POWERSECURE INTERNATIONAL, INC.
Form 10-Q
August 06, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2009

or

o **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 þ No o

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 o No o

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 o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of August 1, 2009, 17,217,531 shares of the issuer s Common Stock were outstanding.

POWERSECURE INTERNATIONAL, INC.
FORM 10-Q
For the Quarterly Period Ended June 30, 2009
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PART I.
FINANCIAL INFORMATION

Item 1. Financial Statements

POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (unaudited)
(in thousands, except share data)

	June 30, 2009	December 31, 2008
Assets		
Current Assets:		
Cash and cash equivalents	$ 18,861	$ 24,316
Trade receivables, net of allowance for doubtful accounts of $264 and $276, respectively	26,593	25,215
Inventories	23,064	19,713
Deferred income taxes	2,919	2,919
Prepaid expenses and other current assets	1,309	1,680
Total current assets	72,746	73,843
Property, plant and equipment:		
Equipment	22,212	20,297
Furniture and fixtures	658	650
Land, building and improvements	4,711	4,674
Total property, plant and equipment, at cost	27,581	25,621
Less accumulated depreciation and amortization	4,435	3,739
Property, plant and equipment, net	23,146	21,882
Other assets:		
Goodwill	7,256	7,256
Restricted annuity contract	2,176	2,133
Intangible rights and capitalized software costs, net of accumulated amortization of $1,695 and $1,453, respectively	1,122	1,276
Investment in unconsolidated affiliate	3,854	4,106
Other assets	325	338
Total other assets	14,733	15,109
Total Assets	$ 110,625	$ 110,834

See accompanying notes to consolidated financial statements.

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POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (unaudited)
(in thousands, except share data)

	June 30, 2009	December 31, 2008
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 7,309	$ 5,817
Accrued and other liabilities	21,652	23,147
Restructuring charges payable	890	1,349
Current income taxes payable		181
Current unrecognized tax benefit	79	79
Capital lease obligations	736	716
Total current liabilities	30,666	31,289
Long-term liabilites:		
Capital lease obligations	4,828	5,201
Unrecognized tax benefit	790	790
Deferred compensation	554	388
Restructuring charges		355
Total long-term liabilities	6,172	6,734
Commitments and contingencies (Note 9)		
Stockholders Equity :		
PowerSecure International stockholders equity:		
Preferred stock undesignated, $.01 par value; 2,000,000 shares authorized; none issued and outstanding		
Preferred stock Series C, $.01 par value; 500,000 shares authorized; none issued and outstanding		
Common stock, $.01 par value; 25,000,000 shares authorized; 17,217,531 and 17,071,889 shares issued and outstanding, respectively	172	171
Additional paid-in-capital	109,444	108,384
Accumulated deficit	(36,194)	(35,744)
Total PowerSecure International stockholders equity	73,422	72,811
Noncontrolling interest	365	
Total stockholders equity	73,787	72,811

Total Liabilities and Stockholders Equity	$ 110,625	$ 110,834

See accompanying notes to consolidated financial statements.

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POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)
(in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	**2008**	**2009**	**2008**
Revenues	$ 25,135	$ 41,952	$ 44,855	$ 75,527
Cost of sales	16,880	28,152	30,726	51,707
Gross profit	8,255	13,800	14,129	23,820
Operating expenses:				
General and administrative	6,006	7,553	12,026	14,796
Selling, marketing and service	969	1,889	1,800	3,214
Depreciation and amortization	563	527	1,105	984
Research and development	66	45	86	64
Total operating expenses	7,604	10,014	15,017	19,058
Operating income (loss)	651	3,786	(888)	4,762
Other income and (expenses):				
Management fees	98	164	203	313
Interest and other income	38	119	91	345
Interest and finance charges	(145)	(52)	(319)	(103)
Equity income	401	1,227	878	2,191
Income (loss) before income taxes	1,043	5,244	(35)	7,508
Income tax provision	(26)	(304)	(50)	(616)
Income (loss) from continuing operations	1,017	4,940	(85)	6,892
Discontinued operations				
Loss on disposal				(42)
Loss from operations, including tax benefit				(35)
Loss on discontinued operations				(77)
Net income (loss)	1,017	4,940	(85)	6,815

Less: Net income attributable to noncontrolling interest	(331)		(365)	
Net income (loss) attributable to PowerSecure International	$ 686	$ 4,940	$ (450)	$ 6,815
Basic earnings (loss) per share attributable to PowerSecure International common stockholders:				
Income (loss) from continuing operations	$ 0.04	$ 0.29	$ (0.03)	$ 0.41
Loss from discontinued operations	.00	.00	.00	(0.01)
Net income (loss) attributable to PowerSecure International common stockholders:	$ 0.04	$ 0.29	$ (0.03)	$ 0.40
Diluted earnings (loss) per share attributable to PowerSecure International common stockholders:				
Income (loss) from continuing operations	$ 0.04	$ 0.28	$ (0.03)	$ 0.40
Loss from discontinued operations	.00	.00	.00	(0.01)
Net income (loss) attributable to PowerSecure International common stockholders:	$ 0.04	$ 0.28	$ (0.03)	$ 0.39
Amounts attributable to PowerSecure International common stockholders:				
Income (loss) from continuing operations, net of tax	$ 686	$ 4,940	$ (450)	$ 6,892
Discontinued operations, net of tax				(77)
Net income (loss)	$ 686	$ 4,940	$ (450)	$ 6,815

See accompanying notes to consolidated financial statements.

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POWERSECURE INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)
(in thousands)

	Six Months Ended June 30, 2009	2008
Cash flows from operating activities:		
Net income (loss)	$ (450)	$ 6,815
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	1,105	985
Noncontrolling interest	365	
Deferred income taxes		65
Loss on disposal of miscellaneous assets	30	149
Equity in income of unconsolidated affiliate	(878)	(2,191)
Distributions from unconsolidated affiliate	1,093	544
Stock compensation expense	787	1,215
Changes in operating assets and liabilities, net of effect of aquisitons:		
Trade receivables, net	(1,378)	(3,586)
Inventories	(3,024)	499
Other current assets and liabilities	189	84
Assets of discontinued operations held for sale		2,400
Other noncurrent assets	14	62
Accounts payable	1,492	1,606
Restructuring charges	(814)	(3,124)
Accrued and other liabilities	(1,494)	(10,883)
Liabilities of discontinued operations held for sale		(755)
Deferred compensation obligation	166	166
Restricted annuity contract	(43)	(70)
Net cash used in operating activities	(2,840)	(6,019)
Cash flows from investing activities:		
Purchases of property, plant and equipment	(1,612)	(15,053)
Additions to intangible rights and software development	(134)	(110)
Acquisition	(800)	
Proceeds from sale of property, plant and equipment	10	1
Net cash used in investing activities	(2,536)	(15,162)
Cash flows from financing activities:		
Proceeds from term loan		2,584
Proceeds from stock option and warrant exercises, net of shares tendered	274	212
Principal payments on long-term notes payable		(65)
Borrowings (payments) on line of credit		
Payments on capital lease obligations	(353)	
Net cash provided by (used in) financing activities	(79)	2,731

NET DECREASE IN CASH AND CASH EQUIVALENTS	(5,455)	(18,450)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	24,316	28,710
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 18,861	$ 10,260

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, 2009 and December 31, 2008 and
For the Three and Six Month Periods Ended June 30, 2009 and 2008
(in thousands, except per share data)

1. Description of Business and Basis of Presentation

Description of Business

PowerSecure International, Inc., based in Wake Forest, North Carolina, was incorporated on April 5, 1991. We are a leading provider of Energy and Smart Grid Solutions to electric utilities, and their commercial, institutional, and industrial customers. Our Energy and Smart Grid Solutions segment provides products and services in the areas of Interactive Distributed Generation® (IDG®), Utility Infrastructure, and Energy Efficiency, and our Energy Services segment provides services to the oil and natural gas industry through our Southern Flow and WaterSecure business units.

Through our PowerSecure, Inc. subsidiary we operate our Energy and Smart Grid Solutions segment and focus on three of these areas: Interactive Distributed Generation®, Utility Infrastructure, and Energy Efficiency. Our core Interactive Distributed Generation® business involves installing sophisticated electric generation equipment directly at the location where power is utilized. This equipment provides a dependable backup power supply during power outages, while at the same time providing a more efficient and environmentally friendly means of delivering power during high cost periods of peak power demand. Our intelligent Interactive Distributed Generation® systems contain sophisticated electronic controls, which enables our systems to be monitored 24x7 by our Smart Grid Monitoring Center, safeguarding our customers from power outages and their related costs. Through this monitoring center, we utilize our proprietary smart grid capabilities to forecast utilities peak demand periods, and electronically deploy our systems to deliver more efficient and environmentally friendly power during these periods of peak demand. Our systems also enable utilities to delay new infrastructure investments for transmitting and distributing power, and minimize energy losses associated with moving electricity over long distances.

Our Utility Infrastructure business is dedicated to helping utilities design and build infrastructure to enhance the efficiency and effectiveness of our nation s electric grid, including transmission and distribution system upgrades, installation of advanced metering and efficient lighting, and emergency storm restoration. Additionally, we provide utilities with a wide range of engineering and design services, and consulting services for regulatory and rate design matters. Our Energy Efficiency business is focused on providing lighting solutions for commercial, industrial, and institutional customers, including our state-of-the-art green EfficientLights LED lighting technology for refrigerated cases in grocery and retail drug stores.

Our Energy Services segment includes our Southern Flow Companies, Inc. and WaterSecure Holdings, Inc. subsidiaries, and the focus of this segment is on business opportunities in the energy services field.

Our Southern Flow subsidiary provides natural gas measurement services to customers involved in the business of oil and natural gas production, transportation and processing, with a focus on the natural gas market. WaterSecure Holdings, Inc., which we also refer to as WaterSecure , owns approximately 40% of the equity interests in an unconsolidated business, Marcum Midstream 1995-2 Business Trust, which we refer to as MM 1995-2 or as our WaterSecure operations . Our WaterSecure operations business operates water processing and disposal facilities in northeastern Colorado.

See Note 11 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, primarily, PowerSecure, Inc. (our PowerSecure subsidiary) (and its majority-owned and wholly-owned subsidiaries, UtilityEngineering, Inc., PowerServices, Inc., EnergyLite, Inc. EfficientLights, LLC and Reid s Trailer, Inc. dba PowerFab), Southern Flow Companies, Inc. (Southern Flow), and WaterSecure Holdings, Inc. (WaterSecure) (and its majority-owned subsidiary, Conquest Acquisition Company LLC (CAC LLC)), 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, 2008.

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, 2009 and the consolidated results of our operations and cash flows for the three and six month periods ended June 30, 2009 and June 30, 2008.

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 unconsolidated affiliate.

Noncontrolling Interest in EfficientLights Our PowerSecure subsidiary has a 66% controlling ownership interest in EfficientLights which is consolidated in our financial statements. The 33% noncontrolling ownership interest in the income of EfficientLights is included as a reduction to net income (loss) to derive income (loss) attributable to PowerSecure International shareholders in our consolidated statement of operations. The 33% noncontrolling ownership interest in the equity of EfficientLights is shown as a separate component of stockholders equity in our consolidated balance sheet.

Reclassification Certain 2008 amounts have been reclassified to conform to current year presentation. Such reclassifications had no impact on our previously reported results of operations or stockholders equity.

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, allowance for doubtful accounts receivable, inventory valuation reserves, and our deferred tax valuation allowance.

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements

Revenue Recognition For our distributed generation turn-key project-based sales and our utility infrastructure projects, we recognize revenue and profit as work progresses using the percentage-of-completion method, which relies on various estimates. We believe the use of the percentage-of-completion method of accounting for our distributed generation projects is preferable to the completed contract method because a typical distributed generation construction project occurs over several accounting periods and the percentage-of-completion method is a better method to match the revenues and costs to the reporting period in which the construction services are performed. Nearly all of our distributed generation projects are fixed-price contracts, with the exception of certain contracts which provide for additional billings based on wire usage to connect the distributed generation equipment to customer facilities.

