POWERSECURE INTERNATIONAL, INC.
Form 10-Q
May 07, 2014
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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 March 31, 2014

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

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

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

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

As of May 1, 2014, 22,364,162 shares of the issuer s Common Stock were outstanding.

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POWERSECURE INTERNATIONAL, INC.

FORM 10-Q

For the Quarterly Period Ended March 31, 2014

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PART I.

FINANCIAL INFORMATION

Item 1. Financial Statements

POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)

(in thousands, except share data)

	March 31, 2014	December 31, 2013
Assets		
Current Assets:		
Cash and cash equivalents	$ 38,210	$ 50,915
Trade receivables, net of allowance for doubtful accounts of $331 and $544, respectively	82,253	89,801
Inventories	18,226	16,864
Income taxes receivable	3,726	1,045
Deferred tax asset, net	5,368	5,368
Prepaid expenses and other current assets	2,285	2,235
Total current assets	150,068	166,228
Property, plant and equipment:		
Equipment	57,220	56,706
Furniture and fixtures	581	572
Land, building and improvements	6,149	6,134
Total property, plant and equipment, at cost	63,950	63,412
Less accumulated depreciation and amortization	18,510	17,467
Property, plant and equipment, net	45,440	45,945
Other assets:		
Goodwill	30,226	30,226
Restricted annuity contract	3,137	3,137
Intangible rights and capitalized software costs, net of accumulated amortization of $5,539 and $4,955, respectively	8,274	8,715
Other assets	1,211	1,240
Total other assets	42,848	43,318
Total Assets	$ 238,356	$ 255,491

See accompanying notes to condensed consolidated financial statements.

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POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)

(in thousands, except share data)

	March 31, 2014	December 31, 2013
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 16,802	$ 24,299
Accrued and other liabilities	25,125	31,195
Accrued restructuring liabilities	490	965
Current portion of long-term debt	3,731	3,731
Current portion of capital lease obligation	947	935
Total current liabilities	47,095	61,125
Long-term liabilities:		
Revolving line of credit		
Long-term debt, net of current portion	20,630	21,563
Capital lease obligation, net of current portion	745	986
Deferred tax liability, net	8,862	8,865
Other long-term liabilities	3,427	3,365
Total long-term liabilities	33,664	34,779
Commitments and contingencies (Notes 7 and 9)		
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 shares authorized; 22,347,147 and 21,945,720 shares issued and outstanding, respectively	223	219
Additional paid-in-capital	159,670	157,401
Retained earnings (deficit)	(2,208)	2,051
Accumulated other comprehensive income (loss)	(88)	(84)
Total stockholders equity	157,597	159,587
Total Liabilities and Stockholders Equity	$ 238,356	$ 255,491

See accompanying notes to condensed consolidated financial statements.

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POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

(in thousands, except per share data)

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Revenues	$ 52,797	$ 44,957
Cost of sales (excluding depreciation and amortization)	41,756	31,217
Gross profit	11,041	13,740
Operating expenses:		
General and administrative	13,044	9,832
Selling, marketing and service	2,009	1,385
Depreciation and amortization	2,178	1,456
Restructuring charges	427	
Total operating expenses	17,658	12,673
Operating income (loss)	(6,617)	1,067
Other income and (expenses):		
Interest income and other income	4	21
Interest expense	(300)	(105)
Income (loss) before income taxes	(6,913)	983
Income tax expense (benefit)	(2,654)	374
Net income (loss)	(4,259)	609
Net loss attributable to non-controlling interest		124
Net income (loss) attributable to PowerSecure International, Inc.	$ (4,259)	$ 733
Earnings (loss) per share attributable to PowerSecure International, Inc. common stockholders:		
Basic	$ (0.19)	$ 0.04
Diluted	$ (0.19)	$ 0.04
Weighted average common shares outstanding during the period:		
Basic	21,979	18,242
Diluted	21,979	18,495

See accompanying notes to condensed consolidated financial statements.

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POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (unaudited)

(in thousands)

	Three Months Ended March 31, 2014	2013
Net income (loss)	$ (4,259)	$ 609
Other comprehensive income (loss), net of tax:		
Cash flow hedge:		
Change in unrealized gain (loss)	(45)	
Reclassification adjustment for net (gains) losses included in net income (loss)	41	
Total comprehensive income (loss), net of tax	(4,263)	609
Comprehensive loss attributable to non-controlling interest		124
Comprehensive income (loss) attributable to PowerSecure International, Inc.	$ (4,263)	$ 733

See accompanying notes to condensed consolidated financial statements.

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POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

(in thousands)

	Three Months Ended March 31,	
	2014	**2013**
Cash flows from operating activities:		
Net income (loss)	$ (4,259)	$ 609
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,178	1,456
Stock compensation expense	278	141
Loss on disposal of miscellaneous assets	41	
Changes in operating assets and liabilities, net of effect of acquisitions:		
Trade receivables, net	7,548	4,698
Inventories	(1,362)	(4,607)
Other current assets and liabilities	(2,731)	902
Other noncurrent assets and liabilities	84	75
Accounts payable	(7,497)	(686)
Accrued and other liabilities	(6,070)	35
Accrued restructuring liabilities	(475)	(216)
Net cash provided by (used in) operating activities	(12,265)	2,407
Cash flows from investing activities:		
Acquisitions, net of cash acquired		(1,835)
Purchases of property, plant and equipment	(1,334)	(1,327)
Additions to intangible rights and software development	(151)	(130)
Proceeds from sale of property, plant and equipment	212	
Net cash used in investing activities	(1,273)	(3,292)
Cash flows from financing activities:		
Borrowings (payments) on revolving line of credit		
Principal payments on long-term borrowings	(933)	(40)
Principal payments on capital lease obligations	(229)	(217)
Proceeds from stock option exercises	1,995	215
Net cash provided by (used in) financing activities	833	(42)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(12,705)	(927)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	50,915	19,122

CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 38,210	$ 18,195

See accompanying notes to condensed consolidated financial statements.

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POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements

As of March 31, 2014 and December 31, 2013 and

For the Three Month Periods Ended March 31, 2014 and 2013

(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 three product and service offerings: our Distributed Generation products and services, our Utility Infrastructure products and services, and our Energy Efficiency products and services. These three product and service groups 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 reliably and efficiently. Our strategy is focused on growing these three products and services 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. They 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 these revenue groupings due to the unique market needs they are addressing, and the distinct technical disciplines and specific capabilities required for us to deliver them, including personnel, technology, engineering, and intellectual capital. Our Utility and Energy Technologies segment operates primarily out of our Wake Forest, North Carolina headquarters office, and its operations also include several satellite offices and manufacturing facilities, the largest of which are in the Raleigh and Greensboro, North Carolina, Atlanta, Georgia, Bethlehem, Pennsylvania, and Stamford, Connecticut 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.

