

POWERSECURE INTERNATIONAL, INC.

Form 10-Q

May 06, 2016

Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2016

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
(State or other jurisdiction of
incorporation or organization)

84-1169358
(I.R.S. Employer
Identification No.)

1609 Heritage Commerce Court

Wake Forest, North Carolina
(Address of principal executive offices)

27587
(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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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

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

As of May 2, 2016, 22,508,173 shares of the issuer's Common Stock were outstanding.

Table of Contents

POWERSECURE INTERNATIONAL, INC.

FORM 10-Q

For the Quarterly Period Ended March 31, 2016

TABLE OF CONTENTS

	Page
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements	
<u>Condensed Consolidated Balance Sheets (unaudited) - March 31, 2016 and December 31, 2015</u>	3
<u>Condensed Consolidated Statements of Operations (unaudited) - For the Three months Ended March 31, 2016 and 2015</u>	5
<u>Condensed Consolidated Statements of Comprehensive Income (Loss) (unaudited) - For the Three months Ended March 31, 2016 and 2015</u>	6
<u>Condensed Consolidated Statements of Cash Flows (unaudited) - For the Three months Ended March 31, 2016 and 2015</u>	7
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	8
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	32
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	60
Item 4. <u>Controls and Procedures</u>	61
PART II. OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	63
Item 1A. <u>Risk Factors</u>	63
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	63
Item 6. <u>Exhibits</u>	63
<u>Signatures</u>	65

Table of Contents**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, 2016	December 31, 2015
Assets		
Current Assets:		
Cash and cash equivalents	\$ 6,399	\$ 18,433
Trade receivables, net of allowance for doubtful accounts of \$464 and \$502, respectively	115,864	137,899
Inventories	65,843	64,062
Income taxes receivable	389	361
Prepaid expenses and other current assets	2,419	3,413
Total current assets	190,914	224,168
Property, plant and equipment:		
Equipment	73,882	69,484
Furniture and fixtures	766	766
Land, building and improvements	8,089	8,089
Total property, plant and equipment, at cost	82,737	78,339
Less accumulated depreciation and amortization	26,926	25,730
Property, plant and equipment, net	55,811	52,609
Other noncurrent assets:		
Goodwill	41,582	41,582
Deferred tax asset, net	2,776	
Restricted annuity contract	3,137	3,137
Intangible assets and capitalized software costs, net of accumulated amortization of \$11,872 and \$10,903, respectively	11,109	11,830
Other assets	2,443	2,489
Total other noncurrent assets	61,047	59,038

Total Assets	\$ 307,772	\$ 335,815
---------------------	------------	------------

See accompanying notes to condensed consolidated financial statements.

Table of Contents**POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)**

(in thousands, except share data)

	March 31, 2016	December 31, 2015
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	\$ 57,460	\$ 88,370
Accrued and other liabilities	47,234	54,917
Accrued restructuring liabilities	38	585
Current portion of long-term debt	4,245	4,416
Total current liabilities	108,977	148,288
Long-term liabilities:		
Revolving line of credit	25,000	
Long-term debt, net of current portion	13,261	14,187
Deferred tax liability, net		2,911
Other long-term liabilities	4,298	4,941
Total long-term liabilities	42,559	22,039
Commitments and contingencies (Note 9)		
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; 22,508,173 and 22,501,173 shares issued and outstanding, respectively	225	225
Additional paid-in-capital	165,142	164,429
Retained earnings (deficit)	(9,025)	898
Accumulated other comprehensive income (loss)	(106)	(64)
Total stockholders equity	156,236	165,488
Total Liabilities and Stockholders Equity	\$ 307,772	\$ 335,815

See accompanying notes to condensed consolidated financial statements.

Table of Contents

POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

(in thousands, except per share data)

	Three Months Ended March 31,	
	2016	2015
Revenues	\$ 105,151	\$ 79,509
Cost of sales (excluding depreciation and amortization)	95,865	58,180
Gross profit	9,286	21,329
Operating expenses:		
General and administrative	18,439	15,634
Selling, marketing and service	3,295	2,748
Depreciation and amortization	2,728	2,477
Total operating expenses	24,462	20,859
Operating income (loss)	(15,176)	470
Other income and (expenses):		
Interest income and other income	1	1
Interest expense	(394)	(269)
Income (loss) before income taxes	(15,569)	202
Income tax expense (benefit)	(5,646)	81
Net income (loss)	\$ (9,923)	\$ 121
Earnings (loss) per share:		
Basic	\$ (0.44)	\$ 0.01
Diluted	\$ (0.44)	\$ 0.01
Weighted average common shares outstanding during the period:		
Basic	22,505	22,385
Diluted	22,505	22,489

See accompanying notes to condensed consolidated financial statements.

Table of Contents**POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (unaudited)****(in thousands)**

	Three Months Ended March 31,	
	2016	2015
Net income (loss)	\$ (9,923)	\$ 121
Other comprehensive income (loss), net of tax:		
Unrealized foreign currency translation adjustment, net of tax benefit of \$0 and \$0, respectively	20	
Cash flow hedge:		
Change in unrealized gain (loss)	(84)	(81)
Reclassification adjustment for net (gains) losses included in net income (loss)	22	36
Other comprehensive income (loss) from cash flow hedge, net of tax	(62)	(45)
Total other comprehensive income (loss), net of tax	(42)	(45)
Total comprehensive income (loss), net of tax	\$ (9,965)	\$ 76

See accompanying notes to condensed consolidated financial statements.

Table of Contents**POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)****(in thousands)**

	Three Months Ended March 31,	
	2016	2015
Cash flows from operating activities:		
Net income (loss)	\$ (9,923)	\$ 121
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	2,728	2,477
Stock compensation expense	632	650
Deferred taxes	(5,646)	
(Gain) loss on disposal of miscellaneous assets	91	(22)
Changes in operating assets and liabilities:		
Trade receivables, net	22,035	(8,906)
Inventories	(1,781)	(2,047)
Other current assets and liabilities	973	1,348
Other noncurrent assets and liabilities	(701)	(9)
Accounts payable	(30,910)	(619)
Accrued and other liabilities	(7,683)	737
Accrued restructuring liabilities	(547)	(88)
Net cash used in operating activities	(30,732)	(6,358)
Cash flows from investing activities:		
Purchases of property, plant and equipment	(5,060)	(2,012)
Additions to intangible rights and software development	(247)	(802)
Proceeds from sale of property, plant and equipment	8	146
Net cash used in investing activities	(5,299)	(2,668)
Cash flows from financing activities:		
Borrowings (payments) on revolving line of credit	25,000	
Principal payments on long-term borrowings	(1,104)	(933)
Principal payments on capital lease obligations		(241)
Proceeds from stock option exercises	81	271
Net cash provided by (used in) financing activities	23,977	(903)
Effects of currency exchange rate changes on cash and cash equivalents	20	
Net decrease in cash and cash equivalents	(12,034)	(9,929)
Cash and cash equivalents at beginning of period	18,433	33,775

Cash and cash equivalents at end of period	\$ 6,399	\$ 23,846
--	----------	-----------

See accompanying notes to condensed consolidated financial statements.

Table of Contents

POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements

As of March 31, 2016 and December 31, 2015 and

For the Three Month Periods Ended March 31, 2016 and 2015

(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. On February 24, 2016, we entered into an Agreement and Plan of Merger, which we refer to as the Merger Agreement, with The Southern Company, Inc., or Southern Company. See Note 2 for further information on this merger.

We provide products and services through our four reportable segments: our Distributed Generation segment, our Solar Energy segment, our Utility Infrastructure segment, and our Energy Efficiency segment. These four reportable segments constitute our major product and service offerings, each of which are focused on serving the needs of utilities and their large commercial, institutional and industrial customers to help them generate, deliver, and utilize electricity more reliably and efficiently. Our strategy is focused on growing these four segments, which require unique knowledge and skills that utilize our core competencies, because they address large market opportunities due to their strong customer value propositions. The segments share common or complementary utility relationships and customer types, common sales and overhead resources, and facilities. However, we distinguish our operations among these segments due to their unique products and services, differing economic characteristics, market needs they are addressing, and the distinct technical disciplines and specific capabilities required for us to deliver their products and services, including personnel, technology, engineering, and intellectual capital. We currently operate primarily out of our Wake Forest, North Carolina headquarters office. Our operations also include several satellite offices and manufacturing facilities, the largest of which are in the Raleigh-Durham and Greensboro, North Carolina, Atlanta, Georgia, Bethlehem, Pennsylvania, and Stamford, Connecticut areas. The locations of our sales organization and field employees for our operations are generally in close proximity to the utilities and commercial, industrial, and institutional customers they serve. Our four operating segments are operated through our principal operating wholly-owned subsidiary, PowerSecure, Inc.

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., PowerSecure Lighting, LLC (PowerSecure Lighting), Solais Lighting, Inc. (Solais), EnergyLite, Inc.(EnergyLite), Reid s Trailer, Inc. d/b/a PowerFab (PowerFab), Innovation Energies, LLC, and PowerSecure Solar, LLC (PowerSecure Solar) and PowerPackages, LLC 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, 2015.

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, 2016 and the condensed consolidated results of our operations, comprehensive income (loss) and cash flows for the three months ended March 31, 2016 and 2015.

Table of Contents

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.

Foreign Currency Translation The functional currency of PowerSecure's subsidiary in Canada is the local currency. The financial statements of PowerSecure's Canadian subsidiary is translated into the Company's reporting currency, which is the U.S. dollar. The foreign currency translation adjustments are recorded as a separate component of accumulated other comprehensive income (loss). The Company does not have any other foreign subsidiaries.

Use of Estimates The preparation of our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires that our management make estimates and assumptions that affect the reported amounts of assets and liabilities and the 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 2015 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.

2. Proposed Merger with Southern Company

On February 24, 2016, we entered into the Merger Agreement with Southern Company and a wholly-owned subsidiary of Southern Company, which we refer to as the Merger Sub, providing for the merger of the Merger Sub with and into PowerSecure, with PowerSecure surviving as a wholly-owned subsidiary of Southern Company (the Merger). At the effective time of the Merger, subject to meeting specified customary closing conditions, each share of our common stock will be converted automatically into the right to receive \$18.75 in cash, without interest, less any applicable withholding taxes. The Merger Agreement also provides that, at the effective time of the Merger, (i) all outstanding stock options will be deemed to be fully vested and converted into the right to receive a cash payment equal to the excess of the merger consideration over the exercise prices of such stock options, (ii) all outstanding restricted shares and restricted stock units will be deemed to be fully vested and converted into the right to receive the merger consideration, except for certain unvested restricted shares held by our Chief Executive Officer, which will be converted into a stock award relating to shares of Southern Company, and (iii) all performance share units payable in shares of Common Stock will be deemed vested at the target level of achievement and converted into the right to receive the merger consideration. In the Merger Agreement, we agreed to covenants affecting the conduct of our business between the date of the Merger Agreement and the effective date of the Merger.

Completion of the Merger is subject to various closing conditions, including, among others (i) the approval of the Merger Agreement by the affirmative vote of the holders of a majority of all outstanding shares of our common stock, which occurred at the special meeting of stockholders held on May 5, 2016, (ii) the receipt of all regulatory approvals required to consummate the Merger, including expiration of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act, as amended (the Hart-Scott-Rodino Act), which have been received, (iii) the absence of any law or injunction prohibiting the closing of the Merger, and (iv) other customary closing conditions, including (a) the accuracy of each party's representations and warranties (subject to customary materiality qualifiers), (b) each party's performance in all material respects with its obligations under the Merger Agreement, and (c) no material adverse effect (as defined in the Merger Agreement) on us having occurred. The Merger is not subject to any financing

condition.

The Merger Agreement contains customary representations, warranties and covenants by us and Southern Company, including, among others, covenants by us not to solicit proposals relating to alternative business combinations or, subject to certain exceptions, enter into discussions concerning or provide information in connection with alternative business combination proposals or withdraw or adversely modify the recommendation of our Board in favor of the stockholder approval. In addition, the Merger Agreement contains (i) agreements by us to conduct our business in the ordinary course

Table of Contents

until the Merger is consummated, to not engage in certain kinds of transactions, and (ii) agreements by each of the parties to use their reasonable best efforts to obtain all required regulatory approvals.

The Merger Agreement contains certain termination rights, including the right by us to terminate the Merger Agreement if our Board has changed its recommendation in favor of the Merger in connection with a Superior Proposal or Intervening Event as such terms are defined in the Merger Agreement. The Merger Agreement also provides that, upon termination of the Merger Agreement in specified circumstances, we will be required to pay Southern Company a termination fee of \$12.0 million. In addition, subject to certain exceptions and limitations, either party may terminate the Merger Agreement if the Merger is not consummated by November 30, 2016.

On February 23, 2016, the lenders under our credit facility provided a waiver of any event of default arising from the execution of the Merger Agreement (but not the consummation of the Merger) under the credit agreement with our lenders. On May 6, 2016, those lenders also provided a waiver of any event of default arising under the credit agreement from (i) the consummation of the Merger Agreement under the credit agreement, and (ii) our failure to comply with the minimum fixed charge coverage ratio financial covenant under the credit agreement at March 31, 2016.

On March 31, 2016, the U.S. Federal Trade Commission granted early termination of the waiting period under the Hart-Scott-Rodino Act with regard to the Merger, and on May 5, 2016, at a special meeting of shareholders of the Company, the holders of a majority of all outstanding shares of our common stock voted to approve the Merger, thus fulfilling two of the primary conditions to complete the transaction.

As of the date of this report, the Company expects to complete the Merger on or around May 9, 2016.

3. Summary of Significant Accounting Policies and Recent Accounting Standards

Revenue Recognition For our turn-key project-based revenues, we recognize revenue and profit as work progresses using the percentage-of-completion method, which relies on various estimates. These turn-key Distributed Generation, Solar Energy, Utility Infrastructure, and Energy Efficiency Services projects are nearly always fixed-price contracts.

In applying the percentage-of-completion method to our Distributed Generation and Solar Energy turn-key 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 this determination 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 Distributed Generation projects that specifically involve data center infrastructure construction, Utility Infrastructure turn-key projects and our Energy Efficiency Services 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 scope, we adjust the purchase price and related costs for these items when they are identified.

Table of Contents

Because the percentage-of-completion method of accounting relies upon estimates as 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, or on very large 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.

Service revenue includes regulatory consulting and rate design services, power system engineering services, energy conservation services, compliance 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 of these cases, we recognize revenue as these services are delivered.

We recognize revenue on non-project-based equipment and product sales 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, and in other instances we sell through distributors.

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 Accounts receivable includes both billed and unbilled receivables from our customers. The balance of unbilled receivables included in accounts receivable was \$47.7 million and \$63.9 million at March 31, 2016 and December 31, 2015, respectively. 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.

Table of Contents

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, although we recently commenced deriving revenues from sales to customers in Canada and the Bahamas, and expect revenues from customers in such countries to increase in the future.

Inventories Inventories are stated at the lower of cost (determined primarily on a specific-identification basis for the majority of our distributed generation inventory and secondarily on a first-in first-out basis for our LED-based lighting product inventory) 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 and Solar projects 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. Inventory also includes shipping costs incurred on incoming product shipments. 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 associated with our revolving line of credit are capitalized and included in other current and non-current assets in our condensed consolidated balance sheets. Debt issuance costs associated with our term loan debt are capitalized and included as a reduction of the balance of our long-term debt. In both cases, 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 Energy Efficiency Services equipment and a 5 to 10 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 Solar Energy products and services including a warranty period of generally 1 to 5 years for defects in material and workmanship, a warranty period that can extend to 10 to 20 years for declines in power performance, and a warranty period which can extend to 15 to 25 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 balance of our warranty reserve was \$1.7 million and \$1.7 million at March 31, 2016 and December 31, 2015, respectively, 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

Table of Contents

last sale price of our common stock on the date of the grant. We measure the fair value of restricted stock units based on the underlying number of shares included in the units that are granted and the last sale price of our common stock on the date of the grant. We measure the fair value of performance unit awards based on the underlying number of shares included in the performance units and the last sale price of our common stock on the date of the grant. We measure the fair value of stock options using the Black-Scholes valuation model.

