

METRETEK TECHNOLOGIES INC

Form 10-Q

May 10, 2007

**Table of Contents**

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

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended March 31, 2007**

**or**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number 0-19793**

**METRETEK TECHNOLOGIES, 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)  
303 East 17<sup>th</sup> Avenue, Suite 660, Denver, Colorado 80203  
(Former name or former address, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No   
As of May 1, 2007, 15,920,382 shares of the issuer's Common Stock were outstanding.

**METRETEK TECHNOLOGIES, INC.**  
**FORM 10-Q**  
**For the Quarterly Period Ended March 31, 2007**  
**TABLE OF CONTENTS**

	Page	
<b><u>PART I.</u></b>	<b><u>FINANCIAL INFORMATION</u></b>	
<b><u>Item 1.</u></b>	<b><u>Financial Statements</u></b>	
	<u>Unaudited Consolidated Balance Sheets March 31, 2007 and December 31, 2006</u>	3
	<u>Unaudited Consolidated Statements of Operations For the Three Months Ended March 31, 2007 and March 31, 2006</u>	5
	<u>Unaudited Consolidated Statements of Cash Flows For the Three Months Ended March 31, 2007 and March 31, 2006</u>	6
	<u>Notes to Unaudited Consolidated Financial Statements</u>	7
<b><u>Item 2.</u></b>	<b><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	18
<b><u>Item 3.</u></b>	<b><u>Quantitative and Qualitative Disclosures about Market Risk</u></b>	37
<b><u>Item 4.</u></b>	<b><u>Controls and Procedures</u></b>	37
<b><u>PART II.</u></b>	<b><u>OTHER INFORMATION</u></b>	
<b><u>Item 1.</u></b>	<b><u>Legal Proceedings</u></b>	39
<b><u>Item 1A.</u></b>	<b><u>Risk Factors</u></b>	39
<b><u>Item 6.</u></b>	<b><u>Exhibits</u></b>	39
<b><u>Signatures</u></b>		40
<u>EX-31.1</u>		
<u>EX-31.2</u>		
<u>EX-32.1</u>		
<u>EX-32.2</u>		

**Table of Contents**

**PART I.**  
**FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**METRETEK TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**Consolidated Balance Sheets**  
**(unaudited)**

	<b>March 31,</b> <b>2007</b>	<b>December 31,</b> <b>2006</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 14,948,763	\$ 15,916,460
Trade receivables, net of allowance for doubtful accounts of \$155,554 and \$225,004, respectively	32,249,762	40,255,372
Other receivables	582,892	431,437
Inventories	16,234,528	12,882,167
Deferred income taxes	231,990	231,990
Prepaid expenses and other current assets	591,346	818,583
Total current assets	64,839,281	70,536,009
<b>PROPERTY, PLANT AND EQUIPMENT:</b>		
Equipment	6,678,362	6,524,549
Vehicles	173,408	166,894
Furniture and fixtures	528,690	568,212
Land, building and improvements	1,077,244	1,073,625
Total property, plant and equipment, at cost	8,457,704	8,333,280
Less accumulated depreciation and amortization	3,920,966	3,889,401
Property, plant and equipment, net	4,536,738	4,443,879
<b>OTHER ASSETS:</b>		
Goodwill	9,146,409	9,146,409
Intangible rights and capitalized software costs, net of accumulated amortization of \$1,673,341 and \$1,543,024, respectively	1,801,587	1,763,970
Investment in unconsolidated affiliate	3,602,992	3,513,501
Assets of discontinued operations	144,490	144,490
Other assets	162,667	151,177
Total other assets	14,858,145	14,719,547

<b>TOTAL</b>	\$ 84,234,164	\$ 89,699,435
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*See accompanying notes to unaudited consolidated financial statements.*

3

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**Table of Contents**

**METRETEK TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**Consolidated Balance Sheets**  
**(unaudited)**

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 6,078,605	\$ 15,090,540
Accrued and other liabilities	17,439,952	16,026,867
Current income taxes payable	60,967	570,217
Current unrecognized tax benefit	62,406	
Capital lease obligations	3,486	4,749
Total current liabilities	23,645,416	31,692,373
<b>LONG-TERM NOTES PAYABLE</b>		
<b>NON-CURRENT CAPITAL LEASE OBLIGATIONS</b>	6,380	7,431
<b>NON-CURRENT UNRECOGNIZED TAX BENEFIT</b>	285,117	
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>STOCKHOLDERS EQUITY:</b>		
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; 15,910,590 and 15,808,634 shares issued and outstanding, respectively	159,106	158,086
Additional paid-in-capital	102,698,310	102,287,543
Accumulated deficit	(42,560,165)	(44,445,998)
Total stockholders equity	60,297,251	57,999,631
<b>TOTAL</b>	<b>\$ 84,234,164</b>	<b>\$ 89,699,435</b>

*See accompanying notes to unaudited consolidated financial statements.*

Table of Contents

**METRETEK TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Operations**  
**(unaudited)**

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2007</b>	<b>2006</b>
<b>REVENUES:</b>		
Sales and services	\$ 26,368,744	\$ 14,736,874
Other	610,485	95,455
Total revenues	26,979,229	14,832,329
<b>COSTS AND EXPENSES:</b>		
Cost of sales and services	18,417,233	10,131,362
General and administrative	5,524,079	3,435,349
Selling, marketing and service	864,283	759,061
Depreciation and amortization	342,924	172,406
Research and development	210,791	177,626
Interest, finance charges and other	7,320	88,375
Total costs and expenses	25,366,630	14,764,179
Income from operations	1,612,599	68,150
Income from litigation settlements, net	278,334	
Equity in income of unconsolidated affiliate	648,560	730,468
Minority interest		(72,464)
Income taxes	(306,137)	(88,515)
<b>Net Income</b>	<b>\$ 2,233,356</b>	<b>\$ 637,639</b>
<b>EARNINGS PER SHARE AMOUNTS (Note 1):</b>		
Basic	\$ 0.14	\$ 0.05
Diluted	\$ 0.13	\$ 0.04
<b>WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:</b>		
Basic	15,830,475	13,183,784

Diluted

17,020,123

15,151,903

*See accompanying notes to unaudited consolidated financial statements.*

5

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**Table of Contents**

**METRETEK TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Cash Flows**  
**(unaudited)**

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2007</b>	<b>2006</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 2,233,356	\$ 637,639
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	342,924	172,406
Minority interest in subsidiary		72,464
Deferred income taxes	(509,250)	
Loss on disposal of property, plant and equipment	63,806	4,144
Equity in income of unconsolidated affiliate	(648,560)	(730,468)
Distributions from unconsolidated affiliate	543,944	
Stock compensation expense	208,910	147,207
Changes in other assets and liabilities:		
Trade receivables, net	8,005,610	(5,609,567)
Inventories	(3,352,361)	(2,735,758)
Other current assets	75,782	(41,311)
Other noncurrent assets	(11,490)	(49,469)
Accounts payable	(9,011,935)	1,578,785
Accrued and other liabilities	1,633,271	4,246,566
Net cash used in continuing operations	(425,993)	(2,307,362)
Net cash provided by discontinued operations of MCM		32,222
Net cash used in operating activities	(425,993)	(2,275,140)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property, plant and equipment	(344,608)	(399,820)
Additions to intangible rights and software development	(177,473)	(27,918)
Investment in unconsolidated affiliate		(1,246,359)
Proceeds from sale of property, plant and equipment		15,300
Net cash used in investing activities	(522,081)	(1,658,797)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from stock warrant and option exercises	202,877	2,282,777
Net borrowings on line of credit		685,800
Principal payments on long-term notes payable		(311,546)
Payments on preferred stock redemptions	(220,186)	(33,762)
Payments on capital lease obligations	(2,314)	(931)
Net cash provided by (used in) financing activities	(19,623)	2,622,338

