carolina, 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 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 divestitures of the last of our 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 held 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 and the proceeds from the sale and the liquidation of its remaining assets were distributed to MM 1995-2 s shareholders, including our WaterSecure subsidiary, in 2011 and 2012. Accordingly, our WaterSecure subsidiary no longer has any on-going operating activity. Our Southern Flow business, which was sold in January 2011, provided oil and natural gas measurement services to customers involved in oil and natural gas production, transportation, and processing, with a focus on the natural gas market. Due to its sale, Southern Flow s operations are reflected as discontinued operations in the accompanying consolidated financial statements. The sales of our WaterSecure and Southern Flow operations completed our strategy to monetize our non-core assets 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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See Note 14 for more information concerning our reportable segments.

Basis of Presentation

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

These consolidated financial statements have been prepared pursuant to rules and regulations of the Securities and Exchange Commission. The accompanying consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2011.

In management s opinion, all adjustments (all of which are normal and recurring) have been made which are necessary for a fair presentation of the consolidated financial position of us and our subsidiaries as of September 30, 2012 and the consolidated results of our operations and cash flows for the three and nine months ended September 30, 2012 and September 30, 2011.

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

Non-controlling Interest On June 5, 2012, we acquired a 90% controlling ownership interest in PowerSecure Solar, a distributed solar energy company (see Note 4). On April 1, 2010, we acquired a 67% controlling ownership interest in IES, an LED lighting company. Both PowerSecure Solar and IES are included in our consolidated financial statements. The non-controlling ownership interests in the income or losses of PowerSecure Solar and IES are included in our consolidated statements of operations as a reduction or addition to net income to derive income attributable to PowerSecure International stockholders. Similarly, the non-controlling ownership interest in the undistributed equity of PowerSecure Solar and IES are shown as a separate component of stockholders equity in our consolidated balance sheets.

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The following is a reconciliation of the amounts attributable to the non-controlling interest in IES and PowerSecure Solar for the nine months ended September 30, 2012 and 2011:

	Nine Months Ended September 30, 2012		
	IES	PowerSecure Solar	Total
Balance, December 31, 2011	$ 909	$	$ 909
Capital contribution		433	433
Income (loss)	(803)	46	(757)
Balance, September 30, 2012	$ 106	$ 479	$ 585

	Nine Months Ended September 30, 2011		
	IES	PowerSecure Solar	Total
Balance, December 31, 2010	$ 1,755	$	$ 1,755
Capital contribution			
Income (loss)	(573)		(573)
Balance, September 30, 2011	$ 1,182	$	$ 1,182

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

Reclassifications The assets, liabilities and operations of our discontinued PowerPackages business have been reclassified to discontinued operations for all periods presented in the accompanying consolidated financial statements. In addition, certain 2011 amounts have been reclassified to conform to current year presentation. Such reclassifications had no effect on net income or stockholders equity.

2. Summary of Significant Accounting Policies and Recent Accounting Standards

Revenue Recognition For our distributed generation turn-key project-based sales and our utility infrastructure turn-key projects, we recognize revenue and profit as work progresses using the percentage-of-completion method, which relies on various estimates. Nearly all of our distributed generation and utility infrastructure turn-key projects are fixed-price contracts.

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

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

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

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

We recognize equipment and product revenue when persuasive evidence of a commercial arrangement exists, delivery has occurred and/or services have been rendered, the price is fixed or determinable, and collectability is reasonably assured. Equipment and product sales are generally made directly to end users of the product, who are responsible for payment for the product, although in some instances we can be a subcontractor, which occurs most frequently on larger jobs that involve more scope than our products and services.

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

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

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

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

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

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

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

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

Warranty Reserve We provide a standard warranty for our distributed generation equipment, switchgear equipment, utility infrastructure equipment, and our LED products, which generally range between one and five years. In addition, we offer extended warranty terms on certain distributed generation turn-key and switchgear projects. We reserve for the estimated cost of product warranties when revenue is recognized, and we evaluate our reserve periodically by comparing our warranty repair experience by product. The purchase price for extended warranties or extended warranties included in the contract terms are deferred as a component of our warranty reserve. The balance of our warranty reserve included in accrued and other liabilities at September 30, 2012 and December 31, 2011 was $1.5 million and $1.1 million, respectively.

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

Pre-tax share-based compensation expense for our stock options and restricted stock awards recognized during the three months ended September 30, 2012 and 2011 was $179 thousand and $450 thousand, respectively. Pre-tax share-based compensation expense for our stock options and restricted stock awards recognized during the nine months ended September 30, 2012 and 2011 was $755 thousand and $1,376 thousand, respectively. All share-based compensation expense is included in general and administrative expense in the accompanying consolidated statements of operations.

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

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

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

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Recent Accounting Pronouncements

Fair Value Measurements In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-04, which amended Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This amendment is intended to result in convergence between U.S. GAAP and International Financial Reporting Standards (IFRS) requirements for measurement of and disclosures about fair value. This amended guidance clarifies the concepts applicable for fair value measurement of non-financial assets and also expands the disclosures for fair value measurements that are estimated using significant unobservable inputs used in a fair value measurement. This amended guidance became effective for us on a prospective basis commencing January 1, 2012. The adoption of this standard had no effect on our financial position or results of operations.

Testing Goodwill for Impairment In September 2011, the FASB issued ASU No. 2011-08, Intangibles-Goodwill and Other (Topic 350) Testing Goodwill for Impairment. This standard, which amends and updates guidance on the periodic testing of goodwill for impairment, provides companies with the option to first assess qualitative factors to determine whether it is more likely than not that that the fair value of a reporting unit is less than its carrying amount. If so, then it is necessary to perform the two-step quantitative goodwill impairment test. This standard becomes effective for fiscal years beginning after December 15, 2011, with early adoption allowed. We adopted this standard effective October 1, 2011. The adoption of this standard had no effect on our financial position or results of operations.

Testing Indefinite-Lived Intangible Assets for Impairment In July 2012, the FASB issued ASU No. 2012-02, Intangibles Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment. This standard, which amends the guidance on testing indefinite-lived intangible assets, other than goodwill, for impairment, provides companies with the option to first perform a qualitative assessment before performing the two-step quantitative impairment test. If the company determines, on the basis of qualitative factors, that the fair value of the indefinite-lived intangible asset is more likely than not to exceed its carrying amount, then the company would not need to perform the two-step quantitative impairment test. This standard does not revise the requirement to test indefinite-lived intangible assets annually for impairment. This standard becomes effective for annual and interim impairment tests performance for fiscal years beginning after September 15, 2012, with early adoption allowed. We do not expect the adoption of this standard will have a material effect on our financial position or results of operations.

3. Earnings (Loss) per Share

Basic earnings (loss) per share is computed by dividing net income (loss) attributable to PowerSecure International, Inc. common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share attributable to PowerSecure International, Inc. common stockholders is computed using the weighted average number of common shares outstanding and, when dilutive, potential common shares from stock options using the treasury stock method. Diluted earnings per share excludes the impact of potential common shares related to stock options in periods in which we reported a loss from continuing operations or in which the option exercise price is greater than the average market price of our common stock during the period because the effect would be antidilutive.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Income from continuing operations	$ 471	$ 1,035	$ 1,444	$ 18,990
Income (loss) from discontinued operations	11	(63)	78	3,970
Net income	$ 482	$ 972	$ 1,522	$ 22,960
Basic weighted-average common shares outstanding in period	18,676	18,966	18,807	18,848
Dilutive effect of stock options	117	197	118	274
Diluted weighted-average common shares outstanding in period	18,793	19,163	18,925	19,122
Basic earnings per common share:				
Income from continuing operations	$ 0.03	$ 0.05	$ 0.08	$ 1.01
Income (loss) from discontinued operations	0.00	(0.00)	0.00	0.21
Basic earnings per common share	$ 0.03	$ 0.05	$ 0.08	$ 1.22
Diluted earnings per common share:				
Income from continuing operations	$ 0.03	$ 0.05	$ 0.08	$ 0.99
Income (loss) from discontinued operations	0.00	(0.00)	0.00	0.21
Diluted earnings per common share	$ 0.03	$ 0.05	$ 0.08	$ 1.20

4. Acquisition

On June 5, 2012, we acquired a distributed solar energy business, adding this capability to our distributed generation system platform. Our new capabilities were acquired through the acquisition of the utility, commercial and industrial solar energy business of Southern Energy Management, Inc., a North Carolina corporation (the Seller). Our decision to offer solar solutions resulted from a thorough evaluation of the industry and of the improved economics of distributed solar energy systems. We believe the decrease in the cost of solar panels (which we do not produce), and corresponding increases in their energy efficiency, in conjunction with our highly efficient distributed generation systems, provides us with a sustainable market opportunity to participate in the downstream segment of the solar business, and bring solar energy projects to our customers and utility partners. We began offering utilities and their large commercial and industrial customers solar energy distributed generation systems immediately after the acquisition, and took over the installation of several significant projects the Seller had in process, including a 4.5 megawatt system.

We consummated the acquisition through the formation of PowerSecure Solar, which entered into, and completed the acquisition contemplated by, an Asset Contribution and Sale Agreement, dated as of June 5, 2012 (the Contribution Agreement), with the Seller. Pursuant to the Contribution Agreement, PowerSecure Solar completed the acquisition of substantially all of the assets and assumed certain liabilities of the Seller relating to the business of designing and selling energy efficiency and solar photovoltaic power systems and other solar power technologies for large customers, including utility, commercial and industrial customers (the Acquired Business).

The effective date of the acquisition of the Acquired Business was June 2, 2012. Total revenues and pre-tax income from PowerSecure Solar since the effective date of acquisition included in the accompanying consolidated statements of operations for the nine month period ended September 30, 2012 was $6.2 million and $457 thousand, respectively. Additional acquisition-related costs in the amount of $128 thousand were recognized as an expense during the nine month period ended September 30, 2012, and are included in general and administrative expense in the accompanying consolidated statements of operations.

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After the acquisition, we own 90% of the membership interests in, and control the management of, PowerSecure Solar. The Seller owns a 10% non-controlling interest in PowerSecure Solar and retained its business selling solar photovoltaic power systems and solar thermal energy to residential customers and small merchants and professional service providers.

Under the terms of the organizational documents for PowerSecure Solar, we have the option (the Call Option), commencing in June 2014, to purchase the remaining 10% membership interest in PowerSecure Solar held by the Seller or by any other non-controlling members at the time at a purchase price based on the greater of (i) a formula of five times the trailing four quarters earnings before interest, taxes, depreciation and amortization of PowerSecure Solar, excluding income attributable to sales of Company-owned projects (Trailing 12 Month EBITDA), multiplied by its percentage interest in PowerSecure Solar, or (ii) $1.0 million. The purchase price of the Call Option is payable in either cash or shares of our common stock, at our discretion. In the event of a change in control of us or the Seller, then the commencement of the Call Option will be accelerated.

In addition, the Seller has the right, commencing in June 2016, to require us to purchase its membership interest for a purchase price equal to three times PowerSecure Solar s Trailing 12 Month EBITDA multiplied by its percentage interest in PowerSecure Solar, less net capital infusions by us into PowerSecure Solar after the closing, which purchase price is payable in either cash or shares of our common stock, at our discretion. The Seller also has the right to join in a sale by us of a majority of our interest in PowerSecure Solar, and we can require the Seller to join in any sale of all of its interests in PowerSecure Solar, in each case on the same terms by Seller as by us.

The Contribution Agreement contains customary representations and warranties as well as indemnification obligations by PowerSecure Solar, on the one hand, and by Seller and its two founders and shareholders (the Seller Principals), on the other hand, to each other. In addition, the Contribution Agreement contains a covenant not to compete by Seller and Seller Principals against PowerSecure Solar and its affiliates in the acquired business, subject to certain exceptions related to its retained solar business for residential and small commercial customers. Correspondingly, PowerSecure Solar has agreed, on behalf of itself and its affiliates, not to compete against the Seller in its retained business. These non-competition covenants continue for a period of five years after the Seller no longer holds any membership interest in PowerSecure Solar.

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The following table summarizes the consideration paid to the Seller for the Acquired Business and the amounts of the assets acquired and the liabilities assumed recognized at the acquisition date, as well as the fair value at the acquisition date of the non-controlling interest in PowerSecure Solar:

Consideration paid to Seller:	
Cash	$ 3,523
Accounts receivable	$ 1,320
Inventories	3
Property, plant and equipment	156
Identifiable intangible assets	39
Accounts payable	(677)
Accrued and other liabilities	(1,799)
Total identifiable net assets (liabilities)	(958)
Non controlling interest in PowerSecure Solar	(433)
Goodwill	4,914
	$ 3,523

The goodwill of $4.9 million arising from the acquisition consists largely of the assembled workforce of PowerSecure Solar, and the synergies and economies of scale expected from combining the operations of our PowerSecure subsidiary and PowerSecure Solar. All of the goodwill was assigned to our Utility and Energy Technologies segment and is expected to be deductible for tax purposes. The non-controlling interest in PowerSecure Solar in the amount of $433 thousand was valued using a combination of an income approach and a market approach using assumptions, including a discount rate and a terminal value, that are not observable in the market.

Supplemental pro forma information, as if the acquisition had occurred on January 1, 2011, is as follows:

	PowerSecure International Inc. Pro Forma Nine Months Ended September 30,	
	2012	2011
Revenues	$ 121,824	$ 107,136
Earnings Attributable to PowerSecure International, Inc.:		
Income from continuing operations	$ 578	$ 18,752
Net income	$ 656	$ 22,722
Diluted earnings per common share:		
Income from continuing operations	$ 0.03	$ 0.98
Net income	$ 0.03	$ 1.19

The supplemental pro forma information above is based on estimates and assumptions, which we believe are reasonable. The pro forma information presented is not necessarily indicative of the consolidated results of operations in future periods or the results that actually would have been realized had the acquisition occurred on January 1, 2011. The supplemental pro forma results above exclude any benefits that may result from the acquisition due to synergies that are expected to be derived from the elimination of any duplicative costs. In addition, the pro forma results for the nine months ended September 30, 2012 were adjusted to exclude $128 thousand of acquisition-related costs incurred in 2012.

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5. Restructuring and Cost Reduction Program

During the third quarter 2012, we initiated a cost reduction program, taking actions to restructure and streamline our organization to reduce our costs, and to set the framework to improve the scalability of our cost structure as we grow revenues. The goal of this cost reduction program is to reduce expenses as a percentage of revenues in future periods thereby improving our operating margin. As a result of these cost reduction initiatives, we incurred pre-tax restructuring and cost reduction charges of $1.5 million during the three and nine months ended September 30, 2012, consisting primarily of severance and related costs from the elimination of employee positions and costs associated with revisions to certain employment arrangements. A total of $1.0 million of the restructuring and cost reduction charges were incurred at our Utility and Energy Technologies segment and the remaining $0.5 million of restructuring and cost reduction charges were incurred at the Corporate level. We estimate additional charges during the fourth quarter 2012 and potentially into 2013 in the amount of approximately $0.6 $1.0 million, the majority of which we expect will be incurred at our Utility and Energy Technologies segment. We expect the cost reduction program will be completed in early 2013. The following table summarizes the restructuring and cost reduction plan activities and the balance of our accrued restructuring and cost reduction liabilities at and for the nine month period ended September 30, 2012:

	Employee Termination Costs	Employment Arrangement Revisions	Total
Accrued restructuring and cost reduction liabilities, January 1, 2012	$	$	$
Costs incurred and charged to expense	534	1,014	1,548
Cash payments	(230)		(230)
Accrued restructuring and cost reduction liabilities, September 30, 2012	$ 304	$ 1,014	$ 1,318

The balance of accrued restructuring and cost reduction plan liabilities at September 30, 2012 is included in current liabilities in our Consolidated Balance Sheet. We expect the majority of the balance of our accrued restructuring plan liabilities at September 30, 2012 will be paid during the fourth quarter 2012.