Pre-tax share-based compensation expense recognized during the three months ended March 31, 2016 and 2015 was \$0.6 million and \$0.7 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, 2016 and 2015.

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.

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.

Level2 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.

Level3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Table of Contents

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 7 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

Employee Share-Based Payments In March 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-09, Improvements to Employee Share-Based Payment Accounting (Topic 718) (ASU 2016-09). ASU 2016-09 revises several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The new standard is effective for annual reporting periods beginning after December 15, 2016, including interim periods therein. We are in the process of evaluating the impact the adoption of this standard will have on our consolidated financial statements and related disclosures.

Leases In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) (ASU 2016-02). ASU 2016-02 requires entities to recognize right-of-use assets and lease liabilities on the balance sheet for the rights and obligations created by all leases, including operating leases, with terms of more than 12 months. The new standard also requires additional disclosures on the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative information. The new standard will be effective for us on January 1, 2019. Early adoption is permitted. We are in the process of evaluating the impact the adoption of this standard will have on our consolidated financial statements and related disclosures.

Balance Sheet Classification of Deferred Taxes In November 2015, the FASB issued ASU No. 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes (ASU 2015-17). ASU 2015-17 requires entities to present deferred tax assets and deferred tax liabilities as noncurrent in a classified balance sheet. The new standard is effective for public entities for annual periods beginning after December 15, 2016, with early adoption allowed on either a prospective or retrospective basis. We adopted ASU 2015-17, on a prospective basis, for our annual period ending December 31, 2015. Accordingly, the accompanying condensed consolidated balance sheet at March 31, 2016 and December 31, 2015 reflects the presentation of deferred tax assets and deferred tax liabilities in accordance with ASU 2015-17.

Business Combinations In September 2015, the FASB issued ASU No. 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments (ASU 2015-16). The new standard requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined and sets forth new disclosure requirements related to the adjustments. The new standard became effective for us on January 1, 2016. The adoption of this standard had no effect on our consolidated financial statements.

Inventory Measurement In July 2015, the FASB issued ASU No. 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory (ASU 2015-11), which requires entities to measure inventory at the lower of cost and net realizable value (NRV). ASU 2015-11 defines NRV as the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The ASU will not apply to inventories that are measured by using either the last-in, first-out method or the retail inventory method. The guidance in ASU 2015-11 is

Table of Contents

effective prospectively for fiscal years beginning after December 15, 2016, and interim periods therein. Early adoption is permitted. Upon transition, entities must disclose the nature of and reason for the accounting change. We do not expect that the adoption of this standard will have a material effect on our consolidated financial statements.

Presentation of Debt Issuance Costs In April 2015, the FASB issued ASU No. 2015-03: Simplifying the Presentation of Debt Issuance Costs (ASU 2015-03), and in August 2015, the FASB issued ASU 2015-15: Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements (ASU 2015-15). These ASUs require debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying amount of that debt consistent with debt discounts. The presentation and subsequent measurement of debt issuance costs associated with lines of credit, may be presented as an asset and amortized ratably over the term of the line of credit arrangement, regardless of whether there are outstanding borrowings on the arrangement. The recognition and measurement guidance for debt issuance costs are not affected by these ASUs. These ASUs are effective for financial statements issued for fiscal years beginning after December 15, 2015 and interim periods within those years. Early adoption is permitted for financial statements that have not been previously issued, and retrospective application is required for each balance sheet presented. We adopted the provisions of ASU 2015-03 and ASU 2015-15 on a retrospective basis for our annual period ended December 31, 2015. Accordingly, the accompanying condensed consolidated balance sheet at March 31, 2016 and December 31, 2015 reflects the presentation of debt issuance costs in accordance with ASU 2015-03 and ASU 2015-15.

Going Concern Disclosures In August 2014, the FASB issued ASU No. 2014-15: Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern (ASU 2014-15). ASU 2014-15 requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date the financial statements are issued and provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. Certain disclosures will be required if conditions give rise to substantial doubt about an entity's ability to continue as a going concern. ASU 2014-15 is effective for annual and interim reporting periods ending after December 15, 2016, with early adoption permitted. We do not expect that the adoption of this standard will have a material effect on our consolidated financial statements.

Stock Compensation In June 2014, the FASB issued ASU No. 2014-12, Compensation – Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (ASU 2014-12). ASU 2014-12 requires that a performance target that affects vesting, and that could be achieved after the requisite service period, be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant date fair value of the award. This standard further clarifies that compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the periods for which the requisite service has already been rendered. The new standard became effective for us on January 1, 2016. The adoption of this standard had no effect on our consolidated financial statements.

Revenue Recognition In May 2014, the FASB issued ASU No. 2014-09: Revenue from Contracts with Customers (ASU 2014-09). The new standard was originally effective for reporting periods beginning after December 15, 2016 and early adoption was not permitted. On August 12, 2015, the FASB approved a one year delay of the effective date to reporting periods beginning after December 15, 2017, while permitting companies to voluntarily adopt the new standard as of the original effective date. This standard replaces existing accounting literature relating to how and when a company recognizes revenue. Under ASU 2014-09, a company will recognize revenue when it transfers goods or services to customers in an amount equal to the amount that it expects to be entitled to receive in exchange for those goods and services. This standard also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in

judgments. ASU 2014-09 will be effective for us for our fiscal year that begins January 1, 2018, and permits the use of either the retrospective or cumulative effect transition method. We are in the process of determining the method of adoption and evaluating the impact, if any, the adoption of this standard will have on our consolidated financial statements and related disclosures.

Table of Contents**4. Earnings (Loss) per Share**

Basic earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share 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 415 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, 2016, 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:

	Three Months Ended March 31,	
	2016	2015
Net income (loss)	\$ (9,923)	\$ 121
Basic weighted-average common shares outstanding in period	22,505	22,385
Dilutive effect of stock options		104
Diluted weighted-average common shares outstanding in period	22,505	22,489
Basic earnings (loss) per common share	\$ (0.44)	\$ 0.01
Diluted earnings (loss) per common share	\$ (0.44)	\$ 0.01

5. Restructuring Charges

From time to time and most recently in 2015, we have engaged in restructuring programs designed to reduce our cost structure and improve productivity. These initiatives typically consist of realigning operations, reducing employee counts, rationalizing facilities, changing manufacturing sourcing, eliminating certain products, inventory writedowns and long term asset disposals, and other actions designed to reduce our cost structure and improve productivity.

The following table summarizes our 2015 business realignment plan activities and the balance of our accrued restructuring liabilities at and for the three months ended March 31, 2016:

	Employee Termination Costs	Long Term Asset Writedowns	Total
2015 Business Realignment Plan:			

Edgar Filing: POWERSECURE INTERNATIONAL, INC. - Form 10-Q

Accrued charges, December 31, 2015	\$	538	\$	\$ 538
Costs paid or otherwise settled		(500)		(500)
Accrued charges, March 31, 2016	\$	38	\$	\$ 38

Table of Contents

The following table summarizes our 2013 business realignment plan activities and the balance of our accrued restructuring liabilities at and for the three months ended March 31, 2016:

	Employee Termination Costs	Inventory Writedowns and Long Term Asset Disposals	Leasehold Termination Other Facility Exit Costs	Total
2013 Business Realignment Plan:				
Accrued charges, December 31, 2015	\$ 47	\$	\$	\$ 47
Costs paid or otherwise settled	(47)			(47)
Accrued charges, March 31, 2016	\$	\$	\$	\$

The balances of our accrued restructuring liabilities at March 31, 2016 and December 31, 2015 are included in current liabilities in our condensed consolidated balance sheet. We expect the majority of the balance of our accrued restructuring charges at March 31, 2016 will be paid or otherwise settled during the remainder of 2016.

6. Debt and Interest Rate Swap Contracts

Long-Term Credit Facility We have a long-term credit facility with Citibank, N.A. (Citibank), as administrative agent and lender, and other lenders under a credit agreement that we first entered into with our lenders in August 2007 and have amended and restated from time-to-time. At March 31, 2016 and December 31, 2015, our credit agreement with Citibank along with Branch Banking and Trust Company (BB&T) as additional lender, consisted of a \$40.0 million senior, first-priority secured revolving line of credit maturing on June 30, 2020, a \$2.6 million term loan maturing on June 30, 2020, and a \$25.0 million, 7 year amortizing term loan maturing on June 30, 2020. Our credit facility also contains an accordion provision permitting us to request an increase in the revolving loan by up to an additional \$20 million, subject to lender s participation

The credit facility contains three basic financial covenants. First, 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 consolidated Earnings before Interest, Taxes, Depreciation and Amortization (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. The fixed charge coverage ratio is currently based on our financial results for the previous four fiscal quarters on a rolling basis. Second, we are required to maintain a minimum consolidated net worth, computed on a quarterly basis, of not less than the sum of \$142.1 million, plus an amount equal to 50% of our net income each fiscal year commencing with the year ending December 31, 2014, 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. Under our third financial covenant, the ratio of our funded indebtedness to our capitalization, computed as funded indebtedness divided by the sum of funded indebtedness plus stockholders equity, cannot exceed 25%.

On February 23, 2016, the lenders under our credit facility provided a waiver of any event of default arising from the execution of the Merger Agreement (but not the consummation of the Merger) under the credit agreement with our lenders. On May 6, 2016, those lenders also provided a waiver of any event of default arising from (i) the consummation of the Merger Agreement under the credit agreement, and (ii) the failure to meet the minimum fixed charge coverage ratio financial covenant under the credit agreement at March 31, 2016.

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

Table of Contents

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%.

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 7, 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, 2016, \$12.1 million of our outstanding credit facility debt bears interest at a fixed rate of 3.73% and \$29.8 million of our outstanding credit facility debt, including amounts borrowed under the revolving portion of the credit facility, 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 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.

Our obligations under the credit facility are secured by guarantees and security agreements by each of our active subsidiaries, including PowerSecure, Inc. 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 guarantor.

At March 31, 2016, there was an aggregate balance of \$16.9 million outstanding under the two term loans under our credit facility and there was \$25.0 million outstanding under the revolving portion of the credit facility. At March 31, 2016 and December 31, 2015, we had \$9.0 million and \$36.0 million, respectively, of available and unused borrowing capacity from our revolving credit facility within the limits of our financial covenants. At May 6, 2016, an aggregate balance of \$30.0 million was outstanding under our revolving credit facility, and there was approximately \$4.0 million of available and unused borrowing capacity within the limits of our financial covenants. The availability of this capacity under our credit facility includes restrictions on the use of proceeds, and is dependent upon our ability to satisfy certain financial and operating covenants including financial ratios, as discussed above.

Acquisition Term Notes We financed a portion of our 2015 acquisition of the assets and business of ESCO Energy Services Company with two unsecured promissory notes payable to the seller in the aggregate amount of \$0.8 million. The first acquisition term note in the principal amount of \$685 thousand is payable in four equal quarterly installments, plus interest at 5%, during 2016. The second acquisition term note in the principal amount of \$150 thousand is payable on December 1, 2017.

Table of Contents

The following table summarizes the balances outstanding on our long-term debt at March 31, 2016 and December 31, 2015:

	March 31, 2016	December 31, 2015
Revolving line of credit, maturing June 30, 2020	\$ 25,000	\$
Term loan, principal of \$0.04 million plus interest payable quarterly at variable rates, maturing June 30, 2020	1,720	1,760
Term loan, principal of \$0.9 million plus interest payable quarterly at variable rates, maturing June 30, 2020	15,178	16,072
Acquisition term notes payable	664	835
Total debt	42,562	18,667
Less: Unamortized debt issuance costs, term loans	(56)	(64)
Total debt, net of term loan debt issuance costs	42,506	18,603
Less: Current portion	(4,245)	(4,416)
Long-term debt, net of current portion	\$ 38,261	\$ 14,187

Scheduled remaining principal payments on our outstanding debt obligations at March 31, 2016, 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	Acquisition Term Notes	Total Principal Payments
Remainder of 2016	\$	\$ 2,677	\$ 120	\$ 514	\$ 3,311
2017		3,571	160	150	3,881
2018		3,572	160		3,732
2019		3,572	160		3,732
2020	25,000	1,786	1,120		27,906
Total scheduled principal payments	\$ 25,000	\$ 15,178	\$ 1,720	\$ 664	\$ 42,562

Table of Contents**7. Accumulated Other Comprehensive Income and Hedging Activities**

Accumulated Other Comprehensive Income Our Accumulated Other Comprehensive Income (AOCI) consists of unrealized foreign currency translation adjustments and activities associated with cash flow hedges related to our interest rate swaps described in greater detail below. The following is a summary of changes in AOCI by component for the three months ended March 31, 2016 (all amounts are net of tax):

	Gains (losses) on Cash Flow Hedge	Foreign Currency Items	Total
Balance of AOCI, December 31, 2015	\$ (55)	\$ (9)	\$ (64)
Other comprehensive income (loss) before reclassifications	(84)	20	(64)
Reclassification adjustment for net (gains) losses included in net income (loss)	22		22
Net other comprehensive income (loss)	(62)	20	(42)
Balance of AOCI, March 31, 2016	\$ (117)	\$ 11	\$ (106)

The following is a summary of changes in AOCI by component for the three months ended March 31, 2015 (all amounts are net of tax):

	Gains (losses) on Cash Flow Hedge	Foreign Currency Items	Total
Balance of AOCI, December 31, 2014	\$ (77)	\$	\$ (77)
Other comprehensive income (loss) before reclassifications	(81)		(81)
Reclassification adjustment for net (gains) losses included in net income (loss)	36		36
Net other comprehensive income (loss)	(45)		(45)
Balance of AOCI, March 31, 2015	\$ (122)	\$	\$ (122)

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 6). The interest rate swaps effectively converted 80% of the outstanding balance 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, 2016 was \$12.1 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.

Table of Contents

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, 2016 and December 31, 2015, are as follows:

Derivative designated as

hedging instrument:	Balance Sheet March 31, 2016		December 31, 2015		Balance Sheet March 31, 2016		December 31, 2015		
	Location				Location				
Interest rate swaps	Other assets	\$	\$		Other long-term liabilities	\$	214	\$	109

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		Affected Line Item in the Consolidated Statements of Operations
	Three Months Ended March 31,		
	2016	2015	
Gain (loss) on cash flow hedges:			
Interest rate swaps	\$ 37	\$ 58	Interest expense
	(15)	(22)	Tax expense (benefit)
	\$ 22	\$ 36	Net of tax

AOCI Component	Amount of gain (loss) recognized in AOCI	
	Three Months Ended March 31,	
	2016	2015
Gain (loss) on cash flow hedges:		
Unrealized gain (loss) Interest rate swaps	\$ (140)	\$ (130)
Tax effect	56	49
Gain (loss) net of tax	\$ (84)	\$ (81)

We did not realize any ineffectiveness related to our cash flow hedges during the three months ended March 31, 2016 and 2015.

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, restricted stock awards, restricted stock units and performance unit 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, 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.

Table of Contents

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, 2016 and 2015 includes \$52 thousand and \$86 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.