We conduct all of our on-going business operations through our Utility and Energy Technologies segment. In 2011, we divested the non-core business operations of our Oil and Gas Services segment, which has ceased on-going operations. See Note 11 for more information concerning our reportable segments.

Basis of Presentation

Organization The accompanying condensed consolidated financial statements include the accounts of PowerSecure International, Inc. and its subsidiaries, 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), Solais Lighting, Inc. (Solais) and PowerPackages, LLC, as well as Southern Flow Companies, Inc. (Southern Flow), WaterSecure Holdings, Inc. (WaterSecure), and Marcum Gas Metering, Inc., which are collectively referred to as the Company or PowerSecure or we or us or our .

These condensed consolidated financial statements have been prepared pursuant to rules and regulations of the Securities and Exchange Commission. The accompanying condensed 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, 2013.

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 condensed consolidated financial position of us and our subsidiaries as of March 31, 2014 and the condensed consolidated results of our operations and cash flows for the three months ended March 31, 2014 and 2013.

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Principles of Consolidation The Condensed Consolidated financial statements include the accounts of PowerSecure International, Inc. and its subsidiaries after elimination of intercompany accounts and transactions.

Comprehensive Income or Loss Comprehensive income or loss represents the changes in stockholders equity during a period resulting from transactions and other events and circumstances from non-owner sources. At March 31, 2014 and December 31,2013, the balance of Accumulated other comprehensive income (loss) (Accumulated OCI) consisted solely of changes in the fair value of our interest rate cash flow hedge contracts, net of taxes.

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

Until May 20, 2013, we held a 90% controlling ownership interest in PowerSecure Solar, a distributed solar energy company which we acquired in June 2012. In addition, until May 22, 2013, we also held a 67% controlling ownership interest in IES, an LED lighting company in which we acquired our original controlling interest in 2010. On May 20, 2013, we acquired the 10% non-controlling ownership interest in PowerSecure Solar in exchange for a cash payment of $153 thousand. On May 22, 2013, we acquired the 33% non-controlling ownership interest in IES in exchange for 209 thousand shares of our common stock valued at a total of $2.9 million on the date of acquisition, issued pursuant to our acquisition shelf registration statement on Form S-4. As a result of these non-controlling interest acquisitions, both PowerSecure Solar and IES are now wholly-owned subsidiaries and there has been no non-controlling interest in those entities after the acquisition dates.

There was no non-controlling interest activity for the three months ended March 31, 2014. The following is a reconciliation of the amounts attributable to the non-controlling interest in IES and PowerSecure Solar for the three months ended March 31, 2013:

	Three Months Ended March 31, 2013		
	IES	PowerSecure Solar	Total
Balance, December 31, 2012	$ (6)	$ 446	$ 440
Capital contribution			
Income (loss)	(91)	(33)	(124)
Acquisition of non-controlling interest			
Balance, March 31, 2013	$ (97)	$ 413	$ 316

Use of Estimates The preparation of our condensed 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, among others, 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, deferred tax valuation allowance, purchase price allocations on business acquisitions, fair value estimates of interest rate swap contracts and any impairment charges on long-lived assets and goodwill.

Reclassifications Certain 2013 amounts have been reclassified to conform to current year presentation. Such reclassifications had no effect on net income (loss) or stockholders equity as previously reported.

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2. Summary of Significant Accounting Policies and Recent Accounting Standards

Revenue Recognition For our turn-key distributed generation projects, our utility infrastructure projects, and our ESCO energy efficiency projects, we recognize revenue and profit as work progresses using the percentage-of-completion method, which relies on various estimates. Nearly all of our turn-key distributed generation, utility infrastructure, and ESCO 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 the 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 turn-key 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 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 and our ESCO energy efficiency projects, revenues and gross profit are recognized as work is performed based on the relationship between actual costs incurred and total estimated costs at completion.

In all cases where we utilize the percentage-of-completion 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 are 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 contain cancellation provisions permitting the customer to cancel the contract prior to completion of a project. Such cancellation provisions generally require the customer to pay/reimburse us for costs we incurred on the project, 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 transmission 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.

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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 monitor collections and payments from our customers and adjust credit limits of customers based upon payment history and a customer s current credit worthiness, as judged by us. In certain instances, from time to time, we may purchase credit insurance on our accounts receivable in order to minimize our exposure to potential credit loss. We maintain a provision for estimated credit losses.

Concentration of Credit Risk We are subject to concentrations of credit risk from our cash and cash equivalents and accounts receivable. We limit our exposure to credit risk associated with cash and cash equivalents by placing them with multiple domestic financial institutions. Nevertheless, our cash in bank deposit accounts at these financial institutions frequently exceeds federally insured limits. 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.

Inventories Inventories are stated at the lower of cost (determined primarily on a specific-identification basis) or market. Our raw materials, equipment and supplies inventory consist primarily of equipment with long lead-times purchased for anticipated customer orders. Our work in progress inventory consists primarily of equipment and parts allocated to specific distributed generation turn-key projects and our utility infrastructure and ESCO project costs accounted for on the percentage-of-completion basis. Our finished goods inventory consists primarily of LED-based lighting products stocked to meet customer order and delivery requirements. We provide a valuation reserve primarily for raw materials, equipment and supplies and certain work in process inventory items that may be in excess of our needs, obsolete or damaged and requiring repair or re-work.

Property, Plant and Equipment Property, plant and equipment are stated at cost and are generally depreciated using the straight-line method over their estimated useful lives, which depending on asset class ranges from 3 to 30 years.

Goodwill and Other Intangible Assets We amortize the cost of specifically identifiable intangible assets that do not have an indefinite life over their estimated useful lives. We do not amortize goodwill and intangible assets with indefinite lives. We perform reviews of goodwill and intangible assets with indefinite lives for impairment annually, as of October 1, or more frequently if impairment indicators arise. We capitalize software development costs integral to our products once technological feasibility of the products and software has been determined. Purchased software and software development costs are amortized over five years, using the straight-line method. Patents and license agreements are amortized using the straight-line method over the lesser of their estimated economic lives or their legal term of existence, currently 3 to 5 years.

Debt Issuance Costs Debt issuance costs are capitalized and included in other current and non-current assets in our condensed consolidated balance sheets. These costs are amortized over the term of the corresponding debt instrument using the straight-line method for debt issuance costs related to the revolving portion of our credit facility and the effective interest method for debt issuance costs on our term loan debt. Amortization of debt issuance costs is included in interest expense in our condensed consolidated statements of operations.

