

POWERSECURE INTERNATIONAL, INC.

Form 10-Q

August 06, 2012

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**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 June 30, 2012

or

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

For the transition period from            to

Commission File Number 1-12014

**POWERSECURE INTERNATIONAL, INC.**

(Exact name of registrant as specified in its charter)

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**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 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. (Check one):

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 Act). Yes  No

As of August 1, 2012, 18,777,811 shares of the issuer's Common Stock were outstanding.

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**POWERSECURE INTERNATIONAL, INC.**

**FORM 10-Q**

**For the Quarterly Period Ended June 30, 2012**

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**Table of Contents****PART I.****FINANCIAL INFORMATION****Item 1. Financial Statements****POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS (unaudited)**

(in thousands, except share data)

	June 30, 2012	December 31, 2011
<b>Assets</b>		
Current Assets:		
Cash and cash equivalents	\$ 23,707	\$ 24,606
Trade receivables, net of allowance for doubtful accounts of \$105 and \$174, respectively	43,124	46,163
Assets of discontinued operations held for sale	190	380
Inventories	19,530	20,290
Income taxes receivable	230	439
Current deferred income taxes	650	650
Prepaid expenses and other current assets	920	1,128
Total current assets	88,351	93,656
Property, plant and equipment:		
Equipment	41,589	38,441
Furniture and fixtures	338	283
Land, building and improvements	5,901	5,885
Total property, plant and equipment, at cost	47,828	44,609
Less accumulated depreciation and amortization	10,048	8,281
Property, plant and equipment, net	37,780	36,328
Other assets:		
Goodwill	12,884	7,970
Deferred income taxes, net of current portion	266	266
Restricted annuity contract	2,412	2,376
Intangible rights and capitalized software costs, net of accumulated amortization of \$3,414 and \$3,070, respectively	1,552	1,642
Investment in unconsolidated affiliate	6	6
Other assets	739	331
Total other assets	17,853	12,591
<b>Total Assets</b>	<b>\$ 143,984</b>	<b>\$ 142,575</b>

See accompanying notes to consolidated financial statements.



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

(in thousands, except share data)

	June 30, 2012	December 31, 2011
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Accounts payable	\$ 7,193	\$ 6,894
Accrued and other liabilities	14,861	16,129
Liabilities of discontinued operations held for sale		125
Current unrecognized tax benefit	287	287
Current portion of term loan	160	
Current portion of capital lease obligations	863	840
<b>Total current liabilities</b>	<b>23,364</b>	<b>24,275</b>
Long-term liabilities:		
Revolving line of credit		
Term loan, net of current portion	2,160	
Capital lease obligations, net of current portion	2,370	2,807
Unrecognized tax benefit	731	731
Other long-term liabilities	2,409	2,300
<b>Total long-term liabilities</b>	<b>7,670</b>	<b>5,838</b>
Commitments and contingencies (Notes 8 and 10)		
Stockholders Equity:		
PowerSecure International stockholders equity:		
Preferred stock - undesignated, \$.01 par value; 2,000,000 shares authorized; none issued and outstanding		
Preferred stock - Series C, \$.01 par value; 500,000 shares authorized; none issued and outstanding		
Common stock, \$.01 par value; 50,000,000 and 25,000,000 shares authorized, respectively; 18,777,811 and 18,908,412 shares issued and outstanding, respectively	188	189
Additional paid-in-capital	116,384	116,803
Accumulated deficit	(4,399)	(5,439)
<b>Total PowerSecure International, Inc. stockholders equity</b>	<b>112,173</b>	<b>111,553</b>
Non-controlling interest	777	909
<b>Total stockholders equity</b>	<b>112,950</b>	<b>112,462</b>
<b>Total Liabilities and Stockholders Equity</b>	<b>\$ 143,984</b>	<b>\$ 142,575</b>

See accompanying notes to consolidated financial statements.

**Table of Contents****POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)**

(in thousands, except per share data)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2012	2011	2012	2011
Revenues	\$ 37,867	\$ 30,086	\$ 71,052	\$ 53,741
Cost of sales	25,663	20,780	49,293	36,706
Gross profit	12,204	9,306	21,759	17,035
Operating expenses:				
General and administrative	9,093	7,952	17,738	15,633
Selling, marketing and service	1,366	1,214	2,424	2,368
Depreciation and amortization	1,136	802	2,221	1,575
Total operating expenses	11,595	9,968	22,383	19,576
Operating income (loss)	609	(662)	(624)	(2,541)
Other income and (expenses):				
Gain on sale of unconsolidated affiliate	1,439	21,786	1,439	21,786
Equity income from unconsolidated affiliate		548		1,559
Management fees		114		282
Interest income and other income	23	22	45	42
Interest expense	(116)	(144)	(224)	(286)
Income before income taxes	1,955	21,664	636	20,842
Income tax provision	(621)	(3,183)	(228)	(3,230)
Income from continuing operations	1,334	18,481	408	17,612
Discontinued operations (Note 5):				
Income (loss) from operations, net of tax	32	(1,388)	67	(1,603)
Gain on disposal, net of tax				5,636
Income (loss) from discontinued operations, net of tax	32	(1,388)	67	4,033
Net income	1,366	17,093	475	21,645
Net loss attributable to non-controlling interest	277	159	565	343
Net income attributable to PowerSecure International, Inc.	\$ 1,643	\$ 17,252	\$ 1,040	\$ 21,988
Amounts attributable to PowerSecure International, Inc. common stockholders:				
Income from continuing operations, net of tax	\$ 1,611	\$ 18,640	\$ 973	\$ 17,955
Income (loss) from discontinued operations, net of tax	32	(1,388)	67	4,033
Net income	\$ 1,643	\$ 17,252	\$ 1,040	\$ 21,988