6. Discontinued Operations

In January 2011 we sold our Southern Flow business and operations, which was part of our Energy Services segment. During the second half of 2011, we substantially completed the shutdown activities of our PowerPackages business which provided medium speed engine distributed generation products and services within our Utility and Energy Technologies segment. As a result, the sale of Southern Flow and the results of operations of PowerPackages are classified as discontinued operations in the accompanying consolidated financial statements.

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The results of PowerPackages discontinued operations for the three and nine months ended September 30, 2012 and 2011 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
PowerPackages Discontinued Operations:				
Total revenues	$ 250	$ 1,645	$ 586	$ 1,834
Cost of sales and operating expenses	233	1,747	460	4,514
Income (loss) before income taxes	17	(102)	126	(2,680)
Income tax benefit (provision)	(6)	39	(48)	1,014
Income (loss) from operations	11	(63)	78	(1,666)
Gain on disposal				
Income tax on disposal				
Income (loss) from discontinued operations	$ 11	$ (63)	$ 78	$ (1,666)

The following assets and liabilities of PowerPackages were segregated and included in Assets and Liabilities of discontinued operations held for sale, as appropriate, in the accompanying consolidated balance sheets as of September 30, 2012 and December 31, 2011:

	September 30, 2012	December 31, 2011
PowerPackages Assets and Liabilities:		
Inventories	$	$ 380
Other assets		
Assets of discontinued operations	$	$ 380
Accrued and other liabilities	$	$ 125
Other liabilities		
Liabilities of discontinued operations	$	$ 125

The results of Southern Flow discontinued operations for the three and nine months ended September 30, 2012 and 2011 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Southern Flow Discontinued Operations:				
Total revenues	$	$	$	$
Cost of sales and operating expenses				
Income (loss) before income taxes				
Income tax benefit (provision)				
Income (loss) from operations				
Gain on disposal				5,538
Income tax benefit on disposal				98

Income (loss) from discontinued operations	$	$	$	$ 5,636

There were no assets or liabilities of Southern Flow discontinued operations at either September 30, 2012 or December 31, 2011.

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7. Investment in Unconsolidated Affiliate

Until June of 2011, we owned a significant non-controlling minority portion of the equity interests in MM 1995-2 through our wholly-owned WaterSecure subsidiary. We accounted for this investment using the equity method and received both equity income and management fees for management services we provided to MM 1995-2 as its managing trustee. In June 2011, MM 1995-2 sold substantially all of its assets and business for cash and a pretax gain in the amount of $21.8 million from the sale is reflected in our financial statements for the nine months ending September 30, 2011.

An amount equal to $4.0 million of the cash sales price owed by the purchaser to MM 1995-2 was held in escrow until June 1, 2012, for potential claims relating to various representations and warranties. The $4.0 million escrow had been subject to the purchaser s rights to these funds for contingencies that were outside of our control. Upon termination of the escrow on June 1, 2012, approximately $3.9 million of the remaining escrow account balance was paid to MM 1995-2, of which we received $1.4 million, which was our share of these escrow proceeds.

A gain in the amount of $1.4 million is reflected in our financial statements for the nine months ended September 30, 2012 related to this final cash distribution from the sale of the assets of MM 1995-2. We do not expect to receive any additional proceeds from the sale. There were no equity income or management fees earned during the nine months ended September 30, 2012 because the sale was consummated in June 2011.

8. Debt

Line of Credit We have had a credit facility with Citibank, N.A. (Citibank), as administrative agent and lender, and other lenders since entering into a credit agreement in August 2007. At September 30, 2012 and December 31, 2011, our credit agreement with Citibank along with Branch Banking and Trust Company (BB&T) as additional lender, consists of a $20.0 million senior, first-priority secured revolving and term credit facility. The credit facility is guaranteed by all of our active subsidiaries and secured by all of our assets and the assets of our active subsidiaries. In addition, the credit facility provides for a five year term loan of up to $2.6 million. We completed the financing of a $2.4 million term loan under this provision on February 7, 2012.

We have used, and intend to continue to use, the proceeds available under the credit facility to finance PowerSecure s recurring revenue projects as well as to finance capital expenditures, working capital, and for general corporate purposes. The credit facility, as a revolving credit facility, will mature and terminate on November 12, 2014. However, we have the option prior to that maturity date to convert a portion of outstanding principal balance thereunder, in an amount not to exceed the present value of estimated annual contract revenues receivable under recurring revenue distributed generation projects, into a term loan for a two year period expiring November 12, 2016, making quarterly payments based upon a four year fully amortized basis.

Outstanding balances under the credit facility (including under the term loan described below) 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 2.00% to 3.25% based upon our leverage ratio, or at Citibank s alternate base rate plus an applicable margin, on a sliding scale ranging from 0.25% to 1.50% based upon our leverage ratio. Our leverage ratio is the ratio of our funded indebtedness as of a given date, net of our cash on hand in excess of $5.0 million, to our consolidated EBITDA, as defined in the credit agreement, for the four consecutive fiscal quarters ending on such date. Citibank s alternate base rate is equal to the higher of the Federal Funds Rate as published by the Federal Reserve of New York plus 0.50%, Citibank s prime commercial lending rate and 30 day LIBOR plus 1.00%.

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The credit facility is not subject to any borrowing base computations or limitations, but does contain certain financial covenants. Under the credit agreement, if cash on hand does not exceed funded indebtedness by at least $5.0 million, then our minimum fixed charge coverage ratio must be in excess of 1.25, where the fixed charge coverage ratio is defined as the ratio of the aggregate of our trailing 12 month consolidated EBITDA plus our lease expense minus our taxes based on income and payable in cash, divided by the sum of our consolidated interest charges plus our lease expenses plus our scheduled principal payments and dividends, computed over the previous period. In addition, we are required to maintain a minimum consolidated tangible net worth, computed on a quarterly basis, of not less than the sum of $80.0 million, plus an amount equal to 50% of our net income each fiscal year commencing January 1, 2012, with no reduction for any net loss in any fiscal year, plus 100% of any equity we raise through the sale of equity interests, less the amount of any non-cash charges or losses. Also, the ratio of our funded indebtedness to our capitalization, computed as funded indebtedness divided by the sum of funded indebtedness plus stockholders equity, cannot exceed 25%. As of September 30, 2012, we were in compliance with these financial covenants.

Under the credit agreement, upon the sale of any of our assets or the assets of our subsidiaries other than in the ordinary course of business or the public or private sale or issuance of any of our equity or our debt or the issuance or any equity or debt of our subsidiaries other than equity issuances where the aggregate net equity proceeds do not exceed $15.0 million, we are required to use the net proceeds thereof to repay any indebtedness then outstanding under the credit facility.

The credit facility contains customary terms and conditions for credit facilities of this type, including restrictions on our ability to incur additional indebtedness, create liens, enter into transactions with affiliates, make acquisitions or sales, pay dividends on or repurchase our capital stock or consolidate or merge with other entities. In addition, the credit agreement contains customary events of default which were not modified in connection with the amendment and restatement, including payment defaults, breach of representations and warranties, covenant defaults, cross-defaults, certain bankruptcy or insolvency events, judgment defaults and certain ERISA-related events, which were not modified by the amendment and restatement.

Our obligations under the credit facility are secured by guarantees (Guarantees) and security agreements (the Security Agreements) by each of our active subsidiaries, including PowerSecure, Inc. and its 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.

There were no balances outstanding on the revolving portion of the credit facility at, or during the nine months ended, September 30, 2012 or at December 31, 2011 or at November 7, 2012. We currently have $20.0 million available to borrow under the credit facility. However, the availability of this capital under our credit facility includes restrictions on the use of proceeds, and is dependent upon our ability to satisfy certain financial and operating covenants, as described above.

Term Loan The credit agreement also provides for a five year term loan of up to $2.6 million. We completed the financing of a $2.4 million term loan under this provision on February 7, 2012. The term loan is secured by deeds of trust we granted for the benefit of the lenders on the real estate and offices of our headquarters in Wake Forest, North Carolina and on the real estate and offices of our PowerFab facility in Randleman, North Carolina. The term loan was made under the credit agreement, and upon the same terms and conditions including covenants and interest rates, except that we are required to make quarterly principal repayments of $40 thousand, plus interest, on the term of the term loan based on a 15 year amortization schedule with the remaining outstanding principal balance due and payable on November 12, 2016.

9. Capital Lease Obligations

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

Proceeds of the lease financing were used to finance capital investments in equipment for our recurring revenue distributed generation projects. We account for the lease financing as a capital lease in our consolidated financial statements.

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

The balance of our capital lease obligations shown in the consolidated balance sheet at September 30, 2012 and December 31, 2011 consist entirely of our obligations under the equipment lease described above.

10. Share-Based Compensation

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

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

In March 2008, our board of directors adopted the PowerSecure International, Inc. 2008 Stock Incentive Plan (the 2008 Stock Plan), which was approved by our stockholders at the Annual Meeting of Stockholders held on June 9, 2008. The 2008 Stock Plan authorizes our board of directors to grant incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, performance awards and other stock-based awards to our officers, directors, employees, consultants and advisors for up to an aggregate of 0.6 million 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. On June 19, 2012, at our 2012 Annual Meeting of Stockholders, our stockholders adopted and approved an amendment and restatement of the 2008 Stock Incentive Plan, including an amendment to increase the number of shares of our common stock authorized thereunder by 1.4 million shares to a total of 2.0 million shares. The 2008 Stock Plan replaced our 1998 Stock Plan.

Stock Options Net income for the three months ended September 30, 2012 and 2011 includes $32 thousand and $59 thousand, respectively, of pre-tax compensation costs related to outstanding stock options. Net income for the nine months ended September 30, 2012 and 2011 includes $91 thousand and $205 thousand, respectively, of pre-tax compensation costs related to outstanding stock options. All of the stock option compensation expense is included in general and administrative expenses in the accompanying consolidated statements of operations.

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A summary of option activity for the nine months ended September 30, 2012 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Balance, December 31, 2011	911	$ 6.98		
Granted	72	4.93		
Exercised	(6)	3.56		
Expired				
Forfeited	(36)	7.12		
Balance, September 30, 2012	941	$ 6.84	4.66	$ n/m (1)
Exercisable, September 30, 2012	741	$ 7.19	3.74	$ n/m (1)

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

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

(1) The aggregate exercise prices of the options exceed the aggregate fair value of the underlying shares of common stock based on the closing sale price of the common stock on the NASDAQ Global Select Market on September 30, 2012 and 2011.

The weighted average grant date fair value of the options granted during the nine months ended September 30, 2012 and 2011 was $1.88 and $2.19, respectively. The fair value of the stock options granted during the nine months ended September 30, 2012 and 2011 was measured using the Black-Scholes valuation model with the following assumptions:

	September 30, 2012	2011
Expected stock price volatility	43.2%	44.8%
Risk free interest rate	0.7%	1.5%
Annual dividends	$	$
Expected life (years)	5	5

The fair value of stock option grants are amortized to expense over their respective service periods using the straight-line method and assuming a forfeiture rate of 5%. As of September 30, 2012 and December 31, 2011, there was $419 thousand and $423 thousand, respectively, of total

unrecognized compensation costs related to stock options. These costs at September 30, 2012 are expected to be recognized over a weighted average period of approximately 1.7 years.

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During the three months ended September 30, 2012 and 2011, the total intrinsic value of stock options exercised was $5 thousand and $0 thousand, respectively. Cash received from stock option exercises during the three months ended September 30, 2012 and 2011 was $9 thousand and $0 thousand, respectively. The total grant date fair value of stock options vested during the three months ended September 30, 2012 and 2011 was $13 thousand and $62 thousand, respectively.

During the nine months ended September 30, 2012 and 2011, the total intrinsic value of stock options exercised was $17 thousand and $1,642 thousand, respectively. Cash received from stock option exercises during the nine months ended September 30, 2012 and 2011 was $23 thousand and $310 thousand, respectively. The total grant date fair value of stock options vested during the nine months ended September 30, 2012 and 2011 was $70 thousand and $255 thousand, respectively.

Restricted Stock Awards Net income for the three months ended September 30, 2012 and 2011 includes $147 thousand and $391 thousand, respectively, of pre-tax compensation costs related to the vesting of outstanding restricted stock awards granted to directors, certain officers and our employees. Net income for the nine months ended September 30, 2012 and 2011 includes $664 thousand and $1,171 thousand, respectively, of pre-tax compensation costs related to the vesting of outstanding restricted stock awards granted to directors, certain officers and our employees. All of the restricted stock award compensation expense during the three and nine months ended September 30, 2012 and 2011 is included in general and administrative expenses in the accompanying consolidated statements of operations.

A summary of restricted stock award activity for the nine months ended September 30, 2012 is as follows:

	Unvested Restricted Shares	Weighted Average Grant Date Fair Value
Balance, December 31, 2011	410	$ 11.47
Granted	101	4.97
Vested	(398)	11.04
Forfeited		
Balance, September 30, 2012	113	$ 7.16

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

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

Restricted shares are subject to forfeiture and cannot be sold or otherwise transferred until they vest. If the holder of the restricted shares leaves us before the restricted shares vest, other than due to termination by us without cause, then any unvested restricted shares will be forfeited and returned to us. The restricted shares granted to directors vest in equal amounts over a period of one or three years, depending on the nature of the grant. The restricted shares granted to employees other than officers vest in equal annual amounts over three or five years. A total of 23 thousand unvested restricted shares issued to officers in 2007 will cliff vest in December 2012. All restricted and unvested shares automatically vest upon a change in control.

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The fair value of employee and director restricted shares along with the cliff vesting restricted shares granted to officers are being amortized on a straight-line basis over the vesting period. At September 30, 2012, the balance of unrecognized compensation cost related to unvested restricted shares was $473 thousand, which is expected to be recognized over a weighted average period of approximately 1.6 years.

11. 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. These claims are inherently difficult to predict, and therefore we generally cannot provide any assurance of the outcome of claims. We do not have any specific claims outstanding at this time.

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

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

We have experienced performance issues with two types of component parts, in particular, which we are in the process of resolving: 1) a supplier of a substantial distributed generation system component indicated its warranty does not cover performance issues related to its being used in conjunction with a component from another supplier, and this configuration has been installed in many of the distributed generation systems deployed for our customers, and 2) generators from a certain supplier have had performance issues in a distributed generation system we own, and for which we have a performance-based recurring revenue contract that is dependent on the system s successful operation. In both of these matters, we have actively worked to correct and resolve the performance issues and have made progress in mitigating their risk, although the risk is not eliminated. Given that we continue to have risk related to these performance issues, and the inherent uncertainty in assessing and quantifying the costs and certainty regarding the resolution of these types of technical issues, we are unable to estimate the potential negative impacts from these particular items, if any, in addition to other component part performance issues discussed above. In addition, we have not recorded any adjustment to our warranty reserve for these particular performance issues, other than an immaterial amount for certain minor repairs, as the estimated cost, if any, of fulfilling our warranty obligations for these performance issues within a possible range of outcomes is not determinable as of this date.