NET DECREASE IN CASH AND CASH EQUIVALENTS	(967,697)	(1,311,599)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	15,916,460	2,188,310
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 14,948,763	\$ 876,711

*See accompanying notes to unaudited consolidated financial statements.*

6

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**Table of Contents**

**METRETEK TECHNOLOGIES, INC. AND SUBSIDIARIES**

**Notes to Unaudited Consolidated Financial Statements**

As of March 31, 2007 and December 31, 2006 and

For the Three Month Periods Ended March 31, 2007 and 2006

**1. Summary of Significant Accounting Policies**

**Organization** The accompanying consolidated financial statements include the accounts of Metretek Technologies, Inc. and its subsidiaries, primarily Southern Flow Companies, Inc. ( Southern Flow ), PowerSecure, Inc. ( PowerSecure ) (and its wholly-owned subsidiaries, UtilityEngineering, Inc., PowerServices, Inc., EnergyLite, Inc. and Reid s Trailer, Inc.), Metretek, Incorporated ( Metretek Florida ) (and its majority-owned subsidiary, Metretek Contract Manufacturing Company, Inc. ( MCM )), and Marcum Gas Transmission, Inc. ( MGT ) (and its majority-owned subsidiary, Conquest Acquisition Company LLC ( CAC LLC )), collectively referred to as the Company or we or us 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 the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

In the opinion of the Company s management, 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 the Company and its subsidiaries as of March 31, 2007 and the consolidated results of their operations and cash flows for the three month periods ended March 31, 2007 and March 31, 2006.

**Basic and Diluted Earnings Per Share** Earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the period on a basic and diluted basis. Diluted earnings per share reflects the potential dilution that would occur if stock options and warrants were exercised using the average market price for the Company s stock for the period. Diluted earnings per share excludes the impact of potential common shares related to stock options and warrants in periods in which the option or warrant exercise price is greater than the average market price of the Company s common stock during the period. The following table sets forth the calculation of basic and diluted earnings per share:

**Table of Contents**

	<b>Three Months Ended March</b>	
	<b>31,</b>	
	<b>2007</b>	<b>2006</b>
Net income attributable to common shareholders	\$ 2,233,356	\$ 637,639
Basic weighted-average common shares outstanding in period	15,830,475	13,183,784
Add dilutive effects of stock options and warrants	1,189,648	1,968,119
Diluted weighted-average common shares outstanding in period	17,020,123	15,151,903
Earnings per common share:		
Basic earnings per common share	\$ 0.14	\$ 0.05
Diluted earnings per common share	\$ 0.13	\$ 0.04

**Statement of Cash Flows** Cash and all highly liquid and unrestricted 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. The Company maintains its cash in bank deposit accounts, which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company does not believe it is exposed to any significant credit risk on cash and cash equivalents.

**Minority Interest** The minority shareholder's interest in the equity and the income of CAC LLC for the three month ended March 31, 2006, is included in minority interest in the accompanying consolidated financial statements. The minority shareholders' interest in CAC LLC was distributed in April 2006 and the separate operating activities of CAC LLC ceased at that time.

**Financial Instruments** Effective January 1, 2007, the Company adopted the provisions of Financial Accounting Standards ( FAS ) No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140 ( FAS 155 ). FAS 155 eliminates the exemption from applying FAS 133, Accounting for Derivative Instruments and Hedging Activities, to interests in securities financial assets. The adoption of FAS 155 had no effect on the Company's financial position or results of operations.

**Fair Value Measurements** Effective January 1, 2007, the Company adopted the provisions of FAS No. 157, Fair Value Measurements ( FAS 157 ). FAS 157 Defines fair value to measure assets and liabilities, establishes a framework for measuring fair value, and requires additional disclosures about the use of fair value. FAS 157 is applicable whenever another accounting pronouncement requires or permits assets and liabilities to be measured at fair value. FAS 157 does not expand or require any new fair value measures. The adoption of FAS 157 had no effect on the Company's financial position or results of operations.

**Reclassification** Certain 2006 amounts have been reclassified to conform to current

**Table of Contents**

year presentation. Such reclassifications had no impact on the Company's net income or stockholders' equity.

**2. Investment in Unconsolidated Affiliate**

The Company owns a 36.26% equity interest in MM 1995-2, which the Company accounts for under the equity method. MM 1995-2 owns and operates five water disposal wells located at four facilities in northeastern Colorado. The Company's equity investment balance includes approximately \$764,000 and \$780,000 of unamortized purchase price premiums in interest acquired at March 31, 2007 and December 31, 2006, respectively. The purchase price premiums are being amortized over a period of 14 years, which represents the weighted average useful life of the underlying assets acquired.

Summarized financial information for MM 1995-2 at March 31, 2007 and December 31, 2006 and for the three months ended March 31, 2007 and 2006, are as follows:

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
Total current assets	\$ 3,048,284	\$ 2,816,175
Property, plant and equipment, net	5,670,555	5,828,718
Total other assets	9,499	9,833
 Total assets	 \$ 8,728,338	 \$ 8,654,726
 Total current liabilities	 \$ 1,014,430	 \$ 1,081,382
Long-term note payable	193,214	341,142
Total shareholders' equity	7,520,694	7,232,202
 Total liabilities and shareholders' equity	 \$ 8,728,338	 \$ 8,654,726
	 <b>Three Months Ended March 31, 2007</b>	 <b>2006</b>
Total revenues	\$ 3,145,449	\$ 2,930,174
Total costs and expenses	1,356,957	1,118,141
 Net income	 \$ 1,788,492	 \$ 1,812,033

**3. Income Taxes**

On January 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes by prescribing a minimum recognition threshold for a tax position taken or expected to be taken in a tax return that is required to be met before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties,

**Table of Contents**

accounting in interim periods, disclosure and transition. At January 1, 2007, the total amount of unrecognized tax benefits for open tax years dating back to 2003 was approximately \$3.4 million, nearly all of which, if recognized would affect our effective tax rate. The cumulative effect of adopting FIN 48 of \$348,000 was recorded as an increase to accumulated deficit, which includes interest and penalties of \$107,000. We recognize interest and penalties related to our tax contingencies as income tax expense. The total liabilities for unrecognized tax benefits relate primarily to the allocation of costs among our operating subsidiaries.

**4. Share-Based Compensation**

The Company accounts for share-based compensation in accordance with FAS No. 123 (Revised 2004), Share-Based Payment ( FAS 123(R) ), which it adopted January 1, 2006, using the modified prospective transition method. Under FAS 123(R) compensation cost for all stock-based awards is measured at the fair value on date of grant and recognized over the service period for awards expected to vest, net of estimated forfeitures. The fair value of restricted stock is determined based on the number of shares granted and the quoted price of the Company's common stock, and the fair value of stock options is determined using the Black-Scholes valuation model.

The Company maintains stock plans under which the Company may grant stock awards, incentive stock options, and nonqualified stock options to employees and officers, consultants, and non-employee directors. Nonqualified stock options have been granted in prior years to the Company's directors (which currently vest over two years) under both our 1991 Directors' Stock Plan and under the Company's 1998 Stock Plan. Nonqualified and incentive stock options have been granted in prior years to the Company's officers and employees (which generally vest over periods up to five years) under the Company's 1991 Stock Option Plan and the Company's 1998 Stock Plan. At March 31, 2007, there were 772,033 options available for grant under the Company's 1998 Stock Plan, while no options can be granted in the future under the Company's 1991 Stock Plans.

Pursuant to the requirements of FAS 123(R), net income for the three months ended March 31, 2007 and 2006 includes \$208,910 and \$130,707 of compensation costs, respectively, related to outstanding stock options and \$0 and \$16,500, respectively, of compensation costs related to restricted stock awards that vested during the period. There were no net income tax benefits related to the Company's stock-based compensation arrangements during the three months ended March 31, 2007 and 2006 because a valuation allowance has been provided for 100% of the Company's net deferred tax assets. All of the stock-based compensation expense is included in general and administrative expenses for each reporting period.