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Basic earnings per share attributable to PowerSecure International, Inc. common stockholders:

Income from continuing operations	\$ 0.09	\$ 0.98	\$ 0.05	\$ 0.96
Income (loss) from discontinued operations		(0.07)	0.01	0.21

Net income attributable to PowerSecure International, Inc. common stockholders	\$ 0.09	\$ 0.91	\$ 0.06	\$ 1.17
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Diluted earnings per share attributable to PowerSecure International, Inc. common stockholders:

Income from continuing operations	\$ 0.09	\$ 0.97	\$ 0.05	\$ 0.94
Income (loss) from discontinued operations		(0.07)		0.21

Net income attributable to PowerSecure International, Inc. common stockholders	\$ 0.09	\$ 0.90	\$ 0.05	\$ 1.15
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*See accompanying notes to consolidated financial statements.*



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

(in thousands)

	Six Months Ended June 30,	
	2012	2011
<b>Cash flows from operating activities:</b>		
Net income	\$ 475	\$ 21,645
Adjustments to reconcile net income to net cash used in operating activities:		
Gain on sale of unconsolidated affiliate	(1,439)	(21,786)
Income from discontinued operations	(67)	(4,033)
Depreciation and amortization	2,221	1,575
Stock compensation expense	576	926
Loss on disposal of miscellaneous assets	45	43
Equity in income of unconsolidated affiliate		(1,559)
Distributions from unconsolidated affiliate		607
Changes in operating assets and liabilities, net of effect of acquisition:		
Trade receivables, net	4,360	(12,580)
Inventories	861	(1,016)
Deferred income taxes		1,154
Other current assets and liabilities	416	895
Other noncurrent assets and liabilities	(335)	1,132
Accounts payable	(378)	(1,099)
Accrued and other liabilities	(3,067)	3,525
Net cash provided by (used in) continuing operations	3,668	(10,571)
Net cash provided by (used in) discontinued operations	132	(1,152)
Net cash provided by (used in) operating activities	3,800	(11,723)
<b>Cash flows from investing activities:</b>		
Acquisition	(3,523)	
Purchases of property, plant and equipment	(3,330)	(9,037)
Additions to intangible rights and software development	(215)	(268)
Proceeds from sale of property, plant and equipment	14	
Proceeds from sale of unconsolidated affiliate	1,445	25,610
Proceeds from sale of discontinued operations		16,515
Discontinued operations investing activities		(3)
Net cash provided by (used in) investing activities	(5,609)	32,817
<b>Cash flows from financing activities:</b>		
Borrowings (payments) on revolving line of credit		5,000
Proceeds from term loan borrowings	2,400	
Proceeds from sale leaseback transactions		2,097
Payments on term loan	(80)	
Payments on capital lease obligations	(414)	(393)
Repurchases of common stock	(1,010)	(162)
Proceeds from stock option exercises	14	310
Net cash provided by financing activities	910	6,852

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NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(899)	27,946
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	24,606	8,202
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 23,707	\$ 36,148

*See accompanying notes to consolidated financial statements.*

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**POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES**

**Notes to Unaudited Consolidated Financial Statements**

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

For the Three and Six Month Periods Ended June 30, 2012 and 2011

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

**1. Description of Business and Basis of Presentation**

**Description of Business**

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

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

Our Utility and Energy Technologies segment includes our three primary product and service offerings: our Interactive Distributed Generation products and services, our Utility Infrastructure products and services, and our Energy Efficiency products. These three groups of products and services are commonly focused on serving the needs of utilities and their commercial, institutional and industrial customers to help them generate, deliver, and utilize electricity more efficiently. Our strategy is focused on growing these three product and service areas because they require unique knowledge and skills that utilize our core competencies, and because they address large market opportunities due to their strong customer value propositions. These three product and service areas share common or complementary utility relationships and customer types, common sales and overhead resources, and facilities. However, we discuss and distinguish our Utility and Energy Technologies business among the three product and service areas due to the unique market needs they are addressing, and the distinct technical disciplines and specific capabilities required for us to deliver them, including personnel, technology, engineering, and intellectual capital. Our Utility and Energy Technologies segment operates primarily out of our Wake Forest, North Carolina headquarters office, and its operations also include several satellite offices and manufacturing facilities, the largest of which are in the Raleigh, North Carolina, Randleman, North Carolina, McDonough, Georgia, and Anderson, South Carolina areas. The locations of our sales organization and field employees for this segment are generally in close proximity to the utilities and commercial, industrial, and institutional customers they serve. Our Utility and Energy Technologies segment is operated through our largest wholly-owned subsidiary, PowerSecure, Inc.