Warranty Reserve We provide a standard one year warranty for our distributed generation, switchgear, utility infrastructure, and ESCO equipment and a five to ten year warranty for our LED lighting-based products. In certain cases, we offer extended warranty terms for those product lines. In addition, we provide longer warranties for our PowerSecure Solar products and services including a warranty period of generally one to five years for defects in material and workmanship, a warranty period that can extend to ten to twenty years for declines in power performance, and a warranty period which can extend to fifteen to twenty-five years on the functionality of solar panels which is generally backed by the panel manufacturer. 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 was $1.3 million at both March 31, 2014 and December 31, 2013, and is included in accrued and other liabilities in the accompanying condensed consolidated balance sheet.

Share-Based Compensation We measure compensation cost for all stock-based awards at their 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 last sale 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 March 31, 2014 and 2013 was $0.3 million and $0.1 million, respectively. All share-based compensation expense is included in general and administrative expense in the accompanying condensed consolidated statements of operations.

Impairment or Disposal of Long-Lived Assets We evaluate our long-lived assets whenever significant events or changes in circumstances occur that indicate that the carrying amount of an asset may be impaired. Recoverability of these assets is determined by comparing the forecasted undiscounted future cash flows from the operations to which the assets relate, based on management s best estimates using appropriate assumptions and projections at the time, to the carrying amount of the assets. If the carrying value is determined not to be recoverable from future operating cash flows, the asset is deemed impaired and an impairment loss is recognized equal to the amount by which the carrying amount exceeds the estimated fair value of the asset or assets. We did not record any long-lived asset impairment charges during the three months ended March 31, 2014 and 2013.

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.

Derivative Financial Instruments Our derivative financial instruments consist solely of two interest rate swap contracts that are used to hedge our interest rate risk on a portion of our variable rate debt. These interest rate swap contracts are designated as cash flow hedges. It is our policy to execute such interest rate swaps with creditworthy banks and we do not enter into derivative financial instruments for speculative purposes.

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Fair Value Measurements We measure our derivative instruments at fair value on a recurring basis. The fair value measurements standard establishes a framework for measuring fair value. The framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements), and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under the standard are described below:

Level 1	Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.
Level 2	Inputs to the valuation methodology include: Quoted market prices for similar assets or liabilities in active markets; Quoted prices for identical or similar assets or liabilities in inactive markets; Inputs other than quoted prices that are observable for the asset or liability; Inputs that are derived principally from or corroborated by observable market data by correlation or other means. If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.
Level 3	Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset s or liability s fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

See Note 6 for more information concerning the fair value of our derivative instruments.

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.

Recent Accounting Pronouncements

Reporting Discontinued Operations In April 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-08: Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity (ASU No. 2014-08). This standard changes the definition of a discontinued operation to include only those disposals of components of an entity that represent a strategic shift that has (or will have) a major effect on an entity s operations and financial results, and changes the criteria and enhances disclosures for reporting discontinued operations. The pronouncement is to be applied prospectively, and is effective for our fiscal year that begins January 1, 2015. We do not expect that the adoption of this pronouncement will have a material effect on our consolidated financial statements.

Presentation of Unrecognized Tax Benefit In July 2013, the FASB issued Accounting Standards Update No. 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit when a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (ASU No. 2013-11). This standard requires an entity to present unrecognized tax benefits as a reduction to deferred tax assets when a net operating loss carryforward, similar tax loss or a tax credit carryforward exists, with limited exceptions. This standard became effective for us commencing January 1, 2014. We applied the standard on a retrospective basis. The adoption of this standard resulted in the reclassification of $0.9 million of unrecognized tax benefit liabilities against the balance of our current deferred tax asset at both March 31, 2014 and December 31, 2013, but had no effect on our net income (loss) or stockholders equity.

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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. A total of 451 thousand common shares issuable upon the potential exercise of outstanding stock options were excluded from the calculation of diluted weighted average number of shares outstanding for the three months ended March 31, 2014, because their effect was antidilutive to our net loss for that period.

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 March 31,	
	2014	**2013**
Net income (loss) attributableto PowerSecure International, Inc.	$ (4,259)	$ 733
Basic weighted-average common shares outstanding in period	21,979	18,242
Dilutive effect of stock options		253
Diluted weighted-average common shares outstanding in period	21,979	18,495
Basic earnings per common share	$ (0.19)	$ 0.04
Diluted earnings per common share	$ (0.19)	$ 0.04

4. Restructuring Charges

During 2013 and 2012, we engaged in restructuring programs designed to reduce our cost structure and improve productivity. These initiatives consisted of realigning operations, reducing employee counts, rationalizing facilities, changing manufacturing sourcing, eliminating certain products, and other actions designed to reduce our cost structure and improve productivity. We also incurred inventory and long-term asset impairment charges in connection with our 2013 restructuring activities for assets sold or made obsolete as a result of this program. Our restructuring program activities and the balances of our accrued restructuring liabilities at March 31, 2014 and December 31, 2013 are described in greater detail below.

2013 Business Realignment Charges During the fourth quarter 2013, we initiated a business realignment program, taking actions to realign our operations to gain cost and performance efficiencies. These actions, which primarily involved our LED lighting operations in our Utility and Energy Technologies segment, consisted of the sale of manufacturing equipment and parts inventory, reorganization of the leadership teams, closing facilities and re-sourcing manufacturing from low-cost manufacturers, eliminating certain products, and the reduction of our overhead cost structure by eliminating duplicative facilities and personnel involved in production, sourcing, warehousing and distribution activities. As a result of these 2013 business realignment initiatives, we incurred pre-tax restructuring charges totaling

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$0.7 million during the three months ended March 31, 2014. These charges consisted of severance and related costs from the elimination of employee positions, inventory write offs, and lease abandonments charges. The inventory write-offs in the amount of $0.3 million during the three months ended March 31, 2014 are included in cost of sales. The expenses associated with the remaining 2013 business realignment charges total $0.4 million and are included in restructuring charges as a component of operating expenses. We do not expect to incur significant charges associated with the 2013 business realignment initiatives after March 31, 2014.