**Table of Contents**

A summary of option activity for the three months ended March 31, 2007 is as follows:

	<b>Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Term (years)</b>	<b>Aggregate Intrinsic Value</b>
Balance, December 31, 2006	2,085,344	\$ 4.61		
Granted				
Exercised	(106,549)	2.37		
Canceled				
Forfeited	(2,500)	3.06		
Balance, March 31, 2007	1,976,295	\$ 4.73	6.45	\$ 8.61
Exercisable, March 31, 2007	1,502,045	\$ 3.28	5.80	\$ 10.06

A summary of option activity for the three months ended March 31, 2006 is as follows:

	<b>Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Term (years)</b>	<b>Aggregate Intrinsic Value</b>
Balance, December 31, 2005	2,289,143	\$ 2.98		
Granted	140,000	10.63		
Exercised	(242,951)	2.09		
Canceled				
Forfeited				
Balance, March 31, 2006	2,186,192	\$ 3.57	6.93	\$ 11.38
Exercisable, March 31, 2006	1,685,358	\$ 2.95	6.26	\$ 12.00

There were no options granted during the three months ended March 31, 2007. The weighted average grant date fair value of the 140,000 options granted during the three months ended March 31, 2006 was \$6.95. The fair value was measured using the Black-Scholes valuation model with the following assumptions: expected stock price volatility of 88%; risk free interest rate of 4.35%; no dividends; and an expected future life of four years. The fair value of the stock option grants are amortized over the four year vesting period using the straight-line method and assuming a forfeiture rate of 5%.

As of March 31, 2007 and December 31, 2006, there was \$2,297,000 and \$2,507,000, respectively, of total unrecognized compensation costs related to stock options. These costs at March 31, 2007 are expected to be recognized over a weighted average period of 1.87 years.

During the three months ended March 31, 2007 and 2006, the total intrinsic value of stock options exercised was \$951,000 and \$2,644,000, respectively, and the total fair value of stock awards vested was \$67,000 and \$70,843,

respectively.



**Table of Contents**

Cash received from stock option exercises for the three months ended March 31, 2007 and 2006 was \$203,000 and \$508,000, respectively.

**5. Commitments and Contingencies and Income from Litigation Settlements**

***Income from Litigation Settlements*** In January 2001, a class action was filed in the District Court for the City and County of Denver, Colorado against the Company and certain affiliates and parties unrelated to the Company. The class action alleged that the defendants violated certain provisions of the Colorado Securities Act in connection with the sale of interests in an energy program of which MGT was the managing trustee. A settlement to fully resolve all claims by the class against the Company and its affiliates was submitted and granted final approval by the district court on June 11, 2004. The loss that occurred as a result of the class action and settlement was recorded by the Company in the fourth quarter of 2002. All obligations of the Company under the settlement were extinguished during the second quarter of 2006.

After the settlement with the class was approved, the Company vigorously pursued cross-claims and third party claims ( Other Party Claims ), including claims against the prior owners of the assets and against attorneys, consultants and a brokerage firm (the Other Parties ) involved in the transactions underlying the claims in the Class Action, seeking recovery of damages and contribution, among other things, from the Other Parties. Some of the Other Parties asserted counterclaims against the Company.

As a result of mediation meetings that occurred during the fourth quarter of 2006, the Company agreed to settlements with four of the five Other Parties (the 2006 Settlements). As a result of the 2006 Settlements, the Company recorded income in the amount of \$343,112 during 2006, which represented the Company's share of the 2006 Settlements due from three of the Other Parties. During the three months ended March 31, 2007, the Company recorded additional income in the amount of \$278,334, representing the Company's share of the 2006 settlements from the fourth party which had been contingent on approval of the original class action participants, which occurred on April 20, 2007. Through March 31, 2007, the Company has received \$150,613 in payment from the 2006 Settlements. The Company expects the remainder of the balance due from the 2006 Settlements will be received during the second quarter 2007 upon release of settlement funds currently held in a trust account payable to the class action participants and to the Company.

A trial on the only remaining Other Party Claim is currently set for August 2007. The Company cannot provide any assurance that it will be successful on the remaining Other Party Claim or that it will prevail on the counterclaims brought against it by the remaining Other Party. Out of the 2006 Settlement proceeds, and any recovery (net of litigation expenses) from the resolution of the remaining Other Party Claim and/or counterclaims, 50% of such net recovery is allocated to the Company, and the remaining 50% is allocated as additional settlement funds payable to the class action participants.

***Other Matters*** From time to time, the Company hires employees that are subject to restrictive covenants, such as non-competition agreements with their former employers. The Company complies, and requires our employees to comply, with the terms of all known

**Table of Contents**

restrictive covenants. However, the Company has 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 the Company does not believe any pending claims have merit, the Company cannot provide any assurance of the outcome of these claims.

From time to time, the Company is involved in other disputes and legal actions arising in the ordinary course of business. The Company intends 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.

***Preferred Stock Redemption*** During the three months ended March 31, 2007, the Company retired an additional 150 shares of its Series B Preferred Stock at a redemption value of \$220,000. The balance of the unpaid redemption obligation at March 31, 2007 and December 31, 2006, was \$104,000 and \$324,000, respectively, and is included in Accrued and other liabilities in the accompanying consolidated balance sheets.

**6. Restructuring Charges (Subsequent Event)**

On April 16, 2007, the Company's founders, W. Phillip Marcum, the former Chairman of the Board, President and Chief Executive Officer of the Company, and A. Bradley Gabbard, the former Executive Vice President and Chief Financial Officer of the Company, retired from and terminated their employment with the Company. In conjunction with those retirements, on April 16, 2007, the Board of Directors elected and appointed Sidney Hinton, the President and Chief Executive Officer of PowerSecure, Inc., as the President and Chief Executive Officer of the Company. Mr. Hinton will also retain his positions with PowerSecure.

In connection with their retirement, Messrs. Marcum and Gabbard each entered into a Separation Agreement and Release with the Company (the Separation Agreements). The Separation Agreements were approved by the Compensation Committee of the Company's Board of Directors. Under the Separation Agreements, the Company will pay Messrs. Marcum and Gabbard severance payments, for a period of three years for Mr. Marcum and two years for Mr. Gabbard, on regular payroll dates in aggregate amounts equal to \$2,810,990, for Mr. Marcum, and \$1,310,540 for Mr. Gabbard. The severance payments are payable as follows: \$468,498 plus interest thereon of \$11,712 to Mr. Marcum, and \$327,635 plus interest thereon of \$8,191 to Mr. Gabbard, are due on October 18, 2007 (the Initial Payment Date) and the remainder are due in equal installments over the severance period on the Company's regular payroll dates. These severance payments were required by, and were established in accordance with, the employment agreements of Messrs. Marcum and Gabbard (the Employment Agreements).

The Company will also pay to Messrs. Marcum and Gabbard the Incentive Compensation (as such term is defined in the Employment Agreements) payments required by

**Table of Contents**

the Employment Agreements in an aggregate amount of \$4,400,000 to Mr. Marcum and \$3,600,000 to Mr. Gabbard. The Incentive Compensation to Messrs. Marcum and Gabbard are payable as follows: (i) \$3,382,500 to Mr. Marcum and \$2,767,500 to Mr. Gabbard (which amounts include interest at the simple rate of 5% per annum) on the Initial Payment Date, and (ii) the remaining \$1,100,000 to Mr. Marcum and the remaining \$900,000 to Mr. Gabbard on June 15, 2008, plus interest at the simple rate of five percent (5%) per annum.

These Incentive Compensation payments are required under the Employment Agreements and were intended, when originally entered into in 1991, to provide incentives for Messrs. Marcum and Gabbard to align their interests with the interests of stockholders and to enhance stockholder value. The formula for these payments was ten percent (10%) of the excess of the fair market value of the Company's Common Stock upon termination over \$10.08, which was the Company's initial public offering price attributable to the Common Stock, as adjusted for the 1998 1-for-4 reverse stock split, multiplied by the number of Common Stock equivalents outstanding. Only Messrs. Marcum and Gabbard were entitled to payments under the Incentive Compensation Fund, which was triggered by their termination of employment.