A summary of option activity for the three months ended March 31, 2016 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Balance, December 31, 2015	422	\$ 10.16		
Granted				
Exercised	(7)	11.57		
Expired				
Forfeited				
Balance, March 31, 2016	415	\$ 10.14	5.84	\$ 3,598
Exercisable, March 31, 2016	235	\$ 9.32	4.09	\$ 2,214

A summary of option activity for the three months ended March 31, 2015 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Balance, December 31, 2014	519	\$ 9.12		
Granted	15	11.24		
Exercised	(50)	5.44		

Edgar Filing: POWERSECURE INTERNATIONAL, INC. - Form 10-Q

Expired Forfeited	(5)		8.91		
Balance, March 31, 2015	479	\$	9.57	5.75	\$ 2,018
Exercisable, March 31, 2015	269	\$	8.66	3.54	\$ 1,290

Table of Contents

There were no stock options granted during the three months ended March 31, 2016. The weighted average grant date fair value of stock options granted during the three months ended March 31, 2015 was \$4.73. The fair value of the stock options granted during the three months ended March 31, 2015 was measured using the Black-Scholes valuation model with the following assumptions:

	Three Months Ended March 31,	
	2016	2015
	(1)	
Expected stock price volatility	n/m	46.5%
Risk free interest rate	n/m	1.6%
Annual dividends	n/m	\$
Expected life (years)	n/m	5

(1) 2016 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, 2016 and December 31, 2015, there was \$0.7 million and \$0.8 million, respectively, of total unrecognized compensation costs related to stock options. These costs at March 31, 2016 are expected to be recognized over a weighted average period of approximately 3.9 years.

During the three months ended March 31, 2016 and 2015, the total intrinsic value of stock options exercised was \$36 thousand and \$0.3 million, respectively. Cash received from stock option exercises during the three months ended March 31, 2016 and 2015 was \$81 thousand and \$0.3 million, respectively. The total grant date fair value of stock options vested during the three months ended March 31, 2016 and 2015 was \$14 thousand and \$28 thousand, respectively.

Restricted Stock Awards and Restricted Stock Units Net income (loss) for the three months ended March 31, 2016 and 2015 includes \$0.5 million and \$0.5 million, respectively, of pre-tax compensation costs related to the vesting of outstanding restricted stock awards and restricted stock units granted to directors and employees. All of the restricted stock award compensation expense during the three months ended March 31, 2016 and 2015 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, 2016 is as follows:

	Unvested Restricted Shares	Weighted Average Grant Date Fair Value
Balance, December 31, 2015	547	\$ 17.44
Granted		
Vested	(1)	15.49
Forfeited		

Balance, March 31, 2016	546	\$	17.44
-------------------------	-----	----	-------

Table of Contents

A summary of restricted stock award activity for the three months ended March 31, 2015 is as follows:

	Unvested Restricted Shares	Weighted Average Grant Date Fair Value
Balance, December 31, 2014	579	\$ 17.20
Granted	28	12.30
Vested	(6)	7.88
Forfeited		
Balance, March 31, 2015	601	\$ 17.06

A summary of restricted stock unit activity for the three months ended March 31, 2016 is as follows:

	Unvested Restricted Stock Units	Weighted Average Grant Date Fair Value
Balance, December 31, 2015	5	\$ 15.49
Granted		
Vested	(2)	15.49
Forfeited		
Balance, March 31, 2016	3	\$ 15.49

There were no restricted stock units issued or outstanding at or during the three months ended March 31, 2015.

Restricted shares and restricted stock units are subject to forfeiture and cannot be sold or otherwise transferred until they vest. If the holder of the restricted shares or stock units leaves us before they 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 and restricted stock units 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 or units automatically vest upon a change in control.

The fair value of the restricted shares and restricted stock units is amortized on a straight-line basis over the respective vesting period. At March 31, 2016, the balance of unrecognized compensation cost related to unvested restricted shares was \$6.0 million, which is expected to be recognized over a weighted average period of approximately 4.1 years. At March 31, 2016, the balance of unrecognized compensation cost related to unvested restricted stock units was \$44 thousand, which is expected to be recognized over a weighted average period of approximately 0.3 years.

Performance Units Net income (loss) for the three months ended March 31, 2016 and 2015 includes \$67 thousand and \$35 thousand, respectively, of pre-tax compensation costs related to outstanding performance units based on the number of awards that we expect will vest over the requisite service period and the probable outcome of the associated

performance condition. All of the performance unit compensation expense during the three months ended March 31, 2016 and 2015 is included in general and administrative expenses in the accompanying condensed consolidated statements of operations.

Table of Contents

A summary of performance unit award activity for the three months ended March 31, 2016 is as follows:

	Unvested Performance Units	Weighted Average Grant Date Fair Value
Balance, December 31, 2015	45	\$ 15.39
Granted		
Vested		
Incremental performance shares vested		
Forfeited		
Balance, March 31, 2016	45	\$ 15.39

A summary of performance unit award activity for the three months ended March 31, 2015 is as follows:

	Unvested Performance Units	Weighted Average Grant Date Fair Value
Balance, December 31, 2014	17	\$ 20.57
Granted	28	12.30
Vested		
Incremental performance shares vested		
Forfeited		
Balance, March 31, 2015	45	\$ 15.39

The performance units outstanding at March 31, 2016 obligate the Company to issue a variable number of shares of its common stock in the event certain cumulative earnings per share performance thresholds are met. At March 31, 2016, the number of shares issuable upon attainment of performance thresholds ranges from 23 thousand to 68 thousand shares. The fair value of the performance units are being amortized on a straight-line basis over the requisite service period. At March 31, 2016, the balance of unrecognized compensation costs related to outstanding performance units was \$0.3 million, which is expected to be recognized over a weighted average period of approximately 1.4 years.

At the effective time of the Merger (see Note 2), (i) all outstanding stock options will be deemed to be fully vested and converted into the right to receive a cash payment equal to the excess of the merger consideration over the exercise prices of such stock options, (ii) all outstanding restricted shares and restricted stock units will be deemed to be fully vested and converted into the right to receive the merger consideration, except for certain unvested restricted shares held by our Chief Executive Officer, which will be converted into a stock award relating to shares of Southern Company, and (iii) all performance share units payable in shares of Common Stock will be deemed vested at the target level of achievement and converted into the right to receive the merger consideration.

9. Commitments and Contingencies

Litigation Relating to the Merger On March 17, 2016, a putative class action lawsuit challenging the Merger (Note 2) was filed by a purported PowerSecure stockholder on behalf of all PowerSecure stockholders in the General Court of Justice of the Superior Court Division of Wake County, North Carolina. The lawsuit names as defendants PowerSecure, its directors, Southern Company and Merger Sub. The lawsuit alleges that the PowerSecure directors breached their fiduciary duties to PowerSecure stockholders by engaging in a flawed process to sell PowerSecure, by agreeing to sell PowerSecure for inadequate consideration and by agreeing to improper deal protection terms in the Merger Agreement. In addition, the lawsuit alleges that the entity defendants aided and abetted these breaches of fiduciary duty. The lawsuit seeks, among other things, an injunction barring the Merger, an accounting for damages and attorneys' fees. The defendants believe that the lawsuit is without merit. The ultimate outcome of this lawsuit cannot be predicted.

Table of Contents

due to the inherent uncertainty of litigation and the litigation is at a very early stage. Other than an immaterial amount for litigation costs, we have not recognized any expense for this matter as we do not believe, based upon current information, that a loss relating to this matter is probable, or that an estimate of a range of potential loss relating to this matter, can reasonably be made.

Securities Class Action and Related Litigation On May 22, 2014, a putative securities class action lawsuit was filed against us and certain of our executive officers in the United States District Court for the Eastern District of North Carolina. Subsequently, in May and in July 2014, two additional purported securities class action lawsuits were filed against the same defendants in the United States District Courts, one in the Eastern District of North Carolina and the other in the Western District of North Carolina. On October 10, 2014, these lawsuits were consolidated in the United States District Court for the Eastern District of North Carolina, and a lead plaintiff was appointed. As consolidated, the lawsuit was filed on behalf of all persons or entities that purchased our common stock during a purported class period from August 8, 2013 through May 7, 2014, which is the longer of the two different purported class periods used in the pre-consolidation lawsuits. A consolidated amended complaint was filed on December 29, 2014. The action alleges that certain statements made by the defendants during the class period violated federal securities laws and seeks damages in an unspecified amount.

We filed a motion to dismiss the amended complaint on February 26, 2015, which the court granted on September 15, 2015, with leave for the plaintiff to file an amended complaint. On October 16, 2015, the plaintiff filed a second amended consolidated class action complaint, with similar allegations over the same class period. On November 23, 2015, we filed a motion to dismiss the second amended complaint, and the briefing on that motion concluded on February 5, 2016. We cannot provide any assurance as to when the court will rule on our motion to dismiss the second amended complaint or whether our motion will be granted, and even if granted whether the complaint will be dismissed with prejudice or appealed.

On August 15, 2014, a shareholder derivative complaint was filed against certain of our executive officers and each of our directors during the class period in the United States District Court for the Eastern District of North Carolina. The complaint alleges breach of fiduciary duty, waste of corporate assets and unjust enrichment by the named officers and directors in connection with substantially the same events as set forth in the class action lawsuit, seeking damages in an unspecified amount. On November 26, 2014, based on mutual agreement of the parties to the lawsuit, the court ordered that proceedings under the complaint be stayed until resolution of the securities class action litigation.

While we believe that we have substantial legal and factual defenses to the claims in the class action and we are pursuing these defenses vigorously the outcome of this litigation is difficult to predict and quantify, and the defense against such claims could be costly. In addition, we have various insurance policies related to the risk associated with our business, including directors and officers liability insurance policies. However, there is no assurance that we will be successful in our defense of the securities class action, and there is no assurance that our insurance coverage will be sufficient or that our insurance carriers will cover all claims in that litigation. If we are not successful in our defense of the claims asserted in the securities class action and the claims are not covered by insurance or exceed our insurance coverage, we may have to pay damage awards, indemnify our officers and directors from damage awards that may be entered against them and pay the costs and expenses incurred in defense of, or in any settlement of, such claims.

While the company is only a nominal defendant in the shareholder derivative litigation, it could be obligated to indemnify and/or to pay an advancement of fees and costs incurred by our officers and directors in their defense of the litigation.

Any such payments or settlement arrangements in these current lawsuits or related litigation or proceedings could be significant and have a material adverse effect on our business, financial condition, results of operations, or cash flows

if the claims are not covered by our insurance carriers or if damages exceed the limits of our insurance coverage. Furthermore, regardless of the outcome of these claims, defending the litigation itself could result in substantial costs and divert management's attention and resources, which could have a material adverse effect on our business, operating results, financial condition and ability to finance our operations.

Table of Contents

The ultimate outcome of these proceedings cannot be accurately predicted due to the inherent uncertainty of litigation and the litigation is at a very early stage. Other than an immaterial amount for legal expenses, we have not recognized any costs for the securities class action as we do not believe, based upon current information, that a loss relating to these matters is probable, or that an estimate of a range of potential loss relating to these matters, can reasonably be made.

SEC Informal Inquiry The SEC is conducting an informal inquiry that appears to be focused on our interpretation and application of the FASB's Accounting Standards Codification (ASC) Topic 280, Segment Reporting (ASC 280), in regards to our identification of operating and reportable segments since 2012, but may be broader in scope. We are cooperating with the SEC in this matter, including consultation with the Office of Chief Accountant of the SEC. There is no assurance that the scope of this inquiry is currently limited to segment reporting or that it will not be expanded in the future. In addition, the outcome of this inquiry could be unfavorable to us and adversely affect our business, financial condition or operating results.

Performance Bonds and Letters of Credit In the ordinary course of business, we are required by certain customers to post surety or performance bonds or letters of credit in connection with services that we provide to them. These bonds and letters of credit 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, in the case of a performance bond, or our lenders, in the case of a letter of credit, make payments or provide services under the bond. We must reimburse the surety or our lenders for any expenses or outlays they incur. 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. As of March 31, 2016, we had approximately \$325.4 million in surety bonds outstanding. Based upon the current status of the completion of our contracts and projects, we estimate our exposure on these surety bonds was approximately \$169.8 million at March 31, 2016.

Employee 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.

Product Performance and Component Parts Matters 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, boilers, chillers, 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. In addition, 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, we can 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, performance issues may not be 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.

Table of Contents

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.

Utility-Scale Solar Project Contract Matters In July 2014, we entered into two Engineering, Procurement and Construction Agreements (EPC Contracts) with Georgia Power Company, a large investor-owned utility customer (the Utility) and in July 2015, we entered into a third EPC Contract with the Utility. The July 2015 EPC Contract was subsequently terminated, by mutual agreement, on March 23, 2016. In connection with the termination agreement, we transferred to the Utility all of our rights, duties and obligations under our solar panel supply agreement, and the Utility agreed to pay us approximately \$3.2 million, which is equal to the sum of the deposit paid by us to the solar panel supplier and the amount owed by us for certain engineering work product. In addition, the Utility fully released and discharged the underlying payment and performance bond. We did not incur any termination fees or penalties as a result of the termination of the July 2015 EPC Contract.

Each of July 2014 EPC Contracts relates to a similarly sized utility-scale solar distributed generation project that is being performed for the Utility for the benefit of the Utility's customers. The two July 2014 EPC Contracts are currently expected to generate a total of approximately \$120 million in revenues, of which we have already recognized \$83.2 million through March 31, 2016. Prior to March 31, 2016, we expected that these projects, which are large in scale and carry significantly lower gross profit margins as a percentage of revenues compared to traditional projects of this type, would carry single digit gross margins as a percentage of revenues. During April 2016, we determined that our costs to complete these projects would be substantially in excess of our prior estimates and that a loss would be incurred to complete the contracts. Accordingly, in accordance with our revenue recognition policy described in Note 3, we recorded an aggregate cost adjustment on the two contracts during the three months ended March 31, 2016 in the amount of \$6.5 million, which is included in cost of sales in the accompanying statement of operations. We do not currently anticipate recording any additional losses to complete these two contracts, but additional losses may be incurred if future events are different from our assumptions, and those losses may be significant. The scheduled

substantial completion and placed in service dates of the two July 2014 EPC Contracts range from August 1, 2016 to October 1, 2016.

The two July 2014 EPC Contracts, which are virtually identical in rights and obligations and differ primarily in project descriptions, provide for customary covenants, representations, warranties and indemnities to the Utility. The EPC Contracts also include terms requiring us to provide performance guarantees and indemnification to the Utility under certain circumstances, as well as provisions requiring us to pay the Utility liquidated damages upon the occurrence of certain events, including certain delays in substantial completion and when the system is placed in service. The aggregate limit on our liability to the Utility for liquidated damages related to delays under the EPC Contracts is approximately \$24

Table of Contents

million per contract, and is \$48 million in total. We could have additional liabilities to the Utility for any breaches of our covenants, representations or warranties in addition to these potential liquidated damages. The EPC Contracts also contain typical events of default, including material breaches of the EPC Contracts after notice and cure periods and defaults relating to bonding and surety failures. The EPC Contracts may be terminated by us upon an event of default by the Utility, in which case we would be entitled to the payment for work performed and for actual costs incurred. We also provide a warranty on each project for three years after substantial completion of the project.

In addition, the solar projects covered by the EPC Contracts are subject to bonding requirements. In connection with these requirements, we have obtained, for the benefit of the Utility, bonding arrangements in the aggregate amount of approximately \$120 million at March 31, 2016 for the two EPC Contracts. Our solar panel manufacturer has provided a supply bond to us in the amount of approximately \$62.0 million that backstops the on-time delivery of quality panels.

Other Matters 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) for the three months ended March 31, 2016 and 2015 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.