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 our construction 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 constructions 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 projects, sales 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, 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 a contract provides for adjustments to the contract price for actual wire or other raw material usage, we recognize the associated revenue when the actual costs are incurred and the customer is billed.

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 charged 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 insignificant. If, however, conditions arise that requires us to adjust our estimated revenues or costs for a series of similar construction projects, the effect on current period earnings would most 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 non-cancelable 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.

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

Revenues on our recurring revenue distributed generation projects are recognized over the term of the contract as we provide utilities and their customers with access to distributed generation systems for standby power and peak shaving or, in certain cases, when energy savings are realized by the customer at their site. 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 for the value of the electrical capacity provided by the system (usually a utility).

Sales of certain goods or services sometimes involve the provision of multiple elements. Revenues from contracts with multiple element arrangements are recognized as each element is earned based on the relative fair value of each element and when the delivered elements have value to customers on a standalone basis. Amounts allocated to each element are based on its objectively determined fair value, such as the sales price for the product or service when it is sold separately or competitor prices for similar products or services.

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.

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 our cash and cash equivalents 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 one-year warranty for our distributed generation and switchgear equipment, and a five-year warranty for our EfficientLights lighting product. In addition, we offer extended warranty terms on our 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.

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

Pre-tax share-based compensation expense for our stock options and restricted stock awards during the three months ended June 30, 2009 and 2008 was $433 and $601, respectively. Pre-tax share-based compensation expense for our stock options and restricted stock awards during the six months ended June 30, 2009 and 2008 was $787 and $1,215, 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 account for uncertainty in income taxes utilizing minimum recognition thresholds for tax positions taken or expected to be taken in a tax return that must be met before being recognized in the financial statements. We recognize interest and penalties related to our tax contingencies as income tax expense.

Recent Accounting Pronouncements

Noncontrolling Interest In late 2007, the Financial Accounting Standards Board (FASB) issued Financial Accounting Standards (FAS) No. 160, Noncontrolling Interests in Consolidated Financial Statements-an amendment of ARB No. 51 (FAS 160), which establishes accounting and reporting standards for the noncontrolling interest in a subsidiary (minority interest) and for the deconsolidation of a subsidiary. We adopted the provisions of FAS 160 on a prospective basis beginning January 1, 2009. Accordingly, the 33% noncontrolling shareholder s ownership interest in the equity of EfficientLights is included as a separate component of stockholders equity in our consolidated balance sheet at June 30, 2009. The 33% noncontrolling shareholder s ownership interest in the income of EfficientLights is included in our consolidated statements of operations in determining net income (loss) and earnings per share attributable to PowerSecure International common stockholders. At December 31, 2008, the accumulated losses of the noncontrolling shareholder s interest in EfficientLights exceeded his basis. Under ARB No. 51, the noncontrolling shareholder s interest in the current period income of EfficientLights would have been offset against the accumulated unrecognized noncontrolling shareholder losses. Accordingly, the effect of adopting the provisions of FAS 160 on our statement of operations for the three and six months ended June 30, 2009 was to increase the net loss attributable to PowerSecure International shareholders by $331 and $365, respectively, for the effects of the unrecovered losses attributable to the noncontrolling shareholder that were accumulated prior to December 31, 2008.

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Accounting for Business Combinations In late 2007, the FASB issued FAS No. 141(R), Business Combinations-a replacement of FASB Statement No. 141 (FAS 141(R)), which significantly changes the principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. FAS 141(R) also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. We adopted the provisions of FAS 141(R) effective January 1, 2009. The adoption of FAS 141(R) had no effect on our financial position, results of operations or financial statement disclosures.

Derivative Instruments and Hedging Activities In March 2008, the FASB issued FAS No. 161, Disclosures About Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (FAS 161). FAS 161 amends FAS No. 133 by requiring expanded disclosures about, but does not change the accounting for, derivative instruments and hedging activities, including increased qualitative, quantitative, and credit-risk disclosures. We adopted the provisions of FAS 161 effective January 1, 2009. The adoption of FAS 161 had no effect on our financial position, results of operations or financial statement disclosures.

Useful Life of Intangible Assets In April 2008, the FASB issued FASB Staff Position (FSP) FAS 142-3, Determination of Useful Life of Intangible Assets (FSP FAS 142-3). FSP FAS 142-3 amends the factors that should be considered in developing the renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FAS 142, Goodwill and Other Intangible Assets. FSP FAS 142-3 also requires expanded disclosure related to the determination of intangible asset useful lives. We adopted the provisions of FSP FAS 142-3 effective January 1, 2009. The adoption of FSP FAS 142-3 had no effect on our financial position or results of operations or financial statement disclosures.

Participating Securities In June 2008, the FASB issued FSP Emerging Issues Task Force (EITF) 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities (FSP EITF 03-6-1). FSP EITF 03-6-1 clarifies that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and are to be included in the computation of earnings per share under the two-class method described in SFAS No. 128, Earnings Per Share. We adopted the provisions of FSP EITF 03-6-1 effective January 1, 2009. All of our unvested restricted stock awards contain nonforfeitable rights to dividends on a basis equal to our other common stockholders. Accordingly, the adoption of FSP EITF 03-6-1 increased our weighted average shares outstanding at June 30, 2008 (for comparative purposes), and reduced our previously reported basic and diluted earnings per share by $0.01 for each of the three and six month periods ended June 30, 2008.

Defensive Intangible Assets In November 2008 the FASB ratified EITF Issue No. 08-7, Accounting for Defensive Intangible Assets , or EITF 08-7. EITF 08-7 applies to defensive intangible assets, which are acquired intangible assets that the acquirer does not intend to actively use but intends to hold to prevent its competitors from obtaining access to them. As these assets are separately identifiable, EITF 08-7 requires an acquiring entity to account for defensive intangible assets as a separate unit of accounting, which should be amortized to expense over the period the asset diminished in value. Defensive intangible assets must be recognized at fair value in accordance with SFAS 141R and SFAS 157. We adopted the provisions of EITF 08-07 effective January 1, 2009. The adoption of EITF 08-07 had no effect on our financial position, results of operations or financial statement disclosures.

Fair Value Accounting Standards On April 9, 2009, the FASB adopted three new guidelines under the so-called mark-to-market accounting rule, addressing concerns over the application of fair value accounting standards given the current market conditions. We adopted all three guidance standards effective June 30, 2009.

The first, FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly , allows companies to value assets at what they would sell for in an orderly sale, as opposed to a forced or distressed sale. This includes certain hard-to-value troubled mortgages, corporate loans, and consumer loans. The new rule establishes a process, by which companies look at several factors and use their judgment to decide whether a formerly active market has become inactive. If found to be inactive, a company must then determine if broker quotes, observed prices, or a discounted cash flow analysis indicate distressed transactions. The adoption of FSB FAS 157-4 had no effect on our financial position, results of operations or financial statement disclosures.

The second, FSP FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (OTTI) , changes the way companies are calculating OTTI for debt securities. Under FSP FAS 115-2 and FAS 124-2, recognition of OTTI is based on management s assertion it does not have the intent to sell the debt instrument and it is more likely than not it will not have to sell the debt instrument before recovery of its cost basis. As such, when adjusting the debt instrument to fair value on the company s balance sheet, the credit component of an other-than-temporary impairment of a debt security will be recorded through earnings and the remaining portion in other comprehensive income. The credit portion of the change in fair value of the debt security is measured on the basis of an entity s estimate of the decrease in expected cash flows. The adoption of FSB FAS 115-2 and FAS 124-2 had no effect on our financial position, results of operations or financial statement disclosures.

The third, FSP FAS 107-1 and APB 28-1, Interim Disclosures About Fair Value of Financial Instruments , increases the frequency of disclosures that provide qualitative and quantitative information about fair value estimates for financial instruments not currently measured on the balance sheet at fair value. The FSP now requires disclosures typically only reported in annual report to be included in the quarterly reports. The FSP does not require any new disclosures related to fair value estimates. The adoption of FSP FAS 107-1 and APB 28-1 had no effect on our financial position, results of operations or financial statement disclosures.

Employers Disclosures about Postretirement Benefit Plan Assets In December 2008, the FASB issued FSP FAS 132(R)-1, Employers Disclosures about Postretirement Benefit Plan Assets , which requires additional disclosures for employers pension and other postretirement benefit plan assets. As pension and other postretirement benefit plan assets were not included within the scope of FAS No. 157, FSP FAS 132(R)-1 requires employers to disclose information about fair value measurements of plan assets similar to the disclosures required under SFAS No. 157, the investment policies and strategies for the major categories of plan assets, and significant concentrations of risk within plan assets. FSP FAS 132(R)-1 will be effective for us as of December 31, 2009. We do not expect the adoption of this standard will have any impact on our financial position, results of operations or financial statement disclosures.

Subsequent Events Disclosure In May 2009, the FASB issued FAS No. 165, Subsequent Events (FAS 165), which requires the disclosure of the date through which an entity has evaluated subsequent events and whether that represents the date the financial statements were issued or were available to be issued. We adopted the provisions of FAS 165 effective June 30, 2009. In accordance with the provisions of FAS 165, we have evaluated events subsequent to June 30, 2009 through August 6, 2009, the date these financial statements were issued.

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Accounting for Transfers of Financial Assets In June 2009, the FASB issued FAS No. 166, Accounting for Transfers of Financial Assets (FAS 166). FAS 166 is a revision to FAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities , and will require more information about transfers of financial assets and where companies have continuing exposure to the risk related to transferred financial assets. It eliminates the concept of a qualifying special purpose entity, changes the requirements for derecognizing financial assets, and requires additional disclosure. This standard is effective for interim and annual periods beginning after November 15, 2009. We will adopt FAS 166 on January 1, 2010. We do not expect the adoption of FAS 166 will have any impact on our financial position, results of operations or financial statement disclosures.

Variable Interest Entities In June 2009, the FASB issued FAS No. 167, Amendments to FASB Interpretation No. 46(R) (FAS 167). FAS 167 is intended to improve financial reporting by providing additional guidance to companies involved with variable interest entities and by requiring additional disclosures about a company s involvement in variable interest entities. Under FAS No. 167, determining whether a company is required to consolidate an entity will be based on, among other things, an entity s purpose and design and a company s ability to direct the activities of the entity that most significantly impact the entity s economic performance. FAS No. 167 is effective for annual reporting periods beginning after November 15, 2009. We will adopt FAS 167 on January 1, 2010. We do not expect the adoption of FAS 167 will have any impact on our financial position, results of operations or financial statement disclosures.

Codification and Hierarchy of Accounting Standards In June 2009 the FASB issued FAS No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Standards (FAS 168). FAS 168 establishes the FASB Accounting Standards Codification (the Codification) as the single source of authoritative nongovernmental U.S. GAAP. The Codification will supersede all existing non-SEC accounting and reporting standards. FAS 168 is effective in the first interim and annual periods ending after September 15, 2009. FAS 168 will have no effect on our consolidated financial statements upon adoption other than current references to GAAP which will be replaced with references to the applicable codification paragraphs.

3. 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 and warrants using the treasury stock method. Diluted earnings per share excludes the impact of potential common shares related to stock options and warrants in periods in which we reported a loss from continuing operations or in which the option or warrant 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 455,000 common shares issuable upon the exercise of in-the-money stock options were excluded from the diluted weighted average number of shares outstanding for the three months ended June 30, 2009 because the net effects of in-the-money stock options, unrecognized stock compensation costs, and tax benefits on nonqualified stock options and time vesting restricted stock awards was antidilutive. A total of 416,000 common shares issuable upon the exercise of in-the-money stock options were excluded from the diluted weighted average number of shares outstanding for the six months ended June 30, 2009 because their effect was antidilutive to our net loss.