The Compensation Committee of the Board of Directors of the Company set \$15.00 as the fair market value of the Common Stock for purposes of determining the Incentive Compensation payable to Messrs. Marcum and Gabbard under their Employment Agreements. In establishing the fair market value of the Common Stock, the Compensation Committee received and relied upon a written opinion by Harris Williams & Co., dated April 16, 2007 (the Harris Williams Opinion). Based on this opinion, the Compensation Committee set \$15.00 per share, which was the midpoint of the valuation range opined upon in the Harris Williams Opinion, as the fair market value of the Common Stock. The Compensation Committee then rounded the resulting Incentive Compensation amount down to the nearest million dollars (\$8 million).

Messrs. Marcum and Gabbard have also entered into consulting agreements with the Company, pursuant to which they have agreed to provide their consulting services to the Company, as requested by the Company, for up to 25 hours per month, cumulative up to 50 hours, for a total gross consulting fee of \$8,000 per month for Mr. Marcum and \$7,500 for Mr. Gabbard. The consulting period is three years for Mr. Marcum and two years for Mr. Gabbard. The Company will pay the consulting fee as follows: \$49,200 to Mr. Marcum and \$46,125 to Mr. Gabbard will be payable upon the Initial Payment Date, and thereafter the consulting fee will be paid over the remainder of the consulting period on the Company's regular payroll dates.

On April 24, 2007, the Company deposited into an escrow account with Zions First National Bank, as escrow agent, the sum of \$1,630,272 for Mr. Marcum and \$1,303,880 for Mr. Gabbard pursuant to an escrow agreement. The amounts represent the amounts payable to Messrs. Marcum and Gabbard on the Initial Payment Date less required tax withholdings. The escrowed funds will be released from escrow on the Initial Payment Date and paid over to Messrs. Marcum and Gabbard by the escrow agent.

**Table of Contents**

The Separation Agreements also contain customary provisions regarding such matters as accelerated payments in the event of a change in control, interest and fees on late payments due, and similar matters.

In connection with the restructuring, the Company has relocated its headquarters to PowerSecure's offices in Wake Forest, North Carolina. The Company expects to record a pre-tax non-recurring restructuring charge in the amount of approximately \$14.1 million during the second quarter of 2007, which includes all amounts payable under the Separation Agreements as well as certain related costs. The restructuring charge also includes amounts the Company is obligated to pay to certain employees who are not relocating to the new corporate headquarters in Wake Forest, North Carolina, as well as early lease termination penalties the Company is obligated to pay on its existing office lease in Denver, Colorado. The Company expects the restructuring and relocation will result in annual savings of approximately \$2.4 million, the effects of which will be recognized for accounting purposes commencing in the second half of 2007, and annually thereafter.

**7. Segment Information**

The Company's reportable segments are strategic business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. The Company's reportable business segments include: natural gas measurement services; distributed generation; and automated energy data collection and telemetry.

***Natural Gas Measurement Services*** The operations of the Company's natural gas measurement services segment are conducted by Southern Flow. 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.

***Distributed Generation*** The operations of the Company's distributed generation segment are conducted by PowerSecure. PowerSecure commenced operations in September 2000. The primary elements of PowerSecure's distributed generation products and services include project design and engineering, negotiation with utilities to establish tariff structures and power interconnects, generator acquisition and installation, process control and switchgear design and installation, and ongoing project monitoring and servicing. PowerSecure markets its distributed generation products and services directly to large end-users of electricity and through outsourcing partnerships with utilities. Through March 31, 2007, the majority of PowerSecure's revenues have been generated from sales of distributed generation systems on a turnkey basis, where the customer purchases the systems from PowerSecure.

During the second half of 2005, PowerSecure added two new business units, UtilityEngineering, Inc. and PowerServices, Inc., to its operating segment and in February 2006, it announced a third addition to its operations, EnergyLite, Inc. PowerServices provides rate analysis and other similar consulting services to PowerSecure's utility, commercial and industrial

**Table of Contents**

customers. Utility Engineering provides fee-based, technical engineering services to PowerSecure's utility partners and customers. EnergyLite assists customers in reducing their use of energy through investments in more energy-efficient technologies.

During the second half of 2006, PowerSecure launched a business unit within PowerSecure to concentrate on marketing to federal customers. PowerSecure launched this business unit by purchasing contract rights to provide services to federal customers of an investor-owned utility. The projects that are marketed and sold to the Federal customers potentially include all the products/services offered within PowerSecure and its various subsidiaries. Finally, in late 2006, PowerSecure acquired the business of Reid's Trailer, Inc., which builds trailers for the transportation of goods and equipment, an important element in PowerSecure's mobile distributed generation equipment business strategy.

Each of these new PowerSecure business units operates in a distinct market with distinct technical disciplines, but share a common customer base which PowerSecure intends to service and grow through shared resources and customer leads. Accordingly, these units are included within PowerSecure's segment results.

***Automated Energy Data Collection and Telemetry*** The operations of our automated data collection and telemetry segment are conducted by Metrotek Florida. Metrotek Florida's manufactured products fall into the following categories: field devices, including data collection products and electronic gas flow computers; data collection software products (such as InvisiConnect™, DC2000 and PowerSpring); and communications solutions that can use public networks operated by commercial wireless carriers to provide real time IP-based wireless internet connectivity, traditional cellular radio, 900 MHz unlicensed radio or traditional wire-line phone service to provide connectivity between the field devices and the data collection software products. Metrotek Florida also provides data collection, M2M telemetry connectivity and post-sale support services for its manufactured products and turnkey solutions.

The accounting policies of the reportable segments are the same as those described in Note 1 of the Notes to Consolidated Financial Statements. The Company evaluates the performance of its operating segments based on operating income (loss) before income taxes, nonrecurring items and interest income and expense. Intersegment sales are not significant.

Summarized financial information concerning the Company's reportable segments is shown in the following table. The "Other" column includes corporate related items, revenues and expenses from managing MM 1995-2, results of insignificant operations and, as it relates to segment profit or loss, income and expense (primarily interest and finance charges) not allocated to reportable segments.

**Table of Contents**

**Summarized Segment Financial Information**  
(all amounts reported in thousands)

	Three Months Ended March 31,	
	2007	2006
<b>Revenues:</b>		
Southern Flow	\$ 3,900	\$ 4,340
PowerSecure	21,516	9,663
Metrotek Florida	953	734
Other	610	95
<b>Total</b>	<b>\$ 26,979</b>	<b>\$ 14,832</b>
 <b>Segment profit (loss):</b>		
Southern Flow	\$ 620	\$ 681
PowerSecure	1,290	256
Metrotek Florida	51	(45)
Other	(348)	(824)
<b>Total</b>	<b>\$ 1,613</b>	<b>\$ 68</b>
 <b>Capital expenditures:</b>		
Southern Flow	\$ 166	\$ 33
PowerSecure	337	368
Metrotek Florida	19	1
Other		26
<b>Total</b>	<b>\$ 522</b>	<b>\$ 428</b>
 <b>Depreciation and amortization:</b>		
Southern Flow	\$ 32	\$ 30
PowerSecure	283	92
Metrotek Florida	10	31
Other	18	19
<b>Total</b>	<b>\$ 343</b>	<b>\$ 172</b>
 <b>Total assets:</b>		
	March 31,	
	2007	2006
Southern Flow	\$ 12,799	\$ 10,249
PowerSecure	53,550	24,090
Metrotek Florida	3,973	3,571
Other	13,912	4,714

Total

\$ 84,234

\$ 42,624

17

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**Table of Contents**

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

**Introduction**

The following discussion of our results of operations for the three month period ended March 31, 2007 (referred to herein as the first quarter 2007 ) and 2006 (referred to herein as the first quarter 2006 ) and of our financial condition as of March 31, 2007 should be read in conjunction with our consolidated financial statements and related notes thereto included elsewhere in this report.