Until the divestitures of our remaining non-core business operations in 2011, our Energy Services segment operated through our two other principal operating subsidiaries, Southern Flow Companies, Inc., which we refer to as Southern Flow, and WaterSecure Holdings, Inc., which we refer to as WaterSecure. WaterSecure holds a significant non-controlling minority portion of the equity interests in an unconsolidated business, Marcum Midstream 1995-2 Business Trust, a Delaware statutory trust, which we refer to as MM 1995-2 or as our WaterSecure operations. Our WaterSecure operations provided water processing, recycling, and disposal services for oil and natural gas producers in northeastern Colorado utilizing environmentally responsible technologies and processes. In June 2011, substantially all of the assets and business of MM 1995-2 were sold and the proceeds from the sale and the liquidation of its remaining assets were distributed to MM 1995-2's shareholders, including our WaterSecure subsidiary, in 2011 and 2012. Accordingly, our WaterSecure subsidiary no longer has any on-going operating activity. Our Southern Flow business, which was sold in January 2011, provided oil and natural gas measurement services to customers involved in oil and natural gas production, transportation, and processing, with a focus on the natural gas market. Due to its sale, Southern Flow's operations are reflected as discontinued operations in the accompanying consolidated financial statements. The sales of our WaterSecure and Southern Flow operations completed our strategy to monetize our non-core assets to focus on the businesses in our Utility and Energy Technologies business segment. As a result of these sales, our Energy Services segment ceased on-going business activities in June 2011.

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See Note 13 for more information concerning our reportable segments.

### **Basis of Presentation**

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

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

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

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

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

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

	Six Months Ended June 30, 2012		
	IES	PowerSecure Solar	Total
Balance, December 31, 2011	\$ 909	\$	\$ 909
Capital contribution		433	433
Income (loss)	(551)	(14)	(565)
Balance, June 30, 2012	\$ 358	\$ 419	\$ 777

	Six Months Ended June 30, 2011		
	IES	PowerSecure Solar	Total
Balance, December 31, 2010	\$ 1,755	\$	\$ 1,755
Capital contribution			
Income (loss)	(343)		(343)
Balance, June 30, 2011	\$ 1,412	\$	\$ 1,412

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

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

## 2. Summary of Significant Accounting Policies and Recent Accounting Standards

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

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

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

In all cases where we utilize the percentage-of-completion method, revenues and gross profit are adjusted



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

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

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

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

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

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

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

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

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

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

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

**Warranty Reserve** We provide a standard warranty for our distributed generation equipment, switchgear equipment, utility infrastructure equipment, and our LED products, which generally range between one and five years. In addition, we offer extended warranty terms on certain distributed generation turn-key and switchgear projects. We reserve for the estimated cost of product warranties when revenue is recognized, and we evaluate our reserve periodically by comparing our warranty repair experience by product. The purchase price for extended warranties or extended warranties included in the contract terms are deferred as a component of our warranty reserve. The balance of our warranty reserve included in accrued and other liabilities at June 30, 2012 and December 31, 2011 was \$1.3 million and \$1.1 million, respectively.

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

Pre-tax share-based compensation expense for our stock options and restricted stock awards recognized during the three months ended June 30, 2012 and 2011 was \$281 thousand and \$446 thousand, respectively. Pre-tax share-based compensation expense for our stock options and restricted stock awards recognized during the six months ended June 30, 2012 and 2011 was \$576 thousand and \$926 thousand, respectively. All share-based compensation expense is included in general and administrative expense in the accompanying consolidated statements of operations.

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

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

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

## **Recent Accounting Pronouncements**

**Fair Value Measurements** In May 2011, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2011-04, which amended Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This amendment is intended to result in convergence between U.S. GAAP and International Financial Reporting Standards ( IFRS )



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requirements for measurement of and disclosures about fair value. This amended guidance clarifies the concepts applicable for fair value measurement of non-financial assets and also expands the disclosures for fair value measurements that are estimated using significant unobservable inputs used in a fair value measurement. This amended guidance became effective for us on a prospective basis commencing January 1, 2012. The adoption of this standard had no effect on our financial position or results of operations.

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

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

### **3. Earnings (Loss) per Share**

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Income from continuing operations	\$ 1,611	\$ 18,640	\$ 973	\$ 17,955
Income (loss) from discontinued operations	32	(1,388)	67	4,033
Net income	\$ 1,643	\$ 17,252	\$ 1,040	\$ 21,988
Basic weighted-average common shares outstanding in period	18,846	18,857	18,874	18,788
Dilutive effect of stock options	95	289	141	325
Diluted weighted-average common shares outstanding in period	18,941	19,146	19,015	19,113