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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,	
	2009	2008	2009	2008
Amounts attributable to PowerSecure International, Inc. common stockholders:				
Income (loss) from continuing operations	$ 686	$ 4,940	$ (450)	$ 6,892
Loss from discontinued operations				(77)
Net income (loss)	$ 686	$ 4,940	$ (450)	$ 6,815
Basic weighted-average common shares outstanding in period	17,159	16,927	17,127	16,912
Add dilutive effects of stock options and warrants		416		516
Diluted weighted-average common shares outstanding in period	17,159	17,343	17,127	17,428
Basic earnings (loss) per common share:				
Income (loss) from continuing operations	$ 0.04	$ 0.29	$ (0.03)	$ 0.41
Loss from discontinued operations				$ (0.01)
Basic earnings (loss) per common share	$ 0.04	$ 0.29	$ (0.03)	$ 0.40
Diluted earnings (loss) per common share:				
Income (loss) from continuing operations	$ 0.04	$ 0.28	$ (0.03)	$ 0.40
Loss from discontinued operations				$ (0.01)
Diluted earnings (loss) per common share	$ 0.04	$ 0.28	$ (0.03)	$ 0.39

4. New Business Unit

On May 8 2009, our PowerSecure subsidiary established a new business unit, PowerPackages, LLC, to provide our utility partners an efficient, dependable continuous power source for their customers. The new business unit broadens our PowerSecure subsidiary s interactive distributed generation system capabilities by utilizing medium speed engine technology as the system s power source. To facilitate the new business unit, our PowerSecure subsidiary purchased certain inventory and equipment of Design Power International, Inc. The fair value of the assets acquired was $800, which also represents the purchase price of the assets. The following provides additional information regarding the fair value of the assets acquired:

Inventory	$ 408
Equipment	392
Total assets	$ 800

The operations of PowerPackages, LLC have been included within our Energy and Smart Grid Solutions operating segment from the date of acquisition. Pro forma results of operations for the periods ended June 30, 2009 and 2008 have not been included herein as the effects of the acquisition were not material to our results of operations.

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5. Investment in Unconsolidated Affiliate

Through WaterSecure, we currently own 40.45% of MM 1995-2, which we account for under the equity method. MM 1995-2 owns and operates five water processing and disposal facilities located in northeastern Colorado. The balance of our equity investment in MM 1995-2 includes approximately $785 and $822 of unamortized purchase premiums we paid on our acquired interests at June 30, 2009 and December 31, 2008, respectively. The premiums are being amortized over a period of 14 years, which represents the weighted average useful life of the underlying assets acquired.

The following table sets forth certain summarized financial information for MM 1995-2 at June 30, 2009 and December 31, 2008 and for the three and six months ended June 30, 2009 and 2008:

	June 30, 2009	December 31, 2008
Total current assets	$ 2,650	$ 4,645
Property, plant and equipment, net	9,234	8,067
Total other assets	11	17
Total assets	$ 11,895	$ 12,729
Total current liabilities	$ 1,482	$ 1,393
Long-term note payable	3,157	3,550
Total shareholders equity	7,256	7,786
Total liabilities and shareholders equity	$ 11,895	$ 12,729

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Total revenues	$ 2,687	$ 5,478	$ 5,674	$ 10,367
Total costs and expenses	1,696	2,095	3,504	4,326
Net income	$ 991	$ 3,383	$ 2,170	$ 6,041

6. Debt

Line of Credit We have an existing credit agreement with Citibank, N.A., as the administrative agent, along with SunTrust Bank and BB&T, providing for a $50 million senior, first-priority secured revolving and term credit facility. The credit facility, as amended, is a $50,000 senior, first-priority secured revolving credit facility that is guaranteed by all of our active subsidiaries and secured by all of our assets and the assets of our active subsidiaries.

We may, from time to time, request an increase in the aggregate revolving commitment amount by up to $15,000 without the prior consent of the lenders provided that each lender has the unilateral right to determine whether it agrees to increase its revolving commitment and that no lender is required to increase its individual pro rata commitment amount without such lender s consent.

The credit facility, as a revolving credit facility, matures and terminates on November 13, 2011. However, we have the option prior to that maturity date to convert a portion of outstanding principal balance, in an amount not to exceed the present value of estimated annual contract revenues receivable under the initial term of contracts for recurring revenue projects executed after December 31, 2007, into a non-revolving term loan for a two year period expiring November 12, 2013, making quarterly payments based upon a four year fully amortized basis.

We intend to use the proceeds available under the credit facility to finance our PowerSecure subsidiary s recurring revenue projects as well as to finance capital expenditures, working capital, acquisitions, and general corporate purposes. Our outstanding borrowings under the credit facility at any time, the proceeds of which were used for working capital purposes and not in connection with recurring revenue projects, cannot exceed $15,000.

Outstanding balances under the credit facility bear interest, at our discretion, at either the London Interbank Offered Rate for the corresponding deposits of U. S. Dollars plus an applicable margin, which is on a sliding scale ranging from 175 basis points to 300 basis points based upon the our leverage ratio, or at Citibank s alternate base rate plus an applicable margin, on a sliding scale ranging from 0 basis points to 125 basis points based upon our leverage ratio. Our leverage ratio is the ratio of our funded indebtedness as of a given date to our consolidated EBITDA as defined in the credit agreement for the four consecutive 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%, and Citibank s prime commercial lending rate.

The credit facility is not subject to any borrowing base computations or limitations, but does contain certain financial covenants. Our maximum leverage ratio cannot exceed 3.25. Our minimum fixed charge coverage ratio must be in excess of 1.50, where the fixed charge coverage ratio is defined as the ratio of the aggregate of our trailing 12 month consolidated EBITDA plus our lease or rent expense minus our taxes based on income and payable in cash, divided by the sum of our consolidated interest charges plus our lease or rent expenses plus our scheduled principal payments and dividends, computed over the previous period. Also, our minimum asset coverage must be in excess of 1.25, where our asset coverage is defined as the summation of 80% of the book value of accounts receivable plus 60% of the book value of inventory plus 50% of the book value of net fixed assets, divided by total funded debt outstanding. In addition, we are required to maintain a minimum consolidated tangible net worth, computed on a quarterly basis, equal to approximately $42.8 million, plus 50% of our net income each year ending after December 31, 2007, with no reduction for any net loss in any year, plus 100% of any equity we raise through the sale of equity interests, less the amount of any non-cash charges or losses. Finally, our debt to worth ratio, which is the ratio of our total consolidated indebtedness to our consolidated tangible net worth, cannot exceed 1.5 to 1.0 at the end of any quarter. At June 30, 2009, we were in compliance with these financial covenants.

Under the credit facility, our cumulative capital expenditures beginning in 2008 cannot exceed the sum of $5,000 plus $1,250 per quarter, on a cumulative basis, plus an allowance for our PowerSecure subsidiary recurring revenue projects generated after December 31, 2007. The credit facility contains other representations and warranties and affirmative and negative covenants, including restrictions with respect to liens, indebtedness, loans and investments, material changes in our business, asset sales or leases or transfers of assets, restricted payments such as distributions and dividends, mergers or consolidations and transactions with affiliates.

Upon the sale of any of our assets or the assets of our subsidiaries other than in the ordinary course of business or the public or private sale of any of our equity or debt or the equity or debt of our subsidiaries other than equity issuances where the aggregate net equity proceeds do not exceed $10,000, we are required to use the net proceeds thereof to repay any indebtedness then outstanding under the credit facility, except for certain reinvestment provisions.

Our obligations under the credit facility are secured by guarantees and security agreements by each of our active subsidiaries, including but not limited to our PowerSecure subsidiary, Southern Flow and WaterSecure. The guarantees guaranty all of our obligations under the credit facility, and the security agreements grant to the lenders a first priority security interest in virtually all of the assets of each of the parties to the credit agreement.

The credit agreement also 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.

At June 30, 2009 and December 31, 2008, there were no balances outstanding under the credit facility and we had $50,000 available to borrow. However, the availability of this capital under our credit facility includes restrictions on the use of proceeds, and is dependent upon our ability to satisfy certain financial and operating covenants, as described above.

Equipment Line On July 22, 2008, Caterpillar Financial Services Corporation (Caterpillar) renewed a line of credit to finance the purchase, from time to time, of Caterpillar generators to be used in our PowerSecure subsidiary s projects, primarily those projects sold under the recurring revenue model, pursuant to a letter by Caterpillar containing the terms of this credit line. The line of credit was increased from its previous $7,500 level to $10,000. Under this line of credit, our PowerSecure subsidiary may submit equipment purchases to Caterpillar for financing, and Caterpillar may provide such financing in its discretion at an interest rate, for a period of time between 12 and 60 months and upon such financing instruments, such as a promissory note or an installment sales contract, as are set by Caterpillar on a project by project basis. The line of credit expires on September 30, 2009 (subject to renewal, if requested by our PowerSecure subsidiary and accepted by Caterpillar in its sole discretion), or at an earlier date upon notice given by Caterpillar in its sole discretion. The letter setting forth the terms of the line of credit confirms the intent of Caterpillar to finance equipment purchases by our PowerSecure subsidiary, but is not an unconditional binding commitment to provide such financing. The line of credit contains various customary provisions and is contingent upon the continued credit-worthiness of our PowerSecure subsidiary in the sole discretion of Caterpillar. This line of credit from Caterpillar is a permitted indebtedness under our credit facility with Citibank. At June 30, 2009 and December 31, 2008, there were no balances borrowed or outstanding under the equipment line of credit with Caterpillar.

7. Capital Lease Obligations

In December 2008, we entered into a sale and leaseback transaction with SunTrust Equipment Finance and Leasing, an affiliate of SunTrust bank, resulting in the sale of distributed generation equipment placed in service at customer locations and a lease of the equipment from SunTrust. We received $5,912 from the sale of the equipment which we are repaying under the terms of the lease with monthly payments of $85 of principal and interest over a period of 84 months. At the expiration of the term of the lease, we have the option to purchase the equipment for $1, assuming no default under the lease by us has occurred and is then continuing. The lease is guaranteed by us under an equipment lease guaranty. The lease and the lease guaranty constitute permitted indebtedness under our current credit agreement, under which an affiliate of the lessor is one of the lenders.

We intend to use the proceeds of the lease financing to finance our PowerSecure subsidiary s recurring revenue projects as well as to finance capital expenditures and working capital. We account for the lease financing as a capital lease in our consolidated financial statements in accordance with generally accepted accounting principles.

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

Under the lease guaranty, we have unconditionally guaranteed the obligations of our PowerSecure subsidiary under the lease for the benefit of the lessor.

Capital lease obligations at June 30, 2009 and December 31, 2008 consist of our obligations under the equipment lease described above as well as $5 of other lease obligations.

8. Share-Based Compensation

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

In March 2008, our board of directors adopted the PowerSecure International, Inc. 2008 Stock Incentive Plan (the 2008 Stock Plan), which was approved by our stockholders at the Annual Meeting of Stockholders held on June 9, 2008. The 2008 Stock Plan authorizes our board of directors to grant incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, performance awards and other stock-based awards to our officers, directors, employees, consultants and advisors for up to an aggregate of 600,000 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. The 2008 Stock Plan replaced our 1998 Stock Plan.

Stock Options Net income for the three months ended June 30, 2009 and 2008 includes $168 and $198, respectively, of pre-tax compensation costs related to outstanding stock options. Net income (loss) for the six months ended June 30, 2009 and 2008 includes $257 and $409, respectively, of pre-tax compensation costs related to outstanding stock options. The after-tax compensation cost of outstanding stock options for the six months ended June 30, 2009 and 2008 was $157 and $250, respectively. All of the stock option compensation expense is included in general and administrative expenses in the accompanying consolidated statements of operations.