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

12. Income Taxes

The income tax expense recorded at September 30, 2012 represents our income before income taxes multiplied by our best estimate of our expected annual effective tax rate taking into consideration our expectation of future earnings, federal alternative minimum tax, state income tax for state jurisdictions in which we expect taxable income, potential effects of adverse outcomes on tax positions we have taken, true-up effects of prior tax provision estimates compared to actual tax returns, and our net operating loss carryforwards.

13. Capital Stock

Stock Repurchases On November 1, 2011, our board of directors authorized a stock repurchase program of up to $5.0 million in shares of our common stock, par value $0.01 per share. Repurchases of shares can be made from time to time in open market purchases or in privately negotiated transactions. The timing and amount of any shares repurchased is determined in the discretion of management based on its evaluation of market conditions and other factors. During the nine months ended September 30, 2012, a total of 421 thousand shares were repurchased under the program at a gross purchase price, including commission costs, of $2.2 million. The stock repurchase program may continue for a period of up to 24 months, although it may be suspended from time to time or discontinued at any time, or it may be renewed or extended, in the discretion of our board of directors. As of September 30, 2012, a total of approximately $2.5 million in shares of common stock remained available to be purchased under the stock repurchase program.

In addition, from time to time we receive shares of our common stock from employees who tender their existing shares to pay all or part of the exercise price of stock options or we withhold shares of our common stock from employees to satisfy tax withholdings on the vesting of restricted shares. In connection with the vesting of restricted shares, we received 119 thousand shares from employees who tendered shares at a gross purchase price of $574 thousand during the nine months ended September 30, 2012. In connection with the vesting of restricted shares, we received 21 thousand shares from employees who tendered shares at a gross purchase price of $166 thousand during the nine months ended September 30, 2011. In each case, the price paid per share with respect to the shares tendered was based on the closing sales price of our common stock on the vesting date as reported on The NASDAQ Global Select Market.

Authorized Shares On June 19, 2012, at our 2012 Annual Meeting of Stockholders, our stockholders adopted and approved an amendment to our Second Restated Certificate of Incorporation to increase the number of shares of common stock authorized for issuance by us by 25.0 million shares to a total of 50.0 million shares. We effected the increase in the number of authorized shares of our common stock by filing a Certificate of Amendment to our Second Restated Certificate of Incorporation with the Secretary of State of the State of Delaware on June 19, 2012, and the amendment became effective as of such date.

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14. Segment Information

We conduct our operations through two business segments. Our Utility and Energy Technologies segment includes our core business operations. It is the only segment that we have been strategically focused on investing in and growing for the last several years. Conversely, our Energy Services segment contains our non-core business operations. We divested the operations of our Energy Services segment over the last several years, with the final divestitures completed in 2011. As a result of these sales, we will no longer operate in the Energy Services segment.

Our reportable segments are strategic business units that offer different products and services and serve different customer bases. They are managed separately because each business requires different technology and marketing strategies. Our operating segments also represent components of our business for which discrete financial information is available and is reviewed regularly by the chief operating decision-maker, or decision-making group, to evaluate performance and make operating decisions.

Utility and Energy Technologies Our Utility and Energy Technologies segment includes 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. These three product and service areas share common or complementary utility relationships and customer types, common sales and overhead resources, and 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 is operated through our largest wholly-owned subsidiary, PowerSecure, Inc.

Our PowerPackages business was previously included in this segment until its discontinuance in the fourth quarter 2011. As a result, PowerPackages financial results are excluded from the Utility and Energy Technologies segment for all periods presented in the information below.

Energy Services 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 and WaterSecure. WaterSecure held a significant non-controlling minority portion of the equity interests in MM 1995-2. 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 and we recorded a $21.8 million gain from the sale in 2011. In the second quarter 2012, we recorded an additional $1.4 million gain from the sale of our WaterSecure operations attributable to our receipt of sales proceeds that had been placed into escrow pending the outcome of contingencies related to the sale. We do not expect to receive any additional proceeds from this sale. Accordingly, our WaterSecure subsidiary no longer has any on-going operating activity. Our Southern Flow business, which was sold in January 2011, provided oil and natural gas measurement services to customers involved in oil and natural gas production, transportation, and processing, with a focus on the natural gas market. The gain on the sale of Southern Flow is reflected in discontinued operations and its activities are excluded from our Energy Services segment for all periods presented in the information below. The sales of our WaterSecure and Southern Flow operations completed our strategy to monetize our non-core assets 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 and thus we no longer report ongoing operations in the Energy Services segment in financial periods after June 30, 2011.

The accounting policies of the reportable segments are the same as those described in Note 1 of the Notes to Consolidated Financial Statements. We evaluate the performance of our operating segments based on income (loss) before income taxes. There are no intersegment sales. Summarized financial information concerning our reportable segments is shown in the following table. Unallocated corporate cost amounts include corporate overhead, other income and interest expense which, for purposes of evaluating the operations of our segments, are not allocated to our segment activities. Total asset amounts exclude intercompany receivable balances eliminated in consolidation.

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	Three Months Ended September 30, 2012			
	Utility and Energy Technologies	Energy Services	Unallocated Corporate Costs	Total
Revenues	$ 44,236	$	$	$ 44,236
Cost of Sales	30,360			30,360
Gross Profit	13,876			13,876
Operating expenses:				
General and administrative	7,813		1,199	9,012
Selling, marketing and service	1,615			1,615
Depreciation and amortization	1,211			1,211
Restructuring and cost reduction charges	1,023		525	1,548
Total operating expenses	11,662		1,724	13,386
Operating Income (loss)	2,214		(1,724)	490
Other income and (expenses):				
Gain on sale of unconsolidated affiliate				
Equity income				
Management fees				
Interest income and other income			22	22
Interest expense	(67)		(47)	(114)
Income (loss) before income taxes	$ 2,147	$	$ (1,749)	$ 398
Total capital expenditures	$ 1,089	$	$	$ 1,089
Total investment in unconsolidated affiliate	$	$	$	$
Total goodwill	$ 12,884	$	$	$ 12,884
Total assets	$ 129,318	$	$ 18,040	$ 147,358

	Three Months Ended September 30, 2011			
	Utility and Energy Technologies	Energy Services	Unallocated Corporate Costs	Total
Revenues	$ 36,585	$	$	$ 36,585
Cost of Sales	25,372			25,372
Gross Profit	11,213			11,213
Operating expenses:				
General and administrative	7,408		1,306	8,714
Selling, marketing and service	1,197			1,197
Depreciation and amortization	857			857
Restructuring and cost reduction charges				
Total operating expenses	9,462		1,306	10,768
Operating Income (loss)	1,751		(1,306)	445

Other income and (expenses):				
Gain on sale of unconsolidated affiliate		44		44
Equity income				
Management fees				
Interest income and other income			31	31
Interest expense	(124)		(44)	(168)
Income (loss) before income taxes	$ 1,627	$ 44	$ (1,319)	$ 352
Total capital expenditures	$ 4,800	$	$	$ 4,800
Total investment in unconsolidated affiliate	$	$ 195	$	$ 195
Total goodwill	$ 7,970	$	$	$ 7,970

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	Nine Months Ended September 30, 2012			
	Utility and Energy Technologies	Energy Services	Unallocated Corporate Costs	Total
Revenues	$ 115,288	$	$	$ 115,288
Cost of Sales	79,653			79,653
Gross Profit	35,635			35,635
Operating expenses:				
General and administrative	22,957		3,793	26,750
Selling, marketing and service	4,039			4,039
Depreciation and amortization	3,432			3,432
Restructuring and cost reduction charges	1,023		525	1,548
Total operating expenses	31,451		4,318	35,769
Operating Income (loss)	4,184		(4,318)	(134)
Other income and (expenses):				
Gain on sale of unconsolidated affiliate		1,439		1,439
Equity income				
Management fees				
Interest income and other income			67	67
Interest expense	(197)		(141)	(338)
Income (loss) before income taxes	$ 3,987	$ 1,439	$ (4,392)	$ 1,034
Total capital expenditures	$ 4,634	$	$	$ 4,634

	Nine Months Ended September 30, 2011			
	Utility and Energy Technologies	Energy Services	Unallocated Corporate Costs	Total
Revenues	$ 90,326	$	$	$ 90,326
Cost of Sales	62,078			62,078
Gross Profit	28,248			28,248
Operating expenses:				
General and administrative	20,574		3,773	24,347
Selling, marketing and service	3,565			3,565
Depreciation and amortization	2,401	30	1	2,432
Restructuring and cost reduction charges				
Total operating expenses	26,540	30	3,774	30,344
Operating Income (loss)	1,708	(30)	(3,774)	(2,096)
Other income and (expenses):				
Gain on sale of unconsolidated affiliate		21,830		21,830
Equity income		1,559		1,559
Management fees		282		282
Interest income and other income			73	73
Interest expense	(311)		(143)	(454)

Income (loss) before income taxes	$ 1,397	$ 23,641	$ (3,844)	$ 21,194
Total capital expenditures	$ 14,105	$	$	$ 14,105

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

Introduction

The following discussion and analysis of our consolidated results of operations for the three and nine month period ended September 30, 2012, which we refer to as the third quarter 2012 and nine month period 2012, respectively, and the three and nine month period ended September 30, 2011, which we refer to as the third quarter 2011 and nine month period 2011, respectively, and of our consolidated financial condition as of September 30, 2012 should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this report.

Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q and the documents incorporated into this report by reference contain forward-looking statements within the meaning of and made under the safe harbor provisions of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. From time to time in the future, we may make additional forward-looking statements in presentations, at conferences, in press releases, in other reports and filings and otherwise. Forward-looking statements are all statements other than statements of historical fact, including statements that refer to plans, intentions, objectives, goals, strategies, hopes, beliefs, projections, prospects, expectations or other characterizations of future events or performance, and assumptions underlying the foregoing. The words may, could, should, would, will, project, intend, continue, believe, anticipate, 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, earnings per share, 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, earnings per share, 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;

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- 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.

Any forward-looking statements we make are based on our current plans, intentions, objectives, goals, strategies, hopes, beliefs, projections and expectations, as well as assumptions made by and information currently available to management. Forward-looking statements are not guarantees of future performance or events, but are subject to and qualified by substantial risks, uncertainties and other factors, which are difficult to predict and are often beyond our control. Forward-looking statements will be affected by assumptions and expectations we might make that do not materialize or that prove to be incorrect and by known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from those expressed, anticipated or implied by such forward-looking statements. These risks, uncertainties and other factors include, but are not limited to, those described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011, as amended or supplemented in subsequently filed Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, as well as other risks, uncertainties and factors discussed elsewhere in this report, in documents that we include as exhibits to or incorporate by reference in this report, and in other reports and documents we from time to time file with or furnish to the Securities and Exchange Commission. In light of these risks and uncertainties, you are cautioned not to place undue reliance on any forward-looking statements that we make.

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

Overview

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

Our Utility and Energy Technologies segment includes our core business operations, and is the only segment that we have been strategically focused on investing in and growing for the last several years. Conversely, our Energy Services segment contained our non-core business operations. We divested the operations of our Energy Services segment over the last several years, with the final divestitures completed in 2011.

Our Utility and Energy Technologies segment includes 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 common or complementary utility relationships and customer types, common sales and overhead resources, and 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, North Carolina, 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 commercial, industrial, and institutional customers they serve. Our Utility and Energy Technologies segment is operated through our largest wholly-owned subsidiary, PowerSecure, Inc.

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Until the divestitures 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 .

Interactive Distributed Generation

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, generally on behalf of electric utilities. Our systems provide a dependable backup power supply during power outages, and provide a more efficient and environmentally friendly source of power during high cost periods of peak power demand. These two sources of value benefit both utilities and their large customers.

Our Interactive Distributed Generation systems are sold to customers utilizing two basic economic models, each of which can vary depending on the specific customer and application. In our original business model, which is still our primary model, we sell the distributed generation system to the customer. We refer to this as a project-based or a customer-owned model. For distributed generation systems sold under the project-based model, the customer acquires ownership of the distributed generation assets upon our completion of the project. Our revenues and profits from the sale of systems under this model are recognized over the period during which the system is installed. In the project-based model, we will also usually receive a modest amount of on-going monthly revenues 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 an increasing portion of our distributed generation business. For distributed generation systems completed under this model, we retain ownership of the distributed generation system after it is installed at the customer s site. Because of this, we invest the capital required to design and build the system, and our revenues are derived from regular fees paid over the life of the recurring revenue contract by the utility or the customer, or both, for access to the system for standby power and peak shaving. The life of these recurring revenue contracts is typically from five to fifteen years. The fees that generate our revenues in the recurring revenue model are generally paid to us on a monthly basis and are established at amounts 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.

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.

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During the nine month period 2012, 79.9% of our distributed generation revenues consisted of customer-owned sales, and 20.1% of our distributed generation revenues were derived from recurring revenue sales. Sales of customer-owned systems deliver revenues and profits that are recorded on our financial statements over the course of the project, 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, installed and successfully operating.

Our recent acquisition of PowerSecure Solar provides us with the ability to provide solar energy systems through our distributed generation business platform. These solar energy systems are sold under the project-based , customer-owned model, and we also plan to own and operate these systems under a PowerSecure-owned , recurring revenue model.

Utility Infrastructure

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

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

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.

Energy Efficiency

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 light emitting diode, or LED, lighting solutions to the marketplace.

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 products include LED-based parking lot lights and outdoor security lighting for retail stores.

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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.

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

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

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

Energy Services Business

We completed the sales of our two Energy Services businesses in 2011, ceasing our operations in this business segment. We previously conducted our Energy Services operations through our WaterSecure and Southern Flow businesses.

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

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

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The sales of our WaterSecure and Southern Flow operations completed our strategy to monetize our non-core assets to focus on the businesses in our Utility and Energy Technologies segment. As a result of these sales, our Energy Services segment ceased business activities in 2011.

Recent Developments

During the third quarter 2012, we initiated a cost reduction program, taking actions to restructure and streamline our organization to reduce our costs, and to set the framework to improve the scalability of our cost structure as we grow revenues. The goal of this cost reduction program is to reduce certain expenses as a percentage of revenues as we grow to drive improvements in our operating margin. As a result of these cost reduction initiatives, we incurred pre-tax restructuring and cost reduction plan charges of $1.5 million during the three and nine months ended September 30, 2012, consisting primarily of severance and related costs from the elimination of employee positions and costs associated with revisions to certain employment arrangements. We estimate additional charges during the fourth quarter 2012 and potentially into 2013 in the amount of approximately $0.6 $1.0 million. We expect the cost reduction program will be completed in early 2013. We anticipate that the cost reduction initiatives, when completed, will result in an annual savings of approximately $5 million and help enhance our operating margins as we grow revenues.

On October 24, 2012, we announced that we received $15 million of new business, including an award for a major industrial combined heat and power (CHP) project. This new business consists of $15 million turnkey sales of distributed generation systems, including our industry leading IDG® systems and solar energy systems. A significant portion of the revenue for these new distributed generation awards relates to the large combined heat and power project. This project builds on a number of CHP projects that we have installed in partnership with utilities over the last decade. These projects enhance the efficiency of distributed power systems by using the heat produced in the generation process as a secondary source of energy in the operations. CHP projects are particularly attractive when natural gas can be used as the primary source of fuel. All of these new awards are for turnkey sales, with most of the revenue expected to be recognized in 2013.