The following table summarizes the 2013 business realignment plan activities, and the balance of our accrued liabilities at and for the three months ended March 31, 2014:

2013 Business Realignment Charges:	**Employee Termination Costs**	**Inventory Writedowns and Long Term Asset Disposals**	**Leasehold Termination and Other Facility Exit Costs**	**Total**
Accrued 2013 business realignment charges, December 31, 2013	$ 681	$	$ 110	$ 791
Costs incurred and charged to cost of sales		312		312
Costs incurred and charged to restructuring expense	162	116	149	427
Costs paid or otherwise settled	(621)	(428)	(114)	(1,163)
Accrued 2013 business realignment charges, March 31, 2014	$ 222	$	$ 145	$ 367

2012 Cost Reduction Program Charges 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 was to reduce expenses as a percentage of revenues in future periods thereby improving our operating margin. The associated cost reduction charges were incurred entirely in the second half of 2012. The following table summarizes the 2012 cost reduction program activities, and the balance of the 2012 cost reduction program liabilities at and for the three months ended March 31, 2014:

2012 Cost Reduction Program Charges:	**Employee Termination Costs**
Accrued 2012 cost reduction program charges, December 31, 2013	$ 174
Costs incurred and charged to expense	
Costs paid or otherwise settled	(51)
Accrued 2012 cost reduction program charges, March 31, 2014	$ 123

The balances of accrued restructuring charges at March 31, 2014 and December 31, 2013 are included in current liabilities in our consolidated balance sheet. We expect the majority of the balance of our accrued restructuring charges at March 31, 2014 will be paid or otherwise settled during the remainder of 2014.

5. Debt and Interest Rate Swap Contracts

We have had a long-term 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 March 31, 2014 and December 31, 2013, our credit agreement with Citibank along with Branch Banking and Trust Company (BB&T) as additional lender, consisted of a $20.0 million senior, first-priority secured revolving line of credit maturing on November 12, 2016, a $2.6 million term loan maturing on November 12, 2016, and a $25.0 million, 7 year amortizing term loan maturing on June 30, 2020. The credit facility has been guaranteed by all our active subsidiaries and is secured by the assets of us and those subsidiaries.

The following table summarizes the balances outstanding on our long-term debt, including our revolving line of credit, with Citibank and BB&T at March 31, 2014 and December 31, 2013:

	March 31, 2014	December 31, 2013
Revolving line of credit, maturing November 12, 2016	$	$
Term loan, principal of $0.04 million plus interest payable quarterly at variable rates, maturing November 12, 2016	2,040	2,080
Term loan, principal of $0.9 million plus interest payable quarterly at variable rates, maturing June 30, 2020	22,321	23,214
Total debt	24,361	25,294
Less: Current portion	(3,731)	(3,731)
Long-term debt, net of current portion	$ 20,630	$ 21,563

We have used, and intend to continue to use, the proceeds available under the credit facility to support our growth and future investments in Company-owned distributed generation projects, additional utility services equipment, working capital, other capital expenditures, acquisitions and general corporate purposes.

Outstanding balances under the credit facility bear interest, at our discretion, at either the London Interbank Offered Rate (LIBOR) for the corresponding deposits of U. S. Dollars plus an applicable margin, which is on a sliding scale ranging from 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%.

Scheduled principal payments on our outstanding debt obligations at March 31, 2014, are as follows:

Scheduled Principal Payments for the Year Ending December 31:	Revolving Line of Credit	$25.0 Million Term Loan	$2.6 Million Term Loan	Total Principal Payments
Remainder of 2014	$	$ 2,678	$ 120	$ 2,798
2015		3,571	160	3,731
2016		3,571	1,760	5,331
2017		3,572		3,572
2018 and thereafter		8,929		8,929
Total scheduled principal payments	$	$ 22,321	$ 2,040	$ 24,361

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In July 2013, we entered into two forward-starting interest rate swap contracts based on three-month LIBOR that effectively converted 80% of the outstanding balance of our $25 million Term Loan to fixed rate debt. As discussed further in Note 6, we have designated the interest rate swaps as a cash flow hedge of the interest payments due on our floating rate debt. Accordingly, at March 31, 2014, $17.9 million of our outstanding debt bears interest at a fixed rate of 3.73% and $6.5 million of our outstanding debt bears interest at floating rates as described above. The termination dates of the swap contracts and the maturity date of the $25 million Term Loan are both June 30, 2020.

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 of approximately $104 million at March 31, 2014, computed on a quarterly basis, which minimum level represents the sum of $75.0 million, plus an amount equal to 50% of our net income each fiscal year ending December 31, 2013, with no reduction for any net loss in any fiscal year, plus 90% 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 30%. As of March 31, 2014, we were in compliance with these financial covenants.

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

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 was an aggregate balance of $24.4 million outstanding under the two term loans under our credit facility as of March 31, 2014. There were no balances outstanding on the revolving portion of the credit facility at, or during the three months ended, March 31, 2014 or at December 31, 2013 or at May 7, 2014. We currently have $20.0 million available to borrow under the revolving portion of the credit facility. 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.

6. Derivative Instruments and Hedging Activities

In July 2013, we entered into two forward-starting interest rate swap contracts to manage interest rate risk associated with a portion of our $25 million Term Loan floating rate debt (see Note 5). The interest rate swaps effectively converted 80% of our $25.0 million floating rate term loan to a fixed rate term loan bearing interest at the rate of 3.73%. The notional amount of the interest rate swaps at March 31, 2014 was $17.9 million. The termination dates of the swap contracts and the maturity date of the $25 million Term Loan are both June 30, 2020.

In accordance with ASC 815, *Derivatives and Hedging*, we have designated both of our interest rate swaps as cash flow hedges of the interest payments due on our floating rate debt. To qualify for designation as a cash flow hedge, specific criteria must be met and the appropriate documentation maintained. Hedging relationships are established pursuant to our risk management policies and are initially and regularly evaluated to determine whether they are expected to be, and have been, highly effective hedges. For our interest rate swap contracts designated as a cash flow hedge of interest on our floating rate debt, the effective portion of the change in fair value of the derivative is reported in other comprehensive income and reclassified into earnings in the period in which the hedged item affects earnings. Any amounts excluded from the effectiveness calculation and any ineffective portion of the change in fair value of the derivative are recognized currently in earnings.

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The interest rate swaps are measured at Level 2 fair value on a recurring basis, using standard pricing models and market-based assumptions for all significant inputs, such as LIBOR yield curves. The fair value of the interest rate swap contracts included within our consolidated balance sheets as of March 31, 2014 and December 31, 2013, are as follows:

Derivative designated as hedging instrument:	Balance Sheet Location	March 31, 2014	December 31, 2013	Balance Sheet Location	March 31, 2014	December 31, 2013
Interest rate swaps	Other assets	$	$	Other long-term liabilities	$ 164	$ 157

The following tables present the effects of derivative instruments designated as cash flow hedges on our consolidated statements of operations and accumulated other comprehensive income (loss) (AOCI):

AOCI Component	Amounts Reclassified from AOCI into income Three Months Ended March 31, 2014	2013	Affected Line Item in the Consolidated Statements of Operations
Gain (loss) on cash flow hedges:			
Interest rate swaps	$ 69	$	Interest expense
	(28)		Tax expense (benefit)
	$ 41	$	Net of tax

AOCI Component	Amount of gain (loss) recognized in AOCI Three Months Ended March 31, 2014	2013
Gain (loss) on cash flow hedges:		
Unrealized gain (loss) Interest rate swaps	$ (75)	$
Tax (expense) benefit	30	
Gain (loss) Net of tax	$ (45)	$

We did not realize any ineffectiveness related to our cash flow hedges during the three months ended March 31, 2014 and 2013.