A summary of option activity for the six months ended June 30, 2009 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Balance, December 31, 2008	1,708	$ 5.21		
Granted	20	4.57		
Exercised	(33)	1.62		
Expired	(6)	6.88		
Forfeited	(49)	11.19		
Balance, June 30, 2009	1,640	$ 5.09	5.27	$ (0.83)
Exercisable, June 30, 2009	1,311	$ 4.79	4.46	$ (0.53)

A summary of option activity for the six months ended June 30, 2008 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Balance, December 31, 2007	1,728	$ 5.34		
Granted	30	12.14		
Exercised	(142)	3.15		
Canceled				
Forfeited	(5)	13.55		
Balance, June 30, 2008	1,611	$ 5.63	5.72	$ 1.63
Exercisable, June 30, 2008	1,305	$ 4.44	5.25	$ 2.82

The weighted average grant date fair value of the options granted during the six months ended June 30, 2009 and 2008 was $2.25 and $6.51, respectively. In each case, the fair value was measured using the Black-Scholes valuation model with the following assumptions:

	June 30, 2009	June 30, 2008
Expected stock price volatilility	54.3%	60.3%
Risk Free interest rate	2.65%	2.96%
Annual dividends	$	$
Expected life employee options	5 years	5 years
Expected life director options	na	na

We amortize the fair value of stock option grants over their respective service periods using the straight-line method and assuming a forfeiture rate of 5%. As of June 30, 2009 and December 31 2008, there was $1,036 and $1,453, respectively, of total unrecognized compensation costs related to all of our outstanding stock options. These costs at June 30, 2009 are expected to be recognized over a weighted average period of 1.5 years.

During the three months ended June 30, 2009 and 2008, the total intrinsic value of stock options exercised was $2 and $452, respectively. Cash received from stock option exercises during the three months ended June 30, 2009 and 2008 was $8 and $362, respectively. The total grant date fair value of stock options vested during the three months ended June 30, 2009 and 2008 was $253 and $395, respectively.

During the six months ended June 30, 2009 and 2008, the total intrinsic value of stock options exercised was $68 and $944, respectively. Cash received from stock option exercises during the six months ended June 30, 2009 and 2008 was $53 and $448, respectively. The total grant date fair value of stock options vested during the six months ended June 30, 2009 and 2008 was $436 and $627, respectively.

Restricted Stock Awards Net income for the three months ended June 30, 2009 and 2008 includes $265 and $403, respectively, of pre-tax compensation costs related to outstanding restricted stock awards. Net income (loss) for the six months ended June 30, 2009 and 2008 includes $530 and $806, respectively, of pre-tax compensation costs related to outstanding restricted stock awards. All of the restricted stock award compensation expense during the three and six months ended June 30, 2009 and 2008 is included in general and administrative expenses in the accompanying consolidated statements of operations.

A summary of restricted stock award activity for the six months ended June 30, 2009 is as follows:

	Unvested Restricted Shares	Weighted Average Grant Date Fair Value
Balance, December 31, 2008	628	$ 12.06
Granted	43	4.65
Vested	(76)	11.90
Forfeited		
Balance, June 30, 2009	595	$ 11.54

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A summary of restricted stock award activity for the six months ended June 30, 2008 is as follows:

	Unvested Restricted Shares	Weighted Average Grant Date Fair Value
Balance, December 31, 2007	641	$ 12.48
Granted	38	8.58
Vested	(60)	12.34
Forfeited		
Balance, June 30, 2008	619	$ 12.25

Restricted shares are subject to forfeiture and cannot be sold or otherwise transferred until they vest. If the holder of the restricted shares leaves us before the restricted shares vest, other than due to termination by us without cause, then any unvested restricted shares will be forfeited and returned to us. Restricted stock awards granted to directors vest in equal amounts over a period of one or three years, depending on the nature of the grant. Restricted stock awards granted to employees other than officers vest in equal annual amounts over five years. Restricted stock awards granted to officers are scheduled to vest as follows:

A total of 300,000 restricted shares will cliff vest in their entirety on August 15, 2012, provided the officer remains employed with us through that date.

A total of 22,500 restricted shares will cliff vest in their entirety on December 10, 2012, provided the officers remain employed with us through that date.

The remaining 193,500 restricted shares vest in three equal annual installments, commencing when our annual report on Form 10-K for the year ended December 31, 2009 is filed, but only upon the achievement of performance targets each year relating to our net income for fiscal years 2009 through 2012.

All restricted and unvested shares will automatically vest upon a change in control.

The fair value of the cliff vesting restricted shares is being amortized on a straight-line basis over the vesting period. The fair value of the performance vesting shares is expensed as the achievement of the performance criteria becomes probable and the related service period conditions are met. At June 30, 2009, the balance of unrecognized compensation cost related to unvested restricted shares was $5,323, which, assuming all future performance criteria will be met, we expect will be recognized over a weighted average period of approximately 3.5 years.

9. Commitments and Contingencies

From time to time, we hire employees that are subject to restrictive covenants, such as non-competition agreements with their former employers. We comply, and require our employees to comply, with the terms of all known restrictive covenants. However, we have in the past and may in the future receive claims and demands by some former employers alleging actual or potential violations of these restrictive covenants. While we do not believe any pending claims have merit, we cannot provide any assurance of the outcome of these claims.

From time to time, in the ordinary course of business we encounter performance issues with key component parts we utilize in our distributed generation systems, switchgear systems, utility infrastructure products, and lighting products, such as engines, generators, alternators, breakers, fuel systems, LED and other lighting technologies, and other complex electrical components. 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. These risks include the expense, time, focus and resources involved in repairing, replacing or modifying distributed generation systems, switchgear systems and lighting systems for component part malfunctions, whether or not covered under manufacturers warranties and the burden and costs we would incur due to manufacturers disputing or failing to timely and fully honor their warranty obligations for quality and performance issues. These risks also include the potential material and adverse effects on our business, operations, reputation and financial results, including reduced revenues, additional expenses and capital cost, and asset write-offs, due to the cancellation or deferral of projects by our customers, or claims made by our customers for damages, as a result of performance issues.

Although we believe our suppliers warranties generally cover these performance issues, from time to time we face disputes with our suppliers with respect to those performance issues and their warranty obligations, or the performance issues are not covered by manufacturer s warranties, and our customers may claim to incur damages as a result of those performance issues. In those cases, we vigorously defend our position and rights, including our warranty rights, and we take all commercially practical actions to ensure our customers are fully satisfied with the quality of our products and services and do not incur any damages. As of the date of this report, we have identified performance issues with approximately $5-10 million of manufacturer s component parts installed in distributed generation systems deployed at customer s sites, and additional performance issues could arise from time to time in the future. We are working collaboratively with the manufacturers to resolve these issues. However, in the event the manufacturers solutions do not fully satisfy the required performance standards, we could incur additional costs to replace, rebuild, or repair these systems, as well as incur adverse material future financial consequences related to the cancellation of customer contracts, including reduced revenues, additional expenses and capital cost, and asset write-offs. In certain instances, these performance issues could also result in customer s claims for damages. We currently expect the manufacturers to rectify these performance issues to meet our customers required performance standards with minimal additional cost to us, however, we cannot provide any assurance that an acceptable solution will be achieved in each case, or if a solution is achieved the timing or costs to us associated with such solutions. Additionally, the outcome of any warranty claims is inherently difficult to predict due to the uncertainty of technical solutions, cost, customer requirements, and the uncertainty inherent in litigation and disputes generally, and thus there is no assurance we will not be adversely affected by these, or other performance issues with key parts and components. In addition, the mere existence of performance issues, even if finally resolved with our suppliers, can have an adverse effect on our reputation for quality, which could adversely affect our business. Accordingly, potential negative financial impacts from these items cannot be estimated at this time.

From time to time, we are involved in other disputes and legal actions arising in the ordinary course of business. We intend to vigorously defend all claims against us. Although the ultimate outcome of these claims 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 dispute is expected to have a material adverse effect on our business, financial condition or results of operations.

10. Income Taxes

No current benefit for federal income taxes has been recorded for the three and six months ended June 30, 2009 due to our history of taxable losses, current valuation allowance and lack of seasonal patterns to support utilization of losses incurred during the period. The tax provision recorded at June 30, 2009 is our best estimate of our tax expense taking into consideration our expectation of future earnings, federal alternative minimum tax, state income tax for state jurisdictions in which we expect taxable income, and our valuation allowance.

11. Segment Information

Our operating segments represent components of our business for which discrete financial information is available and is reviewed regularly by the chief operating decision-maker, or decision-making group, to evaluate performance and make operating decisions. We conduct our operations through two operating segments: Energy and Smart Grid Solutions, and Energy Services. Our reportable segments are strategic business units that offer different products and services and serve different customer bases. They are managed separately because each business requires different technology and marketing strategies. Previously, we were also engaged in a third business segment, Automated Energy Data Collection and Telemetry conducted through our MGM subsidiary. That segment of our business has been discontinued and the results of its operations are excluded from our segment information below.

Energy and Smart Grid Solutions Through our PowerSecure subsidiary we serve utilities and commercial, institutional, and industrial customers in the areas of Interactive Distributed Generation®, Utility Infrastructure and Energy Efficiency. Each of these PowerSecure subsidiary business units operates in a distinct market with distinct technical disciplines, but shares a common customer base with our PowerSecure subsidiary products and services and which we intend to grow through shared resources and customer relationships. Accordingly, these units are included within our Energy and Smart Grid Solutions segment results; and

Energy Services Through our Southern Flow and WaterSecure subsidiaries we serve customers in the oil and natural gas production business with our measurement services and products, and water processing and disposal services. Southern Flow s services include on-site field services, chart processing and analysis, laboratory analysis, and data management and reporting. These services are provided principally to customers involved in natural gas production, gathering, transportation and processing. WaterSecure, through its equity investment MM 1995-2, provides water processing and disposal for oil and natural gas producers.

The accounting policies of the reportable segments are the same as those described in Note 1 of the Notes to Consolidated Financial Statements. We evaluate the performance of our operating segments based on Income (loss) before income taxes. Intersegment sales are not significant. During the year ended December 31, 2008, we changed the composition of our reportable segments to include the management fees and equity income of our WaterSecure operations within our Energy Services segment. Previously, our WaterSecure operations were not included in our segment activity. The segment activity for the three and six months ended June 30, 2008 has been reclassified to conform to current year presentation.

Summarized financial information concerning our reportable segments is shown in the following table. Unallocated corporate cost amounts include corporate overhead and related items including restructuring charges, other income and assets of discontinued operations which, for purposes of evaluating the operations of our segments, are not allocated to our segment activities. Total asset amounts exclude intercompany receivable balances eliminated in consolidation.

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	Three Months Ended June 30, 2009			
	Energy and Smart Grid Solutions	Energy Services	Unallocated Corporate Costs	Total
Revenues	$ 20,671	$ 4,464	$	$ 25,135
Cost of sales	13,629	3,251		16,880
Gross profit	7,042	1,213		8,255
Operating expenses:				
General and administrative	4,308	500	1,198	6,006
Selling, marketing and service	957	12		969
Depreciation and amortization	477	85	1	563
Research and development	66			66
Total operating expenses	5,808	597	1,199	7,604
Operating income (loss)	1,234	616	(1,199)	651
Other income and (expenses)				
Management fees		98		98
Equity income		401		401
Interest and other income			38	38
Interest and finance charges	(77)		(68)	(145)
Income (loss) before income taxes	$ 1,157	$ 1,115	$ (1,229)	$ 1,043
Total capital expenditures	$ 925	$ 167	$	$ 1,092
Total investment in unconsolidated affiliate	$	$ 3,854	$	$ 3,854
Total assets	$ 77,882	$ 15,912	$ 16,831	$ 110,625

	Three Months Ended June 30, 2008			
	Energy and Smart Grid Solutions	Energy Services	Unallocated Corporate Costs	Total
Revenues	$ 37,058	$ 4,894	$	$ 41,952
Cost of sales	24,768	3,384		28,152
Gross profit	12,290	1,510		13,800

Operating expenses:				
General and administrative	5,811	507	1,235	7,553
Selling, marketing and service	1,886	3		1,889
Depreciation and amortization	468	57	2	527
Reasearch and development	45			45
Total operating expenses	8,210	567	1,237	10,014
Operating income (loss)	4,080	943	(1,237)	3,786
Other income and (expenses)				
Management fees		164		164
Equity income		1,227		1,227
Interest and other income	9	7	103	119
Interest and finance charges	(27)		(25)	(52)
Income (loss) before income taxes	$ 4,062	$ 2,341	$ (1,159)	$ 5,244
Total capital expenditures	$ 7,635	$ 37	$	$ 7,672
Total investment in unconsolidated affiliate	$	$ 5,269	$	$ 5,269
Total assets	$ 83,919	$ 16,362	$ 10,571	$ 110,852