On October 11, 2012, we announced that we received $20 million of new orders for our distributed generation systems and utility infrastructure projects. These new distributed generation orders total $11 million, and include installations for industrial, military, hospital, data center, and commercial facilities, including $9 million of traditional turn-key PowerSecure distributed generation projects, $1 million of turn-key solar energy projects, and $1 million of recurring revenue projects. The utility infrastructure orders total $9 million, and include transmission and distribution projects to upgrade utility systems, and substation projects. We expect the majority of these projects will be completed and recognized in 2012, with some projects continuing into 2013.

Financial Results Highlights

Our consolidated revenues during the third quarter 2012 increased by $7.7 million, or 20.9%, compared to our consolidated revenues during the third quarter 2011. The drivers of this revenue increase were the across the board increases in revenues in each of our product and service areas, including a 36.5% increase in revenues from Interactive Distributed Generation products and services, a 5.5% increase in revenues from Utility Infrastructure products and services, and a 4.2% increase in revenues from Energy Efficiency products.

Our third quarter 2012 gross margin as a percentage of revenue increased to 31.4% compared to 30.6% in the third quarter 2011. This year-over-year gross margin increase was driven by a favorable mix of projects completed and a higher percentage of our revenues resulting from sales of our higher margin Interactive Distributed Generation and Energy Efficiency products and services.

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Our operating expenses during the third quarter 2012 increased by $2.6 million, or 24.3%, compared to our operating expenses during the third quarter 2011. The year-over-year increase in operating expenses is largely due to $1.5 million of charges incurred in connection with our cost reduction program in which we took actions to reduce our headcount and revise certain employment agreements. We expect this cost reduction program, which will continue into the fourth quarter 2012, to streamline our cost structure and make it more scalable to set the framework for increased operating margins as revenues grow in the future. In addition, we incurred $0.6 million of incremental operating expenses during the third quarter 2012 at our PowerSecure Solar operations, which we acquired in June 2012. The remaining year-over-year increase in our operating expenses is due to an increase in depreciation from capital expenditures primarily driven by our investments in Company-owned distributed generation systems. While our operating expenses for the third quarter 2012, as a percentage of our revenues, increased by 0.9 percentage points compared to the third quarter 2011, our third quarter 2012 operating expenses excluding the restructuring charges, as a percentage of our revenues, decreased by 2.7 percentage points compared to the third quarter 2011, as we leveraged our operating expenses against a greater level of revenues year-over-year.

Our income from continuing operations attributable to PowerSecure International, Inc. shareholders for the third quarter 2012 was $471 thousand, or $0.03 per diluted share, compared to income from continuing operations attributable to PowerSecure International, Inc. shareholders of $1.0 million, or $0.05 per diluted share, for the third quarter 2011.

Our income (loss) from discontinued operations, consisting of the operating results of PowerPackages, was negligible for each of the third quarter 2012 and the third quarter 2011. We do not expect to recognize any significant additional income or loss in future periods from the operations of PowerPackages as all of its assets and liabilities have been disposed.

In total, our consolidated net income attributable to PowerSecure International, Inc. common stockholders for the third quarter 2012 was $482 thousand, or $0.03 per diluted share, which compared to net income attributable to PowerSecure International, Inc. common stockholders of $972 thousand, or $0.05 per diluted share, for the third quarter 2011.

Our consolidated revenues during the nine month period 2012 increased by $25.0 million, or 27.6%, compared to our consolidated revenues during the nine month period 2011. The drivers of this revenue increase were the across the board increases in revenues in each of our product and service areas, including a 27.2% increase in revenues from Interactive Distributed Generation products and services, a 23.7% increase in revenues from Utility Infrastructure products and services, and a 36.9% increase in revenues from Energy Efficiency products.

Our nine month period 2012 gross margin as a percentage of revenue was 30.9% compared to 31.3% in the nine month period 2011. On a year-over-year basis, gross margins were negatively impacted by the mild winter weather early in 2012, which caused Utility Infrastructure workloads to be reduced at certain utilities and the redeployment of those crews to other utilities and projects. Although Utility Infrastructure revenues increased significantly compared to the same period in 2011, inefficiencies in cost of sales related to the demobilization and redeployment of crews during the first quarter 2012 negatively impacted nine month period 2012 gross margin results. The lower year-over-year gross margins were also due to the overall growth of Utility Infrastructure revenue in 2012, because Utility Infrastructure is generally our lowest gross margin product and service category. In addition, variations in our quarterly gross margins always result from regular on-going differences in the mix of specific projects completed in each quarter.

Our operating expenses during the nine month period 2012 increased by $5.4 million, or 17.9%, compared to our operating expenses during the nine month period 2011. The year-over-year increase in operating expenses is due, in part, to $1.5 million of restructuring costs incurred in connection with our cost reduction program discussed above, $0.9 million of incremental operating expenses from our PowerSecure Solar operations, which we acquired in June 2012, and $1.0 million of incremental depreciation expense associated with capital expenditures, primarily related to capital expenditures for our Company-owned distributed generation systems. During the nine month period 2012, we also incurred incremental expenses as a result of the expansion of each of our Interactive Distributed Generation, Utility Infrastructure, and Energy Efficiency product and service areas. These incremental investments support higher levels of revenue, new product and customer development, engineering, personnel and equipment, as well as additional sales and marketing activities. Our operating expenses for nine month period 2012, as a percentage of our revenues, decreased by 2.6 percentage points compared to the nine month period 2011, and our nine month period 2012 operating expenses excluding the restructuring charges, as a percentage of our revenues, decreased by 3.9 percentage points compared to the nine month period 2011, as we leveraged our operating expenses against a greater level of revenues year-over-year.

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Income from our Energy Services segment, which consists of the gain on the sale of our WaterSecure operations along with management fees and equity income from our WaterSecure operations, decreased $22.2 million during the nine month period 2012 compared to the nine month period 2011, due to the sale of our WaterSecure operations in June 2011 and the resulting $21.8 million gain recorded in the nine month period 2011. In the nine month period 2012, we recorded an additional $1.4 million gain from the sale of our WaterSecure operations attributable to our receipt of sales proceeds that had been placed into escrow pending the outcome of contingencies related to the sale. We do not expect to receive any additional proceeds from this sale.

Our income from continuing operations attributable to PowerSecure International, Inc. shareholders for the nine month period 2012 was $1.4 million, or $0.08 per diluted share, compared to income from continuing operations attributable to PowerSecure International, Inc. shareholders of $19.0 million, or $0.99 per diluted share, for the nine month period 2011, which included the $21.8 million gain from the sale of our WaterSecure operations.

Our income from discontinued operations for the nine month period 2012, which consisted entirely of the operating results of PowerPackages, was negligible. Income from discontinued operations for the nine month period 2011 was $4.0 million, or $0.21 per diluted share, which consisted of the gain we recorded on the sale of Southern Flow, partially offset by a loss from discontinued operations of our PowerPackages business.

In total, our consolidated net income attributable to PowerSecure International, Inc. common stockholders for the nine month period 2012 was $1.5 million, or $0.08 per diluted share, which compared to net income attributable to PowerSecure International, Inc. common stockholders of $23.0 million, or $1.20 per diluted share, for the nine month period 2011, which included the income from the gain on the sale of both Southern Flow and our WaterSecure operations.

As discussed below under Fluctuations, our financial results will fluctuate from quarter to quarter and year to year. Thus, there is no assurance that our past results, including the results of our year ended December 31, 2011 or our quarter ended September 30, 2012, will be indicative of our future results, especially in light of the current significant downturn in the economy and unfavorable credit and capital markets.

Backlog

As of the date of this report, our revenue backlog expected to be recognized after September 30, 2012 is $175 million. This includes revenue related to the new business awards described above under Recent Developments , and approximately $9 million of additional business we received through the date of this report. Our revenue backlog represents revenue expected to be recognized after September 30, 2012, for periods including the fourth quarter of 2012 onward. This backlog figure compares to the revenue backlog of $166 million we reported in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 filed on August 6, 2012 (the date we last reported our backlog). Our revenue backlog and the estimated timing of revenue recognition is outlined below, including project-based revenues expected to be recognized as projects are completed and recurring revenues expected to be recognized over the life of the contracts:

Revenue Backlog to be recognized after September 30, 2012

Description		Anticipated Revenue	Estimated Primary Recognition Period
Project-based Revenue	Near term	$ 77 Million	4Q12 through 2Q13
Project-based Revenue	Long term	$ 27 Million	3Q13 through 2014
Recurring Revenue		$ 71 Million	4Q12 through 2020
Revenue Backlog to be recognized after September 30, 2012		**$ 175 Million**	

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

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

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Operating Segments

We report our operations as two operating segments. Our Utility and Energy Technologies segment includes our core business operations. It is the only segment that has on-going operations and that we have been strategically focused on investing in and growing for the last several years. Conversely, our Energy Services segment contained our non-core business operations. We divested the operations of our Energy Services segment over the last several years, with the final divestitures completed in 2011. As a result of these sales, we no longer operate in the Energy Services segment. Our reportable segments are strategic business units that offer different products and services and serve different customer bases. They are managed separately because each business requires different technology and marketing strategies. Our operating segments also represent components of our business for which discrete financial information is available and is reviewed regularly by the chief operating decision-maker, or decision-making group, to evaluate performance and make operating decisions.

Utility and Energy Technologies

Our Utility and Energy Technologies segment includes 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. These three product and service areas share common or complementary utility relationships and customer types, common sales and overhead resources, and 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 is operated through our largest wholly-owned subsidiary, PowerSecure, Inc.

Energy Services

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 and WaterSecure. WaterSecure held 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 and the proceeds from the sale and the liquidation of its remaining assets were distributed to MM 1995-2 s shareholders, including our WaterSecure subsidiary, in 2011 and 2012. Accordingly, our WaterSecure subsidiary no longer has any on-going operating activity. Our Southern Flow business, which was sold in January 2011, provided oil and natural gas measurement services to customers involved in oil and natural gas production, transportation, and processing, with a focus on the natural gas market. Due to its sale, Southern Flow s operations are reflected as discontinued operations and the results of its operations are excluded from our Energy Services segment for all periods presented in the information below. The sales of our WaterSecure and Southern Flow operations completed our strategy to monetize our non-core assets 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 and thus we no longer report ongoing operations in the Energy Services segment in financial periods after June 30, 2011.

Results of Operations

The following discussion regarding segment revenues, gross profit, costs and expenses, and other income and expenses for the third quarter 2012 compared to the third quarter 2011 excludes revenues, gross profit, and costs and expenses of our PowerPackages business and operations, which were discontinued in 2011, and of our Southern Flow subsidiary, which we sold in January 2011, the financial results of both of which are classified as discontinued operations in our financial statements.

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Third Quarter 2012 Compared to Third Quarter 2011

Revenues

Our consolidated revenues are generated entirely by sales and services provided by our Utility and Energy Technologies segment. We currently provide a variety of Utility and Energy Technologies products and services, including Interactive Distributed Generation products and services, Utility Infrastructure products and services, and Energy Efficiency products. The following table summarizes our Utility and Energy Technologies segment revenues for the periods indicated (dollars in thousands):

	Quarter Ended September 30,		Period-over-Period Difference	
	2012	2011	$	%
Utility and Energy Technologies:				
Interactive Distributed Generation	$ 25,060	$ 18,355	$ 6,705	36.5%
Utility Infrastructure	14,038	13,300	738	5.5%
Energy Efficiency	5,138	4,930	208	4.2%
Total	$ 44,236	$ 36,585	$ 7,651	20.9%

Our consolidated revenues for the third quarter 2012 increased $7.7 million, or 20.9%, compared to the third quarter 2011 due to an across-the-board increase in the sales in each of our Utility and Energy Technologies segment products and services: Interactive Distributed Generation, Utility Infrastructure, and Energy Efficiency revenues.

Our Utility and Energy Technologies segment distributed generation revenues are significantly affected by the number, size and timing of our Interactive Distributed Generation and Utility Infrastructure projects as well as the percentage of completion of in-process projects, and the percentage of customer-owned as opposed to PowerSecure-owned distributed generation recurring revenue projects. Our Interactive Distributed Generation sales have fluctuated significantly in the past and are expected to continue to fluctuate significantly in the future. The increase in our Utility and Energy Technologies segment revenues in the third quarter 2012 over the third quarter 2011 consisted of a $6.7 million, or 36.5%, increase in revenues from Interactive Distributed Generation products and services, a $0.7 million, or 5.5%, increase in revenues from Utility Infrastructure products and services, and a $0.2 million, or 4.2%, increase in revenues from Energy Efficiency products. The year-over-year increase in our Interactive Distributed Generation product sales and services reflects a $6.5 million increase in our customer-owned project sales together with a smaller increase in our PowerSecure-owned recurring revenue systems sales. The year-over-year increase in our customer-owned project sales is primarily driven by solar distributed generation projects from our PowerSecure Solar business, which we acquired in June 2012, and to a lesser extent increases in the volume of traditional distributed generation projects completed during the quarter. The year-over-year increase in our Utility Infrastructure product sales and services was due to an increase in the number of utilities that we service, and an increase in those utilities spending levels on transmission and distribution system maintenance and construction. The increase in our Energy Efficiency revenues in the third quarter 2012 compared to the third quarter 2011 primarily reflects an increase in the sales from our growing portfolio of LED lighting products as well as enhanced market penetration generating a larger base of customers.

Our future revenues will depend on the timing and degree of the recovery of the domestic economy, the health of the credit markets and the return to pre-recession levels of customer spending for capital improvements and energy efficiency projects, as well as our ability to secure new significant purchase orders. The amount and timing of our future revenues will also be affected by the amount and proportion of revenues generated by future recurring revenue projects, which result in revenue being recognized over a longer period. We are particularly susceptible to changes in economic conditions because our product offerings are generally considered discretionary investment items by our customers, who may delay or defer large sales orders, especially when economic conditions are not positive.

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Gross Profit and Gross Profit Margin

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

	Quarter Ended September 30,		Period-over-Period Difference	
	2012	2011	$	%
Utility and Energy Technologies:				
Cost of Sales	$ 30,360	$ 25,372	$ 4,988	19.7%
Gross Profit	$ 13,876	$ 11,213	$ 2,663	23.7%
Gross Profit Margin	31.4%	30.6%		

Cost of sales and services include materials, personnel and related overhead costs incurred to manufacture products and provide services. The 19.7% increase in our consolidated cost of sales and services for the third quarter 2012 compared to the third quarter 2011, was driven by the increase in costs associated with the 20.9% increase in sales, together with the factors discussed below leading to the improvement in our gross profit margin.

Our Utility and Energy Technologies segment gross profit increased $2.7 million, or 23.7%, in the third quarter 2012 compared to the third quarter 2011. As a percentage of revenue, our Utility and Energy Technologies segment gross profit margin in the third quarter 2012 was 31.4%, an increase of 0.8 percentage points compared to the third quarter 2011. An important driver in the period-over-period change in our gross profit margin is the relative gross margins we generally earn in each of our Distributed Generation, Utility Infrastructure and Energy Efficiency product and service categories. Our Distributed Generation products and services generally yield gross profit margins in the 25-45% range, our Utility Infrastructure products and services generally yield gross profit margins in the 5-30% range, and our Energy Efficiency products generally yield gross margins in the 20-40% range. The gross profit margin we realize within these ranges largely correlates to the amount of value-added products and services we deliver, with highly engineered, turn-key projects realizing higher gross profit margins due to the benefits they deliver our customers and the value we deliver because we are vertically integrated. Because of these gross profit margin differences, changes in the mix of our product lines affect our consolidated gross profit margin results. Our gross profit margin improvement in the third quarter 2012 compared to the third quarter 2011 was driven largely by a higher percentage of revenues from our higher margin Distributed Generation and Energy Efficiency products and services. As is always the case, variability in our quarterly gross margins is also caused by regular on-going differences in the mix of specific projects completed in each quarter. In the long-term, we expect that gross profit margins for this segment will increase somewhat because of anticipated greater productivity, operations and manufacturing efficiencies, improvements in technology, and growth in our higher-margin recurring revenue projects.