7. 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 $0.1 million 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 condensed 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.

The balance of our capital lease obligations shown in the condensed consolidated balance sheet at March 31, 2014 and December 31, 2013 consists entirely of our obligations under the equipment lease described above.

8. 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 (loss) for the three months ended March 31, 2014 and 2013 includes $44 thousand and $39 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 condensed consolidated statements of operations.

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A summary of option activity for the three months ended March 31, 2014 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Balance, December 31, 2013	669	$ 8.59		
Granted				
Exercised	(218)	9.18		
Expired				
Forfeited				
Balance, March 31, 2014	451	$ 8.31	5.01	$ 15.13
Exercisable, March 31, 2014	299	$ 7.42	3.34	$ 16.02

A summary of option activity for the three months ended March 31, 2013 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Balance, December 31, 2012	838	$ 7.21		
Granted	5	8.25		
Exercised	(45)	4.77		
Expired				
Forfeited				
Balance, March 31, 2013	798	$ 7.35	4.43	$ 5.36
Exercisable, March 31, 2013	636	$ 7.75	3.52	$ 4.96

There were no options granted during the three months ended March 31, 2014. The weighted average grant date fair value of the options granted during the three months ended March 31, 2013 was $3.43. The fair value of the stock options granted during the three months ended March 31, 2014 and 2013 was measured using the Black-Scholes valuation model with the following assumptions:

	Three Months Ended March 31,	
	2014 (1)	2013

Expected stock price volatility	n/m	47.5%
Risk free interest rate	n/m	0.8%
Annual dividends	n/m	$
Expected life (years)	n/m	5

(1) 2014 amounts are not meaningful as there were no stock options granted during the period.

The fair value of stock option grants is amortized to expense over the respective service periods using the straight-line method and assuming a forfeiture rate of 5%. As of March 31, 2014 and December 31, 2013, there was $0.5 million and $0.5 million, respectively, of total unrecognized compensation costs related to stock options. These costs at March 31, 2014 are expected to be recognized over a weighted average period of approximately 1.9 years.

During the three months ended March 31, 2014 and 2013, the total intrinsic value of stock options exercised was $3.3 million and $0.2 million, respectively. Cash received from stock option exercises during the three months ended March 31, 2014 and 2013 was $2.0 million and $0.2 million, respectively. The total grant date fair value of stock options vested during the three months ended March 31, 2014 and 2013 was $5 thousand and $5 thousand, respectively.

Restricted Stock Awards Net income (loss) for the three months ended March 31, 2014 and 2013 includes $0.2 million and $0.1 million, respectively, of pre-tax compensation costs related to the vesting of outstanding restricted stock awards granted to directors and employees. All of the restricted stock award compensation expense during the three months ended March 31, 2014 and 2013 is included in general and administrative expenses in the accompanying condensed consolidated statements of operations.

A summary of restricted stock award activity for the three months ended March 31, 2014 is as follows:

	Unvested Restricted Shares	**Weighted Average Grant Date Fair Value**
Balance, December 31, 2013	387	$ 14.37
Granted	184	23.33
Vested	(3)	15.18
Forfeited		
Balance, March 31, 2014	568	$ 17.27

A summary of restricted stock award activity for the three months ended March 31, 2013 is as follows:

	Unvested Restricted Shares	**Weighted Average Grant Date Fair Value**
Balance, December 31, 2012	100	$ 5.62
Granted	30	8.42
Vested	(15)	4.21
Forfeited		
Balance, March 31, 2013	115	$ 6.53

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 generally vest over five or ten years. All restricted and unvested shares automatically vest upon a change in control.

The fair value of the restricted shares is amortized on a straight-line basis over the respective vesting period. At March 31, 2014, the balance of unrecognized compensation cost related to unvested restricted shares was $9.5 million, which is expected to be recognized over a weighted average period of approximately 6.0 years.

9. Commitments and Contingencies

Performance Bonds and Parent Guarantees In the ordinary course of business, we are required by certain customers to post surety or performance bonds in connection with services that we provide to them. These bonds provide a guarantee to the customer that we will perform under the terms of a contract and that we will pay subcontractors and vendors. If we fail to perform under a contract or to pay subcontractors and vendors, the customer may demand that the surety make payments or provide services under the bond. We must reimburse the surety for any expenses or outlays it incurs. As of March 31, 2014, we had approximately $102 million in surety bonds outstanding. Based upon the current status of our contracts and projects, we estimate our remaining exposure on these surety bonds was approximately $33 million at March 31, 2014. We have not been required to make any reimbursements to our sureties for bond-related costs, and we do not currently expect that we will have to fund significant claims under our surety arrangements in the foreseeable future.

Other Matters 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, or may invalidate warranties or performance certifications. 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. As a result, from time to time we encounter situations in which the responsibility for the performance issues is unclear, or difficult to ascertain. Because of our strong focus on customer satisfaction, we often take on the cost of repairs in excess of our contractual obligations. Additionally, the outcome of any performance disputes or 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. As a result, 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 5-10% 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 have made progress in correcting or mitigating, but which continue to represent operational and financial risks to our business: 1) a component we incorporated into a distributed generation system configuration installed in many of the systems deployed for our customers has been deemed to invalidate the generator manufacturer s warranty and may cause other customer issues and costs, and 2) generators we purchased from a certain supplier have had performance issues in a 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 certain elements of their risk, but the risk is not eliminated. Given that we continue to have risk related to these matters, and the inherent uncertainty in assessing and quantifying the costs and certainty regarding their resolution, we are unable to estimate the potential negative impacts from these two particular items, if any, in addition to other component part performance issues discussed above. In addition, we have not recorded any specific adjustment to our warranty reserve for these particular performance issues, other than our regular reserves for minor repairs, as the estimated cost, if any, of fulfilling our obligations for these matters within a possible range of outcomes is not determinable as of this date.

From time to time, we are involved in other disputes, claims, proceedings and legal actions arising in the ordinary course of business. We intend to vigorously defend all claims against us, and pursue our full legal rights in cases where we have been harmed. 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.