	Six Months Ended June 30, 2009			
	Energy and Smart Grid Solutions	Energy Services	Unallocated Corporate Costs	Total
Revenues	$ 35,886	$ 8,969	$	$ 44,855
Cost of sales	24,070	6,656		30,726
Gross profit	11,816	2,313		14,129
Operating expenses:				
General and administrative	8,701	1,014	2,311	12,026
Selling, marketing and service	1,783	17		1,800
Depreciation and amortization	938	165	2	1,105
Reasearch and development	86			86
Total operating expenses	11,508	1,196	2,313	15,017
Operating income (loss)	308	1,117	(2,313)	(888)
Other income and (expenses)				
Management fees		203		203
Equity income		878		878
Interest and other income	3		88	91
Interest and finance charges	(185)		(134)	(319)
Income (loss) before income taxes	$ 126	$ 2,198	$ (2,359)	$ (35)
Total capital expenditures	$ 1,466	$ 280	$	$ 1,746

	Six Months Ended June 30, 2008			
	Energy and Smart Grid Solutions	Energy Services	Unallocated Corporate Costs	Total
Revenues	$ 66,164	$ 9,363	$	$ 75,527
Cost of sales	45,071	6,636		51,707
Gross profit	21,093	2,727		23,820
Operating expenses:				
General and administrative	11,276	929	2,591	14,796
Selling, marketing and service	3,208	6		3,214
Depreciation and amortization	867	114	3	984
Reasearch and development	64			64

Total operating expenses	15,415	1,049	2,594	19,058
Operating income (loss)	5,678	1,678	(2,594)	4,762
Other income and (expenses)				
Management fees		313		313
Equity income		2,191		2,191
Interest and other income	40	24	281	345
Interest and finance charges	(54)		(49)	(103)
Income (loss) before income taxes	$ 5,664	$ 4,206	$ (2,362)	$ 7,508
Total capital expenditures	$ 15,084	$ 79	$	$ 15,163

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

Introduction

The following discussion and analysis of our consolidated results of operations for the three and six month periods ended June 30, 2009, which we refer to as the second quarter 2009 and six month period 2009, respectively, and the three and six month period ended June 30, 2008, which we refer to as the second quarter 2008 and six month period 2008, respectively, and of our consolidated financial condition as of June 30, 2009 should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this report.

Overview

PowerSecure International, Inc., based in Wake Forest, North Carolina, is a leading provider of Energy and Smart Grid Solutions to electric utilities, and their commercial, institutional, and industrial customers. Our Energy and Smart Grid Solutions segment provides products and services in the areas of Interactive Distributed Generation® (IDG®), Utility Infrastructure, and Energy Efficiency, and our Energy Services segment provides services to the oil and natural gas industry through our Southern Flow and WaterSecure business units.

Through our PowerSecure, Inc. subsidiary we operate our Energy and Smart Grid Solutions segment and focus on three of these areas: Interactive Distributed Generation®, Utility Infrastructure, and Energy Efficiency. Our core Interactive Distributed Generation® business involves installing sophisticated electric generation equipment directly at the location where power is utilized. This equipment provides a dependable backup power supply during power outages, while at the same time providing a more efficient and environmentally friendly means of delivering power during high cost periods of peak power demand. Our intelligent Interactive Distributed Generation® systems contain sophisticated electronic controls, which enables our systems to be monitored 24x7 by our Smart Grid Monitoring Center, safeguarding our customers from power outages and their related costs. Through this monitoring center, we utilize our proprietary smart grid capabilities to forecast utilities peak demand periods, and electronically deploy our systems to deliver more efficient and environmentally friendly power during these periods of peak demand. Our systems also enable utilities to delay new infrastructure investments for transmitting and distributing power, and minimize energy losses associated with moving electricity over long distances.

Our Utility Infrastructure business is dedicated to helping utilities design and build infrastructure to enhance the efficiency and effectiveness of our nation s electric grid, including transmission and distribution system upgrades, installation of advanced metering and efficient lighting, and emergency storm restoration. Additionally, we provide utilities with a wide range of engineering and design services, and consulting services for regulatory and rate design matters. Our Energy Efficiency business is focused on providing lighting solutions for commercial, industrial, and institutional customers, including our state-of-the-art green EfficientLights LED lighting technology for refrigerated cases in grocery and retail drug stores.

Our Energy Services segment includes our Southern Flow Companies, Inc. and WaterSecure Holdings, Inc. subsidiaries, and the focus of this segment is on business opportunities in the energy services field.

Our Southern Flow subsidiary provides natural gas measurement services to customers involved the business of oil and natural gas production, transportation and processing, with a focus on the natural gas market. WaterSecure owns approximately 40% of the equity interests in MM 1995-2, our WaterSecure operations , an unconsolidated business. Our WaterSecure operations provide water processing and disposal services at its facilities in northeastern Colorado.

Recent Developments

On May 8, 2009, our PowerSecure subsidiary established a new business unit, PowerPackages, LLC, to provide our utility partners an efficient, dependable continuous power source for its customers. The new business unit broadens our PowerSecure subsidiary s interactive distributed generation system capabilities by utilizing medium speed engine technology as the system s power source. To facilitate the new business unit, our PowerSecure subsidiary purchased the inventory and equipment of Design Power International, Inc. The fair value of the assets acquired was $800, which also represents the purchase price of the assets.

To complement our project-based Interactive Distributed Generation® sales model, we have implemented a recurring revenue business model, which is our marketing and business strategy that is designed to generate long-term revenues by generating a base of revenues that recur on an annual basis from ongoing, long-term distributed generation projects. Since late 2007, this strategy has generated several new long-term recurring revenue contracts with utility partners and their customers under which we provide them with efficient standby power and access to reliable distributed generation assets during peak power periods for a number of years, typically five to fifteen years, and receive revenues in each of those years. As we create an increased number of recurring revenue projects, we expect to receive an increased and more stable base of future revenue, profit and cash flow. The development of these recurring revenue projects requires a substantial increase in our capital expenditures, utilizes cash flow from operations, and, if needed, debt and lease financing, and also extends revenue and profit recognition over longer periods compared to our traditional project-based sales, where revenue and profit is recognized as the projects are completed. Accordingly, as these long-term recurring revenue projects become an increasing portion of our overall projects and business, we will have a need for more capital in the short-term to finance these recurring revenue projects, with the anticipated goal of greater and more stable future revenues with higher gross margins. During the six month period 2009, we incurred approximately $1.7 million in total capital expenditures, including $1.2 million invested in capital expenditures for PowerSecure-owned distributed generation systems to generate future recurring revenue and profit under recurring revenue contracts.

Due to a decrease in revenues in our PowerSecure and Southern Flow subsidiaries, our consolidated revenues during the second quarter 2009 decreased by $16.8 million, representing a 40.1% decrease compared to our second quarter 2008 consolidated revenues. The decrease in revenues in the second quarter 2009 over the second quarter 2008 was attributable to a decline in revenues from Publix, our largest customer in the prior year period, along with the combination of the continued difficult economic environment, the uncertain regulatory environment, and the crisis in the capital markets which reduced capital spending by our customers. In anticipation of lower revenues in light of very difficult current economic conditions and the capital markets crisis, we initiated measures during the third quarter of 2008 as well as during the first and second quarters of 2009 to control our costs, such as staff reductions and compensation measures such as cutbacks in certain bonus plans and other employee incentives, and other sales and general and administrative spending reductions. As a result, our total operating expenses during the second quarter 2009 decreased by $2.4 million, or 24.1%, compared to our second quarter 2008 operating expenses. We expect these cost reduction measures to continue over the near-term in order to address the negative effects of the current economic recession on our business. Over the long-term, however, we expect to continue to invest in operational infrastructure and sales and new business development to drive and support our growth. As a result of decreased prices and volumes in the oil and gas markets, our second quarter 2009 management fees and equity income from the WaterSecure operations decreased by a combined $0.9 million compared to the second quarter 2008. Overall, our income from continuing operations and net income was $1.0 million during the second quarter 2009, as compared to income from continuing operations and net income of $4.9 million during the second quarter 2008.

Due to a decrease in revenues in our PowerSecure and Southern Flow subsidiaries, our consolidated revenues during the six month period 2009 decreased by $30.7 million, representing a 40.6% decrease compared to our six month period 2008 consolidated revenues. The decrease in revenues in the six month period 2009 over the six month period 2008 was attributable to the same factors attributable to the decrease in revenues during the second quarter 2009 compared to the second quarter 2008 discussed above. As a result of our cost reduction measures described above, our total operating expenses during the six month period 2009 decreased by $4.0 million, or 21.2%, compared to our six month period 2008 operating expenses. As a result of decreased prices and volumes in the oil and gas markets, our six month period 2009 management fees and equity income from the WaterSecure operations decreased by a combined $1.4 million compared to the six month period 2008. Overall, our loss from continuing operations was less than $0.1 million during the six month period 2009, as compared to income from continuing operations of $6.9 million during the six month period 2008. Our net loss was less than $0.1 million during the six month period 2009, as compared to net income of $6.8 million during the six month period 2008, which included a loss from discontinued operations of $0.1 million.

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, 2008 or our quarter and six month periods ended June 30, 2009, will be indicative of our future results, especially in light of the current significant downturn in the economy and crisis negatively affecting the credit and capital markets.

Backlog

As of the date this report is filed, our revenue backlog expected to be recognized after June 30, 2009 is $88 million. This includes revenue related to new business announcements made by us on June 22 and July 20, 2009, and is $1 million more than the $87 million of revenue backlog we reported in our Quarterly Report on Form 10-Q for the period ended March 31, 2009 filed on May 7, 2009. Our revenue backlog and the estimated timing of revenue recognition is outlined below, including project-based revenues expected to be recognized as projects are completed and recurring revenues expected to be recognized over the life of the contracts:

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Revenue backlog to be recognized after June 30, 2009

Description		Anticipated Revenue	Estimated Primary Recognition Period
Project-based Revenue	Near term	$38 Million	3Q09 through 1Q10
Project-based Revenue	Long term	$18 Million	2Q10 through 2011
Recurring Revenue		$32 Million	3Q09 through 2015
Backlog to be recognized after June 30, 2009		**$88 Million**	

Note: Anticipated revenue and primary recognition periods are estimates subject risks and uncertainties and subject to change. Consistent with past practice, these revenue backlog amounts are not intended to constitute the Company s total revenue over the indicated time periods, as the Company has additional, regular on-going revenues. Examples of additional, regular recurring revenues include revenues from our Southern Flow business, UtilityEngineering and PowerServices engineering fees, monitoring and maintenance revenue, among others.

Orders in our backlog are subject to delay, deferral, acceleration, resizing, or cancellation from time to time by our customers, subject to contractual rights. 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.

Operating Segments

We conduct our operations through two operating segments: Energy and Smart Grid Solutions, and Energy Services. Our reportable segments are strategic business units that offer different products and services and serve different customer bases. They are managed separately because each business requires different technology and marketing strategies. Previously, we were also engaged in a third business segment, Automated Energy Data Collection and Telemetry conducted through our Metretek Florida subsidiary. That segment of our business has been discontinued and the results of its operations are reported as discontinued operations.

Energy and Smart Grid Solutions

Through our PowerSecure subsidiary we serve utilities and commercial, institutional, and industrial customers in the areas of Interactive Distributed Generation®, Utility Infrastructure and Energy Efficiency. Each of these PowerSecure subsidiary business units operates in a distinct market with distinct technical disciplines, but share a common customer base with our PowerSecure subsidiary products and services and which we intend to grow through shared resources and customer relationships. Accordingly, these units are included within our Energy and Smart Grid Solutions segment results.

Energy Services

Through our Southern Flow and WaterSecure subsidiaries we serve customers in the oil and natural gas production business with our measurement services and products, and water processing and disposal services. Southern Flow s services include on-site field services, chart processing and analysis, laboratory analysis, and data management and reporting. These services are provided principally to customers involved in natural gas production, gathering, transportation and processing. WaterSecure, through its equity investment in MM 1995-2, provides water processing and disposal for oil and natural gas producers.