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

- the absolute level of revenue achieved in any particular period, given that portions of our cost of sales are relatively fixed over the near-term, the most significant of which is personnel and equipment costs;
- the allocation of revenue among each of our Distributed Generation, Utility Infrastructure and Energy Efficiency product and service categories, which have different gross profit margins;
- our ability to improve our operating efficiency and benefit from economies of scale;
- our level of investments in our businesses, particularly for anticipated or new business awards;
- improvements in technology and manufacturing methods and processes;

the mix of higher and lower margin projects, products and services, and the impact of new products and technologies on our pricing and volumes;

our ability to manage our materials and labor costs, including any future inflationary pressures;

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the costs to maintain and operate distributed generation systems we own in conjunction with recurring revenue contracts, including the price of fuel, run hours, weather, and the amount of fuel utilized in their operation, as well as their operating performance;

the geographic density of our projects;

the selling price of products and services sold to customers, and the revenues we expect to generate from recurring revenue projects;

the rate of growth of our new businesses, which tend to incur costs in excess of revenues in their earlier phases and then become profitable and more efficient over time if they are successful;

costs and expenses of business shutdowns, when they occur; and

other factors described below under Fluctuations.

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

Operating Expenses

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

	Quarter Ended September 30,		Period-over-Period Difference	
	2012	2011	$	%
Consolidated Operating Expenses:				
General and administrative	$ 9,012	$ 8,714	$ 298	3.4%
Selling, marketing and service	1,615	1,197	418	34.9%
Depreciation and amortization	1,211	857	354	41.3%
Restructuring and cost reduction charges	1,548		1,548	n/m
Total	$ 13,386	$ 10,768	$ 2,618	24.3%

Costs related to personnel, including wages, benefits, stock compensation, bonuses and commissions, are the most significant component of our operating expenses. During the third quarter 2012, a total of $1.5 million of the year-over-year increase in operating expenses is due to costs incurred in connection with the restructuring and cost reduction program we initiated to reduce our costs, streamline our organization, and set the framework to improve the scalability of our cost structure as we grow revenues. The goal of this program is to reduce expenses as a percentage of revenues as we grow to drive improvements in our operating margin. During the third quarter 2012, we also incurred $0.6 million of incremental operating expenses at our PowerSecure Solar operations which we acquired in June 2012 and we also incurred incremental depreciation expense related to our capital expenditures, primarily driven by capital expenditures for our Company-owned distributed generation systems. We estimate additional restructuring and cost reduction plan charges, which were geared towards driving our future cost structure as a percentage of revenues down, during the fourth quarter 2012 and potentially into 2013 in the amount of approximately $0.6 $1.0 million. We expect that these cost reduction initiatives, when completed, will result in an annual savings of approximately $5 million and improvements in

our operating margin. In the longer term, we expect our operating costs to grow to support the growth of our business, although at a lower growth rate than revenues, and that growth will be dependent in large part upon future economic and market conditions. Accordingly, the timing and the amount of future increases in operating expenses will depend on the timing and level of future improvements in economic and business conditions and the effects of such economic recovery on our revenues, as well as upon the success of our cost reduction initiative. We cannot provide any assurance as to if, when, how much or for how long economic conditions will improve, or the effects of future economic conditions on our revenues, expenses or net income.

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General and Administrative Expenses. General and administrative expenses include personnel wages, benefits, stock compensation, and bonuses and related overhead costs for the support and administrative functions incurred in our Utility and Energy Technologies segment together with unallocated corporate general and administrative costs. The 3.4% increase in our consolidated general and administrative expenses in the third quarter 2012, as compared to the third quarter 2011, was due primarily to an increase in vehicle, insurance, rent and other expenses to support our increasing levels of revenue and investments in new business opportunities. The following table provides further detail of our general and administrative expenses by segment (dollars in thousands):

	Quarter Ended September 30,		Period-over-Period Difference	
	2012	2011	$	%
Segment G&A Expenses:				
Utility and Energy Technologies:				
Personnel costs	$ 4,901	$ 4,955	$ (54)	(1.1)%
Vehicle lease and rental	765	641	124	19.3%
Insurance	349	198	151	76.3%
Rent-office and equipment	263	202	61	30.2%
Professional fees and consulting	122	152	(30)	(19.7)%
Travel	337	262	75	28.6%
Development costs	191	240	(49)	(20.4)%
Other	885	758	127	16.8%
Energy Services				n/m
Unallocated Corporate Costs	1,199	1,306	(107)	(8.2)%
Total	$ 9,012	$ 8,714	$ 298	3.4%

The increase in our vehicle, insurance, rent, travel, and other expenses during the third quarter 2012 compared to the third quarter 2011 was incurred primarily as a result of $0.5 million of incremental costs incurred at our PowerSecure Solar operations which we acquired in June 2012, partially offset by expense reductions in our other product and service areas within our Utility and Energy Technologies segment. Over the long-term, we expect our expenses in these areas to increase, although at lower growth rates than our revenues, as we strive to leverage our cost structure and deliver higher operating profit margins.

Unallocated corporate general and administrative expenses include similar personnel costs as described above as well as costs incurred for the benefit of all of our business operations, such as acquisition costs, legal, Sarbanes-Oxley, public company reporting, director expenses, accounting costs, and stock compensation expense on our stock options and restricted stock grants which we do not allocate to our operating segments. These costs decreased year-over-year due primarily to a reduction in stock compensation expense partially offset by costs incurred in connection with the recent acquisition of our PowerSecure Solar operations. We expect our unallocated corporate costs for the remainder of 2012 to decrease slightly compared to the levels incurred during the third quarter 2012 as a result of our cost reduction initiative that was initiated in the third quarter 2012 and reductions in stock compensation expense.

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Selling, Marketing and Service Expenses. Selling, marketing and service expenses consist of personnel and related overhead costs, including commissions for sales and marketing activities, together with travel, advertising and promotion costs incurred in our Utility and Energy Technologies segment. The 34.9% increase in selling, marketing and service expenses in the third quarter 2012, as compared to the third quarter 2011, was due to increases in compensation, travel, and advertising and promotion expenses, as well as additional expenses related to the PowerSecure Solar acquisition. The following table provides further detail of our segment selling, marketing and service expenses (dollars in thousands):

	Quarter Ended September 30,		Period-over-Period Difference	
	2012	2011	$	%
Segment Selling, Marketing and Service:				
Utility and Energy Technologies:				
Salaries	$ 855	$ 530	$ 325	61.3%
Commission	296	387	(91)	(23.5)%
Travel	199	140	59	42.1%
Advertising and promotion	233	107	126	117.8%
Bad debt expense (recovery)	32	33	(1)	(3.0)%
Energy Services				n/m
Total	$ 1,615	$ 1,197	$ 418	34.9%

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

Depreciation and Amortization Expenses. Depreciation and amortization expenses include the depreciation of property, plant and equipment and the amortization of certain intangible assets including capitalized software development costs and other intangible assets. The 41.3% increase in depreciation and amortization expenses in the third quarter 2012, as compared to the third quarter 2011, primarily reflects increased depreciation and amortization resulting from capital investments at our Utility and Energy Technologies segment during 2011. These capital investments are primarily investments in PowerSecure-owned distributed generation systems for projects deployed under our recurring revenue model.

Restructuring and Cost Reduction Charges. Restructuring and cost reduction plan charges consist primarily of severance and related costs from the elimination of employee positions and costs associated with revisions to certain employment arrangements. During the third quarter 2012, management initiated actions to restructure and reorganize the organization to streamline operations and set the framework for a more scalable and long-term cost structure. The goal of this cost reduction program is to reduce expenses as a percentage of revenues and drive improvements in operating margins as revenues grow. As a result of these cost reduction initiatives, we incurred pre-tax restructuring and cost reduction plan charges of $1.5 million during the third quarter 2012. We estimate additional charges during the fourth quarter 2012 and potentially into 2013 in the amount of approximately $0.6 $1.0 million. We expect the cost reduction program will be completed in the first quarter 2013. We anticipate that these cost reduction initiatives, when completed, will result in an annual savings of approximately $5 million and drive improvements in our operating margin.

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Other Income and Expenses

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

	Quarter Ended September 30,		Period-over-Period Difference	
	2012	2011	$	%
Other Segment Income and (Expenses):				
Utility and Energy Technologies:				
Interest income and other income	$	$	$	n/m
Interest expense	(67)	(124)	57	(46.0)%
Segment total	(67)	(124)	57	
Energy Services:				
Gain on sale of unconsolidated affiliate		44	(44)	(100.0)%
Equity income				n/m
Management fees				n/m
Segment total		44	(44)	
Unallocated Corporate:				
Interest income and other income	22	31	(9)	(29.0)%
Interest expense	(47)	(44)	(3)	6.8%
Income tax benefit (provision)	(119)	453	(572)	(126.3)%
Segment total	(144)	440	(584)	
Total	$ (211)	$ 360	$ (571)	

Gain on Sale of Unconsolidated Affiliate. Gain on sale of unconsolidated affiliate at our Energy Services segment consists of our minority ownership share of the gain recognized by our WaterSecure operations related to the sale of substantially all of the assets and business of MM 1995-2 in June 2011. We do not expect to receive any additional proceeds from the sale of MM 1995-2.

Equity Income. Equity income at our Energy Services segment consists of our minority ownership interest in the earnings of the WaterSecure operations. Our equity income is a direct function of the net income of the WaterSecure operations. We recorded no equity income during the third quarter 2012 or the third quarter 2011 due to the sale of the WaterSecure operations on June 1, 2011, and due to that sale we will not record any equity income from this source in the future.

Management Fees. Management fees at our Energy Services segment consist entirely of fees we earn as the managing trustee of the WaterSecure operations. These fees, to a large extent, are based on a percentage of the revenues of the WaterSecure operations. We recorded no management fees during the third quarter 2012 or the third quarter 2011 due to the sale of the WaterSecure operations on June 1, 2011, and due to that sale we will not record any management fees from this source in the future.

Interest Income and Other Income. Interest income and other income for each segment consists primarily of interest we earn on the interest-bearing portion of our cash and cash equivalent balances. In total, interest income and other income decreased slightly during the third quarter 2012, as compared to the third quarter 2011. This slight decrease was attributable to a reduction in interest-bearing cash and cash equivalent balances in the third quarter 2012 compared to the third quarter 2011. Our future interest income will depend on our cash and cash equivalent balances, which will increase and decrease depending upon our profit, capital expenditures, and our working capital needs, and future interest rates.

Interest Expense. Interest expense for each segment consists of interest and finance charges on our credit facilities, term loan and capital leases. In total, interest expense decreased during the third quarter 2012, as compared to the third quarter 2011. The decrease in our interest expense reflects the reduction in balances outstanding on our capital lease obligation due to regular payments made on our capital leases over the year together with a reduction in interest associated with decreased borrowings under the revolving portion of our credit facility during the third quarter 2012, partially offset by the interest associated with our term loan we completed on February 7, 2012. We expect our future interest and finance charges to increase over time as a result of anticipated borrowings under our credit facility to fund future working capital needs and recurring revenue projects at our Utility and Energy Technologies segment.

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Income Taxes. The income tax provision or benefit we record is the result of applying our annual effective tax rate by our pre-tax income or loss. Our effective tax rate and our income tax provision or benefit includes the effects of permanent differences between our book and taxable income, changes in our deferred tax assets and liabilities, changes in the valuation allowance for our net deferred tax assets, state income taxes in various state jurisdictions in which we have taxable activities, and expenses associated with uncertain tax positions that we have taken or expense reductions from uncertain tax positions as a result of a lapse of the applicable statute of limitations. We recorded an income tax benefit during the third quarter 2011 as a result of a lapse of the statute of limitations on uncertain tax positions taken in prior years. In addition, our overall effective tax rate in the third quarter 2012 increased, as compared to the third quarter 2011, as we expect our effective tax rate in 2012 will more closely approximate statutory rates.

Non-controlling Interest. We acquired a 67% controlling ownership interest in IES on April 1, 2010 and we acquired a 90% controlling ownership interest in PowerSecure Solar effective June 2, 2012. We record the full amount of income or loss from IES and PowerSecure Solar in our consolidated statements of operations. The non-controlling ownership interests in the income or loss of IES and PowerSecure Solar is reflected as a reduction or addition to net income or losses to derive income attributable to PowerSecure International stockholders. The decrease in the addition for the non-controlling interest in the loss of our majority-owned subsidiaries in the third quarter 2012, as compared to the third quarter 2011, is a result of increased development activities at IES to bring a broader complement of new lighting products to market partially offset by the minority interest share of the income of our recently acquired PowerSecure Solar operations.

Nine Month Period 2012 Compared to Nine Month Period 2011

Revenues

The following table summarizes our Utility and Energy Technologies segment revenues for the periods indicated (dollars in thousands):

	Nine Months Ended September 30,		Period-over-Period Difference	
	2012	2011	$	%
Utility and Energy Technologies:				
Interactive Distributed Generation	$ 53,705	$ 42,225	$ 11,480	27.2%
Utility Infrastructure	40,077	32,387	7,690	23.7%
Energy Efficiency	21,506	15,714	5,792	36.9%
Total	$ 115,288	$ 90,326	$ 24,962	27.6%

Our consolidated revenues for the nine month period 2012 increased $25.0 million, or 27.6%, compared to the nine month period 2011 due to an increase in sales in each of our Utility and Energy Technologies segment products and services, including increases in Interactive Distributed Generation, Utility Infrastructure, and Energy Efficiency revenues.

Our Utility and Energy Technologies segment distributed generation revenues are significantly affected by the number, size and timing of our Interactive Distributed Generation and Utility Infrastructure projects as well as the percentage of completion of in-process projects, and the percentage of customer-owned as opposed to PowerSecure-owned distributed generation recurring revenue projects. Our Interactive Distributed Generation sales have fluctuated significantly in the past and are expected to continue to fluctuate significantly in the future. The increase in our Utility and Energy Technologies segment revenues in the nine month period 2012 over the nine month period 2011 consisted of a $11.5 million, or 27.2%, increase revenues from Interactive Distributed Generation products and services, a $7.7 million, or 23.7%, increase in a in revenues from Utility Infrastructure products and services, and a $5.8 million, or 36.9%, increase in revenues from Energy Efficiency products. The year-over-year increase in our Interactive Distributed Generation product sales and services was driven by increases in customer-owned project sales, increases in solar distributed generation project sales from the acquisition of PowerSecure Solar in June 2012, and an increase in our PowerSecure-owned recurring revenue systems sales. The year-over-year increase in our Utility Infrastructure product sales and services was due to an increase in the number of utilities that we service, and an increase in those utilities spending levels on transmission and distribution system maintenance and construction. The increase in our Energy Efficiency sales and services in the nine month period 2012 compared to the nine month period 2011 primarily reflects an increase in revenues from our portfolio of LED lighting products including existing and new products that were introduced in 2010 and 2011 as well as an increase in the number of customers.