11. Segment Information

Our reportable segments are currently organized around the following products and services that we offer as part of our core business strategy:

Distributed Generation solutions;

Solar Energy solutions;

Utility Infrastructure solutions; and

Energy Efficiency solutions.

Our Chief Operating Decision Maker (CODM) reviews revenues including intersegment revenues, gross profit and operating income (loss) before income taxes when evaluating segment performance and allocating resources to each segment. Accordingly, intersegment revenue is included in the segment revenues presented in the tables below and is eliminated from revenues and cost of sales in the Eliminations and Other column. The Eliminations and Other column also includes various expense items that we do not allocate to our reportable segments. These expenses include corporate overhead and corporate-wide items such as legal and professional fees as well as expense items for which we have not identified a reasonable basis for allocation. The accounting policies of the reportable segments are the same as those described in Note 3 of the notes to condensed consolidated financial statements.

Distributed Generation

Our Distributed Generation segment manufactures, installs and operates electric generation equipment on site at facilities where the power is used, including commercial, institutional and industrial operations. Our Distributed Generation systems typically utilize our proprietary PowerBlock units or, alternatively, generators sourced from major global generator manufacturers as the power plants for our systems. Our Distributed Generation 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.

Table of Contents

Solar Energy

Our Solar Energy segment engineers, procures, constructs and maintains solar power generation equipment for utilities, independent power producers, developers who sell power to utilities and industrial, commercial and institutional customers for on site power requirements. Our Solar Energy systems use photovoltaic solar panels (which we do not manufacture) to provide utilities and their customers with environmentally friendly power to augment their core power requirements.

Utility Infrastructure

Our Utility Infrastructure segment 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 system 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.

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 regulatory compliance services to the utility industry.

Energy Efficiency

We deliver Energy Efficiency products and services to assist our customers in the achievement of their energy efficiency goals. We have two primary product and service offerings in our Energy Efficiency segment: LED lighting fixtures and lamps, and energy efficiency upgrades for our Energy Efficiency Services customers. Our LED lighting products are primarily focused on the utility, commercial and industrial, and retail markets, while our Energy Efficiency Services solutions are focused on serving large energy services companies, referred to as ESCOs. In the future, we plan to bring our LED lighting products to our Energy Efficiency Services customer base. In both of our Energy Efficiency segment 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.

Table of Contents

Summarized financial information concerning our reportable segments is shown in the following tables.

Three Months Ended March 31, 2016

	Distributed Generation	Solar Energy	Utility Infrastructure	Energy Efficiency	Eliminations and Other	Total
Revenues	\$ 30,223	\$ 24,243	\$ 37,634	\$ 13,837	\$ (786)	\$ 105,151
Cost of Sales (excluding depreciation and amortization)	23,723	30,723	33,024	9,181	(786)	95,865
Gross Profit	6,500	(6,480)	4,610	4,656		9,286
Operating expenses:						
General and administrative	4,550	814	2,484	3,288	7,303	18,439
Selling, marketing and service	1,299	79	526	753	638	3,295
Depreciation and amortization	1,147	48	742	474	317	2,728
Total operating expenses	6,996	941	3,752	4,515	8,258	24,462
Operating income (loss)	(496)	(7,421)	858	141	(8,258)	(15,176)
Other income and (expenses):						
Interest income and other income					1	1
Interest expense					(394)	(394)
Income (loss) before income taxes	\$ (496)	\$ (7,421)	\$ 858	\$ 141	\$ (8,651)	\$ (15,569)
Total capital expenditures YTD 2016	\$ 4,296	\$ 21	\$ 617	\$ 118	\$ 255	\$ 5,307
Total goodwill at March 31, 2016	\$ 11,403	\$ 4,914	\$ 2,325	\$ 22,940	\$	\$ 41,582
Total assets at March 31, 2016	\$ 141,276	\$ 47,157	\$ 44,404	\$ 52,848	\$ 22,087	\$ 307,772

Three Months Ended March 31, 2015

	Distributed Generation	Solar Energy	Utility Infrastructure	Energy Efficiency	Eliminations and Other	Total
Revenues	\$ 30,731	\$ 6,348	\$ 28,883	\$ 13,562	\$ (15)	\$ 79,509
Cost of Sales (excluding depreciation and amortization)	18,881	5,733	25,033	8,548	(15)	58,180
Gross Profit	11,850	615	3,850	5,014		21,329
Operating expenses:						
General and administrative	4,360	780	2,873	3,255	4,366	15,634
Selling, marketing and service	1,213	97	336	591	511	2,748
Depreciation and amortization	1,070	32	776	392	207	2,477

Edgar Filing: POWERSECURE INTERNATIONAL, INC. - Form 10-Q

Total operating expenses	6,643	909	3,985	4,238	5,084	20,859
Operating income (loss)	5,207	(294)	(135)	776	(5,084)	470
Other income and (expenses):						
Interest income and other income					1	1
Interest expense					(269)	(269)
Income (loss) before income taxes	\$ 5,207	\$ (294)	\$ (135)	\$ 776	\$ (5,352)	\$ 202
Total capital expenditures YTD 2015	\$ 1,158	\$ 34	\$ 993	\$ 67	\$ 562	\$ 2,814
Total goodwill at March 31, 2015	\$ 11,403	\$ 4,914	\$ 2,325	\$ 21,568	\$	\$ 40,210
Total assets at March 31, 2015	\$ 105,984	\$ 21,935	\$ 56,172	\$ 41,686	\$ 39,393	\$ 265,170

Table of Contents

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

The following discussion and analysis of our consolidated results of operations for the three month period ended March 31, 2016, which we refer to as the first quarter 2016, and the three month period ended March 31, 2015, which we refer to as the first quarter 2015, and of our consolidated financial condition as of March 31, 2016 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, estimate, 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:

certain risks and uncertainties associated with the proposed merger with Southern Company, including without limitation, the possibility that the proposed merger does not close, disruptions from the proposed merger making it more difficult to maintain our business and operational relationships as well as maintaining our relationships with our employees, suppliers or customers, the risk that unexpected costs will be incurred during the merger process and the impact of the diversion of management's time on merger-related issues;

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;

Table of Contents

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;

fluctuations in the gross margins of the projects and changes to customer relationships in each of our segments, as well as our ability to address inefficiencies in our Utility Infrastructure segment and improve the segment's gross margins;

the amount of anticipated revenues and profits from, the timing of, and our ability to successfully execute on, the large solar projects;

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, including but not limited to the securities class action 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, 2015, 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.

We currently provide products and services through the following reportable segments: our Distributed Generation segment, our Solar Energy segment, our Utility Infrastructure segment, and our Energy Efficiency segment. These reportable segments constitute our major product and services offerings, each of which are 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.

Table of Contents

Our strategy is focused on growing these segments 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 operations among these segments due to their unique products and services, market needs they are addressing, cost structure, and the distinct technical disciplines and specific capabilities required for us to deliver them, including personnel, technology, engineering, and intellectual capital.

We currently operate 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 Raleigh-Durham and Greensboro, North Carolina, Atlanta, Georgia, Bethlehem, Pennsylvania, and Stamford, Connecticut areas. The locations of our sales organization and field employees for our operations are generally in close proximity to the utilities and commercial, industrial, and institutional customers they serve. Our reportable segments are operated through our principal operating wholly-owned subsidiary, PowerSecure, Inc.

Distributed Generation

Our Distributed Generation segment manufactures, installs and operates electric generation equipment on site at a facility where the power is used, including commercial, institutional and industrial operations. Our Distributed Generation systems typically utilize our proprietary PowerBlock units or, alternatively, generators sourced from major global generator manufacturers as the power plants for our systems. 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.

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

Table of Contents

the customer paying us 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 2016, 85.3% of our Distributed Generation systems revenues consisted of customer-owned system sales, and 14.7% of our Distributed Generation systems 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 18 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 15 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.

We have developed, and since 2015 have been offering, sophisticated energy storage solutions, which support a microgrid and enable a customer to integrate solar and other generation sources with our control solutions. Our energy storage solutions, including battery storage solutions, enable the enhanced utilization of renewable energy sources, designed to improve the reliability and quality of alternative energy sources such as solar or wind power. Our typical energy storage solution is intended to help leverage a customer's renewable energy investment in a number of ways, such as by providing output firming, which stabilizes power against variances in meteorological conditions. Another advantage of our solutions is power smoothing, which improves power quality and eliminates harmonics, rapid voltage swings and frequency deviations. Our energy storage solutions can be combined with our Distributed Generation or Solar Energy systems to provide the benefits of those solutions, including peak shifting and fast and reliable standby power. In addition, our energy storage solutions are scalable, flexible and technology-neutral to meet the needs of our customers.

Our Energy Storage solutions are sold to customers under the project-based model, the customer acquires ownership of the Energy Storage system 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.

Solar Energy

Our Solar Energy segment is operated primarily by our PowerSecure Solar subsidiary. Our Solar Energy systems use photovoltaic solar panels (which we do not manufacture) to provide utilities and their customers with environmentally friendly power to augment their core power requirements. Our PowerSecure Solar team provides us with the ability to deliver Solar Energy systems integrated with our Distributed Generation and Energy Storage solutions platform. These Solar Energy systems are sold under the project-based, customer-owned model. We are engaged to design, source, procure, build and install Solar Energy systems and projects, for utilities and their customers or for developers and their customers. We are generally paid a fixed contractual price for these projects, plus any modifications or scope additions. We recognize revenues from these projects on an output method using percentage-of-completion basis.

Our Solar Energy business significantly expanded in 2015 under awards from Georgia Power, one of the largest investor-owned utilities in the U.S., to provide utility-scale solar installations that we currently expect to generate a total of approximately \$120 million in revenues during 2015 and 2016, including revenues from such projects that we

have already recognized. In July 2014, we entered into two Engineering, Procurement and Construction Agreements (EPC Contracts) with Georgia Power. In July 2015, we entered into a third EPC Contract with Georgia Power. The July 2015 EPC Contract was subsequently terminated, by mutual agreement, on March 23, 2016. In connection with the termination agreement, we transferred to Georgia Power all of our rights, duties and obligations under our solar panel supply agreement, and Georgia Power agreed to pay us approximately \$3.2 million, which is equal to the sum of the deposit paid by us to the solar panel supplier and the amount owed by us for certain engineering work product. In addition, Georgia Power fully released and discharged the underlying payment and performance bond. We did not incur any termination fees or penalties as a result of the termination of the July 2015 EPC Contract.

Table of Contents

Utility Infrastructure

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

On February 8, 2016, we entered into a five-year MSA with the Bahamas Power and Light Company, a wholly owned subsidiary of Bahamas Electricity Corporation, the government owned electric utility for The Bahamas (excluding Grand Bahama), to assist BPL to conduct its operations as the electric utility for The Bahamas, manage the Bahamas electric infrastructure, and enhance its overall electric generation system and supply. The MSA includes a business plan which outlines cost-reduction and reliability targets along with renewable energy and customer service initiatives.

Our largest source of revenue within our Utility Infrastructure segment 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 system 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 provides cybersecurity consulting and compliance services to the utility industry, helping large investor owned utilities (IOUs), municipalities and cooperative utilities assess, improve and maintain their compliance with the NERC's CIP Reliability Standards.

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 unit 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 and distribution 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 adjustments. We recognize revenues from these projects on a percentage-of-completion basis. 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.

Table of Contents

Energy Efficiency

We deliver Energy Efficiency solutions to assist our customers in the achievement of their energy efficiency goals. We have two primary Energy Efficiency product and service offerings: light emitting diode, or LED, lighting fixtures and lamps, and energy efficiency upgrades for large energy services companies, referred to as ESCO customers, and large retailers. Our LED lighting solutions are primarily focused on the utility, commercial and industrial markets, while our energy efficiency solutions are primarily focused on serving Energy Services Companies (ESCO) and retail channels. We have begun including our Distributed Generation products and services in our Energy Efficiency Services solutions. In the future, we also plan to bring our LED lighting solutions to our ESCO and retail 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 products include our PowerSecure Lighting, 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 realigned and consolidated these operations into PowerSecure Lighting, 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 Energy Efficiency Services business, which gives us the capability to provide general lighting, building envelope, HVAC and water efficiency solutions to ESCOs, which deliver these energy efficiency solutions to commercial, industrial and institutional facilities. In September 2014, we acquired the retail energy services operations of Apex Controls, Inc. (Apex). The acquired operations provides retrofit and electrical contracting services to major retailers, in most cases through general contractors, and provides us with the capacity to provide our Energy Efficiency Services solutions to large retailers. In December 2015, we expanded our energy efficiency operations through the acquisition of the assets and business of ESCO Energy Services Company, a private company based in Lennox, Massachusetts that provides energy efficiency facilities services to business, government agencies and other institutions across the United States.

Our LED lighting products, led by our PowerSecure Lighting team, 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.

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.

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 products. EnergyLite's products are marketed to customers and utilities directly, and through third party distribution arrangements.

The primary client base for our Energy Efficiency Services business consists of large, publicly-traded ESCOs. Through our relationships with these ESCOs, we provide facility upgrades for public sector customers, including federal, state and local government agencies and educational institutions. As 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 retail, commercial and industrial clients for which we provide our products and services directly, when an 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 the ESCO's customers save money, improve facilities and meet energy efficiency goals and mandates. Our solutions include energy efficient lighting upgrades, energy efficient mechanical and electrical retrofit and upgrade services, water conservation, building

Table of Contents

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. We plan to continue 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, 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, and overhead lighting for walk-in storage coolers; 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, historically the majority of our lights have been sold by us directly to our customers, although we also have distributor relationships that serve certain product lines and are becoming an increasing part of our sales channels. 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 with a greater portion of our sales driven through distributorship channels.

Our Energy Efficiency Services business revenues are generated through a full range of turn-key services we provide to ESCOs and retailers. 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 some of the most appropriate, effective and proven technologies available in the marketplace.

Recent Developments

On February 24, 2016, we entered into a Merger Agreement with Southern Company and a new wholly-owned subsidiary of Southern Company, which we refer to as the Merger Sub, providing for the merger of the Merger Sub with and into PowerSecure, with PowerSecure surviving as a wholly-owned subsidiary of Southern Company. At the effective time of the merger, subject to receipt of required shareholder and regulatory approvals, and meeting specified customary closing conditions, each share of our common stock will be converted automatically into the right to receive \$18.75 in cash, without interest, less any applicable withholding taxes. In the Merger Agreement, we agreed to covenants affecting the conduct of our business between the date of the Merger Agreement and the effective date of the Merger.

Table of Contents

On March 31, 2016, the U.S. Federal Trade Commission granted early termination of the waiting period under the Hart-Scott-Rodino Act with regard to the Merger, and on May 5, 2016, at a special meeting of shareholders of the Company, the holders of a majority of all outstanding shares of our common stock voted to approve the Merger, thus fulfilling two of the primary conditions to complete the transaction. Accordingly, as of the date of this report, the Company expects to complete the Merger on or around May 9, 2016.

During April 2016, we determined that our costs to complete two large utility-scale solar projects would be substantially in excess of our prior estimates and that a loss would be incurred to complete the contracts. In accordance with generally accepted accounting principles, we recorded an aggregate cost adjustment on the two contracts during the three months ended March 31, 2016 in the amount of \$6.5 million representing the full amount of the loss we expect to incur, which is included in our cost of sales during that period. We currently do not anticipate recording any additional losses to complete these two contracts, but additional losses may be incurred if future events are different from our assumptions, and those losses may be significant. The scheduled substantial completion and placed in service dates of the two utility-scale solar contracts range from August 1, 2016 to October 1, 2016.