10. Income Taxes

The income tax expense (benefit) recorded at March 31, 2014 and 2013 represents our income (loss) before income taxes multiplied by our best estimate of our expected annual effective tax rate taking into consideration our expectation of future earnings, federal income 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.

At both March 31, 2014 and December 31, 2013, we had a current deferred tax asset of $6.3 million, which was primarily related to our net operating loss carryforwards. Similarly, at both March 31, 2014 and December 31, 2013, we had a liability in the amount of $0.9 million for unrecognized tax benefits. In accordance with the provisions of ASU No. 2013-11, we have reclassified the liability for the unrecognized tax benefit as a reduction of our net current deferred tax asset at both March 31, 2014 and December 31, 2013. The reclassification of the liability for the unrecognized tax benefit and corresponding reduction of our net current deferred tax asset had no effect on our income tax expense for the three months ended March 31, 2014 or on our stockholders equity at either March 31, 2014 or at December 31, 2013.

11. Segment Information

We conduct our core business operations through our Utility and Energy Technologies segment. In 2011, we divested the non-core business operations of our Oil and Gas Services segment, which has ceased operations.

Our reported segments are strategic business units with different products and services and serve different customer bases. They are separate because each segment requires different technology and marketing strategies. Our operating segments also represent components for which discrete financial information is available and is (or was, in the case of our Oil and Gas Services segment) 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 product and service offerings: our Distributed Generation products and services, our Utility Infrastructure products and services, and our Energy Efficiency products and services. These three product and service groupings 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. They 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 these groups 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.

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The accounting policies of the reportable segments are the same as those described in Note 2 of the notes to condensed 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 and Other amounts include corporate overhead, insignificant results related to our divested Oil and Gas Services Segment, and other income and interest expense amounts which, for purposes of evaluating the operations of our segments, are not allocated to our segment activities. Total asset amounts exclude intercompany receivable balances eliminated in consolidation.

	Three Months Ended March 31, 2014		
	Utility and Energy Technologies	Unallocated Corporate and Other	Total
Revenues	$ 52,797	$	$ 52,797
Cost of Sales (excluding depreciation and amortization)	41,756		41,756
Gross Profit	11,041		11,041
Operating expenses:			
General and administrative	11,671	1,373	13,044
Selling, marketing and service	2,009		2,009
Depreciation and amortization	2,178		2,178
Restructuring charges	427		427
Total operating expenses	16,285	1,373	17,658
Operating income (loss)	(5,244)	(1,373)	(6,617)
Other income and (expenses):			
Interest income and other income		4	4
Interest expense	(45)	(255)	(300)
Income (loss) before income taxes	$ (5,289)	$ (1,624)	$ (6,913)
Total capital expenditures	$ 1,485	$	$ 1,485
Total goodwill	$ 30,226	$	$ 30,226
Total assets	$ 196,949	$ 41,407	$ 238,356

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	Three Months Ended March 31, 2013		
	Utility and Energy Technologies	Unallocated Corporate and Other	Total
Revenues	$ 44,957	$	$ 44,957
Cost of Sales (excluding depreciation and amortization)	31,217		31,217
Gross Profit	13,740		13,740
Operating expenses:			
General and administrative	8,602	1,230	9,832
Selling, marketing and service	1,385		1,385
Depreciation and amortization	1,456		1,456
Restructuring charges			
Total operating expenses	11,443	1,230	12,673
Operating income (loss)	2,297	(1,230)	1,067
Other income and (expenses):			
Interest income and other income		21	21
Interest expense	(58)	(47)	(105)
Income (loss) before income taxes	$ 2,239	$ (1,256)	$ 983
Total capital expenditures	$ 1,457	$	$ 1,457
Total goodwill	$ 16,703	$	$ 16,703
Total assets	$ 156,373	$ 13,106	$ 169,479

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

Introduction

The following discussion and analysis of our consolidated results of operations for the three month period ended March 31, 2014, which we refer to as the first quarter 2014, and the three month period ended March 31, 2013, which we refer to as the first quarter 2013, and of our consolidated financial condition as of March 31, 2014 should be read in conjunction with our condensed consolidated financial statements and related notes included elsewhere in this report.

Cautionary Note Regarding Forward-Looking Statements

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

our prospects, including our future business, revenues, expenses, net income (loss), earnings (loss) 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 (loss), earnings (loss) 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 our business acquisitions;

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

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

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

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

- fluctuations in our effective tax rates, including the expectation that with the utilization of a significant portion of our tax net operating losses in recent years 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, 2013, 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 consists of our three product and service offerings: our Distributed Generation products and services, our Utility Infrastructure products and services, and our Energy Efficiency products and services. These three product and service groups 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 reliably and efficiently.

Our strategy is focused on growing these three product and service offerings because they address large unmet market opportunities due to their strong customer value propositions, and because they require unique knowledge and skills that utilize our core competencies. They share a number of common or complementary utility relationships and customer types, common sales and overhead resources, and common facilities.

Our business operates primarily out of our Wake Forest, North Carolina headquarters office, and our operations also include several satellite offices and manufacturing facilities, the largest of which are in the following areas: Raleigh and Greensboro, North Carolina; Atlanta, Georgia; Bethlehem, Pennsylvania; and Stamford, Connecticut. The locations of our sales organization and field employees are generally in close proximity to the utilities we serve and to their commercial, industrial and institutional customers. We conduct our business through our wholly-owned subsidiary, PowerSecure, Inc.

We conduct all of our on-going business operations through our Utility and Energy Technologies segment. In 2011, we divested the non-core business operations of our Oil and Gas Services segment, which has ceased operations.

Distributed Generation

Our Distributed Generation solutions involve manufacturing, installing and operating electric generation equipment on site at a facility where the power is used, including commercial, institutional and industrial operations. Our systems provide a highly 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. In addition, our solar energy systems provide utilities and their customers with environmentally friendly power to augment their core power requirements.

Our 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 traditional business model, which is our predominant 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, after the system is installed 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 for us, which we refer to as our recurring revenue model or PowerSecure-owned or company-owned model. For Distributed Generation systems deployed 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 as shared savings arrangements, although they can also be structured with fixed monthly payments. For our shared savings 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 highly 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, and utilities and their customers receive access to our system without making a large up-front investment of capital. Under the PowerSecure-owned model, contracts can be structured between us and the utility, us and the customer, or all three parties.

In the first quarter 2014, 80.0% of our Distributed Generation revenues consisted of customer-owned sales, and 20.0% 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, shifts in the sales of customer-owned versus PowerSecure-owned systems have significant impacts on our near-term revenues and profits and cause them to fluctuate from period-to-period. An additional contrast of the two models is that 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 requires us to invest our own capital in the project without any return on capital until after the project is completed, installed, commissioned and successfully operating.