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Gross Profit and Gross Profit Margin

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

	Nine Months Ended September 30,		Period-over-Period Difference	
	2012	2011	$	%
Utility and Energy Technologies:				
Cost of Sales	$ 79,653	$ 62,078	$ 17,575	28.3%
Gross Profit	$ 35,635	$ 28,248	$ 7,387	26.2%
Gross Profit Margin	30.9%	31.3%		

The 28.3% increase in our consolidated cost of sales and services for the nine month period 2012 compared to the nine month period 2011, was driven by the increase in costs associated with the 27.6% increase in sales, together with the factors discussed below leading to the decrease in our gross profit margin.

Our Utility and Energy Technologies segment gross profit increased $7.4 million, or 26.2%, in the nine month period 2012 compared to the nine month period 2011. As a percentage of revenue, our Utility and Energy Technologies segment gross profit margin in the nine month period 2012 was 30.9%, a decrease of 0.4 percentage points compared to the nine month period 2011. An important driver in the period-over-period change in our gross profit margin is the relative gross margins we generally earn in each of our Distributed Generation, Utility Infrastructure and Energy Efficiency product and service categories. Our Distributed Generation products and services generally yield gross profit margins in the 25-45% range, our Utility Infrastructure products and services generally yield gross profit margins in the 5-30% range, and our Energy Efficiency products generally yield gross margins in the 20-40% range. The gross profit margin we realize within these ranges largely correlates to the amount of value-added products and services we deliver, with highly engineered, turn-key projects realizing higher gross profit margins due to the benefits they deliver our customers and the value we deliver because we are vertically integrated. Because of these gross profit margin differences, changes in the mix of our product lines affect our consolidated gross profit margin results. Our lower gross profit margins in the nine month period 2012 compared to the nine month period 2011 were due to an increase in the growth and amount of Utility Infrastructure revenue in the nine month period 2012, which is generally our lowest gross margin product and service category. In addition, gross margins were negatively impacted by the mild winter weather in the first quarter 2012, which caused Utility Infrastructure workloads to be reduced at certain utilities and the redeployment of those crews to other utilities and projects. Therefore, although Utility Infrastructure revenues increased significantly compared to the same period in 2011, inefficiencies in cost of sales related to the demobilization and redeployment of crews negatively impacted nine month period 2012 gross margin results. As is always the case, variability in our quarterly gross margins is also caused by regular on-going differences in the mix of specific projects completed in each quarter. In the long-term, we expect that gross profit margins for this segment will increase because of anticipated greater productivity, operations and manufacturing efficiencies, improvements in technology, and growth in our higher-margin recurring revenue projects.

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Operating Expenses

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

	Nine Months Ended September 30,		Period-over-Period Difference	
	2012	2011	$	%
Consolidated Operating Expenses:				
General and administrative	$ 26,750	$ 24,347	$ 2,403	9.9%
Selling, marketing and service	4,039	3,565	474	13.3%
Depreciation and amortization	3,432	2,432	1,000	41.1%
Restructuring and cost reduction charges	1,548		1,548	n/m
Total	$ 35,769	$ 30,344	$ 5,425	17.9%

During the nine month period 2012, a total of $1.5 million of the year-over-year increase in operating expenses is due to restructuring and cost reduction plan charges incurred in connection with our cost reduction program in which we took actions reduce our headcount and revise certain employment arrangements to streamline our costs and set the framework for a more scalable cost structure as revenues grow. During the nine month period 2012, we also incurred $0.9 million of incremental operating expenses at our PowerSecure Solar operations, which we acquired in June 2012. During the nine month period 2012, we also incurred incremental expenses to support and drive the growth of each of our Interactive Distributed Generation, Utility Infrastructure, and Energy Efficiency product and service areas. These expenses support higher levels of revenue, new product and customer development, engineering, personnel and equipment, as well as additional sales and marketing activities, and also include increases in depreciation from capital expenditures for our Company-owned distributed generation systems. We estimate additional restructuring and cost reduction charges during the fourth quarter 2012 and potentially into 2013 in the amount of approximately $0.6 $1.0 million. We anticipate that these cost reduction initiatives, when completed, will result in an annual savings of approximately $5 million and help drive improvements in our operating margin. In the longer term future, we expect our operating costs to grow to support the growth of our business, although at a lower growth rate than revenues over time, and that growth will be dependent in large part upon future economic and market conditions. Accordingly, the timing and the amount of future increases in operating expenses will depend on the timing and level of future improvements in economic and business conditions and the effects of such economic recovery on our revenues. We cannot provide any assurance as to if, when, how much or for how long economic conditions will improve, or the effects of future economic conditions on our revenues, expenses or net income.

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General and Administrative Expenses. The 9.9% increase in our consolidated general and administrative expenses in the nine month period 2012, as compared to the nine month period 2011, was due to investments in personnel, vehicles and other expenses to support our increasing levels of revenue and investments in new business opportunities. The following table provides further detail of our general and administrative expenses by segment (dollars in thousands):

	Nine Months Ended September 30,		Period-over-Period Difference	
	2012	2011	$	%
Segment G&A Expenses:				
Utility and Energy Technologies:				
Personnel costs	$ 14,818	$ 13,893	$ 925	6.7%
Vehicle lease and rental	2,087	1,721	366	21.3%
Insurance	912	502	410	81.7%
Rent-office and equipment	762	621	141	22.7%
Professional fees and consulting	437	525	(88)	(16.8)%
Travel	952	774	178	23.0%
Development costs	490	542	(52)	(9.6)%
Other	2,499	1,996	503	25.2%
Energy Services				n/m
Unallocated Corporate Costs	3,793	3,773	20	0.5%
Total	$ 26,750	$ 24,347	$ 2,403	9.9%

The increase in our personnel costs, vehicle lease and rental, insurance, travel and rental costs during the nine month period 2012 compared to the nine month period 2011 was due to staffing increases to support our recent and expected growth and investments in new and expanded business opportunities across each of our product and service areas of Distributed Generation, Energy Efficiency, and Utility Infrastructure. These cost increases also reflect $0.6 million of incremental costs incurred at our PowerSecure Solar operations which we acquired in June 2012. Other general and administrative expenses including professional and consulting fees and development costs decreased as a result of cost control efforts undertaken earlier in the first quarter of 2012. Over the long-term, we expect our expenses in these areas to increase, although at lower growth rates than our revenues, as we strive to leverage our cost structure and deliver higher operating profit margins.

The slight increase in our unallocated corporate general and administrative expenses during the nine month period 2012 as compared to the nine month period 2011 was due primarily to costs incurred in connection with the mid-year acquisition of our PowerSecure Solar operations, partially offset by a reduction in our stock compensation expense.

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Selling, Marketing and Service Expenses. The 13.3% increase in selling, marketing and service expenses in the nine month period 2012, as compared to the nine month period 2011, was primarily due to an increase in travel and advertising and promotion expense. These cost increases also reflect $0.2 million of incremental costs incurred at our PowerSecure Solar operations which we acquired in June 2012. The following table provides further detail of our segment selling, marketing and service expenses (dollars in thousands):

	Nine Months Ended September 30,		Period-over-Period Difference	
	2012	2011	$	%
Segment Selling, Marketing and Service:				
Utility and Energy Technologies:				
Salaries	$ 2,257	$ 1,776	$ 481	27.1%
Commission	702	1,031	(329)	(31.9)%
Travel	576	432	144	33.3%
Advertising and promotion	524	251	273	108.8%
Bad debt expense (recovery)	(20)	75	(95)	(126.7)%
Energy Services				n/m
Total	$ 4,039	$ 3,565	$ 474	13.3%

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

Depreciation and Amortization Expenses. The 41.1% increase in depreciation and amortization expenses in the nine month period 2012, as compared to the nine month period 2011, primarily reflects increased depreciation and amortization resulting from capital investments at our Utility and Energy Technologies segment during 2011. These capital investments are primarily investments in PowerSecure-owned distributed generation systems for projects deployed under our recurring revenue model.

Restructuring and Cost Reduction Charges. Restructuring and cost reduction plan charges consist primarily of severance and related costs from the elimination of employee positions and costs associated with revisions to certain employment arrangements. During the third quarter 2012, management initiated actions to restructure and reorganize the organization to streamline operations and set the framework for a more scalable and long-term cost structure. The goal of this cost reduction program is to reduce expenses as a percentage of revenues and drive improvements in operating margins as revenues grow. As a result of these cost reduction initiatives, we incurred pre-tax restructuring and cost reduction plan charges of $1.5 million during the third quarter 2012. We estimate additional charges during the fourth quarter 2012 and potentially into 2013 in the amount of approximately $0.6 $1.0 million. We anticipate the cost reduction program will be completed in the first quarter 2013. We anticipate that these cost reduction initiatives, when completed, will result in an annual savings of approximately $5 million and drive improvements in our operating margin.

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Other Income and Expenses

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

	Nine Months Ended September 30,		Period-over-Period Difference	
	2012	2011	$	%
Other Segment Income and (Expenses):				
Utility and Energy Technologies:				
Interest income and other income	$	$	$	n/m
Interest expense	(197)	(311)	114	(36.7)%
Segment total	(197)	(311)	114	
Energy Services:				
Gain on sale of unconsolidated affiliate	1,439	21,830	(20,391)	(93.4)%
Equity income		1,559	(1,559)	(100.0)%
Management fees		282	(282)	(100.0)%
Segment total	1,439	23,671	(22,232)	
Unallocated Corporate:				
Interest income and other income	67	73	(6)	(8.2)%
Interest expense	(141)	(143)	2	(1.4)%
Income tax benefit (provision)	(347)	(2,777)	2,430	(87.5)%
Segment total	(421)	(2,847)	2,426	
Total	$ 821	$ 20,513	$ (19,692)	

Gain on Sale of Unconsolidated Affiliate. Gain on sale of unconsolidated affiliate at our Energy Services segment consists of our minority ownership share of the gain recognized by our WaterSecure operations related to the sale of substantially all of the assets and business of MM 1995-2 in June 2011. At the time of the sale, MM 1995-2 deferred $4.0 million of the gain until such time as certain contingencies associated with the sale were eliminated and associated escrowed sales proceeds were received. These contingencies expired and were resolved in the second quarter 2012 and $3.9 million of the funds that were placed into escrow were released. In June 2012, we received our share of the escrowed sales proceeds and recorded a corresponding gain in the amount of $1.4 million during the nine month period 2012. We do not expect to receive any additional proceeds from the sale of MM 1995-2.

Equity Income. We recorded no equity income during the nine month period 2012 due to the sale of the WaterSecure operations on June 1, 2011, and due to that sale we will not record any equity income from this source in the future.

Management Fees. We recorded no management fees during the nine month period 2012 due to the sale of the WaterSecure operations on June 1, 2011, and due to that sale we will not record any management fees from this source in the future.

Interest Income and Other Income. In total, interest income and other income decreased slightly during the nine month period 2012, as compared to the nine month period 2011. This slight decrease was attributable to a reduction in interest-bearing cash and cash equivalent balances in the nine month period 2012 compared to the nine month period 2011. Our future interest income will depend on our cash and cash equivalent balances, which will increase and decrease depending upon our profit, capital expenditures, and our working capital needs, and future interest rates.

Interest Expense. In total, interest expense decreased during the nine month period 2012, as compared to the nine month period 2011. The decrease in our interest expense reflects the reduction in balances outstanding on our capital lease obligation due to regular payments made on our capital leases over the year together with a reduction in interest associated with decreased borrowings under the revolving portion of our credit facility during the nine month period 2012, partially offset by the interest associated with our term loan we completed on February 7, 2012. We expect our future interest and finance charges to increase over time as a result of anticipated borrowings under our credit facility to fund future working capital needs and recurring revenue projects at our Utility and Energy Technologies segment.

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Income Taxes. Our overall effective tax rate in the nine month period 2012 increased, as compared to the nine month period 2011, as we expect our effective tax rate in 2012 will more closely approximate statutory rates.

Non-controlling Interest. The increase in the addition for the non-controlling interest in the loss of our majority-owned subsidiaries in the nine month period 2012, as compared to the nine month period 2011, is a result of increased development activities at IES to bring a broader complement of new lighting products to market partially offset by the minority interest share of the income of our recently acquired PowerSecure Solar operations.

Fluctuations

Our revenues, expenses, margins, net income, cash flow, cash, working capital, debt balances, and other operating results and balance sheet amounts have fluctuated significantly from quarter-to-quarter, period-to-period and year-to-year during our operating history and are likely to continue to fluctuate in the future due to a variety of factors, many of which are outside of our control. Factors that affect our operating results include the following:

- the effects of general economic and financial conditions, including the ongoing challenges in the economy and the difficult capital and credit markets, the potential economic consequences if Congress fails to act to avoid certain important year-end fiscal, tax and budgetary deadlines sometimes referred to as the fiscal cliff , and the potential for such economic and market challenges to continue or recur in the future, negatively impacting our business operations and our revenues and net income, including the negative impact these conditions could have on the timing of and amounts of orders from our customers, and the potential these factors have to negatively impact our access to capital to finance our business;

- the size, timing and terms of sales and orders, including large customer orders, as well as the effects of the timing of phases of completion of projects for customers, and customers delaying, deferring or canceling purchase orders or making smaller purchases than expected;

- our strategy to increase our revenues through long-term recurring revenue projects, recognizing that increasing our revenues from recurring revenue projects will require significant up-front capital expenditures and will protract our revenue and profit recognition from those projects over a longer period compared to turn-key sales, while at the same time increasing our gross margins over the long-term;

- our ability to sell, complete and recognize satisfactory levels of near-term quarterly revenues and net income related to our project-based sales and product and service revenues, which are recognized and billed as they are completed, in order to maintain our current profits and cash flow and to satisfy our financial covenants in our credit facilities and to successfully finance the recurring revenue portion of our business model;

- our ability to maintain and grow our Utility Infrastructure revenues, and maintain and increase pricing, utilization rates and productivity rates, given the significant levels of vehicles, tools and labor in which we have invested and which is required to serve utilities in this business area, and the risk that our utility customers will change work volumes or pricing, or will displace us from providing services;

- the sale of our non-core Southern Flow and WaterSecure businesses, including the associated loss of revenues, cash flow and income from those businesses and our ability to redeploy the sales proceeds productively and profitably into our core business;

our ability to obtain adequate supplies of key components and materials of suitable quality for our products on a timely and cost-effective basis, including the impact of potential supply line constraints, substandard parts, changes in environmental requirements, and fluctuations in the cost of raw materials and commodity prices, including without limitation with respect to our Energy Efficiency business unit in relation to third party manufacturing arrangements we have with vendors in China and other component parts that originate in Japan;

our ability to successfully grow, on a profitable basis, our newly acquired PowerSecure Solar business;

the performance of our products, services and technologies, and the ability of our systems to meet the performance standards they are designed and built to deliver to our customers, including but not limited to our recurring revenue projects for which we retain the on-going risks associated with the performance and ownership of the systems;

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our ability to access significant capital resources on a timely basis in order to fund working capital requirements, fulfill large customer orders, finance capital required for recurring revenue projects, and finance working capital and equipment;

our ability to develop new products, services and technologies with competitive advantages and positive customer value propositions;

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

the pace of revenue and profit realization from our new businesses and the development and growth of their markets, including the timing, pricing and market acceptance of our new products and services;

our success in controlling and reducing our costs and expenses, such as under our recently implemented cost reduction program;

changes in our pricing policies and those of our competitors, including the introduction of lower cost competing technologies and the potential for them to impact our pricing and our profit margins;

variations in the length of our sales cycle and in the product and service delivery and construction process;

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

changes in our expenses, including prices for materials including but not limited to copper, aluminum and other raw materials, labor costs and other components of our products and services, fuel prices including diesel, natural gas, oil and gasoline, and our ability to hedge or otherwise manage these prices to protect our costs and revenues, minimize the impact of volatile exchange rates and mitigate unforeseen or unanticipated expenses;

changes in our valuation allowance for our net deferred tax asset, and the resulting impact on our current tax expenses, future tax expenses and balance sheet account balances;

the effects of severe weather conditions, such as hurricanes, on the business operations of our customers, and the potential effect of such conditions on our results of operations;

the life cycles of our products and services, and competitive alternatives in the marketplace;

budgeting cycles of utilities and other industrial, commercial and institutional customers, including impacts of the current downturn in the economy and difficult capital markets conditions on capital projects and other spending items;

changes and uncertainties in the lead times required to obtain the necessary permits and other governmental and regulatory approvals for projects;

the development and maintenance of business relationships with strategic partners such as utilities and large customers;

economic conditions and regulations in the energy industry, especially in the electric utility industry, including the effects of changes in energy prices, electricity pricing and utility tariffs;

changes in the prices charged by our suppliers;

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

the effects of litigation, warranty claims and other claims and proceedings;

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

our ability to achieve and maintain a positive safety record, due to the importance of safety on attracting and retaining quality employees, maintaining positive financial performance, and attracting and retaining utility and customer contracts.