**Overview**

We are a diversified provider of energy technology products, services and data management systems primarily to industrial and commercial users and suppliers of natural gas and electricity. As a holding company, we conduct our operations and derive our revenues through our three operating subsidiaries, each of which operates a separate business:

PowerSecure, which designs, sells and manages distributed generation systems;

Southern Flow, which provides natural gas measurement services; and

Metretek Florida, which designs, manufactures and sells data collection and energy measurement monitoring systems.

In addition to these operating subsidiaries, we own approximately 36% of the equity interests of an unconsolidated business, MM 1995-2, through our wholly-owned subsidiary MGT. MGT also is the managing trustee of MM 1995-2. MM 1995-2 owns and operates five oil field production water disposal wells located at four facilities in northeastern Colorado. The equity income from MM 1995-2 contributed \$649,000 to our net income during the first quarter 2007, a slight decrease from \$658,000 (net of minority interest) in the first quarter 2006.

We commenced operations in 1991 as an energy services holding company, owning subsidiaries with businesses designed to exploit service opportunities primarily in the natural gas industry. Since then, our business has evolved and expanded through acquisitions and developments of companies, businesses and product lines that have allowed us to reach not only a broader portion of the energy market, including the electricity market, but also markets outside of the energy field. In recent years, we have focused our efforts on growing our businesses by offering new and enhanced products, services and technologies and by entering new markets, within a framework emphasizing the goal of achieving profitable operations on a sustained basis.

Our revenues and results of operations, on a quarterly, period and annual basis, are dependent upon, and are the consolidated result of, the revenues and results of operations of each of our operating subsidiaries, our equity income in MM 1995-2 and our corporate



**Table of Contents**

overhead. While we operate generally in the energy technology products, services and data management industry, our businesses are diversified and each of our business segments is operated independently of the others and influenced and affected by many factors that may apply only to that segment. Accordingly, our consolidated results of operations are an aggregation of different businesses and thus dependent upon a variety of factors applicable to each of these businesses.

PowerSecure is an expanding company that has developed a distributed generation turnkey business. In addition, during late 2005 and early 2006, PowerSecure added three new business units designed to expand and complement its core distributed generation business and customers. UtilityEngineering provides fee-based, technical engineering services to PowerSecure's utility partners and customers. PowerServices provides rate analysis and other similar consulting services to PowerSecure's utility, commercial and industrial customers. EnergyLite assists customers in reducing their use of energy through investments in more energy-efficient technologies. During mid-2006, PowerSecure launched a business unit within PowerSecure to concentrate on marketing to federal customers, primarily in conjunction with our utility alliances. In the second half of 2006, PowerSecure launched this business unit by purchasing contract rights, know-how and other intellectual properties to facilitate the providing of services to the federal customers of an investor-owned utility. The projects that are marketed and sold to PowerSecure's federal customers potentially include all the products and services offered by PowerSecure as well as by its subsidiaries. In late 2006, PowerSecure acquired the business of Reid's Trailer, Inc., which builds trailers for the transportation of goods and equipment, an important element in PowerSecure's mobile distributed generation equipment business strategy.

Even with the addition of these business units and acquisitions, PowerSecure is still in large part dependent upon the size and timing of the receipt of orders for, and of the completion of, its projects, and its results of operations can be significantly impacted by large, individual projects. During the first quarter 2007, PowerSecure's revenues and segment profit showed substantial increases over the first quarter 2006 primarily due to the increased revenues from the Publix Supermarkets, Inc. ( Publix ) projects, which did not fully ramp up until the second quarter 2006, as well as the growth of PowerSecure's core distributed generation business and its new businesses as well as normal fluctuations inherent in its operations. During the first quarter 2007, PowerSecure's revenues were \$21,516,000 (of which \$14,501,000 was attributable to the Publix projects), an increase of \$11,853,000, or 123%, over the first quarter 2006.

During the first quarter 2007, we announced that PowerSecure had procured new contracts that are expected to generate approximately \$50 million in total revenues for PowerSecure during 2007 and 2008.

Southern Flow is a well established, strong and expanding oil field services company that renders natural gas measurement and other services to oil and gas production companies. During the first quarter 2007, Southern Flow's revenues decreased by \$440,000, or 10%, as compared to the first quarter 2006, due to equipment sales in the first quarter 2006 to customers

**Table of Contents**

repairing damage from Hurricanes Rita and Katrina in late 2005. There were no similar equipment sales for hurricane repairs in the first quarter 2007.

Metrotek Florida has been in operation since 1977 with a core business of designing, manufacturing and selling data collection and energy measurement monitoring systems. Metrotek Florida's future results of operations will be largely dependent upon its ability to successfully address its core markets, as well as its ability to generate incremental sales from certain new markets into which it has recently introduced new telemetry products. Metrotek Florida's revenues increased by \$219,000, or 30%, during the first quarter 2007 as compared to the first quarter 2006, as a result of improved market success for its M2M business.

During the first quarter 2007, we recorded additional income from litigation settlements in the amount of \$278,000 representing our share of litigation claims settled in 2006, but which had been contingent on court approval, which occurred on April 20, 2007.

Due principally to an increase in revenues at our PowerSecure operating segment, our consolidated revenues during the first quarter 2007 increased by \$12,147,000, representing an 82% increase over first quarter 2006 consolidated revenues. We recorded net income of \$2,233,000 during the first quarter 2007, including \$649,000 equity in income from MM 1995-2, as compared to net income of \$638,000 during the first quarter 2006, which included \$658,000 equity in income of MM 1995-2 (net of minority interest).

Subsequent to the first quarter 2007, we incurred nonrecurring restructuring charges in the amount of approximately \$14.1 million related to the retirement of the two founders of our Company, the severance, consulting and incentive compensation incurred in connection with their employment and separation agreements, and the relocation of our corporate offices from Denver to PowerSecure's offices in Wake Forest, North Carolina, including severance benefits payable to personnel who will not be relocated. These costs will be reflected in the results of operations during the second quarter 2007.

**Critical Accounting Policies**

Management's discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition and percentage of completion, fixed price contracts, product returns, warranty obligations, bad debt, inventories, cancellations costs associated with long term commitments, investments, intangible assets, assets subject to disposal, income taxes, restructuring, service contracts, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making estimates and

**Table of Contents**

judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Estimates, by their nature, are based on judgment and available information. Therefore, actual results could differ from those estimates and could have a material impact on our consolidated financial statements, and it is possible that such changes could occur in the near term.

We have identified the accounting principles which we believe are most critical to understanding our reported financial results by considering accounting policies that involve the most complex or subjective decisions or assessments. These accounting policies are described in our Annual Report on Form 10-K for the year ended December 31, 2006 in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

**Results of Operations**

The following table sets forth selected information related to our primary business segments and is intended to assist in understanding our results of operations for the periods presented. The following table excludes revenues and costs and expenses of the discontinued MCM operations as well as equity income in our unconsolidated affiliate, minority interest and income taxes for all periods presented.

	Three Months Ended March 31,	
	2007	2006
	(all amounts reported in thousands)	
<b>Revenues:</b>		
Southern Flow	\$ 3,900	\$ 4,340
PowerSecure	21,516	9,663
Metrotek Florida	953	734
Other	610	95
Total	\$ 26,979	\$ 14,832
<b>Gross Profit:</b>		
Southern Flow	\$ 1,052	\$ 1,117
PowerSecure	6,317	3,020
Metrotek Florida	583	468
Total	\$ 7,952	\$ 4,605
<b>Segment Profit (Loss):</b>		
Southern Flow	\$ 620	\$ 681
PowerSecure	1,290	256
Metrotek Florida	51	(45)
Other	(348)	(824)
Total	\$ 1,613	\$ 68

**Table of Contents**

We have three reportable segments. Our reportable segments are strategic business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. Our reportable business segments are natural gas measurement services, distributed generation and automated energy data management.