Our 2012 acquisition of PowerSecure Solar provided us with the ability to deliver 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 expect we will own and operate certain systems in the future under a PowerSecure-owned , recurring revenue model.

Utility Infrastructure Solutions

Our Utility Infrastructure business is focused on helping electric utilities design, build, upgrade and maintain infrastructure that enhances the efficiency of their grid systems.

Our largest source of revenue within our Utility Infrastructure area is our UtilityServices products and services. We have significantly expanded our UtilityServices scope of utility relationships, customers and geography over the last few years. Our UtilityServices team provides utilities with transmission and distribution construction and maintenance, including substation construction and maintenance, advanced metering and lighting installations, and storm restoration. In addition to providing these services directly to utilities, we also perform this work on behalf of utilities for their large industrial and institutional customers, and directly to large oil and gas companies. Similar to the products and services we provide for utilities, our work for large utility customers includes turn-key design, procurement and construction services for large transmission and distribution projects, including substations. Our resources include a fleet of owned and leased utility vehicles along with experienced field personnel and engineers, and we also utilize third party resources from time to time, as needed, to supplement our internal resources on particular projects.

Through our Encari, UtilityEngineering and PowerServices teams, we serve the engineering and consulting needs of our utility clients, broadening our offerings to our utility partners. The scope of services that we offer through UtilityEngineering includes technical engineering services for our utility partners and their customers, including design and engineering relating to virtually every element of their transmission and distribution systems, substations and renewable energy facilities. Through PowerServices, we provide management consulting services to utilities and commercial and industrial customers, including planning and quality improvement, technical studies involving reliability analysis and rate analysis, acquisition studies, accident investigations and power supply contracts and negotiations. Our Encari business, which we acquired in October 2013, provides cybersecurity consulting and compliance services to the utility industry. Our team of engineers operates in various locations, with principal offices in Raleigh, North Carolina.

Revenues for our UtilityServices products and services are generally earned, billed, and recognized using two primary models. Under the first model, we have regular, on-going assignments with utilities to provide 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 a time and materials 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 contractual 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 the future we could be engaged by utilities and their customers to build or upgrade transmission and distribution infrastructure that we own and maintain. In those cases, we would receive fees over a long-term contract in exchange for providing the customer with access to the infrastructure to transmit or receive power.

Revenues for our Encari, UtilityEngineering and PowerServices consulting services 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 Solutions

We deliver Energy Efficiency solutions to assist our customers in the achievement of their energy efficiency goals. We have two primary product and service offerings in our Energy Efficiency Solutions: 1) LED lighting fixtures and lamps, and 2) energy efficiency upgrades for our ESCO customers. Our LED lighting solutions are primarily focused on the utility, commercial and industrial markets, while our ESCO energy efficiency solutions are focused on serving the ESCO channel. In the future, we plan to bring our Distributed Generation and LED lighting solutions to our ESCO customer base. In both of our Energy Efficiency product and service lines we deliver highly engineered product solutions and upgrades with strong value propositions that are designed to reduce energy costs, improve operations and benefit the environment.

Our LED lighting solutions include our Solais, EfficientLights, IES and EnergyLite operations and brands, all of which are focused on bringing LED lighting solutions to the marketplace. As a result of our acquisition of Solais in 2013, we recently realigned and consolidated these operations into Solais, which is now leading all of our LED operations, although we may continue to have legacy brands in the marketplace for a period of time. In 2013, we acquired our ESCO solutions, which give us the capability to provide general lighting, building envelope, HVAC and water efficiency solutions to the super ESCOs, which are the largest of the energy service companies and which deliver these energy efficiency solutions to commercial, industrial and institutional facilities.

Our LED lighting products, led by our Solais team and operations, include the following:

- Our Solais brand, which includes LED-based lamps and fixtures for department stores and other commercial applications. The 2013 acquisition of Solais strengthened and complemented our existing LED lighting business through the addition of these new product lines and customer channels. This acquisition also enhanced our skill sets around product design, product commercialization, and manufacturing and sourcing capabilities. Solais oversees all of our LED lighting operations.

- Our EfficientLights brand, which includes LED-based lighting fixtures for grocery, drug and convenience stores. EfficientLights products include our EfficientLights fixture for reach-in refrigerated cases, shelf and canopy lighting for open refrigerated cases, overhead lighting for walk-in storage coolers, and outdoor lighting.

- Our IES brand, which includes LED-based lighting fixtures for utilities, commercial and industrial, and OEM applications. IES products include street lights, area lights, indoor overhead lighting, and other specialty lighting applications.

- Our EnergyLite brand, which is used to market our IES and EfficientLights brands primarily, but we may also use it from time to time for other LED lighting solutions. EnergyLite s products are marketed to customers and utilities directly, and through third party distribution arrangements.

The primary client base for our ESCO products and services include large energy service companies, referred to as super ESCOs . Through our relationships with super ESCOs, we provide facility upgrades for public sector customers, including federal, state and local government agencies and educational institutions. As super ESCOs are awarded project contracts with public sector clients, we assist them by providing energy efficiency expertise to develop and implement tailored solutions under their contracts. From time to time, we also serve larger commercial and industrial clients for which we provide our energy efficiency solutions directly, when a super ESCO is not involved in the customer relationship.

We focus on deploying solutions to improve the energy efficiency of large facilities, including reducing energy-related expenditures, and the impact of energy use on operations and the environment. This helps our super ESCO customers save money, improve facilities and meet energy efficiency goals and mandates for their end-customers. Our solutions include energy efficient lighting upgrades, energy efficient mechanical and electrical retrofit and upgrade services, water conservation, building weatherization, and renewable energy project development and implementation. We provide energy solutions across a range of facilities, including high-rise office buildings, distribution facilities, manufacturing plants, retail sites, multi-tenant residential buildings, mixed use complexes, hospitals, universities and large government sites. In the future we plan to offer our Distributed Generation and LED lighting products as part of these solutions.

Our LED lighting revenues are generated through the sale of LED-based light fixtures and lamps. Our portfolio of products consists exclusively of our proprietary designs, which are generally focused on very specific applications. These applications require our lights to be highly engineered to maximize the quality, and amount of light produced, at the lowest cost. This formula, in turn, enables us to provide our customers with lighting that maximizes the return on investment for their lighting spend. We design and manufacture our LED-based lights for utilities, commercial and industrial customers. Our lighting generally reduces energy consumption by 60-70%, improves the quality of light, reduces maintenance expense, extends light life by several-fold, lowers a facilities carbon footprint, and eliminates the use of traditional lighting which can contain environmental hazards.