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

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Our revenues and other operating results are heavily dependent upon the size and timing of customer orders and payments, and the timing of the completion of those projects. The timing of large individual orders, and of project completion, is difficult for us to predict. Because our operating expenses are based on anticipated revenues over the long-term and because a high percentage of these are relatively fixed, a shortfall or delay in recognizing revenues can cause our operating results to vary significantly from quarter-to-quarter and can result in significant operating losses or declines in profit margins in any particular quarter. If our revenues fall below our expectations in any particular quarter, we may not be able to or it may not be prudent to reduce our expenses rapidly in response to the shortfall, which can result in us suffering significant operating losses or declines in profit margins in that quarter.

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

Due to all of these factors and the other risks, uncertainties and other factors discussed in this report and in our Annual Report on Form 10-K for the year ended December 31, 2011, quarter-to-quarter, period-to-period or year-to-year comparisons of our results of operations should not be relied on as an indication of our future performance. Quarterly, period or annual comparisons of our operating results are not necessarily meaningful or indicative of future performance.

Liquidity and Capital Resources

Overview

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

- operations;
- inventory;
- accounts receivable;
- property and equipment expenditures, including capital expenditures related to distributed generation PowerSecure-owned recurring revenue projects;
- software purchases or development;
- debt service requirements;
- lease obligations;

deferred compensation obligations;

restructuring and cost reduction obligations;

business and technology acquisitions and other growth transactions; and

stock repurchases.

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Working Capital

At September 30, 2012, we had working capital of $63.6 million, including $22.6 million in cash and cash equivalents, compared to working capital of $69.4 million, including $24.6 million in cash and cash equivalents at December 31, 2011. Changes in the components of our working capital from December 31, 2011 to September 30, 2012 and from December 31, 2010 to September 30, 2011 are explained in greater detail below. At both September 30, 2012 and December 31, 2011, we had $20.0 million of available and unused borrowing capacity from our credit facility. However, the availability of this capacity under our credit facility includes restrictions on the use of proceeds, and is dependent upon our ability to satisfy certain financial and operating covenants including financial ratios, as discussed below.

Cash Flows

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

	Nine Months Ended September 30,	
	2012	2011
Net cash provided by (used in) operating activities	$ 5,750	$ (10,551)
Net cash provided by (used in) investing activities	(6,697)	28,393
Net cash provided by (used in) financing activities	(1,109)	6,648
Net increase (decrease) in cash and cash equivalents	$ (2,056)	$ 24,490

Cash Provided by (Used in) Operating Activities

Cash provided by (used in) operating activities consists primarily of net income adjusted for certain non-cash items including depreciation and amortization, stock-based compensation expenses and equity income. Cash provided by (used in) operating activities also include operating cash distributions from our unconsolidated affiliate, the effect of changes in working capital and other activities, and cash provided by or used by our discontinued operations.

Cash provided by operating activities of $5.8 million for the nine month period 2012 included the effects of the following:

- our income from continuing operations of $0.7 million;
- gain on sale of unconsolidated affiliate of $1.4 million;
- non-cash charges of $3.4 million in depreciation and amortization;
- stock-based compensation expense of $0.8 million;
- a decrease of $0.9 million in accounts receivable;
- an increase of $0.9 million in inventories;
- an increase of $2.1 million of accounts payable;

a net decrease of $0.6 million of accrued expenses including restructuring charges;

a net decrease of 0.4 million in other assets and liabilities; and

cash provided by discontinued operations of $0.3 million.

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

our income from continuing operations of $18.4 million;

gain on sale of unconsolidated affiliate of $21.8 million;

non-cash charges of $2.4 million in depreciation and amortization;

stock-based compensation expense of $1.4 million;

non-cash equity income from our WaterSecure operations of $1.6 million partially offset by cash distributions from those operations of $1.5 million;

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an increase of $18.0 million in accounts receivable;

a decrease of $0.6 million in inventories;

a decrease of $1.2 million in deferred income taxes;

a net decrease of $1.0 million in other assets and liabilities;

an increase of $0.1 million of accounts payable;

an increase of $5.5 million of accrued expenses; and

cash used in discontinued operations of $1.2 million.

Cash Provided by (Used in) Investing Activities

Cash used in investing activities was $6.7 million in the nine month period 2012 and cash provided by investing activities was $28.4 million in the nine month period 2011. Historically, our principal cash investments have related to the purchase of equipment used in our production facilities, the acquisitions of certain contract rights, the acquisition and installation of equipment related to our recurring revenue sales, and the acquisition of businesses or technologies. During the nine month period 2012, we used $3.5 to million to acquire a 90% ownership interest in PowerSecure Solar, we used $2.6 million to purchase and install equipment at our recurring revenue distributed generation sites, we used $2.0 million principally to acquire operational assets, and we received $1.4 million from the sale of our WaterSecure operations. During the nine month period 2011, we received $26.0 million from the sale of our WaterSecure operations, we received $16.5 million from the sale of our Southern Flow business, we used $11.4 million to purchase and install equipment at our recurring revenue distributed generation sites, and we used $2.7 million principally to acquire operational assets.

Cash Provided by (Used in) Financing Activities

Cash used in financing activities was $1.1 million in the nine month period 2012 and cash provided by financing activities was $6.6 million in the nine month period 2011. During the nine month period 2012, we received $2.4 million proceeds from a term loan, we used $2.8 million to repurchase shares of our common stock and we used $0.7 million to repay our capital lease and term loan obligations. During the nine month period 2011, we received $5.0 million from borrowings on our credit facility, we received $2.1 million from sale leaseback transactions, we received $0.3 million from the exercise of stock options, we used $0.2 million to repurchase our common stock, and we used $0.6 million to repay our capital lease obligations.

Capital Spending

Our capital expenditures during the nine month period 2012 were approximately $4.6 million, of which we used $2.6 million to purchase and install equipment for our PowerSecure-owned recurring revenue distributed generation systems, and we used $2.0 million to purchase equipment and other capital items. Our capital expenditures during the nine month period 2011 were approximately $14.1 million, of which we used $11.4 million to purchase and install equipment at our recurring revenue distributed generation sites, and we used $2.7 million to purchase equipment and other capital items.

We anticipate making capital expenditures of approximately $9-10 million for fiscal year 2012, including capital expenditures for our company-owned distributed generation systems deployed under long-term recurring revenue contracts, and operational assets, particularly for equipment used in our Utility Infrastructure business. Customer demand for our Interactive Distributed Generation systems under recurring revenue contract arrangements, and economic and financial conditions could cause us to reduce or increase those capital expenditures. The vast majority of our capital spending has to date been and will continue to be used for investments in assets related to our recurring revenue projects as well as equipment to support our growth.

Indebtedness

Line of Credit. We have had a credit facility with Citibank, N.A. (Citibank), as administrative agent and lender, and other lenders since entering into a credit agreement in August 2007. At September 30, 2012 and December 31, 2011, our credit agreement with Citibank along with Branch Banking and Trust Company (BB&T) as additional lender, consists of a $20.0 million senior, first-priority secured revolving and term credit facility. The credit facility is guaranteed by all of our active subsidiaries and secured by all of our assets and the assets of our active subsidiaries. In addition, the credit facility provides for a five year term loan of up to $2.6 million. We completed the financing of a $2.4 million term loan under this provision on February 7, 2012.

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We have used, and intend to continue to use, the proceeds available under the credit facility to finance PowerSecure s recurring revenue projects as well as to finance capital expenditures, working capital, and for general corporate purposes. The credit facility, as a revolving credit facility, will mature and terminate on November 12, 2014. However, we have the option prior to that maturity date to convert a portion of outstanding principal balance thereunder, in an amount not to exceed the present value of estimated annual contract revenues receivable under recurring revenue distributed generation projects, into a non-revolving term loan for a two year period expiring November 12, 2016, making quarterly payments based upon a four year fully amortized basis.

Outstanding balances under the credit facility (including under the term loan described below) 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 2.00% to 3.25% based upon our leverage ratio, or at Citibank s alternate base rate plus an applicable margin, on a sliding scale ranging from 0.25% to 1.50% based upon our leverage ratio. Our leverage ratio is the ratio of our funded indebtedness as of a given date, net of our cash on hand in excess of $5.0 million, to our consolidated EBITDA, as defined in the credit agreement, for the four consecutive fiscal quarters ending on such date. Citibank s alternate base rate is equal to the higher of the Federal Funds Rate as published by the Federal Reserve of New York plus 0.50%, Citibank s prime commercial lending rate and 30 day LIBOR plus 1.00%.

The credit facility is not subject to any borrowing base computations or limitations, but does contain certain financial covenants. Under the credit agreement, if cash on hand does not exceed funded indebtedness by at least $5.0 million, then our minimum fixed charge coverage ratio must be in excess of 1.25, where the fixed charge coverage ratio is defined as the ratio of the aggregate of our trailing 12 month consolidated EBITDA plus our lease expense minus our taxes based on income and payable in cash, divided by the sum of our consolidated interest charges plus our lease expenses plus our scheduled principal payments and dividends, computed over the previous period. In addition, we are required to maintain a minimum consolidated tangible net worth, computed on a quarterly basis, of not less than the sum of $80.0 million, plus an amount equal to 50% of our net income each fiscal year commencing January 1, 2012, with no reduction for any net loss in any fiscal year, plus 100% of any equity we raise through the sale of equity interests, less the amount of any non-cash charges or losses. Also, the ratio of our funded indebtedness to our capitalization, computed as funded indebtedness divided by the sum of funded indebtedness plus stockholders equity, cannot exceed 25%. As of September 30, 2012, we were in compliance with these financial covenants.

Under the credit agreement, upon the sale of any of our assets or the assets of our subsidiaries other than in the ordinary course of business or the public or private sale or issuance of any of our equity or our debt or the issuance or any equity or debt of our subsidiaries other than equity issuances where the aggregate net equity proceeds do not exceed $15.0 million, we are required to use the net proceeds thereof to repay any indebtedness then outstanding under the credit facility.

The credit facility contains customary terms and conditions for credit facilities of this type, including restrictions on our ability to incur additional indebtedness, create liens, enter into transactions with affiliates, make acquisitions or sales, pay dividends on or repurchase our capital stock or consolidate or merge with other entities. In addition, the credit agreement contains customary events of default which were not modified in connection with the amendment and restatement, including payment defaults, breach of representations and warranties, covenant defaults, cross-defaults, certain bankruptcy or insolvency events, judgment defaults and certain ERISA-related events, which were not modified by the amendment and restatement.

Our obligations under the credit facility are secured by guarantees (Guarantees) and security agreements (the Security Agreements) by each of our active subsidiaries, including PowerSecure, Inc. and its 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.

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There were no balances outstanding on the revolving portion of the credit facility at, or during the nine months ended, September 30, 2012 or at December 31, 2011 or at November 7, 2012. We currently have $20.0 million available to borrow under the credit facility. However, the availability of this capital under our credit facility includes restrictions on the use of proceeds, and is dependent upon our ability to satisfy certain financial and operating covenants, as described above.

Term Loan. The credit agreement also provides for a five year term loan of up to $2.6 million. We completed the financing of a $2.4 million term loan under this provision on February 7, 2012. The term loan is secured by deeds of trust we granted for the benefit of the lenders on the real estate and offices of our headquarters in Wake Forest, North Carolina and on the real estate and offices of our PowerFab facility in Randleman, North Carolina. The term loan was made under the credit agreement, and upon the same terms and conditions including covenants and interest rates, except that we are required to make quarterly principal repayments of $40 thousand, plus interest, on the term of the term loan based on a 15 year amortization schedule with the remaining outstanding principal balance due and payable on November 12, 2016. The outstanding balance on our term loan was $2.3 million at September 30, 2012.

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

Proceeds of the lease financing were used to finance capital investments in equipment for our recurring revenue distributed generation projects. We account for the lease financing as a capital lease in our consolidated financial statements.

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

Under the lease guaranty, we have unconditionally guaranteed the obligation of our PowerSecure subsidiary under the lease for the benefit of the lessor. Our capital lease obligation at September 30, 2012 and December 31, 2011 was $3.0 million and $3.6 million, respectively.

Preferred Stock Redemption. The terms of our Series B preferred stock required us to redeem all shares of our Series B preferred stock that remained outstanding on December 9, 2004 at a redemption price equal to the liquidation preference of $1 thousand per share plus accumulated and unpaid dividends. Our remaining redemption obligation at September 30, 2012, to holders of outstanding shares of Series B preferred stock that have not been redeemed, is $0.1 million.

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Contractual Obligations and Commercial Commitments

We incur various contractual obligations and commercial commitments in our normal course of business. We lease certain office space, operating facilities and equipment under long-term lease agreements; in February 2012, we completed a $2.4 million term loan under our credit facility; to the extent we borrow under the revolving portion of our credit facility, we are obligated to make future payments under that facility; we have restructuring and cost reduction obligations; we have a deferred compensation obligation; and we have a non-compete agreement providing for on-going payments. At September 30, 2012, we also had a liability for unrecognized tax benefits and related interest and penalties totaling $0.9 million. We do not expect a significant payment related to these obligations within the next year and we are unable to make a reasonably reliable estimate if and when cash settlement with a taxing authority would occur. Accordingly, the information in the table below, which is as of September 30, 2012, does not include the liability for unrecognized tax benefits (dollars in thousands):

		Payments Due by Period			
	Total	Remainder of 2012	1 - 3 Years	4 - 5 Years	More than 5 Years
Contractual Obligations					
Revolving portion of credit facility (1)	$	$	$	$	$
Term loan (2)	2,572	60	467	2,045	
Capital lease obligations (2)	3,299	254	2,030	1,015	
Operating leases	10,110	681	4,805	3,320	1,304
Deferred compensation (3)	2,661			2,661	
Non-compete agreement	300		200	100	
Series B preferred stock	104	104			
Restructuring and cost reduction obligations	1,318	1,267	51		
Total	$ 20,364	$ 2,366	$ 7,553	$ 9,141	$ 1,304

(1) Total repayments are based upon borrowings outstanding as of September 30, 2012, not actual or projected borrowings after such date. Repayments do not included interest that may become due and payable in any future period.
(2) Repayments amounts include interest on the term loan at the interest rate in effect as of September 30, 2012 and on the capital lease obligation at the interest rate per the agreement.
(3) Total amount represents our expected obligation on the deferred compensation arrangement and does not include the value of the restricted annuity contract, or interest earnings thereon, that we purchased to fund our obligation.