Financial Results Highlights

Our consolidated revenues in the first quarter 2016 were \$105.2 million, an increase of \$25.6 million, or 32.3%, over our consolidated revenues during the first quarter 2015. The drivers of this year-over-year revenue increase were revenue increases in our Solar Energy, Utility Infrastructure and Energy Efficiency segments, as follows: a \$17.9 million, or 281.9%, increase in our Solar Energy segment revenues; a \$8.8 million, or 30.3%, increase in our Utility Infrastructure segment revenues; and a \$0.3 million, or 2.0%, increase in our Energy Efficiency segment revenues. The revenue increases by these segments was partially offset by a \$0.5 million, or 1.7% decrease in revenues from our Distributed Generation segment. The increase in our Solar Energy segment revenues reflects an increase in the size of solar projects we are executing year-over-year, in particular the EPC Contracts. The increase in our Utility Infrastructure revenues was driven primarily by a \$7.7 million increase in UtilityServices revenues, which was due to continued growth in services provided to key customers. The increase in our Energy Efficiency segment revenues was due to a \$2.1 million increase in revenues from our Energy Efficiency Services projects, partially offset by a \$2.0 million decrease in LED lighting product sales. The decrease in our Distributed Generation segment revenues during the first quarter 2016 was primarily due to an unanticipated delay encountered in achieving revenue recognition milestones related to certain projects in process during that period and further as a result of a delay in sales pipeline conversion from data center customers.

Our first quarter 2016 gross margin as a percentage of revenue decreased to 8.8%, compared to 26.8% in the first quarter 2015, on a consolidated basis. Distributed Generation segment gross profit margins were 21.5% in the first quarter 2016 compared to 38.6% in the first quarter 2015. Solar Energy segment gross profit margins were a negative 26.7% in the first quarter 2016 compared to 9.7% in the first quarter 2015. Utility Infrastructure segment gross profit margins were 12.2% in the first quarter 2016 compared to 13.3% in the first quarter 2015. Energy Efficiency segment gross profit margins were 33.6% in the first quarter 2016 compared to 37.0% in the first quarter 2015.

The year-over-year gross profit margin decrease in our Solar Energy segment was primarily driven by a \$6.5 million cost of sales adjustment due to costs expected to be incurred to complete two utility-scale solar projects in excess of prior estimates, which reduced our gross profit and gross profit margin during the first quarter 2016. In accordance with generally accepted accounting principles, since we now expect to realize a loss on the contracts underlying those two projects, the full amount of the cost of sales adjustment was recognized in the first quarter 2016 versus over the remaining contract period. Our Distributed Generation gross profit and gross profit margin was affected by the volume of revenue in the first quarter 2016, which was less than we had anticipated as discussed above. Portions of our Distributed Generation cost of sales are relatively fixed over the near-term. Therefore, the lower than anticipated

Distributed Generation revenue level during the first quarter 2016 combined with the fixed portion of our costs of sales resulted in a higher cost of sales as a percentage of revenues, lower gross profit, and a reduction in our Distributed Generation gross profit margin during that period. The decrease in our Utility Infrastructure segment gross profit margin is due to a reduction in operational

Table of Contents

efficiencies within our UtilityServices operations, despite the overall increase in gross profit. Our Energy Efficiency segment gross profit margin decrease was driven primarily by the reduction of sales of our higher margin LED products in the first quarter 2016 compared to the first quarter 2015. Our Distributed Generation, Utility Infrastructure and Energy Efficiency segment gross profit margins also decreased due to differences in the mix of projects period-to-period. As is always the case, variability in our quarterly and year-to-date gross profit margins is also caused by regular ongoing differences in the mix of specific projects completed in each period.

Our operating expenses during the first quarter 2016 increased by \$3.6 million, or 17.3%, compared to our operating expenses during the first quarter 2015. The year-over-year increase in operating expenses was driven primarily by \$2.6 million of incremental expenses associated with the anticipated Merger during the first quarter 2016. The remaining year-over-year increase in our operating expenses was driven by increases in costs incurred to support our growing business platforms, an increase in selling expenses due to additional sales executives and sales compensation, and an increase in depreciation and amortization from our investments in equipment, company-owned distributed generation systems, and acquisition-related intangibles.

Our consolidated operating loss for the first quarter 2016 was \$15.2 million compared to operating income of \$0.5 million for the first quarter 2015. The reduction in our consolidated operating income during the first quarter 2016 was driven by the \$6.5 million cost of sales adjustment related to losses we currently expect to incur on our utility-scale solar projects, Merger related expenses of \$2.6 million, and the effects on operating income of unanticipated delays encountered in our Distributed Generation segment in achieving certain revenue recognition milestones related to certain projects in process during that period. The following table summarizes our operating income (loss) by segment for the periods indicated (dollars in thousands):

	Quarter Ended		Period-over-Period	
	2016	2015	Difference	
			\$	%
Segment operating income (loss):				
Distributed Generation	\$ (496)	\$ 5,207	\$ (5,703)	(109.5)%
Solar Energy	(7,421)	(294)	(7,127)	(2,424.1)%
Utility Infrastructure	858	(135)	993	735.6%
Energy Efficiency	141	776	(635)	(81.8)%
Corporate and other unallocated costs	(8,258)	(5,084)	(3,174)	(62.4)%
Total	\$ (15,176)	\$ 470	\$ (15,646)	(3,328.9)%

Our consolidated net loss for the first quarter 2016 was \$9.9 million, or a loss of (\$0.44) per diluted share, compared to net income of \$0.1 million, or \$0.01 per diluted share, for the first quarter 2015.

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, 2015 or our quarter ended March 31, 2016, will be indicative of our future results, especially in light of the current economic conditions and unfavorable credit and capital markets.

Backlog

Our revenue backlog stands at \$302 million, as of May 6, 2016. This revenue backlog represents revenue expected to be recognized after March 31, 2016, for periods including the second quarter of 2016 onward. Our \$302 million revenue backlog and the estimated timing of revenue recognition are outlined below, including project-based revenues expected to be recognized as projects are completed, and recurring revenues expected to be recognized over the life of the underlying contracts. Also outlined below, our \$302 million revenue backlog is broken down between non-solar revenue backlog and solar revenue backlog.

Table of Contents**Revenue Backlog expected to be recognized after March 31, 2016**

Description		Anticipated Revenue	Estimated Primary Recognition Period
Project-based Revenue	Near term	\$ 189 million	2Q16 through 4Q16
Project-based Revenue	Long term	\$ 25 million	1Q17 through 2017
Recurring Revenue		\$ 88 million	2Q16 through 2020

Revenue Backlog expected to be recognized after March 31, 2016 **\$ 302 million**

Description	Anticipated Non-Solar Revenue	Anticipated Solar Revenue
Revenue Backlog expected to be recognized after March 31, 2016 by category	\$ 260 million	\$ 42 million
Revenue Backlog as reported May 6, 2015 by category	\$ 268 million	\$ 134 million
Change in Revenue Backlog by category	(\$ 8 million)	(\$ 92 million)
% Change in Revenue Backlog by category	-3.0%	-68.7%

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

Orders in our backlog are subject to delay, deferral, acceleration, resizing, or cancellation from time to time by our customers, subject to contractual rights, and estimates are utilized in the determination of the backlog amounts. For example, the anticipated revenue from one large solar project is subject to a potential modification resulting in a larger reduction in size than anticipated or potential termination. Given the irregular sales cycle of customer orders, and especially of large orders, our revenue backlog at any given time is not necessarily an accurate indication of our future revenues.

Reportable Segments

Our reportable segments are currently organized around the following products and services that we offer as part of our core business strategy:

Distributed Generation solutions;

Solar Energy solutions;

Utility Infrastructure solutions; and

Energy Efficiency solutions.

Results of Operations

The following discussion regarding segment revenues, gross profit, costs and expenses, and other income and expenses for the first quarter 2016 compared to the first quarter 2015 are entirely attributable to our reportable segments together with corporate and other unallocated cost items as noted in the tables and discussion below.

Table of Contents**First Quarter 2016 Compared to First Quarter 2015***Revenues*

Our consolidated revenues are generated entirely by product sales and services by our four reportable segments: Distributed Generation, Solar Energy, Utility Infrastructure, and Energy Efficiency. Intersegment revenues, if any, are eliminated from total segment revenues as reflected in the tables below. The following table summarizes our revenues, including intersegment revenues, by these segments for the periods indicated (dollars in thousands):

	Quarter Ended March 31,		Period-over-Period Difference	
	2016	2015	\$	%
Segment Revenues:				
Distributed Generation	\$ 30,223	\$ 30,731	\$ (508)	(1.7)%
Solar Energy	24,243	6,348	17,895	281.9%
Utility Infrastructure	37,634	28,883	8,751	30.3%
Energy Efficiency	13,837	13,562	275	2.0%
Intersegment Eliminations	(786)	(15)	(771)	(5,140.0)%
Total	\$ 105,151	\$ 79,509	\$ 25,642	32.3%

Our consolidated revenues in the first quarter 2016 of \$105.2 million increased \$25.6 million, or 32.3%, compared to the first quarter 2015, due to an increase in sales in our Solar Energy, Utility Infrastructure, and Energy Efficiency segments, partially offset by a decrease in sales in our Distributed Generation segment. The increase in our revenues in the first quarter 2016 over the first quarter 2015 consisted of a \$17.9 million, or 281.9% increase in revenues from our Solar Energy segment, a \$8.8 million, or 30.3%, increase in revenues from our Utility Infrastructure segment and a \$0.3 million, or 2.0%, increase in revenues from our Energy Efficiency segment, partially offset by a \$0.5 million, or 1.7% decrease from our Distributed Generation segment.

The increase in our Solar Energy segment revenues reflects a year-over-year increase in the size of solar projects, including the two utility-scale solar installation projects we were awarded in July 2014. The year-over-year increase in our Utility Infrastructure segment revenues was due to a \$7.7 million increase in UtilityServices revenue, together with a \$0.4 million increase in revenues from engineering, consulting and management services we provide to utilities. The increase in our UtilityServices revenue was primarily due to our efforts to focus on new business development activity. The increase in our Energy Efficiency segment revenues was due to a \$2.1 million increase in revenues from our Energy Efficiency Services projects, partially offset by a \$2.0 million decrease in LED lighting product sales. The year-over-year decrease in our Distributed Generation segment revenues during the first quarter 2016 was driven primarily by a \$2.1 million decrease in our Distributed Generation business caused by unanticipated delays encountered on certain projects in process during the first quarter 2016, which was partially offset by an increase \$1.6 million increase in our Energy Storage project sales.

Our revenues are significantly affected by the number, size and timing of our Distributed Generation, Solar Energy, Utility Infrastructure and Energy Efficiency projects as well as the percentage of completion of in-process projects, and the percentage of customer-owned as opposed to PowerSecure-owned distributed generation recurring revenue projects. Our sales have fluctuated significantly in the past and are expected to continue to fluctuate significantly in the future.

Our future revenues will also depend on the vitality of the domestic economy, the health of the credit markets and the continuing levels of customer spending for capital improvements and energy efficiency projects, as well as our ability to secure new significant purchase orders, to expand our markets and product and service lines and to convert our sales pipeline into contract awards, and to realize the growth opportunities provided by our recent acquisitions and any future acquisitions. The amount and timing of our future revenues will also be affected by the amount and proportion of revenues generated by future PowerSecure-owned Distributed Generation recurring revenue projects, which result in revenue being recognized over a longer period. We are particularly susceptible to changes in economic conditions because our product offerings are generally considered discretionary investment items by our customers, who may delay, defer, reduce or terminate large sales orders, such as the 2015 solar project, depending on their business requirements and capital budgets.

Table of Contents*Gross Profit and Gross Profit Margin*

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

	Quarter Ended March 31,		Period-over-Period Difference	
	2016	2015	\$	%
Segment Cost of Sales (excluding depreciation and amortization):				
Distributed Generation	\$ 23,723	\$ 18,881	\$ 4,842	25.6%
Solar Energy	30,723	5,733	24,990	435.9%
Utility Infrastructure	33,024	25,033	7,991	31.9%
Energy Efficiency	9,181	8,548	633	7.4%
Intersegment Eliminations	(786)	(15)	(771)	(5,140.0)%
Total	\$ 95,865	\$ 58,180	\$ 37,685	64.8%
Segment Gross Profit:				
Distributed Generation	\$ 6,500	\$ 11,850	\$ (5,350)	(45.1)%
Solar Energy	(6,480)	615	(7,095)	(1,153.7)%
Utility Infrastructure	4,610	3,850	760	19.7%
Energy Efficiency	4,656	5,014	(358)	(7.1)%
Total	\$ 9,286	\$ 21,329	\$ (12,043)	(56.5)%
Segment Gross Profit Margins:				
Distributed Generation	21.5%	38.6%		
Solar Energy	(26.7)%	9.7%		
Utility Infrastructure	12.2%	13.3%		
Energy Efficiency	33.6%	37.0%		
Total	8.8%	26.8%		

Cost of sales includes materials, vehicles, personnel and related overhead costs incurred to manufacture products and provide services, but excludes depreciation and amortization. Cost of sales also includes inventory write-downs occurring in the normal course of business, as well as those occurring, from time to time, in connection with periodic restructuring and realignment actions. Intersegment cost of sales from intersegment revenues are eliminated from total cost of sales. The 64.8% increase in our consolidated cost of sales and services for the first quarter 2016 compared to the first quarter 2015 was driven by the increase in costs associated with the 32.0% increase in revenues and other factors discussed below leading to the decrease in our consolidated gross profit margin.

Our consolidated gross profit decreased \$12.0 million, or 56.5%, in the first quarter 2016 compared to the first quarter 2015, despite the 32.3% increase in consolidated revenues. As a percentage of revenue, our consolidated gross margin in the first quarter 2016 was 8.8%, a decrease of 18.0 percentage points compared to the first quarter 2015. Distributed Generation segment gross profit margins were 21.5% in the first quarter 2016 compared to 38.6% in the first quarter 2015. Solar Energy segment gross profit margins were a negative 26.7% in the first quarter 2016 compared to 9.7% in

the first quarter 2015. Utility Infrastructure segment gross profit margins were 12.2% in the first quarter 2016 compared to 13.3% in the first quarter 2015. Energy Efficiency segment gross profit margins were 33.6% in the first quarter 2016 compared to 37.0% in the first quarter 2015.

The year-over-year consolidated gross profit margin decrease in our Solar Energy segment was primarily driven by a \$6.5 million adjustment to cost of sales due to costs expected to be incurred to complete two utility-scale solar projects in excess of prior estimates, which reduced our gross profit and gross profit margin during the first quarter 2016. In accordance with generally accepted accounting principles, since we now expect to realize a loss on the contracts

Table of Contents

underlying those two projects, the full amount of the cost of sales adjustment was recognized in the first quarter 2016 versus over the remaining contract period. In addition, our Distributed Generation gross profit and gross profit margin was affected by the volume of revenue in the first quarter 2016, which was less than we had anticipated as discussed above. Portions of our Distributed Generation cost of sales are relatively fixed over the near-term. Therefore, the lower than anticipated Distributed Generation revenue level during the first quarter 2016 combined with the fixed portion of our costs of sales resulted in a higher cost of sales as a percentage of revenues, lower gross profit, and a reduction in our Distributed Generation gross profit margin during that period. The decrease in our Utility Infrastructure segment gross profit margin is due to a reduction in operational efficiencies within our UtilityServices operations, despite the overall increase in gross profit. Our Energy Efficiency segment gross profit margin decrease was driven primarily by the reduction of sales of our higher margin LED products in the first quarter 2016 compared to the first quarter 2015. Our Distributed Generation, Utility Infrastructure and Energy Efficiency segment gross profit margins also decreased due to differences in the mix of projects period-to-period.