Results of Operations

The following discussion regarding segment revenues, gross profit, costs and expenses, and other income and expenses for the second quarter 2009 compared to the second quarter 2008 excludes revenues, gross profit, and costs and expenses of discontinued operations.

Second Quarter 2009 Compared to Second Quarter 2008

Revenues

Our segment revenues are generated entirely by sales and services provided by our PowerSecure subsidiary (Energy and Smart Grid Solutions segment) and our Southern Flow subsidiary (Energy Services segment). The following table summarizes our segment revenues for the periods indicated (dollars in thousands):

	Quarter Ended June 30,		Period-over-Period Difference	
	2009	**2008**	**$**	**%**
Segment Revenues:				
Energy and Smart Grid Solutions	$ 20,671	$ 37,058	$ (16,387)	-44.2%
Energy Services	4,464	4,894	(430)	-8.8%
Total	$ 25,135	$ 41,952	$ (16,817)	-40.1%

Our consolidated revenues for the second quarter 2009 decreased $16.8 million, or 40.1%, compared to the second quarter 2008 due primarily to a decrease in our Energy and Smart Grid Solutions segment revenues, together with a smaller decrease in sales and service revenues of our Energy Services segment.

Our Energy and Smart Grid Solutions segment distributed generation revenues are very heavily affected by the number, size and timing of our Interactive Distributed Generation® projects as well as the percentage of completion of in-process projects, and the percentage of turn-key as opposed to recurring revenue projects. Our Interactive Distributed Generation® sales have fluctuated significantly in the past and are expected to continue to fluctuate significantly in the future. Our Energy and Smart Grid Solutions segment revenues decreased by $16.4 million, or 44.2%, during the second quarter 2009 compared to the second quarter 2008. The decrease in those revenues in the second quarter 2009 over the second quarter 2008 was attributable to a decline in revenues from Publix, our largest customer in the prior period, partially offset by an increase in revenues from our other customers. The following table summarizes our Energy and Smart Grid Solutions segment project-based revenues from Publix and from all other customers for the periods indicated (dollars in thousands):

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	Quarter Ended June 30,		Period-over-Period Difference	
	2009	2008	$	%
Revenues from Publix projects	$ 2,097	$ 19,226	$ (17,129)	-89.1%
Revenues from all other customers	18,574	17,832	742	4.2%
Total	$ 20,671	$ 37,058	$ (16,387)	-44.2%
Publix as a percentage of total Energy and Smart Grid Solutions segment revenues	10.1%	51.9%		

The overall decrease in our Energy and Smart Grid Solutions segment revenues during the second quarter 2009 compared to the second quarter 2008 of $16.4 million was driven by a $17.1 million decrease in revenues from Publix partially offset by a $0.7 million increase in project-based revenues from customers other than Publix. The 89.1% decline in revenues from Publix is due to the completion in 2008 of the majority of the Publix distributed generation systems awarded to us. The 4.2% increase in sales to customers other than Publix was primarily the result of increased revenues from our EfficientLights LED lighting technology products and services. Notwithstanding increases in revenues from our LED lighting products and services, the economic downturn and the liquidity crisis continues to negatively affect the demand for our products and services and the ability of potential customers to finance the purchase of our products and services.

The future level of our revenues will depend on the timing and degree of the recovery of the domestic economy, the health of the credit markets and the return to pre-recession customer spending for capital improvements and energy efficiency, as well as our ability to secure new significant purchase orders. The level and timing of our future revenues will also be affected by the amount and proportion of revenues coming from recurring revenue projects in the future, which results in revenue being recognized over a longer period.

We expect that, in 2009 and beyond, revenues from Publix will continue to constitute a smaller portion of our total revenues than in recent years because we have completed the majority of the Publix distributed generation systems awarded to us, and our anticipated future projects from Publix will generally be implemented over a longer time period, and will be smaller in absolute amount. At present, management expects future Energy and Smart Grid Solutions segment revenues will continue to be negatively impacted by current economic conditions, including the lack of availability of credit which makes it difficult for certain of our customers to finance the purchase of our systems. In addition, some of our customers have indicated they are deferring capital expenditures until economic conditions show indications of improvement. As a result, management expects our Energy and Smart Grid Solutions segment revenues to remain depressed in 2009, and perhaps beyond, depending on how quickly economic conditions stabilize and customers resume pre-recession spending on capital improvements and energy efficiency.

Our Energy Services segment sales and service revenue decreased 8.8%, during the second quarter 2009, as compared to the second quarter 2008, due to a combined decrease in field and service related revenues together with a decrease in equipment sales. The recent decline in market conditions in the oil and gas sector negatively affected our Energy Services segment sales and service revenue during the second quarter 2009, and we expect low natural gas prices to continue to negatively affect our Energy Services segment in the foreseeable future. In addition, our Energy Services revenues are significantly affected by severe weather conditions, the extent of which is unpredictable for any particular period. See Fluctuations below.

Gross Profit and Gross Profit Margins

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

	Quarter Ended June 30,		Period-over-Period Difference	
	2009	2008	$	%
Segment Cost of Sales and Services:				
Energy and Smart Grid Solutions	$ 13,629	$ 24,768	$ (11,139)	-45.0%
Energy Services	3,251	3,384	(133)	-3.9%
Total	$ 16,880	$ 28,152	$ (11,272)	-40.0%
Segment Gross Profit:				
Energy and Smart Grid Solutions	$ 7,042	$ 12,290	$ (5,248)	-42.7%
Energy Services	1,213	1,510	(297)	-19.7%
Total	$ 8,255	$ 13,800	$ (5,545)	-40.2%
Segment Gross Profit Margins:				
Energy and Smart Grid Solutions	34.1%	33.2%		
Energy Services	27.2%	30.9%		
Total	32.8%	32.9%		

Costs of sales and services include materials, personnel and related overhead costs incurred to manufacture products and provide services. The 40.0% decrease in our consolidated cost of sales and services for the second quarter 2009, compared to the second quarter 2008, was attributable almost entirely to the costs avoided associated with the 40.1% decrease in sales.

The 45.0% decrease in our Energy and Smart Grid Solutions segment cost of sales and services in the second quarter 2009 was driven by a 44.2% decrease in our Energy and Smart Grid Solutions segment sales and services revenue, together with factors leading to the improvement in our Energy and Smart Grid Solutions segment gross profit margin. Our Energy and Smart Grid Solutions segment gross profit decreased $5.2 million, or 42.7%, in the second quarter 2009, compared to the second quarter 2008. Additionally, our Energy and Smart Grid Solutions segment gross profit margin increased by 0.9 percentage points in the second quarter 2009 over the second quarter 2008, to 34.1%. A total of $5.4 million of the gross profit decrease was driven by the decline in our Energy and Smart Grid Solutions segment s revenue, partially offset by the positive effects of a $0.2 million reduction in costs taken in response to anticipated negative economic conditions affecting our sales. Specific cost reduction measures taken in 2009 include reductions in construction personnel and other operational spending reductions.

The 3.9% decrease in our Energy Services segment costs of sales and services in the second quarter 2009 is primarily the result of the costs associated with the 8.8% decrease in its sales and service revenues, together with factors that resulted in a decline in our Energy Services segment gross profit margin. Our Energy Services segment gross profit margin decreased to 27.2% for the second quarter 2009, compared to 30.9% during the second quarter 2008. The decline in our Energy Services segment gross profit margin was due to inefficiencies in the utilization of field personnel due to the lower revenues, additional field service vehicle costs, and an increase in small tools and parts costs in the second quarter 2009 as compared to the second quarter 2008. During the second quarter 2009, our Southern Flow subsidiary took additional actions to reduce personnel costs in response to the decline in sales and service revenues. The effects of these cost reductions were not fully realized during the second quarter 2009.

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;
- Our ability to improve our operating efficiency and benefit from economies of scale;
- Our ability to manage our materials and labor costs;
- The geographic density of our projects;
- The mix of higher and lower margin products and services;
- The selling price of our products and services;
- The price of oil and natural gas, the financial health of our customer base, and the level of new oil and natural gas production activity in our operating geography;
- 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; and
- Other factors described below under Fluctuations.

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

Operating Expenses

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

	Quarter Ended June 30,		Period-over-Period Difference	
	2009	2008	$	%
Consolidated Operating Expenses:				
General and administrative	$ 6,006	$ 7,553	$ (1,547)	-20.5%
Selling, marketing and service	969	1,889	(920)	-48.7%
Depreciation and amortization	563	527	36	6.8%
Research and development	66	45	21	46.7%
Total	$ 7,604	$ 10,014	$ (2,410)	-24.1%

Costs related to personnel, including wages, stock compensation, bonuses and commissions, are the most significant component of our operating expenses. During 2008, we expanded our investment in personnel driven by our high levels of revenue, diversification investments in new businesses, and high levels of projects. In anticipation of the current economic recession and in anticipation of a decline in revenues during a significant portion of 2009, we took measures during the third quarter of 2008, and again in the first and second quarters of 2009 to control our costs and reduce our operating expenses. These measures included staff reductions and compensation measures such as reductions in certain bonus plans and other employee incentives, and other sales and general and administrative spending reductions. We expect these cost reduction measures to continue over the near-term in order to address the negative effects of the current economic downturn on our business. Over the long-term, however, we expect demand for our business to expand allowing us to grow our business and to invest in future business opportunities.

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. The 20.5% decrease in our consolidated general and administrative expenses in the second quarter 2009, as compared to the second quarter 2008, was due to cost reductions in corporate expenses and staff reductions and other measures taken at our Energy and Smart Grid Solutions segment to control and reduce our costs. The following table provides further detail of our general and administrative expenses by segment (dollars in thousands):

	Quarter Ended June 30,		Period-over-Period Difference	
	2009	2008	$	%
Segment G&A Expenses:				
Energy and Smart Grid Solutions:				
Personnel costs	$ 2,772	$ 3,850	$ (1,078)	-28.0%
Vehicle lease and rental	450	640	(190)	-29.7%
Insurance	275	258	17	6.6%
Rent-office and equipment	194	207	(13)	-6.3%
Professional fees and consulting	102	112	(10)	-8.9%
Travel	169	249	(80)	-32.1%
Other	346	495	(149)	-30.1%
Energy Services	500	507	(7)	-1.4%
Unallocated Corporate Costs	1,198	1,235	(37)	-3.0%
Total	$ 6,006	$ 7,553	$ (1,547)	-20.5%

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The decrease in our Energy and Smart Grid Solutions segment personnel costs during the second quarter 2009, as compared to the second quarter 2008, was due to staff reductions and other actions taken to reduce costs in anticipation of a decrease in revenues at our PowerSecure subsidiary. Other general and administrative expenses including vehicle lease and rental, professional and consulting fees, travel and other expenses decreased as a result of our specific cost reduction efforts. We expect our Energy and Smart Grid Solutions general and administrative expenses to remain consistent from our second quarter 2009 levels in the near-term as we continue to manage the effects of the current economic recession on our business. Over the long-term, we expect our expenses in these areas to increase at our Energy and Smart Grid Solutions segment as we return to investing and supporting long-term growth.

Our Energy Services segment general and administrative expenses include similar personnel and related overhead costs incurred for the support and administrative functions of our Energy Services segment. The slight decrease in our Energy Services segment general and administrative expense during the second quarter 2009, as compared to the second quarter 2008 was due to similar cost reduction initiatives taken in anticipation of a decrease in revenues at our Southern Flow subsidiary. We expect general and administrative expenses at our Energy Services segment to stabilize or decline slightly from current levels over the near-term. Over the long-term, we expect recent growth initiatives implemented in our Southern Flow subsidiary will increase its revenue growth and expand its markets and business opportunities and will likely result in increased general and administrative expenses in the future.

Unallocated corporate general and administrative expenses include similar personnel costs as described above as well as costs incurred for the benefit of all of our business operations, such as legal, Sarbanes-Oxley, public company reporting, director expenses, accounting costs, and stock compensation expense on our stock options and restricted stock grants which we do not allocate to our operating segments. Overall, these costs decreased during the second quarter 2009 as compared to the second quarter 2008 due to a decline in bonus expense and a reduction of stock compensation expense.