Our LED lighting product line includes:

- LED-based lamps and fixtures for department stores and other commercial applications, including display and down-lighting;
- LED-based lighting fixtures for grocery, drug and convenience stores, including lights for reach-in refrigerated cases, shelf and canopy lighting for open refrigerated cases, overhead lighting for walk-in storage coolers, and outdoor lighting; and
- LED-based lighting fixtures for utilities, commercial and industrial, and OEM applications, including street lights, area lights, indoor overhead lighting, and other specialty lighting applications.

The majority of our LED lights are sold as retrofits for existing traditional lighting, and to a lesser extent for new construction lighting installations. Additionally, the majority of our lights are sold by us directly to the customer, although we also have distributor relationships that serve certain product lines. Occasionally we 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, utilities, department stores, and large commercial and industrial customers. These customers typically install LED lighting across numerous locations over a diverse geographic scope. 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, we expect to employ a similar business model with our LED lighting products.

Our ESCO energy efficiency revenues are generated through a full range of turn-key services we provide to the super ESCOs. We apply our engineering expertise to analyze each facility s energy consumption and operational needs, and develop customized energy efficiency and renewable energy solutions to optimize that facility s return on investment. We provide complete turn-key implementation services for a range of energy efficiency and renewable energy projects, including energy efficient lighting upgrades, energy efficiency mechanical and electrical retrofit and upgrade services, water conservation, weatherization, combined heat and power or cogeneration and renewable project development and implementation. We consider factors such as current facility infrastructure, best available technologies, building environmental conditions, hours of operation, energy costs, available utility rebates, tax incentives, and installation, operation and maintenance costs of various efficiency alternatives. Our extensive knowledge of energy solutions and their results in numerous environments enables us to apply the most appropriate, effective and proven technologies available in the marketplace.

Recent Developments

In the first quarter 2014, we substantially completed our 2013 restructuring and realignment program that is designed to integrate and streamline our operations and product offerings primarily within our Energy Efficiency product area. These activities, which occurred during the fourth quarter of 2013 and the first quarter 2014, included eliminating certain duplicative facilities, re-sourcing from certain of our energy efficiency suppliers, reducing the number of our Energy Efficiency product offerings, and streamlining our overall organization. These restructuring and realignment actions resulted in a charge of $0.7 million in the first quarter 2014, of which $0.3 million was included in our cost of sales. In total, we incurred $5.6 million of charges related to our 2013 restructuring and realignment program during the fourth quarter of 2013 and the first quarter 2014. We do not expect to incur significant charges related to our 2013 restructuring and realignment program after March 31, 2014.

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On April 25, 2014, we announced that we received approximately $23 million in new business awards. The new business awards included $8 million of new turn-key distributed generation business, $6 million in new recurring distributed generation revenues, $5 million in new ESCO energy efficiency projects, and $4 million in new utility infrastructure awards.

Financial Results Highlights

Our consolidated revenues in the first quarter 2014 of $52.8 million increased by $7.8 million, or 17.4%, compared to our consolidated revenues during the first quarter 2013. The drivers of this year-over-year revenue increase included a $7.0 million, or 35.2%, increase in revenues from Utility Infrastructure products and services and a $4.3 million, or 104.2%, increase in revenues from Energy Efficiency products and services, partially offset by a $3.5 million, or 16.5% reduction in revenues from Distributed Generation products and services. Overall, $6.2 million of the increase in revenues was due to incremental revenues from our Solais, Encari and ESCO operations which we acquired in 2013, and the remaining $1.6 million of incremental revenue growth occurred in our existing operations, representing a 3.7% increase over our consolidated revenues in the first quarter 2013. Overall, our revenue growth is the result of our continued strategy of growing our revenues by expanding our product and services lines, our customer and market base, our geographic footprint, and our utility partners. The reduction in revenues in our Distributed Generation product line during the quarter was a result of a reduction in traditional turn-key Distributed Generation project sales, and to a lesser extent, a reduction in solar distributed generation project sales.

Our first quarter 2014 gross margin as a percentage of revenue decreased to 20.9%, compared to 30.6% in the first quarter 2013. This year-over-year gross margin decrease was driven primarily by inefficiencies in our Utility Infrastructure services, in particular our UtilityServices group, as we took actions to shift resources, including equipment and people, away from certain lower-profit assignments. Our intent was to deploy these resources towards customer opportunities to increase our long-term profitability. However, we were not successful in redeploying all of the assets to new assignments in a timely manner as a result of lower-than-expected revenues from certain customers. These productivity losses caused us to incur higher levels of personnel and equipment cost in our cost of goods sold as a percentage of our revenues, driving the gross margin on our UtilityServices revenue to 5.9 percent for the first quarter 2014, and our overall Utility Infrastructure revenue gross margin to 9.9 percent. This compares to 25.6% Utility Infrastructure revenue gross margin in the first quarter 2013. Distributed Generation revenue gross margins were 36.2% in the first quarter 2014 compared to 36.0% in the first quarter 2013. Energy efficiency revenue gross margins were 24.2% in the first quarter 2014 compared to 26.6% in the first quarter 2013. The year-over-year gross margin decrease in our Energy Efficiency gross margins was due to the $0.3 million inventory charge incurred as part of our restructuring and realignment activities. As is always the case, variability in our quarterly and year-to-date gross margins is also caused by regular on-going differences in the mix of specific projects completed in each period.

Our operating expenses during the first quarter 2014 increased by $5.0 million, or 39.3%, compared to our operating expenses during the first quarter 2013. The year-over-year increase in operating expenses was largely due to $2.8 million of incremental operating expenses during the first quarter 2014 from our 2013 acquisitions of Solais, Encari and ESCO operations, along with $0.4 million of restructuring charges incurred during the first quarter 2014. The remaining year-over-year increase in our operating expenses was due to an increase in selling expenses related to our higher revenue, depreciation and amortization from capital expenditures driven by our investments in Company-owned distributed generation systems, utility infrastructure equipment and acquisition related intangibles, and increases in personnel and equipment to drive and support our growth.

Our consolidated net loss attributable to PowerSecure International, Inc. shareholders for the first quarter 2014 was ($4.3) million, or ($0.19) per diluted share, which includes the $0.7 million restructuring charges, compared to net income attributable to PowerSecure International, Inc. shareholders of $0.7 million, or $0.04 per diluted share, for the first quarter 2013, during which period we did not incur any restructuring charges.

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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, 2013 or our quarter ended March 31, 2014, will be indicative of our future results, especially in light of the current economic conditions and unfavorable credit and capital markets.

Backlog

As of the date of this report, our revenue backlog expected to be recognized after March 31, 2014 is $225 million. This includes revenue related to the ne