The operations of our natural gas measurement services segment are conducted by Southern Flow. 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.

The operations of our distributed generation segment are conducted by PowerSecure. The primary elements of PowerSecure's distributed generation products and services include project design and engineering, negotiation with utilities to establish tariff structures and power interconnects, generator acquisition and installation, process control and switchgear design and installation, and ongoing project monitoring and servicing. PowerSecure markets its distributed generation products and services directly to large end-users of electricity and through outsourcing partnerships with utilities. Through March 31, 2007, the majority of PowerSecure's revenues have been generated from sales of distributed generation systems on a turnkey basis, where the customer purchases the systems from PowerSecure.

PowerSecure is an expanding company that has developed a distributed generation turnkey business. In addition, during the second half of fiscal 2005, PowerSecure added two new business units, UtilityEngineering and PowerServices, to its operating segment. In January 2006, it announced a third addition to its operations, EnergyLite. UtilityEngineering provides fee-based, technical engineering services to PowerSecure's utility partners and customers. PowerServices provides rate analysis and other similar consulting services to PowerSecure's utility, commercial and industrial customers. EnergyLite assists customers in reducing their use of energy through investments in more energy-efficient technologies. These units are intended to increase PowerSecure's future growth opportunities beyond its core distributed generation business.

During mid-2006, PowerSecure launched a business unit within PowerSecure to concentrate on marketing to federal customers, primarily in conjunction with its utility alliances. In the second half of 2006, PowerSecure launched this business unit by purchasing contract rights, know-how and other intellectual properties to facilitate the providing of services to the federal customers of an investor-owned utility. The projects that are marketed and sold to PowerSecure's federal customers potentially include all the products and services offered by PowerSecure as well as by its subsidiaries. In late 2006, PowerSecure acquired the business of Reid's Trailer, Inc., which builds trailers for the transportation of goods and equipment, an important element in PowerSecure's mobile distributed generation equipment business strategy.

Each of PowerSecure's business units operates in a separate market with distinct technical disciplines, but all of these business units share a common customer base which

**Table of Contents**

PowerSecure intends to service and grow through shared resources and customer leads. Accordingly, these units are included within PowerSecure's segment results.

The operations of our automated data collection and telemetry segment are conducted by Metrotek Florida. Metrotek Florida's manufactured products fall into the following categories: field devices, including data collection products and electronic gas flow computers; data collection software products (such as InvisiConnect®, DC2000 and PowerSpring); and communications solutions that can use public networks operated by commercial wireless carriers to provide real time IP-based wireless internet connectivity, traditional cellular radio, 900 MHz unlicensed radio or traditional wire-line phone service to provide connectivity between the field devices and the data collection software products. Metrotek Florida also provides data collection, M2M telemetry connectivity and post-sale support services for its manufactured products and turnkey solutions.

We evaluate the performance of our operating segments based on operating income (loss) before taxes, nonrecurring items and interest income and expense. Other profit (loss) amounts in the table above include corporate related items, fees earned from managing our unconsolidated affiliate, results of insignificant operations, and income and expense (primarily interest income and expense) and non-recurring charges not allocated to its operating segments. Intersegment sales are not significant.

**First Quarter 2007 Compared to First Quarter 2006**

*Revenues.* Our revenues are derived almost entirely from the sales of products and services by our subsidiaries. Our consolidated revenues for the first quarter 2007 increased \$12,147,000, or 82%, compared to the first quarter 2006 due primarily to increase in revenues at PowerSecure.

PowerSecure's revenues are influenced by the number, size and timing of various projects as well as the percentage completion on in-process projects. PowerSecure's revenues have fluctuated significantly in the past and are expected to continue to fluctuate significantly in the future. PowerSecure's revenues increased \$11,853,000, or 123%, during the first quarter 2007 compared to the first quarter 2006. The increase in PowerSecure's revenues during the first quarter 2007 compared to the first quarter 2006 was due to a \$9,938,000 increase in distributed generation turnkey system project sales and services together with an increase of \$1,915,000 in revenues from shared savings projects, professional services, monitoring and other service related revenues, including \$2,012,000 of increased revenues contributed by PowerServices, UtilityEngineering, EnergyLite, Reids Trailer and government sector projects. The increase in PowerSecure's distributed generation turnkey system project sales and services revenues was largely attributable to a substantial increase in the total number of projects completed or in process during the first quarter 2007 compared to the first quarter 2006. The increase in the number of distributed generation projects was primarily due to the large orders placed by Publix in late 2005 and early 2006. The growth of PowerSecure was also attributable to the continued expansion of PowerSecure's projects into new geographic markets as a result of increased marketing efforts and the growth and market acceptance of new products and services by

**Table of Contents****PowerSecure.**

Southern Flow's revenues decreased \$440,000, or 10%, during the first quarter 2007, as compared to the first quarter 2006, due to a \$670,000 decline in equipment sales, partially offset by an increase of \$230,000 field and service related revenues. The decline in equipment sales is due to first quarter 2006 sales activity related to customers repairing damage from Hurricanes Rita and Katrina in late 2005. There were no similar equipment sales for hurricane repairs in the first quarter 2007. The increase in field and other service related revenue in the first quarter 2007 is due to continued favorable market conditions in the oil and gas sector.

Metrotek Florida's revenues increased by \$219,000, or 30%, during the first quarter 2007 compared to the first quarter 2006 due to normal fluctuations in its business as it continues to develop its M2M business and take advantage of new sales opportunities. As discussed below under **Quarterly Fluctuations**, Metrotek Florida's revenues have fluctuated significantly in the past and are expected to continue to fluctuate significantly in the future as it continues to develop its M2M business.

Other revenues increased \$515,000 during the first quarter 2007, as compared to the first quarter 2006. This increase was comprised principally of insurance proceeds from a fire claim at Southern Flow as well as interest earned on cash and cash equivalents balances which resulted from the net proceeds of our 2006 private placement which occurred in the second quarter 2006.

*Costs and Expenses.* The following table sets forth our costs and expenses during the periods indicated:

	<b>Quarter Ended March</b>		<b>Quarter-over-Quarter</b>	
	<b>31,</b>		<b>Difference</b>	
	<b>2007</b>	<b>2006</b>	<b>\$</b>	<b>%</b>
	<b>(In thousands)</b>			
<b>Costs and Expenses:</b>				
Costs of Sales and Services				
Southern Flow	\$ 2,848	\$ 3,222	\$ (374)	-12%
PowerSecure	15,199	6,643	8,556	129%
Metrotek Florida	370	266	104	39%
<b>Total</b>	<b>18,417</b>	<b>10,131</b>	<b>8,286</b>	<b>82%</b>
General and administrative	5,524	3,435	2,089	61%
Selling, marketing and service	864	759	105	14%
Depreciation and amortization	343	172	171	99%
Research and development	211	178	33	19%
Interest, finance charges and other	7	88	(81)	-92%
Income taxes	306	89	217	244%

Costs of sales and services include materials, personnel and related overhead costs incurred to manufacture products and provide services. The 82% increase in cost of sales and services for the first quarter 2007, compared to the first quarter 2006, was attributable almost entirely to the increase in sales at PowerSecure.

The 129% increase in PowerSecure's costs of sales and services in the first quarter 2007

**Table of Contents**

is almost entirely a direct result of the 123% increase in PowerSecure's revenues. PowerSecure's gross profit margin decreased to 29.4% during the first quarter 2007, as compared to 31.3% during the first quarter 2006, reflecting additional personnel and capacity costs incurred to effectively meet customer delivery expectations, in the first quarter 2007 compared to the first quarter 2006. This decline also reflects some embedded margin reduction priced into the Publix projects to induce those large orders.