An important driver in the period-over-period change in our consolidated gross profit margin is the relative gross profit margins we generally earn in each of our Distributed Generation, Solar Energy, Utility Infrastructure and Energy Efficiency reportable segments. Our Distributed Generation segment products and services generally yield gross profit margins in the 25-45% range, our Solar Energy segment products and services generally yield gross profit margins that are in the 5-20% range, our Utility Infrastructure segment products and services generally yield gross profit margins in the 5-25% range, and our Energy Efficiency segment products generally yield gross profit margins in the 15-40% range (with our ESCO revenues having gross profit margins that are generally at the mid-point of this range). The gross profit margin we realize in each of our reportable segments largely correlates to the amount of value-added products and services we deliver, with highly engineered, turn-key projects realizing higher gross profit margins due to the benefits they deliver our customers and the value we deliver because we are vertically integrated. Because of these gross profit margin differences, changes in the mix of our segment revenues, and individual product lines within those segments, affect our consolidated gross profit margin results.

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

the absolute level of revenue achieved in any particular period, given that portions of our cost of sales are relatively fixed over the near-term, the most significant of which is personnel and equipment costs;

the impact of our utility-scale solar projects in our Solar Energy segment that will be completed during 2016, which will have nominal ongoing gross margins during the remainder of 2016 and which is expected to produce negative gross margins for the full year 2016;

our ability to continue to improve and realize the financial benefits of operational efficiencies in all of our segments, in particular the UtilityServices area of our Utility Infrastructure segment, including increasing our revenue and improving the productivity of our personnel and equipment as well as managing our labor and asset costs during periods when work assignments, and therefore revenue, is lower or when our crews are in-between work assignments;

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

the mix of revenue among each of our segments, and products and services within these segments, which have different gross profit margins, and certain types of projects within each segment;

our ability to execute on our customer orders efficiently and with operational excellence, to generate customer satisfaction, profitability and future additional business, especially with respect to significant awards such as the utility-scale solar projects;

our ability to benefit from economies of scale, including the ability to re-source from low-cost manufacturers;

our level of investments in our businesses, particularly for anticipated or new business awards;

improvements in technology and manufacturing methods and processes;

the impact of competition on our volumes or pricing;

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

Table of Contents

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

the geographic density of our projects;

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

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

the impact of acquisitions of businesses, assets and technologies, including differing margins of new products and services acquired and our ability to strategically benefit from cost efficiencies these acquisitions provide and to manage the costs of our related growth from acquisitions;

the ability to realize gross profit margin increases from our operations that have lower gross profit margin profiles, such as our Solar Energy segment;

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

other factors described below under *Fluctuations* .

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

Operating Expenses

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

	Quarter Ended		Period-over-Period	
	2016	2015	\$	%
Consolidated Operating Expenses:				
General and administrative	\$ 18,439	\$ 15,634	\$ 2,805	17.9%

Edgar Filing: POWERSECURE INTERNATIONAL, INC. - Form 10-Q

Selling, marketing and service	3,295	2,748	547	19.9%
Depreciation and amortization	2,728	2,477	251	10.1%
Total	\$ 24,462	\$ 20,859	\$ 3,603	17.3%

Table of Contents

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

	Quarter Ended		Period-over-Period	
	2016	2015	Difference	
			\$	%
Distributed Generation:				
General and administrative	\$ 4,550	\$ 4,360	\$ 190	4.4%
Selling, marketing and service	1,299	1,213	86	7.1%
Depreciation and amortization	1,147	1,070	77	7.2%
Total Distributed Generation operating expenses	\$ 6,996	\$ 6,643	\$ 353	5.3%
Solar Energy:				
General and administrative	\$ 814	\$ 780	\$ 34	4.4%
Selling, marketing and service	79	97	(18)	(18.6)%
Depreciation and amortization	48	32	16	50.0%
Total Solar Energy operating expenses	\$ 941	\$ 909	\$ 32	3.5%
Utility Infrastructure:				
General and administrative	\$ 2,484	\$ 2,873	\$ (389)	(13.5)%
Selling, marketing and service	526	336	190	56.5%
Depreciation and amortization	742	776	(34)	(4.4)%
Total Utility Infrastructure operating expenses	\$ 3,752	\$ 3,985	\$ (233)	(5.8)%
Energy Efficiency:				
General and administrative	\$ 3,288	\$ 3,255	\$ 33	1.0%
Selling, marketing and service	753	591	162	27.4%
Depreciation and amortization	474	392	82	20.9%
Total Energy Efficiency operating expenses	\$ 4,515	\$ 4,238	\$ 277	6.5%
Corporate and other unallocated costs:				
General and administrative	\$ 7,303	\$ 4,366	\$ 2,937	67.3%
Selling, marketing and service	638	511	127	24.9%
Depreciation and amortization	317	207	110	53.1%
Total corporate and other unallocated costs	\$ 8,258	\$ 5,084	\$ 3,174	62.4%
Total consolidated operating expenses	\$ 24,462	\$ 20,859	\$ 3,603	17.3%

Costs related to personnel, including wages, benefits, stock compensation, bonuses and commissions, are the most significant component of our operating expenses. During the first quarter 2016, we incurred an aggregate of \$2.6 million of incremental Merger related expenses. The remaining year-over-year increase in our operating expenses was

driven by increased costs incurred to support our growing business platforms and anticipated growth, an increase in selling expenses due to additional sales executives and sales compensation, and an increase in depreciation and amortization from our investments in equipment, company-owned distributed generation systems, and acquisition-related intangibles.

Our operating expenses as a percentage of our revenues decreased by 3.0 percentage points in the first quarter 2016 compared to the first quarter 2015. Excluding the effects of the \$2.6 million of incremental Merger related expenses, our operating expenses as a percentage of our revenues decreased by 5.4 percentage points in the first quarter 2016 compared to the first quarter 2015. This decrease reflects operating efficiencies we experienced in the first quarter 2016 driven by increased revenue levels during that period.

Table of Contents

General and Administrative Expenses. General and administrative expenses include personnel wages, benefits, stock compensation, and bonuses and related overhead costs for the support and administrative functions, together with unallocated corporate and other administrative costs.

The overall \$2.8 million, or 17.9%, increase in our consolidated general and administrative expenses in the first quarter 2016, as compared to the first quarter 2015, was due primarily to the \$2.6 million of incremental Merger related costs. The following table provides further details of our general and administrative expenses by expense category for the periods indicated (dollars in thousands):

	Quarter Ended March 31,		Period-over-Period Difference	
	2016	2015	\$	%
Consolidated General and Administrative Expense:				
Personnel costs	\$ 8,320	\$ 8,973	\$ (653)	(7.3)%
Merger related costs	2,630		2,630	n/m
Vehicle lease and rental	474	599	(125)	(20.9)%
Insurance	623	643	(20)	(3.1)%
Rent-office and equipment	453	452	1	0.2%
Professional fees and consulting	502	378	124	32.8%
Travel	879	679	200	29.5%
Telephone	304	213	91	42.7%
Meals and entertainment	345	256	89	34.8%
Utilities	94	112	(18)	(16.1)%
Other	1,561	1,070	491	45.9%
Corporate costs	2,254	2,259	(5)	(0.2)%
Total	\$ 18,439	\$ 15,634	\$ 2,805	17.9%

The following table provides detail of our general and administrative expenses by segment along with unallocated corporate and other administrative costs for the periods indicated (dollars in thousands):

	Quarter Ended March 31,		Period-over-Period Difference	
	2016	2015	\$	%
Segment General and Administrative Expense:				
Distributed Generation	\$ 4,550	\$ 4,360	\$ 190	4.4%
Solar Energy	814	780	34	4.4%
Utility Infrastructure	2,484	2,873	(389)	(13.5)%
Energy Efficiency	3,288	3,255	33	1.0%
Corporate and other unallocated costs	7,303	4,366	2,937	67.3%
Total	\$ 18,439	\$ 15,634	\$ 2,805	17.9%

The 4.4% increase in our first quarter 2016 Distributed Generation segment general and administrative expense compared to the first quarter 2015, was due to increases in costs to support the growth in revenue incurred over the course of 2015 including the startup of the Energy Storage business which occurred in mid-2015. The 4.4% increase in Solar Energy segment general and administrative expense is due to increases in personnel and related costs that were necessary to support the revenue growth of our Solar segment and, in particular, fulfilment of the utility-scale solar projects. The 13.5% decrease in our first quarter 2016 Utility Infrastructure segment general and administrative expense compared to the first quarter 2015 was due to reductions in personnel and related costs that were implemented to increase the profitability of our Utility Services operations. The 1.0% increase in our first quarter 2016 Energy Efficiency segment general and administrative expense compared to the first quarter 2015 was due to increases in personnel and related costs of our Energy Efficiency Services operations and, in particular, the additional costs associated with the ESCO Energy Services Company operations we acquired in December 2015.

Table of Contents

Corporate and other unallocated costs include similar personnel costs as described above as well as costs incurred for the benefit of all of our business operations, such as acquisition costs, legal, Sarbanes-Oxley compliance, public company reporting, director expenses, accounting costs, and stock compensation expense on our stock options, restricted stock awards, and performance units which we do not allocate to our operating segments. The increase in our corporate and other unallocated costs during the first quarter 2016 as compared to the first quarter 2015 was due primarily to the \$2.6 million of incremental Merger related costs incurred.

Selling, Marketing and Service Expenses. Selling, marketing and service expenses consist of personnel and related overhead costs, including commissions for sales and marketing activities, together with travel, advertising and promotion costs. The 19.9% increase in consolidated selling, marketing and service expenses in the first quarter 2016, as compared to the first quarter 2015, was due to increases in salaries due to investments in sales teams, increases in commissions, increases in business development costs to promote growth, and travel incurred on increased revenues. The following table provides further detail of our selling, marketing and service expenses by expense category for the periods indicated (dollars in thousands):

	Quarter Ended March 31,		Period-over-Period Difference	
	2016	2015	\$	%
Consolidated Selling, Marketing and Service:				
Salaries	\$ 1,236	\$ 1,103	\$ 133	12.1%
Commission	654	489	165	33.7%
Travel	502	414	88	21.3%
Advertising and promotion	879	645	234	36.3%
Bad debt expense (recovery)	(24)	49	(73)	(149.0)%
Vehicle lease and rental	48	48		%
Total	\$ 3,295	\$ 2,748	\$ 547	19.9%

The following table provides further detail of our selling, marketing and service expenses by segment for the periods indicated (dollars in thousands):

	Quarter Ended March 31,		Period-over-Period Difference	
	2016	2015	\$	%
Segment Selling, Marketing and Service Expense:				
Distributed Generation	\$ 1,299	\$ 1,213	\$ 86	7.1%
Solar Energy	79	97	(18)	(18.6)%
Utility Infrastructure	526	336	190	56.5%
Energy Efficiency	753	591	162	27.4%
Unallocated costs	638	511	127	24.9%
Total	\$ 3,295	\$ 2,748	\$ 547	19.9%

The growth in our selling, marketing and services expenses represents additional personnel and compensation to grow and support anticipated future revenue growth.

Depreciation and Amortization Expenses. Depreciation and amortization expenses include the depreciation of property, plant and equipment and the amortization of certain intangible assets including capitalized software development costs and other intangible assets acquired in our recent acquisitions.

Table of Contents

The following table provides detail of our depreciation and amortization expense by segment for the periods indicated (dollars in thousands):

	Quarter Ended		Period-over-Period	
	March 31,		Difference	
	2016	2015	\$	%
Segment Depreciation and Amortization:				
Distributed Generation	\$ 1,147	\$ 1,070	\$ 77	7.2%
Solar Energy	48	32	16	50.0%
Utility Infrastructure	742	776	(34)	(4.4)%
Energy Efficiency	474	392	82	20.9%
Unallocated costs	317	207	110	53.1%
Total	\$ 2,728	\$ 2,477	\$ 251	10.1%

The 10.1% increase in consolidated depreciation and amortization expenses in the first quarter 2016, compared to the first quarter 2015, primarily reflects increased depreciation resulting from capital investments as well as increased amortization expense associated with intangible assets acquired. Our capital investments are primarily investments in PowerSecure-owned Distributed Generation segment systems for projects deployed under our recurring revenue model.

Other Income and Expenses

Our other income and expenses include interest income, interest expense, and income taxes. None of these income or expense amounts are allocated to our operating segments for purposes of evaluating segment performance or allocating resources. The following table sets forth our consolidated other income and expenses for the periods indicated (dollars in thousands):

	Quarter Ended		Period-over-Period	
	March 31,		Difference	
	2016	2015	\$	%
Other Income (Expense):				
Interest and other income	\$ 1	\$ 1	\$	%
Interest expense	(394)	(269)	(125)	46.5%
Total	\$ (393)	\$ (268)	\$ (125)	46.6%

Interest and Other Income. Interest and other income consists primarily of interest we earn on the interest-bearing portion of our cash and cash equivalent balances. The amount of interest income during the first quarter 2016 was similar compared to the first quarter 2015. Our future interest income will depend on our cash and cash equivalent balances, which will increase and decrease depending upon our profit, capital expenditures, acquisitions, working capital needs, and future interest rates.

Interest Expense. Interest expense consists of interest and finance charges on the revolving portion of our credit facility, term loans and capital leases. Interest expense increased during the first quarter 2016, as compared to the first quarter 2015. The increase in our interest expense reflects the effects on interest expense on incremental borrowings on the revolving portion of our credit facility, partially offset by a reduction in balances outstanding on our outstanding term loans due to regular payments made on those obligations over the year.

Income Taxes. The income tax expense or benefit we record is the result of applying our annual effective tax rate by our pre-tax income or loss. Our effective tax rate and our income tax expense or benefit includes the effects of permanent differences between our book and taxable income, changes in our deferred tax assets and liabilities, changes in

Table of Contents

the valuation allowance for our net deferred tax assets, federal and state income taxes in various state jurisdictions in which we have taxable activities, and expenses associated with uncertain tax positions that we have taken or expense reductions from uncertain tax positions as a result of a lapse of the applicable statute of limitations. We recognized a tax benefit in the amount of \$5.6 million during the first quarter 2016 compared to tax expense of \$0.1 million during the first quarter 2015. Our overall effective tax rate of 36.3% in the first quarter 2016 was slightly lower than compared to the 40.0% effective tax rate in the first quarter 2015. We recorded an income tax benefit during the first quarter 2016 as we incurred a pre-tax loss during that period whereas we recorded an income tax expense during the first quarter 2015 on pre-tax income during that period.