Off-Balance Sheet Arrangements

During the third quarter 2012, we did not engage in any material off-balance sheet activities or have any relationships or arrangements with unconsolidated entities established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities nor do we have any commitment or intent to provide additional funding to any such entities.

Liquidity

Based upon our plans and assumptions as of the date of this report, we believe that our capital resources, including our cash and cash equivalents, amounts available under our credit facility, along with funds expected to be generated from our operations, will be sufficient to meet our anticipated cash needs, including for working capital, capital spending and debt service commitments, for at least the next 12 months. However, any projections of future cash needs and cash flows are subject to substantial risks and uncertainties. See Cautionary Note Regarding Forward-Looking Statements above in this report and Part II Item 1A. Risk Factors. Although we believe that we have sufficient capital to fund our activities and commitments for at least the next 12 months, our future cash resources and capital requirements may vary materially from those now planned. Our ability to meet our capital needs in the future will depend on many factors, including the effects of the current economic and financial crisis, the timing of sales, the mix of products, the amount of recurring revenue projects, our ability to meet our financial covenants under our credit facility, unanticipated events over which we have no control increasing our operating costs or reducing our revenues beyond our current expectations, and other factors listed above under Fluctuations above. For these reasons, we cannot provide any assurance that our actual cash requirements will not be greater than we currently expect or that these sources of liquidity will be available when needed.

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

Accordingly, we cannot provide any assurance that sufficient additional funds will be available to us when needed or desired or that, if available, such funds can be obtained on terms favorable to us and our stockholders and acceptable to those parties who must consent to the financing. Our inability to obtain sufficient additional capital on a timely basis on favorable terms when needed or desired could have a material adverse effect on our business, financial condition and results of operations.

Critical Accounting Policies

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

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

- revenue recognition;
- allowance for doubtful accounts;
- inventory valuation reserve;
- warranty reserve;
- impairment of goodwill and long-lived assets;
- deferred tax valuation allowance;

uncertain tax positions;

costs of exit or disposal activities and similar nonrecurring charges; and

stock-based compensation.

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These accounting policies are described in our Annual Report on Form 10-K for the year ended December 31, 2011 in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

Recent Accounting Pronouncements

Fair Value Measurements In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-04, which amended Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This amendment is intended to result in convergence between U.S. GAAP and International Financial Reporting Standards (IFRS) requirements for measurement of and disclosures about fair value. This amended guidance clarifies the concepts applicable for fair value measurement of non-financial assets and also expands the disclosures for fair value measurements that are estimated using significant unobservable inputs used in a fair value measurement. This amended guidance became effective for us on a prospective basis commencing January 1, 2012. The adoption of this standard had no effect on our financial position or results of operations.

Testing Goodwill for Impairment In September 2011, the FASB issued ASU No. 2011-08, Intangibles-Goodwill and Other (Topic 350) Testing Goodwill for Impairment. This standard, which amends and updates guidance on the periodic testing of goodwill for impairment, provides companies with the option to first assess qualitative factors to determine whether it is more likely than not that that the fair value of a reporting unit is less than its carrying amount. If so, then it is necessary to perform the two-step quantitative goodwill impairment test. This standard becomes effective for fiscal years beginning after December 15, 2011, with early adoption allowed. We adopted this standard effective October 1, 2011. The adoption of this standard had no effect on our financial position or results of operations.

Testing Indefinite-Lived Intangible Assets for Impairment In July 2012, the FASB issued ASU No. 2012-02, Intangibles Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment. This standard, which amends the guidance on testing indefinite-lived intangible assets, other than goodwill, for impairment, provides companies with the option to first perform a qualitative assessment before performing the two-step quantitative impairment test. If the company determines, on the basis of qualitative factors, that the fair value of the indefinite-lived intangible asset is more likely than not to exceed its carrying amount, then the company would not need to perform the two-step quantitative impairment test. This standard does not revise the requirement to test indefinite-lived intangible assets annually for impairment. This standard becomes effective for annual and interim impairment tests performance for fiscal years beginning after September 15, 2012, with early adoption allowed. We do not expect the adoption of this standard will have a material effect on our financial position or results of operations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to certain market risks arising from transactions we enter into in the ordinary course of business. These market risks may adversely affect our financial condition, results of operations and cash flow.

Interest Rate Risk. We are exposed to market risk resulting from changes in interest rates. Changes in the interest rates affect the income we receive from our investments of excess cash in short-term interest-bearing marketable securities, because that income is dependent upon the interest rate of the securities held, and the interest expenses we pay on our borrowings under our credit facility, because the interest rate on our borrowings is based on floating interest rates as described in Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations of this report. Our lease with SunTrust is at a fixed interest rate and thus not impacted by changes in interest rates.

At September 30, 2012, our cash and cash equivalent balance was approximately $22.6 million and we had no outstanding balance on the revolving portion of our credit facility. On February 7, 2012, we borrowed $2.4 million on a term loan under the credit facility. Our credit facility, which is comprised of a revolving credit line and a term loan, bears interest at a rate based on LIBOR or an alternative base rate based on prevailing interest rates, in each case plus an applicable margin based on our leverage ratio. From time to time we enter into interest rate swap agreements to reduce our exposure to interest rate fluctuations under the credit facility.

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Our cash equivalents are invested in a combination of bank deposits, money market or U.S. government mutual funds, short-term time deposits, and government agency and corporate obligations, or similar kinds of instruments, the income of which generally increases or decreases in proportion to increases or decreases, respectively, in interest rates. We do not believe that changes in interest rates have had a material impact on us in the past or are likely to have a material impact on us in the foreseeable future. For example, a change of 1% (100 basis points) in the interest rate on either our investments or any future reasonably likely borrowings would not have a material impact on our financial condition, results of operations or cash flow. While we believe we have our cash and cash equivalents invested in relatively risk-free investments, the current capital market crisis make it difficult to accurately assess the risk of each of our holdings. This risk includes, but is not limited to, bank deposits in excess of FDIC insurance limits.

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

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

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

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of September 30, 2012, the end of the period covered by this report. Based upon management s evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that, as of September 30, 2012, our disclosure controls and procedures were designed at the reasonable assurance level and were effective at the reasonable assurance level to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

We regularly review our system of internal control over financial reporting and make changes to our processes and systems to improve controls and increase efficiency, while ensuring that we maintain an effective internal control environment. Changes may include such activities as implementing new, more efficient systems, consolidating activities and migrating processes. There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended September 30, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Limitations in Control Systems

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

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PART II

OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are involved in disputes and legal proceedings. There has been no material change in our pending legal proceedings as described in Item 3. Legal Proceedings in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011.

Item 1A. Risk Factors

Our business and operating results are subject to many risks, uncertainties and other factors. If any of these risks were to occur, our business, affairs, assets, financial condition, results of operations, cash flows and prospects could be materially and adversely affected. These risks, uncertainties and other factors include the information discussed elsewhere in this report as well as the risk factors set forth in Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011, which have not materially changed as of the date of this report, except for the addition of the following risk factor:

We have recently acquired a distributed solar energy business and added solar energy systems as a product line in our distributed generation area, so we now face a variety of risks and uncertainties related to solar technologies, the industry generally, and our solar business specifically that could adversely affect our operating results if they materialize.

In June 2012, we acquired our distributed solar energy business, adding this capability to our distributed generation area, and we operate it through Southern Energy Management PowerSecure, LLC, of which we own a 90% interest. Accordingly, we have limited experience in the solar power business on which to base our prospects and anticipated results of operations. In addition, we face a number of risks inherent in the solar business, including but not limited to the following:

While the demand for solar installations is emerging and rapidly evolving, its future success is uncertain. If solar power technology proves unsuitable for widespread commercial deployment or if demand fails to develop sufficiently, we may not be able to generate enough revenues to achieve and sustain it as a profitable product line. The factors influencing the widespread adoption of solar power technology include cost-effectiveness, performance, and reliability; the availability of government subsidies and incentives; the desire of utilities and commercial, industrial, and institutional customers to invest in alternative green energy technology; and fluctuations in economic and market conditions which impact the viability of conventional and non-solar alternative energy sources; and the willingness and ability of customers to make significant capital expenditures to purchase the products.

The reduction, elimination, or expiration of government tax and economic incentives could adversely affect our ability to achieve sales and market share in the solar business, because we believe that the near-term growth of the solar market depends in large part on the availability and size of government and economic incentives. To encourage the adoption of solar technologies, the U.S. government and numerous state governments have provided subsidies in the form of cost reductions, tax write-offs and other incentives to end users, distributors, systems integrators and manufacturers of solar power products. Reduction, elimination and/or periodic interruption of these government subsidies and economic incentives because of policy changes, fiscal tightening or other reasons may result in the diminished competitiveness of solar energy, and materially and adversely affect the growth of these markets and our revenues. Additionally, many state governments have adopted, or endorse, or encourage utilities to achieve certain renewable portfolio standards and goals which have driven the adoption of solar and other alternative energy technologies. The reduction, elimination, or expiration of these standards could negatively impact demand for solar technology generally and our solar energy product line specifically.

The execution of our growth strategy is dependent upon the continued availability of third-party financing arrangements for our customers. Depending on the status of financial markets, companies may be unwilling or unable to finance the cost of construction of solar projects. We often act as the general contractor for our customers in connection with the installations of our solar power systems and are subject to risks associated with construction, bonding, cost overruns, delays and other contingencies, which could have a material adverse effect on

our business and results of operations.

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Many of our customers require long-term performance guarantees by us that guarantee certain levels of energy output from the systems we install. Due to general risks inherent in the performance of solar systems, including unexpected performance problems or other events could cause us to fail to meet these performance criteria, we could face significant revenue and earnings losses and financial penalties.

Existing regulations and policies and changes to these regulations and policies may present technical, regulatory and economic barriers to the purchase and use of solar power technology, which may significantly reduce demand for our solar energy systems. These regulations and policies are being modified and may continue to be modified, including tariffs and taxes related to international trade matters involving solar panel prices. Our costs and customer purchases of solar power technology could be deterred by these regulations and policies, which could result in a significant reduction in the potential demand for our solar energy systems. Any new government regulations or utility policies pertaining to our solar energy systems may result in significant additional expenses to us and our customers and, as a result, could cause a significant reduction in demand for our solar energy systems.

These regulations and policies are being modified and may continue to be modified. Customer purchases of solar power technology could be deterred by these regulations and policies, which could result in a significant reduction in the potential demand for our solar energy systems. Any new government regulations or utility policies pertaining to our solar energy systems may result in significant additional expenses to us and our customers and, as a result, could cause a significant reduction in demand for our solar energy systems.

Problems with product quality or product performance of systems we engineer and install could result in a decrease in customers and revenue, unexpected expenses and loss of market share. The components we purchase for our systems are complex and may contain undetected errors or defects. These defects could cause us to, or may cause us to request that suppliers incur significant re-engineering costs, divert the attention of our personnel from product selling efforts and significantly affect our customer relations and business reputation. If we deliver solar energy systems with errors or defects, or if there is a perception that such solar energy systems or their components, including solar panels we source from third parties, contain errors or defects, our credibility and the market acceptance and sales of our solar energy systems could be harmed. The possibility of future product failures could cause us to incur substantial expense to repair or replace defective products. Furthermore, widespread product failures may damage our market reputation and reduce our market share and cause sales to decline. We may need to indemnify customers in some circumstances against liability from defects in our solar energy systems. In addition, we may be subject to product liability claims in the event that our solar energy systems fail to perform as expected or if a failure of our solar energy systems results, or is alleged to result, in bodily injury, property damage or other damages.

Since the solar energy systems we purchase and sell, and their associated components, including solar panels, cannot be tested for the duration of their standard multi-year warranty period, we may be subject to unexpected warranty expense and product liability claims that our vendors do not cover. Additionally, the solar panel manufacturing industry is undergoing a significant economic downturn, driven largely by decreasing panel prices, and this has weakened the financial health of many of the panel manufacturers. The current standard product warranty for the solar energy systems we sell includes a warranty period of generally one to five years for defects in material and workmanship, a warranty period of generally ten to twenty years for declines in power performance, and a warranty period of generally fifteen to twenty-five years on the functionality of solar panels which is generally backed by the panel manufacturer. Due to the long warranty period and even though we pass through manufacturers warranties from the manufacturer, we may bear the risk of extensive warranty claims long after we have shipped product and recognized revenue. Any warranty claims that the manufacturer does not cover could cause us to increase the amount of warranty reserves and have a corresponding negative impact on our results.

Technological changes in the solar power industry could render the solar energy systems we intend to engineer and install uncompetitive or obsolete, which could prevent us from achieving market share and sales.

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Our success in developing and growing a profitable distributed solar energy business depends in large part on our ability to anticipate and effectively manage these and other risks and uncertainties, many of which are outside of our control. Any of these risks could materially and adversely affect our solar operations and distributed generation business, and consequently, our operating results.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table sets forth information with respect to our repurchases of our shares of common stock during the three monthly periods ending September 30, 2012:

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share (2)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (3)	Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs (3)
July 1, 2012 July 31, 2012	183	$ 4.69		$ 3,839,133
August 1, 2012 August 31, 2012	201,033	$ 4.63	103,500	3,353,812
September 1, 2012 September 30, 2012	242,150	$ 5.29	143,700	2,522,290
Total	443,366	$ 5.29	247,200	$ 2,522,290

(1) From time to time, we withhold shares of our common stock from employees to satisfy tax withholding obligations with respect to the vesting of restricted stock awards granted under our 1998 Stock Incentive Plan, as amended and restated.

(2) The price paid per share with respect to shares withheld to satisfy tax withholding obligations as referred to in note (1) above, if any, is based on the closing sales price of our common stock on the vesting date, as reported on The NASDAQ Global Select Market.

(3) On November 1, 2011, our Board of Directors authorized a stock repurchase program that provides for the repurchase of up to $5.0 million in shares of our common stock. Our Board of Directors authorization specifies the maximum dollar amount but not the maximum number of shares to be repurchased. 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.

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Item 6. Exhibits

(10.1)	Employment and Non-Competition Agreement, dated as of September 28, 2012, by and between PowerSecure International, Inc. and Gary J. Zuiderveen. (Incorporated by reference to Exhibit 10.1 to the Registrant s Current Report on Form 8-K filed October 4, 2012.)
(31.1)	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (Filed herewith.)
(31.2)	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (Filed herewith.)
(32.1)	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 and Rule 13a-14(b) or 15d-14(b) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (Filed herewith.)
(32.2)	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 and Rule 13a-14(b) or 15d-14(b) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (Filed herewith.)
(101.INS)*	XBRL Instance Document
(101.SCH)*	XBRL Taxonomy Extension Schema Document
(101.CAL)*	XBRL Taxonomy Extension Calculation Linkbase Document
(101.DEF)*	XBRL Taxonomy Extension Definition Linkbase Document
(101.LAB)*	XBRL Taxonomy Extension Label Linkbase Document
(101.PRE)*	XBRL Taxonomy Extension Presentation Linkbase Document

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

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

POWERSECURE INTERNATIONAL, INC.

Date: November 7, 2012

By: /s/ Sidney Hinton

Sidney Hinton
President and Chief Executive Officer

Date: November 7, 2012

By: /s/ Christopher T. Hutter

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