The 12% decrease in Southern Flow's costs of sales and services in the first quarter 2007 is the result of the 10% decrease in its revenues. Southern Flow's gross profit margin increased to 27.0% for the first quarter 2007, compared to 25.7% during the first quarter 2006, which is within the range of normal fluctuations for Southern Flow.

The 39% increase in Metrotek Florida's costs of sales and services in the first quarter 2007 is due to the 30% increase in its revenues. Metrotek Florida's gross profit margin decreased to 61.2% for the first quarter 2007, compared to 63.8% during the first quarter 2006, which is within the range of normal fluctuations for Metrotek Florida.

General and administrative expenses include personnel and related overhead costs for the support and administrative functions. The 61% increase in general and administrative expenses in the first quarter 2007, as compared to the first quarter 2006, was due to increases in personnel and related overhead costs associated with the development and growth of PowerSecure's business, and increased corporate overhead costs related to personnel costs, stock based compensation expenses and director fees and expenses.

Selling, marketing and service expenses consist of personnel and related overhead costs, including commissions for sales and marketing activities, together with advertising and promotion costs. The 14% increase in selling, marketing and service expenses in the first quarter 2007, as compared to the first quarter 2006, was due primarily to increased personnel and business development expenses associated with the development and growth of the business of PowerSecure, and increased personnel expenses at Metrotek Florida.

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 that do not have indefinite useful lives. The 99% increase in depreciation and amortization expenses in the first quarter 2007, as compared to the first quarter 2006, primarily reflects an increase in depreciable assets acquired by PowerSecure in the latter portions of fiscal 2006 as well as an increase in amortization expense associated with contract rights acquired by PowerSecure in the third quarter of 2006.

Research and development expenses, most of which relate to activities at Metrotek Florida, include payments to third parties, wages and related expenses for personnel, materials costs and related overhead costs related to product and service development, enhancements, upgrades, testing and quality assurance. Historically, our research and development expenses have been incurred primarily at Metrotek Florida. During the first quarter 2007, however, PowerSecure incurred approximately \$18,000 of development expenses for which there was no

**Table of Contents**

similar expenditure in the first quarter 2006. The 19% increase in research and development expenses in the first quarter 2007, as compared to the first quarter 2006, primarily reflects the product development costs incurred by PowerSecure together with increased personnel related expenses at Metrotek Florida.

Interest, finance charges and other expenses include interest and finance charges on our credit facility as well as other non-operating expenses. The 92% decrease in interest, finance charges and other expenses in the first quarter 2007, as compared to the first quarter 2006, reflects the repayment of all of our long-term debt obligations, during the second quarter 2006.

Income tax expenses include state income taxes in various state jurisdictions in which we have taxable activities as well as federal alternative minimum tax. Historically, we have incurred no federal income tax expense because of our consolidated net operating losses. During the second half of fiscal 2006, however, we determined that we would likely incur federal alternative minimum tax during fiscal 2006 and beyond. The increase in income taxes in the first quarter 2007, as compared to the first quarter 2006, was due to increases in state income taxes incurred by PowerSecure and Southern Flow in states in which they generated taxable income as well as federal alternative minimum tax.

*Equity in Income of Unconsolidated Affiliate.* We record equity in income of unconsolidated affiliate due to our ownership of a minority interest in MM 1995-2. During the first quarter 2007, our equity in income of unconsolidated affiliate decreased by \$9,000, or 1%, over the first quarter 2006, net of minority interests held by others in 2006. The performance of MM 1995-2 was negatively impacted by major facility repairs and adverse weather conditions during the later portion of 2006 which continued into the first quarter 2007. This resulted in the decrease in our equity in income of MM 1995-2.

*Income from Litigation Settlements.* During the fourth quarter of fiscal 2006, we agreed to settlements of outstanding litigation claims against four other parties relating to a class action lawsuit that we had previously settled with the class. As a result of these settlements, we recorded income from litigation settlements in the amount of \$343,000 during fiscal 2006, representing the expected net proceeds to us from three of the other parties. During the first quarter 2007, we recorded additional income from litigation settlements from the fourth party in the amount of \$278,000 representing our share of litigation claims settled in 2006, but which had been contingent on court approval, which occurred on April 20, 2007. A trial on the claims with the only remaining other party that has not agreed to a settlement is currently set for August 2007.

**Quarterly Fluctuations**

Our revenues, expenses, margins, net income 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 size, timing and terms of sales and orders, including large customer orders, such as



**Table of Contents**

the recent significant orders at PowerSecure, as well as the effects of customers delaying, deferring or canceling purchase orders or making smaller purchases than expected;

the effects of severe weather conditions, such as hurricanes, on the demand requirements of our customers;

our ability to obtain adequate supplies of key components and materials for our products on a timely and cost-effective basis;

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

the pace of development of our new businesses, including PowerSecure's new businesses, and the 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 product and service implementation process;

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

changes in the mix of international and domestic revenues;

the life cycles of our products and services;

budgeting cycles of utilities and other major customers;

general economic and political conditions;

the effects of litigation, claims and other proceedings;

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

economic conditions in the energy industry, especially in the natural gas and electricity sectors including the effect of cyclical changes in energy prices;

changes in the prices charged by our suppliers;

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

changes in our operating expenses; and

the development and maintenance of business relationships with strategic partners.

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

Our revenues and other operating results are heavily dependant upon the volume and timing of customer orders and payments and the date of product delivery. The timing of large individual sales is difficult for us to predict. Because our operating expenses are based on anticipated revenues and because a high percentage of these are relatively fixed, a shortfall or delay in recognizing revenue could cause our operating results to vary significantly from



**Table of Contents**

quarter-to-quarter and could result in significant operating losses in any particular quarter. If our revenues fall below our expectations in any particular quarter, we may not be able to reduce our expenses rapidly in response to the shortfall, which could result in us suffering significant operating losses in that quarter.

Over PowerSecure's six year operating history, its revenues, costs, gross margins, cash flow, net income and other operating results have varied from quarter-to-quarter, period-to-period and year-to-year for a number of reasons, including the factors mentioned above, and we expect such fluctuations to continue in the future. PowerSecure's revenues depend in large part upon the timing and the size of projects awarded to PowerSecure, such as the recent significant orders received by PowerSecure, and the timing of the completion of those projects. As PowerSecure develops new related lines of business, its revenues and costs will fluctuate as it takes time for revenues to develop, but also requires start-up expenses. Another factor that could cause material fluctuations in PowerSecure's quarterly results is the amount of recurring, as opposed to non-recurring, sources of revenue. To date, the majority of PowerSecure's revenues have consisted of non-recurring revenues.

Southern Flow's operating results tend to vary, to some extent, with energy prices, especially the price of natural gas. For example, in recent years, the high price of natural gas has led to an increase in production activity by Southern Flow's customers, resulting in higher revenues and net income by Southern Flow. Since energy prices tend to be cyclical, rather than stable, future cyclical changes in energy prices are likely to affect Southern Flow's future revenues and net income. In addition, Southern Flow's Gulf Coast customers are exposed to the risks of hurricanes and tropical storms, which can adversely affect Southern Flow's results of operations during hurricane season, such as during fiscal 2005, and which can positively affect Southern Flow's revenues in subsequent periods, such as during fiscal 2006.

Metrotek Florida has historically derived most of its revenues from sales of its products and services to the utility industry. Metrotek Florida has experienced variability in its operating results on both an annual and a quarterly basis due primarily to utility purchasing patterns and delays of purchasing decisions as a result of mergers and acquisitions in the utility industry and changes or potential changes to the federal and state regulatory frameworks within which the utility industry operates. The utility industry, both domestic and foreign, is generally characterized by long budgeting, purchasing and regulatory process cycles that can take up to several years to complete. In addition, Metrotek Florida has only a limited operating history with its new M2M and telemetry business, and its operating results in this new business may fluctuate significantly as it develops this business.