Fluctuations

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

the effects of general economic, business and financial conditions, including the negative impact that continuing weak and uncertain economic and financial market conditions and inconsistent capital and credit markets, or their deterioration, could have on our business operations, our revenues and our ability to operate and grow profitably, including the negative impact these conditions could have on the timing of and amounts of orders from our customers, and the potential these factors have to negatively impact our access to capital to finance our business;

the size, timing and terms of sales and orders, especially large customer orders, as well as the effects of the timing of phases of completion of projects for customers, and customers delaying, deferring or canceling purchase orders or making smaller purchases than expected, such as the recent termination of the large solar project contemplated by the July 2015 EPC Contract;

our ability to execute on our customer orders efficiently and profitably, to generate customer satisfaction, enhanced operating income and future additional business, especially with respect to significant awards such as the utility-scale solar projects, which are our largest projects in terms of revenues but have relatively low margins;

our ability to make strategic acquisitions of key businesses, technologies and other assets and resources, to realize the expected benefits from such acquisitions, to effectively integrate the acquired businesses, assets and personnel in our organization, to grow acquired businesses and to manage the costs related to such acquisitions, including our recent acquisitions of our retail energy services operations, our mission critical data center energy services operations, and our ESCO Energy Services Company;

our ability to sell, complete and recognize satisfactory levels of near-term quarterly revenues and net income related to our project-based sales and product and service revenues, which are recognized and billed as they are completed, in order to maintain our current profits and cash flow and to satisfy our financial covenants in

our credit facility and to successfully finance the recurring revenue portion of our business model;

our ability to maintain and grow our Utility Infrastructure revenues on a profitable basis, including maintaining and improving our pricing, utilization rates and productivity rates, given the significant levels of vehicles, tools and labor in which we have invested and which are required to serve utilities, and the risk that our utility customers will change work volumes or pricing, or will displace us from providing services;

our ability to maintain our safety performance and safety record at levels that meet or exceed the standards of our utility customers, the inability of which could cause us to be abruptly and immediately released from our work assignments with those utilities, and to lose the opportunity to obtain additional or new work from those utilities;

our ability to obtain adequate supplies of key components and materials of suitable quality for our products on a timely and cost-effective basis, including the impact of potential supply line constraints, substandard parts, changes in environmental requirements, and fluctuations in the cost of raw materials and commodity prices, including without limitation with respect to our LED lighting products and third party manufacturing arrangements we have, and arrangements we have established to source these products and components from vendors in Asia;

Table of Contents

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

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

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

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

permitting and regulatory or customer-caused delays on projects;

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

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

the amount of costs and expenses we incur to support our growth internally and through acquisitions, and our success in controlling and reducing our costs and expenses;

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

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

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

changes in our expenses, including prices for materials such as copper, aluminum and other raw materials, labor costs and other components of our products and services, fuel prices including diesel, natural gas, oil and gasoline, and our ability to hedge or otherwise manage these prices to protect our costs and revenues,

minimize the impact of volatile exchange rates and mitigate unforeseen or unanticipated expenses;

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

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

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

budgeting cycles of utilities and other industrial, commercial and institutional customers, including impacts of the slow economic recovery and inconsistent capital markets conditions on capital projects and other spending items;

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

economic conditions and regulations in the energy industry, especially in the electric utility industry, including the effects of changes in energy prices, electricity pricing and utility tariffs as well as the impact of future reductions in solar tax credits and incentives;

changes in the prices charged by our suppliers;

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

the effects of litigation, warranty claims and other claims and proceedings, including the securities class action.

Table of Contents

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

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

As we develop new lines of business, our revenues and costs will fluctuate because generally new businesses require start-up expenses and it takes time for revenues to develop, which can result in losses in early periods. Another factor that could cause material fluctuations in our annual results is an increase in recurring, as opposed to project-based, sources of revenue we generate for our Distributed Generation projects. To date, the majority of our revenues have consisted of project-based Distributed Generation revenues, project-based Utility Infrastructure revenues, project-based Solar Energy revenues, project-based Energy Efficiency Services revenues and sales of LED lighting fixtures, which are recognized as the sales occur or the projects are completed. Recurring revenue projects, compared to project-based sales, are generally more profitable over time, and growth in this business model can result in delayed recognition of revenue and net income, especially in the short-term, as we implement an increased number of these recurring revenue projects.

Due to all of these factors and the other risks, uncertainties and other factors discussed in this report and in our Annual Report on Form 10-K for the year ended December 31, 2015, quarter-to-quarter, period-to-period or year-to-year comparisons of our results of operations should not be relied on as an indication of our future performance. Quarterly, period or annual comparisons of our operating results are not necessarily meaningful or indicative of future performance.

Liquidity and Capital Resources

Overview

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

operations;

inventory;

accounts receivable;

property and equipment expenditures, including capital expenditures related to Distributed Generation PowerSecure-owned recurring revenue projects;

software purchases or development;

debt service requirements;

lease obligations;

deferred compensation obligations;

restructuring and cost reduction obligations; and

acquisitions and other business transactions.

Table of Contents***Working Capital***

At March 31, 2016, we had working capital of \$81.9 million, including \$6.4 million in cash and cash equivalents, compared to working capital of \$75.9 million, including \$18.4 million in cash and cash equivalents at December 31, 2015. During 2015 and 2016, our working capital balances, including our cash and cash equivalents, have been affected by our progress towards completion of two large-scale Solar Energy projects that we were awarded in July 2014. The timing of cash payments to our suppliers and cash receipts from our customer have affected the balances of our cash and cash equivalents, accounts receivable, inventory, accounts payable and accrued expenses. We expect similar effects during the remainder of 2016 as we move further towards completion of these large-scale solar projects, and the effects on our working capital, including our cash and cash equivalents, may be material. Changes in the components of our working capital from December 31, 2015 to March 31, 2016 and from December 31, 2014 to March 31, 2015 are explained in greater detail below.

During the first quarter 2016, we borrowed \$25.0 million on the revolving portion of our credit facility partially to finance the activities related to the large-scale Solar Energy projects described above. At March 31, 2016 and December 31, 2015, we had \$9.0 million and \$36.0 million, respectively, of available and unused borrowing capacity from our revolving credit facility, within the limits of our financial covenants. As a result of additional borrowings from our revolving credit facility during the second quarter 2016 through the date of this report, at May 6, 2016, an aggregate balance of \$30.0 million was outstanding, and there was approximately \$4.0 million available and unused borrowing capacity within the limits of our financial covenants under our revolving credit facility. The availability of this capacity under our credit facility includes restrictions on the use of proceeds, and is dependent upon our ability to satisfy certain financial and operating covenants including financial ratios, as discussed below.

Cash Flows

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

	Three Months Ended March 31,	
	2016	2015
Net cash used in operating activities	\$ (30,732)	\$ (6,358)
Net cash used in investing activities	(5,299)	(2,668)
Net cash provided by (used in) financing activities	23,977	(903)
Currency exchange rate changes	20	
Net decrease in cash and cash equivalents	\$ (12,034)	\$ (9,929)

Cash Used by Operating Activities

Cash used by operating activities consists primarily of net income (loss) adjusted for certain non-cash items including depreciation and amortization and stock-based compensation expenses. Cash used by operating activities also includes the effect of changes in working capital and other activities.

Cash used by operating activities for the first quarter 2016 was approximately \$30.7 million and consisted of \$9.9 million of net loss, \$2.2 million of non-cash operating items, and \$18.6 million used by changes in working capital balances. The \$2.2 million of non-cash items consisted primarily of a \$5.6 million increase in deferred taxes, partially offset by \$2.7 million of depreciation and amortization expense and \$0.6 million of stock compensation expense. Cash

used by working capital and other activities consisted primarily of a \$30.9 million decrease in accounts payable, a \$7.7 million decrease in accrued and other liabilities, a \$1.8 million increase in inventories, and a \$0.5 million reduction in accrued restructuring charges. The cash used by these working capital account changes were partially offset by a \$22.0 million decrease in accounts receivable. The fluctuations in our accounts receivable, accounts payable and our accrued and other liabilities is a function of the timing of customer remittances, payments to our vendors, and our inventory, advance billings and accrued project costs on projects in process, respectively. These working capital accounts can and do fluctuate significantly from period to period, depending on the timing and size of individual projects.

Table of Contents

Cash used in operating activities for the first quarter 2015 was approximately \$6.4 million and consisted of \$9.6 million used by changes in working capital balances, partially offset by \$3.2 million of net income and non-cash operating expenses. The non-cash items consisted primarily of \$2.5 million of depreciation and amortization expense and \$0.7 million of stock compensation expense. Cash used by working capital and other activities consisted primarily of a \$8.9 million increase in accounts receivable, a \$2.0 million increase in inventories, and a \$0.6 million reduction in accounts payable. The cash used by these working capital account changes were partially offset by a \$0.7 million increase in accrued and other liabilities and a net \$1.3 million reduction in other current and noncurrent assets and liabilities.

Cash Used in Investing Activities

Cash used in investing activities was \$5.3 million in the first quarter 2016 and cash used in investing activities was \$2.7 million in the first quarter 2015. Historically, our principal cash investments have related to the acquisition and installation of equipment related to our recurring revenues sales, the acquisition of businesses or technologies, the purchase of equipment used in our production facilities, and the acquisitions of certain contract rights. During the first quarter 2016, we used \$3.5 million to purchase and install equipment at our recurring revenue distributed generation sites and we used \$1.8 million principally to acquire operational assets. During the first quarter 2015, we used \$1.1 million to purchase and install equipment at our recurring revenue distributed generation sites, we used \$1.7 million principally to acquire operational assets, and we received \$0.1 million cash proceeds from the sale of property plant and equipment.

Cash Provided by (Used in) Financing Activities

Cash provided by financing activities was \$24.0 million in the first quarter 2016 and cash used in financing activities was \$0.9 million in the first quarter 2015. During the first quarter 2016, we borrowed \$25.0 million on the revolving portion of our credit facility, we used \$1.1 million to make scheduled payments on our term loan obligations, and we received \$0.1 million from the exercise of stock options. During the first quarter 2015, we used \$1.2 million to make scheduled payments on our capital lease and term loan obligations and we received \$0.3 million from the exercise of stock options.

Capital Spending

Our capital expenditures during the first quarter 2016 were approximately \$5.3 million, of which we used \$3.5 million to purchase and install equipment for our PowerSecure-owned recurring revenue distributed generation systems, and we used \$1.8 million to purchase equipment and other capital items. Our capital expenditures during the first quarter 2015 were approximately \$2.8 million, of which we used \$1.1 million to purchase and install equipment for our PowerSecure-owned recurring revenue distributed generation systems, and we used \$1.7 million to purchase equipment and other capital items.

We anticipate making total capital expenditures of approximately \$16 million in 2016, including capital expenditures for our company-owned distributed generation systems deployed under long-term recurring revenue contracts, and operational assets, particularly for equipment used in our businesses. Customer demand for our Distributed Generation systems under recurring revenue contract arrangements, and economic and financial conditions could cause us to reduce or increase those capital expenditures. The majority of our capital spending has to date been and will continue to be used for investments in assets related to our recurring revenue projects as well as equipment to support the growth of our Utility Infrastructure product and services.

Indebtedness

Long-Term Credit Facility We have a long-term credit facility with Citibank, N.A. (Citibank), as administrative agent and lender, and other lenders under a credit agreement that we first entered into with our lenders in August 2007 and have amended and restated from time-to-time. At March 31, 2016 and December 31, 2015, our credit agreement with Citibank along with Branch Banking and Trust Company (BB&T) as additional lender, consisted of a \$40.0 million senior, first-priority secured revolving line of credit maturing on June 30, 2020, a \$2.6 million term loan maturing on June 30, 2020, and a \$25.0 million, 7 year amortizing term loan maturing on June 30, 2020. Our credit facility also contains an accordion provision permitting us to request an increase in the revolving loan by up to an additional \$20 million, subject to lender s participation

Table of Contents

The credit facility contains three basic financial covenants. First, 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 consolidated Earnings before Interest, Taxes, Depreciation and Amortization (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. The fixed charge coverage ratio is currently based on our financial results for the previous four fiscal quarters on a rolling basis. Second, we are required to maintain a minimum consolidated net worth, computed on a quarterly basis, of not less than the sum of \$142.1 million, plus an amount equal to 50% of our net income each fiscal year commencing with the year ending December 31, 2014, 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. Under our third financial covenant, the ratio of our funded indebtedness to our capitalization, computed as funded indebtedness divided by the sum of funded indebtedness plus stockholders equity, cannot exceed 25%.

On February 23, 2016, the lenders under our credit facility provided a waiver of any event of default arising from the execution of the Merger Agreement (but not the consummation of the Merger) under the credit agreement with our lenders. On May 6, 2016, those lenders also provided a waiver of any event of default arising from (i) the consummation of the Merger Agreement under the credit agreement, and (ii) the failure to meet the minimum fixed charge coverage ratio financial covenant under the credit agreement at March 31, 2016.

We have used, and intend to continue to use, the proceeds available under the credit facility to support our growth and future investments in working capital, additional UtilityServices equipment, Company-owned distributed generation projects, 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%.

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. 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, 2016, \$12.1 million of our outstanding credit facility debt bears interest at a fixed rate of 3.73% and \$29.8 million of our outstanding credit facility debt, including amounts borrowed under the revolving portion of our credit facility, 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 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.

Our obligations under the credit facility are secured by guarantees and security agreements by each of our active subsidiaries, including PowerSecure, Inc. 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 guarantor.

At March 31, 2016, there was an aggregate balance of \$16.9 million outstanding under the two term loans under our credit facility and there was \$25.0 million outstanding under the revolving portion of the credit facility. At March 31, 2016 and December 31, 2015, we had \$9.0 million and \$36.0 million, respectively, of available and unused borrowing

Table of Contents

capacity from our revolving credit facility within the limits of our financial covenants. At May 6, 2016, an aggregate balance of \$30.0 million was outstanding under our revolving credit facility, and there was approximately \$4.0 million of available and unused borrowing capacity within the limits of our financial covenants. The availability of this capacity under our credit facility includes restrictions on the use of proceeds, and is dependent upon our ability to satisfy certain financial and operating covenants including financial ratios, as discussed above.

Acquisition Term Notes We financed a portion of our 2015 acquisition of the assets and business of ESCO Energy Services Company with two unsecured promissory notes payable to the seller in the aggregate amount of \$0.8 million. The first acquisition term note in the principal amount of \$685 thousand is payable in four equal quarterly installments, plus interest at 5%, during 2016. The second acquisition term note in the principal amount of \$150 thousand is payable on December 1, 2017.

The following table summarizes the balances outstanding on our long-term debt at March 31, 2016 and December 31, 2015:

	March 31, 2016	December 31, 2015
Revolving line of credit, maturing June 30, 2020	\$ 25,000	\$
Term loan, principal of \$0.04 million plus interest payable quarterly at variable rates, maturing June 30, 2020	1,720	1,760
Term loan, principal of \$0.9 million plus interest payable quarterly at variable rates, maturing June 30, 2020	15,178	16,072
Acquisition term notes payable	664	835
Total debt	42,562	18,667
Less: Unamortized debt issuance costs, term loans	(56)	(64)
Total debt, net of term loan debt issuance costs	42,506	18,603
Less: Current portion	(4,245)	(4,416)
Long-term debt, net of current portion	\$ 38,261	\$ 14,187

Scheduled remaining principal payments on our outstanding debt obligations at March 31, 2016, are as follows:

Scheduled Principal Payments for the Year Ending December 31:	Revolving			Acquisition Term Notes	Total Principal Payments
	Line of Credit	\$25.0 Million Term Loan	\$2.6 Million Term Loan		
Remainder of 2016	\$	\$ 2,677	\$ 120	\$ 514	\$ 3,311
2017		3,571	160	150	3,881
2018		3,572	160		3,732
2019		3,572	160		3,732

2020	25,000	1,786	1,120	27,906	
Total scheduled principal payments	\$ 25,000	\$ 15,178	\$ 1,720	\$ 664	\$ 42,562

Preferred Stock Redemption. The terms of our Series B preferred stock required us to redeem all shares of our Series B preferred stock that remained outstanding on December 9, 2004 at a redemption price equal to the liquidation preference of \$1 thousand per share plus accumulated and unpaid dividends. Our remaining redemption obligation at March 31, 2016, to holders of outstanding shares of Series B preferred stock that have not been redeemed, is \$0.1 million.

Table of Contents***Contractual Obligations and Commercial Commitments***

We incur various contractual obligations and commercial commitments in our normal course of business, reflected in the table below including:

we lease certain office space, operating facilities and equipment under long-term lease agreements;

to the extent we borrow under the revolving portion of our credit facility, we are obligated to make future payments under that facility;

we make repayments on two terms loans under our credit facility;

we have an obligation to make installment payments on our PowerLine acquisition;

we have contingent earn-out payments potentially due on acquisitions of operations from Apex and from ESCO Energy Services Company;

we have restructuring and cost reduction obligations; and

we have a deferred compensation obligation.