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 48.7% decrease in selling, marketing and service expenses in the second quarter 2009, as compared to the second quarter 2008, was due to reductions in sales compensation expense driven by the current period decline in revenues, advertising and promotion, travel, and a decrease in bad debt expense at our Energy and Smart Grid Solutions segment. The following table provides further detail of our segment selling, marketing and service expenses (dollars in thousands):

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	Quarter Ended June 30,		Period-over-Period Difference	
	2009	2008	$	%
Segment Selling, Marketing and Service:				
Energy and Smart Grid Solutions:				
Salaries	$ 451	$ 562	$ (111)	-19.8%
Commission	280	808	(528)	-65.3%
Travel	126	155	(29)	-18.7%
Advertising and promotion	78	122	(44)	-36.1%
Bad debt expense (recovery)	22	239	(217)	-90.8%
Energy Services	12	3	9	300.0%
Total	$ 969	$ 1,889	$ (920)	-48.7%

In the future, we expect our near-term Energy and Smart Grid Solutions segment selling, marketing and services expenses to stabilize at current levels in the near-term as we continue to manage our costs and have lower commission expense due to lower revenues as a result of the current economic recession, but increase in the long-term to reflect, drive, and support future growth.

Depreciation and Amortization Expenses. Depreciation and amortization expenses include the depreciation of property, plant and equipment and the amortization of certain intangible assets including capitalized software development costs and other intangible assets. The $36, or 6.8%, overall increase in depreciation and amortization expenses in the second quarter 2009, as compared to the second quarter 2008, primarily reflects capital investments at both our Energy and Smart Grid Solutions segment and our Energy Services segment throughout 2008 and early 2009. As a result, we incurred a $28, or 49.1% increase in depreciation and amortization expenses at our Energy Services segment and a $9, or 1.9%, increase at our Energy and Smart Grid Solutions segment in the second quarter 2009, compared to the second quarter 2008.

Research and Development Expenses. Research and development expenses include the cost of materials and payments to consultants related to product design and development at our Energy and Smart Grid Solutions segment. The slight increase in research and development expenses in the second quarter 2009, as compared to the second quarter 2008, reflects an increase in normal product design and prototype costs for certain technologies incurred in each of the respective quarters in 2009 and 2008.

Other Income and Expenses

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

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	Quarter Ended June 30,		Period-over-Period Difference	
	2009	**2008**	**$**	**%**
Other Segment Income and (Expenses):				
Energy and Smart Grid Solutions:				
Interest and other income	$	$ 9	$ (9)	-100.0%
Interest and finance charges	(77)	(27)	(50)	185.2%
Segment total	(77)	(18)	(59)	
Energy Services:				
Management fees	98	164	(66)	-40.2%
Equity income	401	1,227	(826)	-67.3%
Interest and other income		7	(7)	-100.0%
Segment total	499	1,398	(899)	
Unallocated Corporate:				
Interest and other income	38	103	(65)	-63.1%
Interest and finance charges	(68)	(25)	(43)	-172.0%
Income tax benefit (provision)	(26)	(304)	278	91.4%
Segment total	(56)	(226)	170	
Total	$ 366	$ 1,154	$ (788)	

Interest and Other Income. Interest and other income for each segment consists of interest we earn on the interest-bearing portion of our cash and cash equivalent balances. In total, interest and other income decreased $0.1 million during the second quarter 2009, as compared to the second quarter 2008. This decrease was attributable to a decline in our interest income resulting from both a decline in our interest-bearing cash and cash equivalent balances as well as declining interest rates earned on our cash and cash equivalent balances in the second quarter 2009 compared to the second quarter 2008. Our future interest income will depend on our interest-bearing cash and cash equivalent balances, which will increase and decrease depending upon our profit, capital expenditures, and our working capital needs, and future interest rates.

Interest and Finance Charges. Interest and finance charges for each segment consists of interest and finance charges on our credit facilities and capital leases. In total, interest and finance charges increased $.01 million during the second quarter 2009, as compared to the second quarter 2008. The increase in our unallocated corporate interest and finance charges reflects the unused revolving credit facility fee and amortization of our finance charges incurred on our credit facility. The increase in our Energy and Smart Grid Solutions segment interest and finance charges reflects interest and amortized finance charges on a $5.9 million capital lease obligation which we entered into in December 2008 to finance certain recurring revenue projects. We expect our future interest and finance charges to increase over time as a result of anticipated borrowings under our credit facility to fund anticipated future recurring revenue projects at our Energy and Smart Grid Solutions segment.

Management Fees. Management fees at our Energy Services segment consist entirely of fees we earn as the managing trustee of the WaterSecure operations. These fees, to a large extent, are based on a percentage of the revenues of the WaterSecure operations. Due to the continued economic downturn and the significant reduction in oil prices during early 2009 compared to 2008, the current market conditions in the oil and gas sector have substantially weakened in 2009 compared to 2008 and have negatively affected the revenues of the WaterSecure operations in 2009. As a direct result, our Energy Services segment management fees decreased in the second quarter 2009 by 40.2% compared to the second quarter 2008.

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Equity Income. Equity income at our Energy Services segment consists of our minority ownership interest in the earnings of the WaterSecure operations. Our equity income is a direct function of the net income of the WaterSecure operations as well as changes in our ownership interest. During the second quarter 2009, our equity income decreased by $0.9 million, or 67.3%, over the second quarter 2008. The performance of the WaterSecure operations, and our related equity income, was negatively affected by soft market conditions in the oil and gas sector generally, and in the region in which it operates during the second quarter 2009. Accordingly, notwithstanding a small increase in our ownership interest that was acquired in July 2008, our equity income decreased during the second quarter 2009, as compared to the second quarter 2008.

Income Taxes. We account for income taxes in accordance with Financial Accounting Standards (FAS) No. 109, Accounting for Income Taxes (FAS 109), and Financial Accounting Standard Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109 (FIN 48). Under the provisions of FAS 109, a deferred tax liability or asset (net of a valuation allowance) is provided in our financial statements by applying the provisions of applicable laws to measure the deferred tax consequences of temporary differences that will result in net taxable or deductible amounts in future years as a result of events recognized in the financial statements in the current or preceding years. Our income tax benefit or provision includes the effects of changes in the valuation allowance for our net deferred tax asset, state income taxes in various state jurisdictions in which we have taxable activities, federal alternative minimum tax, expenses associated with uncertain tax positions that we have taken or expense reductions from tax positions as a result of a lapse of the applicable statute of limitations. The decrease in our the second quarter 2009 income tax provision compared to our the second quarter 2008 income tax provision was due to the decline in our net income during second quarter 2009 compared to the second quarter 2008, and the resulting decreases in both our federal alternative minimum tax and state income tax.

Six Month Period 2009 Compared to Six Month Period 2008

Revenues

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

	Six Months Ended June 30,		**Period-over-Period Difference**	
	2009	**2008**	**$**	**%**
Segment Revenues:				
Energy and Smart Grid Solutions	$ 35,886	$ 66,164	$ (30,278)	-45.8%
Energy Services	8,969	9,363	(394)	-4.2%
Total	$ 44,855	$ 75,527	$ (30,672)	-40.6%

Our consolidated revenues for the six month period 2009 decreased $30.7 million, or 40.6%, compared to the six month period 2008 due primarily to a decrease in our Energy and Smart Grid Solutions segment revenues, together with a smaller decrease in sales and service revenues of our Energy Services segment.

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Our Energy and Smart Grid Solutions segment distributed generation revenues are very heavily affected by the number, size and timing of our Interactive Distributed Generation® projects as well as the percentage of completion of in-process projects, and the percentage of turn-key as opposed to recurring revenue projects. Our Interactive Distributed Generation® sales have fluctuated significantly in the past and are expected to continue to fluctuate significantly in the future. Our Energy and Smart Grid Solutions segment revenues decreased by $30.3 million, or 45.8%, during the six month period 2009 compared to the six month period 2008. The decrease in those revenues in the six month period 2009 over the six month period 2008 was attributable to a decline in revenues from Publix, our largest customer, along with the combination of the difficult economic environment, the uncertain regulatory environment, and the crisis in the capital markets which reduced capital spending by our customers. The decline in revenues from Publix is due to the completion in 2008 of the majority of the Publix distributed generation systems awarded to us. The continued economic downturn and the liquidity crisis negatively affected the demand for our products and services and the ability of potential customers to finance the purchase of our products and services.

The following table summarizes our Energy and Smart Grid Solutions segment project-based revenues from Publix and from all other customers for the periods indicated (dollars in thousands):

	Six Months Ended June 30,		**Period-over-Period Difference**	
	2009	**2008**	**$**	**%**
Revenues from Publix projects	$ 4,139	$ 33,091	$ (28,952)	-87.5%
Revenues from all other customers	31,747	33,073	(1,326)	-4.0%
Total	$ 35,886	$ 66,164	$ (30,278)	-45.8%
Publix as a percentage of total Energy and Smart Grid Solutions segment revenues	11.5%	50.0%		

The overall decrease in our Energy and Smart Grid Solutions segment revenues during the six month period 2009 compared to the six month period 2008 of $30.3 million was driven by a $29.0 million decrease in revenues from Publix together with a $1.3 million decrease in project-based revenues from customers other than Publix.

The future level of our revenues will depend on the timing and degree of the recovery of the domestic economy, the health of the credit markets and the return to pre-recession customer spending for capital improvements and energy efficiency, as well as our ability to secure new significant purchase orders. The level and timing of our future revenues will also be affected by the amount and proportion of future recurring revenue projects, which sacrifices near-term revenue for long-term annual recurring revenues in the future.

We expect that, in 2009 and beyond, revenues from Publix will continue to constitute a smaller portion of our total revenues than in recent years because we have completed the majority of the Publix distributed generation systems awarded to us, and our anticipated future projects from Publix will generally be implemented over a longer time period, and will be smaller in absolute amount. At present, management expects future Energy and Smart Grid Solutions segment revenues will continue to be negatively impacted by current economic conditions including the lack of availability of credit which

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makes it difficult for certain of our customers to finance the purchase of our systems. In addition, some of our customers have indicated they are deferring capital expenditures until economic conditions show indications of improvement. As a result, management expects our Energy and Smart Grid Solutions segment revenues to remain depressed in 2009, and perhaps beyond, depending on how quickly economic conditions stabilize and customers resume pre-recession spending on capital improvements and energy efficiency.

Our Energy Services segment sales and service revenue decreased by $0.4 million, or 4.2%, during the six month period 2009, as compared to the six month period 2008, due to a decrease in both field and service related revenues and a decrease in equipment sales. The recent decline in market conditions in the oil and gas sector negatively affected our Energy Services segment sales and service revenue during the six month period 2009, and we expect low natural gas prices to continue to negatively affect our Energy Services segment in the foreseeable future. In addition, our Energy Services revenues are significantly affected by severe weather conditions, the extent of which is unpredictable for any particular period. See Fluctuations below.

Gross Profit and Gross Profit Margins

The following tables summarizes our segment costs of sales along with our segment gross profits and gross profit margins for the periods indicated (dollars in thousands):

	Six Months Ended June 30,		Period-over-Period Difference	
	2009	**2008**	**$**	**%**
Segment Cost of Sales and Services:				
Energy and Smart Grid Solutions	$ 24,070	$ 45,071	$ (21,001)	-46.6%
Energy Services	6,656	6,636	20	0.3%
Total	$ 30,726	$ 51,707	$ (20,981)	-40.6%
Segment Gross Profit:				
Energy and Smart Grid Solutions	$ 11,816	$ 21,093	$ (9,277)	-44.0%
Energy Services	2,313	2,727	(414)	-15.2%
Total	$ 14,129	$ 23,820	$ (9,691)	-40.7%
Segment Gross Profit Margins:				
Energy and Smart Grid Solutions	32.9%	31.9%		
Energy Services	25.8%	29.1%		
Total	31.5%	31.5%		

The 40.6% decrease in our consolidated cost of sales and services for the six month period 2009, compared to the six month period 2008, was attributable almost entirely to the costs avoided associated with the 40.6% decrease in sales.