In addition, at March 31, 2016, we had a liability for unrecognized tax benefits and related interest and penalties totaling \$0.4 million. We do not expect a significant payment related to these obligations within the next year and we are unable to make a reasonably reliable estimate if and when cash settlement with a taxing authority would occur. Accordingly, the information in the table below, which is as of March 31, 2016, does not include the liability for unrecognized tax benefits (dollars in thousands):

Contractual Obligations	Total	Payments Due by Period			More than 5 Years
		Remainder of 2016	1 - 3 Years	4 - 5 Years	
Revolving portion of credit facility (1)	\$ 25,000	\$	\$	\$ 25,000	\$
Term loans (2)	18,713	3,669	8,218	6,826	
Operating leases	18,245	4,725	8,668	4,400	452
Deferred compensation (3)	3,137	3,137			
Installment payments due on acquisition	220		220		
Earnout payments due on acquisitions (4)	1,240		1,240		
Series B preferred stock	104	104			
Restructuring and cost reduction obligations	38	38			

Total	\$ 66,697	\$ 11,673	\$ 18,346	\$ 36,226	\$ 452
-------	-----------	-----------	-----------	-----------	--------

- (1) Total repayments are based upon borrowings outstanding as of March 31, 2016, not actual or projected borrowings after such date. Repayments do not include interest that may become due and payable in any future period.
- (2) Repayments amounts include interest on the term loans at the interest rate in effect as of March 31, 2016.
- (3) Total amount represents our potential obligation on the deferred compensation arrangement, based on the first date it could commence (which is earlier than the expected date of commencement), and does not include the value of the restricted annuity contract, or interest earnings thereon, that we purchased to fund our obligation.
- (4) Total amount represents the undiscounted probability-weighted estimate of the earn-out payments due. Actual total payment amount may exceed the estimated amount, depending on the achievement of certain gross profit targets of the acquired business.

Performance Bonds and Letters of Credit

In the ordinary course of business, we are required by certain customers to post surety or performance bonds or letters of credit in connection with services that we provide to them. These bonds and letters of credit 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, in the case of a performance bond, or our lenders, in the case of a letter of credit, make payments or provide services under the

Table of Contents

bond. We must reimburse the surety or our lenders for any expenses or outlays they incur. 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. As of March 31, 2016, we had approximately \$325.4 million in surety bonds outstanding. Based upon the current status of the completion of our contracts and projects, we estimate our exposure on these surety bonds was approximately \$169.8 million at March 31, 2016.

Off-Balance Sheet Arrangements

During the first quarter 2016, we did not engage in any material off-balance sheet activities or have any relationships or arrangements with unconsolidated entities established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities nor do we have any commitment or intent to provide additional funding to any such entities.

Liquidity

At March 31, 2016, we had \$6.4 million in cash and cash equivalents, total working capital of \$81.8 million, and approximately \$9.0 million available for borrowing under the revolving portion of our credit facility. As a result of additional borrowings from our revolving credit facility during the second quarter 2016 through the date of this report at May 6, 2016, an aggregate balance of \$30 million was outstanding, and there was approximately \$4.0 million of available and unused borrowing capacity within the limits of our financial covenants under our revolving credit facility. Based upon our plans and assumptions as of the date of this report, we believe that our capital resources, including our cash and cash equivalents, amounts available under our credit facility, along with funds expected to be generated from our operations, will be sufficient to meet our anticipated cash needs, including for working capital, capital spending and debt service commitments, for at least the next 12 months. However, any projections of future cash needs and cash flows are subject to substantial risks and uncertainties. See **Cautionary Note Regarding Forward-Looking Statements** above in this report and Part II **Item 1A. Risk Factors**.

The Merger Agreement includes certain restrictions, limitations and prohibitions as to actions we may or may not take in the period prior to completion of the Merger without the prior consent of Southern Company. Among other restrictions, the Merger Agreement limits, beyond previously budgeted and planned amounts and allowed exceptions, our total capital spending, limits the extent to which we can obtain financing through long-term debt and equity, and prohibits the payment of cash dividends.

Although we believe that we have sufficient capital to fund our activities and commitments for at least the next 12 months, our future cash resources and capital requirements may vary materially from those now planned. Our ability to meet our capital needs in the future will depend on many factors, including a reduction in revenues if the demand for our products and services decreases, the timing of sales, the mix of products and services and other factors affecting our gross margins, the amount of recurring revenue projects in which we invest, our ability to meet our financial covenants under our credit facility, unanticipated events over which we have no control increasing our operating costs or reducing our revenues beyond our current expectations, and other factors listed above under

Fluctuations above. For these reasons, we cannot provide any assurance that our actual cash requirements will not be greater than we currently expect or that these sources of liquidity will be available when needed.

During 2015 and 2016, our working capital balances, including our cash and cash equivalents, have been affected by our progress towards completion of two utility-scale Solar Energy projects that we were awarded in July 2014. The timing of cash payments to our suppliers and cash receipts from our customer have affected the balances of our cash and cash equivalents, accounts receivable, inventory, accounts payable and accrued expenses. We expect similar

effects during the remainder of 2016 and beyond as we move further towards completion of these utility-scale Solar Energy projects, and the effects on our cash resources may be material.

We also continually evaluate opportunities to expand our current or to develop new products, services, technology and businesses that could increase our capital needs. In addition, from time to time we consider the acquisition of, or the investment in, complementary businesses, products, services and technology that might affect our liquidity requirements. We may seek to raise any needed or desired additional capital from the proceeds of public or private equity or debt offerings at the parent level or at the subsidiary level or both, from asset or business sales, from traditional credit

Table of Contents

financings or from other financing sources. Furthermore, we continually evaluate opportunities to improve our credit facilities, through increased credit availability, lower debt costs or other more favorable terms. However, our ability to obtain additional capital or replace or improve our credit facilities when needed or desired will depend on many factors, including general economic and market conditions, our operating performance and investor and lender sentiment, and thus cannot be assured. In addition, depending on how it is structured, a financing could require the consent of our current lending group. Even if we are able to raise additional capital, the terms of any financings could be adverse to the interests of our stockholders. For example, the terms of a debt financing could restrict our ability to operate our business or to expand our operations, while the terms of an equity financing, involving the issuance of capital stock or of securities convertible into capital stock, could dilute the percentage ownership interests of our stockholders, and the new capital stock or other new securities could have rights, preferences or privileges senior to those of our current stockholders.

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

Critical Accounting Policies

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

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

revenue recognition;

allowance for doubtful accounts;

inventory valuation reserve;

warranty reserve;

impairment of goodwill and long-lived assets;

deferred tax valuation allowance;

uncertain tax positions;

costs of exit or disposal activities and similar nonrecurring charges;

stock-based compensation; and

derivative financial instruments.

Table of Contents

The accounting policies listed above are described in our Annual Report on Form 10-K for the year ended December 31, 2015 in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Recent Accounting Pronouncements

Information about recent accounting pronouncements and their potential effects on our financial position and results of operations is included in Note 3, Summary of Significant Accounting Policies and Recent Accounting Standards of the notes to our condensed consolidated financial statements included elsewhere in this report.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to certain market risks arising from transactions we enter into in the ordinary course of business. These market risks may adversely affect our financial condition, results of operations and cash flow. These market risks include, but are not limited to, fluctuations in interest rates and commodity prices, and to a lesser extent fluctuations in currency exchange rates.

We employ interest rate swap agreements for the purpose of hedging certain specifically identified interest rates. The use of these financial instruments is intended to mitigate some of the risks associated with fluctuations in interest rates, but does not eliminate such risks. We do not use derivative financial instruments for trading or speculative purposes, and except as indicated in this item we do not use derivative financial instruments to manage or hedge our exposure to interest rate changes, commodity price risks, foreign currency exchange risks or other market risks.

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

At March 31, 2016, our cash and cash equivalents balance was approximately \$6.4 million, \$25.0 million was drawn on the revolving portion of our credit facility, and \$16.9 million was outstanding on two term loans under the credit facility. Our credit facility, which is comprised of a revolving credit line and two term loans, bears interest at a rate based on LIBOR or an alternative base rate based on prevailing interest rates, in each case plus an applicable margin based on our leverage ratio. From time to time we may enter into interest rate swap agreements to reduce our exposure to interest rate fluctuations under the credit facility. In July 2013, we entered into two forward-starting interest rate swap contracts to manage interest rate risk on our floating rate debt. 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, 2016 was \$12.1 million.

In accordance with ASC 815, *Derivatives and Hedging*, we have designated the interest rate swaps as cash flow hedges of the interest payments due on that portion of our floating rate debt. Accordingly, the fair value of the interest rate swaps are recorded as an asset (other assets) or as a liability (other long-term liabilities), the effective portion of the change in fair value of the interest rate swaps is recorded in other comprehensive income (loss) and the quarterly settlements are recorded as either an addition to or reduction of our interest expense for the period. The remainder of our indebtedness under our credit facility continues to bear interest at variable rates that fluctuate.

Pursuant to the swap contracts, the three-month LIBOR rate on the term loan was swapped for a fixed rate of 1.73%. When added to the term loan's current applicable margin, the interest rate applicable to 80% of the term loan has been effectively fixed at 3.73%, subject only to changes in the applicable margin. Notwithstanding the terms of the swap contracts, we remain fully obligated for all amounts due and payable on the term loan. The initial counterparties to the swap contracts are the financial institutions that are also lenders under our credit facility, but the swap contracts may be assigned to other counterparties. The termination dates of the swap contracts and maturity date of the term loan are both June 30, 2020. We may enter into additional swap transactions in the future from time to time.

Table of Contents

Our cash equivalents are invested in a combination of bank deposits, money market or U.S. government mutual funds, short-term time deposits, and government agency and corporate obligations, or similar kinds of instruments, the income of which generally increases or decreases in proportion to increases or decreases, respectively, in interest rates. While we believe we have our cash and cash equivalents invested in very low risk investments, they are not risk free, as our bank deposits are generally in excess of FDIC insurance limits.

We do not believe that changes in interest rates have had a material impact on us in the past or are likely to have a material impact on us in the foreseeable future. For example, for the first quarter 2016, a hypothetical 1% (100 basis points) increase in the interest rate on the variable rate portion of our average outstanding borrowings under our credit facility would have resulted in an increase in our interest expense of \$64 thousand, and an increase in our interest income from the average balance of our interest-bearing cash equivalents of approximately \$2 thousand. Conversely, a hypothetical 1% (100 basis points) decrease of 1% (100 basis points) in the interest rate on the variable rate portion our average outstanding borrowings under our credit facility would have resulted in a decrease in our interest expense of \$64 thousand, and a decrease in our interest income from the average balance of our interest-bearing cash equivalents of approximately \$1 thousand.

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

Foreign Exchange Risk. Historically, substantially all of our revenues, expenses and capital spending were transacted in U.S. dollars and we faced minimal exposure to adverse movements in foreign currency exchange rates. We recently commenced limited operations in Canada and we now have transactions denominated in Canadian dollars. As a result, fluctuations in exchange rates between U.S. and Canadian currency may adversely affect our expenses and results of operations as well as the value of our assets and liabilities. The potential loss in fair value resulting from a hypothetical 10% increase in the value of the U.S. dollar compared to the Canadian dollar was not material at March 31, 2016. If our international operations expand in the future, then our exposure to foreign currency risks could increase, which could materially affect our financial condition and results of operations. In addition, because our LED lighting operations purchases component parts manufactured in China, then to the extent the U.S. Dollar exchange rate with the Chinese Yuan changes significantly, our business and results of operations could be materially impacted.

Item 4. Controls and Procedures
Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of March 31, 2016, the end of the period covered by this report. Based upon management's evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that, as of March 31, 2016, our disclosure controls and procedures were designed at the reasonable assurance level and were effective at the reasonable assurance level to provide reasonable assurance that information required to be disclosed by us in reports

that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Table of Contents

Changes in Internal Control Over Financial Reporting

We regularly review our system of internal control over financial reporting and make changes to our processes and systems to improve controls and increase efficiency, while ensuring that we maintain an effective internal control environment. Changes may include such activities as implementing new, more efficient systems, consolidating activities and migrating processes. There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended March 31, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Limitations in Control Systems

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

Table of Contents

PART II

OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are involved in disputes and legal proceedings. There has been no material change in our pending legal proceedings as described in Item 3. Legal Proceedings in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015, except as described in note 9 to our financial statements in this Report.

Item 1A. Risk Factors

Our business and operating results are subject to many risks, uncertainties and other factors. If any of these risks were to occur, our business, affairs, assets, financial condition, results of operations, cash flows and prospects could be materially and adversely affected. These risks, uncertainties and other factors include the information discussed elsewhere in this report as well as the risk factors set forth in Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015, which have not materially changed as of the date of this report.

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

None.

Item 6. Exhibits

- (2.2) Agreement and Plan of Merger, dated February 24, 2016, by and among The Southern Company, PSMS Corp. and PowerSecure International, Inc. (Incorporated by reference to Exhibit 2.1 to Registrant's Current Report on Form 8-K, filed February 25, 2016).*
- (10.1) Amended and Restated Employment and Non-Competition Agreement, dated as of February 15, 2016, between Registrant and Ronnie Brannen. (Incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed February 19, 2016.)**
- (10.2) Waiver to Credit Agreement, dated as of February 23, 2016, among PowerSecure International, Inc., Citibank, N.A., as administrative agent and lender, and Branch Banking and Trust Company, as lender. (Incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed February 25, 2016.)
- (10.3) Waiver to Credit Agreement, dated as of May 6, 2016, among PowerSecure International, Inc., Citibank, N.A., as administrative agent and lender, and Branch Banking and Trust Company, as lender. (Incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed May 6, 2016.)
- (10.4) Amendment No. 1 to Second Amended and Restated Employment and Non-Competition Agreement, dated as of December 17, 2009, by and between Registrant and Sidney Hinton. (Filed herewith.)**

Edgar Filing: POWERSECURE INTERNATIONAL, INC. - Form 10-Q

- (10.5) Amendment No. 2 to First Amended and Restated Employment and Non-Competition Agreement, dated as of November 6, 2014, by and between Registrant and Christopher T. Hutter. (Filed herewith.)**
- (31.1) Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (Filed herewith.)
- (31.2) Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (Filed herewith.)

Table of Contents

(32.1)	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (Filed herewith.)
(32.2)	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (Filed herewith.)
(101.INS)	XBRL Instance Document
(101.SCH)	XBRL Taxonomy Extension Schema Document
(101.CAL)	XBRL Taxonomy Extension Calculation Linkbase Document
(101.DEF)	XBRL Taxonomy Extension Definition Linkbase Document
(101.LAB)	XBRL Taxonomy Extension Label Linkbase Document
(101.PRE)	XBRL Taxonomy Extension Presentation Linkbase Document

* The schedules to this have been omitted pursuant to Item 601(b)(2) of Regulation S-K. The Registrant hereby agrees to furnish supplementally a copy of any omitted schedule or exhibit to the Securities and Exchange Commission upon request by the Commission.

** Indicates management contract or compensation plan or arrangement.

Table of Contents

SIGNATURES

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

POWERSECURE INTERNATIONAL, INC.

Date: May 6, 2016

By: /s/ Sidney Hinton
Sidney Hinton
President and Chief Executive Officer

Date: May 6, 2016

By: /s/ Eric Dupont
Eric Dupont
Executive Vice President and Chief Financial
Officer