The 46.6% decrease in our Energy and Smart Grid Solutions segment cost of sales and services in the six month period 2009 was driven by a 45.8% decrease in our Energy and Smart Grid Solutions segment sales and services revenue, together with factors leading to the improvement in our Energy and Smart Grid Solutions segment gross profit margin. Our Energy and Smart Grid Solutions segment gross profit decreased $9.3 million, or 44.0%, in the six month period 2009, compared to the six month period 2008. Additionally, our Energy and Smart Grid Solutions segment gross profit margin increased by 1.0

percentage points in the six month period 2009 over the six month period 2008, to 32.9%. A total of $9.7 million of the gross profit decrease was driven by the decline in our Energy and Smart Grid Solutions segment s revenue, partially offset by the positive effects of a $0.4 million reduction in costs taken in response to anticipated negative economic conditions affecting our sales. Specific cost reduction measures taken in 2009 include reductions in construction personnel and other operational spending reductions.

The 0.3% increase in our Energy Services segment costs of sales and services in the six month period 2009, notwithstanding the decline in its sales and service revenues, is the result of factors that resulted in a decline in our Energy Services segment gross profit margin. Our Energy Services segment gross profit margin decreased to 25.8% for the six month period 2009, compared to 29.1% during the six month period 2008. The decline in our Energy Services segment gross profit margin was due to inefficiencies in the utilization of field personnel due to the lower revenues, additional field service vehicle costs, and an increase in small tools and parts costs in the six month period 2009 as compared to the six month period 2008. During the second quarter 2009, our Southern Flow subsidiary took actions to reduce personnel costs in response to the decline in sales and service revenues. The effects of these cost reductions were not fully realized during the six month period 2009.

*Operating Expense*s

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

	Six Months Ended June 30,		**Period-over-Period Difference**	
	2009	**2008**	**$**	**%**
Consolidated Operating Expenses:				
General and administrative	$ 12,026	$ 14,796	$ (2,770)	-18.7%
Selling, marketing and service	1,800	3,214	(1,414)	-44.0%
Depreciation and amortization	1,105	984	121	12.3%
Research and development	86	64	22	34.4%
Total	$ 15,017	$ 19,058	$ (4,041)	-21.2%

During the six month period 2008, we expanded our investment in personnel driven by our high levels of revenue, diversification investments in new businesses, and high levels of projects. In anticipation of the current economic recession and in anticipation of a decline in revenues during a significant portion of 2009, we took measures during the third quarter of 2008, and again in the first and second quarters of 2009 to control our costs and reduce our operating expenses. These measures included staff reductions and compensation measures such as reductions in certain bonus plans and other employee incentives, and other sales and general and administrative spending reductions. We expect these cost reduction measures to continue over the near-term in order to address the negative effects of the current economic downturn on our business. Over the long-term, however, we expect demand for our business to expand allowing us to grow our business and to invest in future business opportunities.

General and Administrative Expenses. The 18.7% decrease in our consolidated general and administrative expenses in the six month period 2009, as compared to the six month period 2008, was due to cost reductions in corporate expenses and staff reductions and other measures taken at our Energy and Smart Grid Solutions segment to control and reduce our costs. The following table provides further detail of our general and administrative expenses by segment (dollars in thousands):

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	Six Months Ended June 30,		Period-over-Period Difference	
	2009	2008	$	%
Segment G&A Expenses:				
Energy and Smart Grid Solutions:				
Personnel costs	$ 5,694	$ 7,324	$ (1,630)	-22.3%
Vehicle lease and rental	773	1,119	(346)	-30.9%
Insurance	541	457	84	18.4%
Rent-office and equipment	361	449	(88)	-19.6%
Professional fees and consulting	145	339	(194)	-57.2%
Travel	355	455	(100)	-22.0%
Other	832	1,133	(301)	-26.6%
Energy Services	1,014	929	85	9.1%
Unallocated Corporate Costs	2,311	2,591	(280)	-10.8%
Total	$ 12,026	$ 14,796	$ (2,770)	-18.7%

The decrease in our Energy and Smart Grid Solutions segment personnel costs during the six month period 2009, as compared to the six month period 2008, was due to staff reductions and other actions taken to reduce costs in anticipation of a decrease in revenues at our PowerSecure subsidiary. Other general and administrative expenses including vehicle lease and rental, professional and consulting fees, travel and other expenses decreased as a result of our specific cost reduction efforts. We expect our Energy and Smart Grid Solutions general and administrative expenses to remain consistent from our six month period 2009 levels in the near-term as we continue to manage the effects of the current economic recession on our business. Over the long-term, we expect our expenses in these areas to increase at our Energy and Smart Grid Solutions segment as we return to investing and supporting long-term growth.

The increase in our Energy Services segment general and administrative expense during the six month period 2009, as compared to the six month period 2008 was due to investments in additional personnel to support growth initiatives in the operations of our Southern Flow subsidiary. We expect general and administrative expenses at our Energy Services segment to decline slightly from current levels over the near-term as cost reduction actions taken in the second quarter 2009 take effect. Over the long-term, we expect recent growth initiatives implemented in our Southern Flow subsidiary will reverse its revenue decline and expand its markets and business opportunities and will likely result in increased general and administrative expenses in the future.

The decrease in unallocated corporate costs during the six month period 2009 as compared to the six month period 2008 is due to a decline in bonus expense and a reduction of stock compensation expense.

Selling, Marketing and Service Expenses. The 44.0% decrease in selling, marketing and service expenses in the six month period 2009, as compared to the six month period 2008, was due to reductions in sales compensation expense driven by the current period decline in revenues, advertising and promotion, travel, and a decrease in bad debt expense at our Energy and Smart Grid Solutions segment. The following table provides further detail of our segment selling, marketing and service expenses (dollars in thousands):

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	Six Months Ended June 30,		Period-over-Period Difference	
	2009	2008	$	%
Segment Selling, Marketing and Service:				
Energy and Smart Grid Solutions:				
Salaries	$ 907	$ 1,098	$ (191)	-17.4%
Commission	498	1,312	(814)	-62.0%
Travel	256	324	(68)	-21.0%
Advertising and promotion	114	223	(109)	-48.9%
Bad debt expense (recovery)	8	251	(243)	-96.8%
Energy Services	17	6	11	183.3%
Total	$ 1,800	$ 3,214	$ (1,414)	-44.0%

In the future, we expect our near-term Energy and Smart Grid Solutions segment selling, marketing and services expenses to stabilize at current levels in the near-term as we continue to manage our costs and have lower commission expense due to lower revenues as a result of the current economic recession, but increase in the long-term to reflect, drive, and support future growth.

Depreciation and Amortization Expenses. The 12.3% increase in depreciation and amortization expenses in the six month period 2009, as compared to the six month period 2008, primarily reflects an increase in depreciable assets acquired by our Energy and Smart Grid Solutions segment throughout 2008, including capital expenditures related to Interactive Distributed Generation® systems installed for sales under our recurring revenue model. Primarily as a result of the above, our Energy and Smart Grid Solutions segment depreciation and amortization expenses increased in the six month period 2009 by $71, or 8.2%, compared to the six month period 2008. Depreciation and amortization expense at our Energy Services segment also increased in the six month period 2009 by $51, or 44.7%, compared to the six month period 2008 due to capital investments late in 2008 and early 2009 to support growth initiatives.

Research and Development Expenses. The slight increase in research and development expenses in the six month period 2009, as compared to the six month period 2008, reflects an increase in normal product design and prototype costs for certain technologies incurred in each of the respective periods in 2009 and 2008.

Other Income and Expenses

The following table sets forth our other income and expenses for the periods indicated, by segment (dollars in thousands):

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	Six Months Ended June 30,		Period-over-Period Difference	
	2009	2008	$	%
Other Segment Income and (Expenses):				
Energy and Smart Grid Solutions:				
Interest and other income	$ 3	$ 40	$ (37)	-92.5%
Interest and finance charges	(185)	(54)	(131)	242.6%
Segment total	(182)	(14)	(168)	
Energy Services:				
Management fees	203	313	(110)	-35.1%
Equity income	878	2,191	(1,313)	-59.9%
Interest and other income		24	(24)	-100.0%
Segment total	1,081	2,528	(1,447)	
Unallocated Corporate:				
Interest and other income	88	281	(193)	-68.7%
Interest and finance charges	(134)	(49)	(85)	-173.5%
Income tax benefit (provision)	(50)	(616)	566	91.9%
Segment total	(96)	(384)	288	
Total	$ 803	$ 2,130	$ (1,327)	

Interest and Other Income. In total, interest and other income decreased $0.3 million during the six month period 2009, as compared to the six month period 2008. This decrease was attributable to a decline in our interest income resulting from both a decline in our interest-bearing cash and cash equivalent balances as well as declining interest rates earned on our cash and cash equivalent balances in the six month period 2009 compared to the six month period 2008. Our future interest income will depend on our interest-bearing cash and cash equivalent balances, which will increase and decrease depending upon our profit, capital expenditures, and our working capital needs, and future interest rates.

Interest and Finance Charges. In total, interest and finance charges increased $0.2 million during the six month period 2009, as compared to the six month period 2008. The increase in our unallocated corporate interest and finance charges reflects the unused revolving credit facility fee and amortization of our finance charges incurred on our credit facility. The increase in our Energy and Smart Grid Solutions segment interest and finance charges reflects interest and amortized finance charges on a $5.9 million capital lease obligation which we entered into in December 2008 to finance certain recurring revenue projects. We expect our future interest and finance charges to increase over time as a result of anticipated borrowings under our credit facility to fund anticipated future recurring revenue projects at our Energy and Smart Grid Solutions segment.

Management Fees. These fees, to a large extent, are based on a percentage of the revenues of the WaterSecure operations. Due to the continued economic downturn and the significant reduction in oil prices during early 2009 compared to 2008, the current market conditions in the oil and gas sector have substantially weakened in 2009 compared to 2008 and have negatively affected the revenues of the WaterSecure operations in 2009. As a direct result, our Energy Services segment management fees decreased in the six month period 2009 by 35.1% compared to the six month period 2008.

Equity Income. During the six month period 2009, our equity income decreased by $1.3 million, or 59.9%, over the six month period 2008. The performance of the WaterSecure operations, and our related equity income, was negatively affected by soft market conditions in the oil and gas sector generally, and in the region in which it operates during the six month period 2009. Accordingly, notwithstanding a small increase in our ownership interest that was acquired in July 2008, our equity income decreased during the six month period 2009, as compared to the six month period 2008.

Income Taxes. The decrease in our the six month period 2009 income tax provision compared to our the six month period 2008 income tax provision was due to our net loss in the six month period 2009 compared to our net income in the six month period 2008, and the resulting decreases in both our federal alternative minimum tax and state income tax.

Fluctuations

Our revenues, expenses, margins, net income, cash flow 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. These factors include, without limitation, the following:

- the effects of general economic conditions, including the current significant downturn in the economy and financial crisis in the capital and credit markets, and the strong likelihood of continuing future economic and market challenges negatively impacting our business and our revenues and profit, including the negative impact these conditions will have on the timing of and amounts of orders from our customers, and on our access to capital to finance our business;

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

- our ability to continue to grow our business and generate increased revenues from customers other than Publix, our largest customer from 2006-2008, and our ability to replace the revenues from Publix with new revenue streams;

- our ability to increase our revenues through long-term recurring revenue projects, recognizing that increased revenues from recurring revenue projects requires significant up-front capital expenditures and protracts revenue and profit recognition, while increasing gross margins over the long-term; as well as our ability to sell, complete, and recognize satisfactory levels of quarterly revenue and profits related to our project-based sales, in order to maintain current profits, cash flow, and covenants related to our debt facilities and successfully finance the recurring portion of our business model;

- 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, and fluctuations in the cost of raw materials and commodity prices;

- 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 ownership of the systems;

- our ability to access significant capital resources on a timely basis in order to fulfill large customer orders and finance capital required for recurring revenue 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;

the timing, pricing and market acceptance of our new products and services;

changes in our pricing policies and those of our competitors;

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

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

changes in our operating expenses, including unforeseen or unanticipated expenses;

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

the effects of severe weather conditions, such as hurricanes, on the business opera