Due to all of these factors and the other risks discussed in this Report and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006, you should not rely on quarter-to-quarter, period-to-period or year-to-year comparisons of our results of operations as an indication of our future performance. Quarterly, period, or annual comparisons of our operating results are not necessarily meaningful or indicative of future performance.

**Table of Contents**

**Liquidity and Capital Resources**

*Capital Requirements.* We require capital primarily to finance our:  
operations;

inventory;

accounts receivable;

research and development efforts;

property and equipment acquisitions, including investments in shared savings projects;

software development;

debt service requirements;

severance and incentive compensation obligations under separation agreements with our prior President and Chief Financial Officer; and

business and technology acquisitions and other growth transactions.

*Cash Flow.* We have historically financed our operations and growth primarily through a combination of cash on hand, cash generated from operations, borrowings under credit facilities, borrowings on other project or term loans, and proceeds from private and public sales of equity. At March 31, 2007, we had working capital of \$41,194,000, including \$14,949,000 in cash and cash equivalents, compared to working capital of \$38,844,000 on December 31, 2006, which included \$15,916,000 in cash and cash equivalents. At March 31, 2007 and December 31, 2006, we had \$4,500,000 of additional borrowing capacity from our credit facilities available to support working capital needs.

Net cash used in operating activities was \$426,000 in the first quarter 2007, consisting of approximately \$2,235,000 of cash provided by operations, before changes in assets and liabilities, and approximately \$2,661,000 of cash used by changes in working capital and other asset and liability accounts. This compares to net cash used in operating activities of \$2,275,000 in the first quarter 2006, consisting of approximately \$303,000 of cash provided by operations, before changes in assets and liabilities, approximately \$2,610,000 of cash used by changes in working capital and other asset and liability accounts, and approximately \$32,000 of cash provided by discontinued operations of MCM.

Net cash used in investing activities was \$522,000 in the first quarter 2007, as compared to net cash used in investing activities of \$1,659,000 in the first quarter 2006. The majority of the net cash used by investing activities during the first quarter 2007 was attributable to the purchase of equipment at PowerSecure and Southern Flow and the purchase of software at PowerSecure. The net cash used by investing activities during the first quarter 2006 was attributable to the purchase of our additional investment in our unconsolidated affiliate.

Net cash used in financing activities was \$20,000 in the first quarter 2007, compared to net cash provided by financing activities of \$2,622,000 in the first quarter 2006. The majority of the net cash used in financing activities during the first quarter 2007 was attributable to cash payments on our preferred stock redemptions, partially offset by proceeds from the exercise of stock options. The majority of the net cash provided by financing activities during the first

**Table of Contents**

quarter 2006 was attributable to cash proceeds from the exercise of stock warrants and options and net borrowings on our lines of credit, partially offset by principal payments on our long-term notes payable.

Our research and development expenses totaled \$211,000 during the first quarter 2007 compared to \$178,000 during the first quarter 2006. The majority of our first quarter 2007 research and development expenses were directed toward the enhancement of Metrotek Florida's business, including the development of its M2M communications products. During fiscal 2007, we plan to continue our research and development efforts to enhance our existing products and services and to develop new products and services. We anticipate that our research and development expenses in fiscal 2007 will total approximately \$785,000, the majority of which will be directed to Metrotek Florida's business.

Our capital expenditures during the first quarter 2007 were approximately \$522,000, including \$167,000 of which was incurred at Southern Flow, largely to replace equipment items lost or damaged in a fire at its facility in Lafayette, Louisiana. During the first quarter 2006, our capital expenditures were approximately \$428,000, the vast majority of which was incurred for the purchase of miscellaneous equipment items at PowerSecure. We anticipate capital expenditures in fiscal 2006 of approximately \$1.5 million, the vast majority of which will be for the benefit of the business of PowerSecure. In addition, we may incur additional capital expenditures for PowerSecure's shared savings distributed generation projects during fiscal 2007.

*Equipment Line of Credit.* On May 9, 2005, Caterpillar Financial Services Corporation offered PowerSecure a \$5,000,000 equipment line of credit, which was increased to \$7,500,000 on May 18, 2006. The equipment line is available to finance the purchase, from time to time, of Caterpillar generators used in PowerSecure projects, primarily in shared savings arrangements, pursuant to a letter by Caterpillar to PowerSecure containing the terms of this credit line. Under the Caterpillar equipment line, PowerSecure 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 letter from Caterpillar provides that the equipment line is not an unconditional binding commitment to provide such financing and that the equipment line is contingent upon the continued credit-worthiness of PowerSecure in the sole discretion of Caterpillar. At March 31, 2007, PowerSecure had the full \$7.5 million available for additional equipment purchases under the Caterpillar equipment line. With respect to any equipment financed by Caterpillar, PowerSecure must make a 10% cash down payment of the purchase price and grant to Caterpillar a first priority security interest in the equipment being financed as well as other equipment related to the project.

*Working Capital Credit Facility.* We have a credit facility with First National Bank of Colorado that provides for a \$4.5 million revolving credit facility. On August 7, 2006, our credit facility with FNBC was modified to reduce the interest rate on borrowed funds, reduce the unused line fee, eliminate the annual fee and relax certain financial covenants and reporting

**Table of Contents**

requirements. Southern Flow and PowerSecure are the borrowers under the credit facility. Amounts, if any, borrowed under the credit facility currently bear interest at the lender's prime rate. The credit facility matures on September 1, 2007. The credit facility had been used primarily to fund the operations and growth of PowerSecure, as well as the operations of Southern Flow and Metrotek Florida. In April 2006, upon completion of the 2006 private placement, we paid down our credit facility balances to \$0 and have not borrowed on the credit facility since that time.

The credit facility is structured in two parts: a \$2.5 million facility for PowerSecure and a \$2.0 million facility for Southern Flow. Borrowings under the PowerSecure facility are limited to a borrowing base consisting of the sum of 75% of PowerSecure's eligible accounts receivable, plus 25% of the sum of PowerSecure's unbilled accounts receivable less the amount of PowerSecure's unearned revenues or advanced billings on contracts, plus 25% of PowerSecure's inventory. Borrowings under the Southern Flow facility are limited to a borrowing base consisting of the sum of 80% of Southern Flow's eligible accounts receivable plus 20% of Southern Flow's inventory. At March 31, 2007, the aggregate borrowing base under the credit facility was \$4,500,000, all of which was available to us for borrowing.

The credit facility is primarily evidenced by a credit agreement, to which Metrotek Technologies, PowerSecure, Southern Flow and Metrotek Florida are obligor parties and FNBC is the lender. The obligations of PowerSecure and Southern Flow, as borrowers, under the credit agreement are secured by security agreements by Southern Flow, PowerSecure and Metrotek Florida and are guaranteed by Metrotek Technologies. The security agreements grant to FNBC a first priority security interest in virtually all of the assets of each of the parties to the credit facility.

The credit agreement contains customary representations and warranties and affirmative and negative covenants, including financial covenants pertaining to minimum current assets to current liabilities ratio for PowerSecure, minimum tangible net worth for Southern Flow and maximum debt to tangible net worth ratios of the Company. The credit agreement contains other customary covenants that apply to us and to PowerSecure, Southern Flow and Metrotek Florida, limiting the incurrence of additional indebtedness or liens, restricting dividends and redemptions of capital stock, restricting their ability to engage in mergers, consolidations, sales and acquisitions, to make investments, to issue guarantees of other obligations, to engage in transactions with affiliates to or make restricted payments and other matters customarily restricted in secured loan agreements, without FNBC's prior written consent.

The credit agreement contains customary events of default, including payment defaults, breach of representations and warranties, covenant defaults, cross-defaults, certain bankruptcy or insolvency events, judgment defaults and certain ERISA-related events.

*Preferred Stock Redemption.* The terms of our Series B preferred stock required us to redeem all shares of our Series B preferred stock that remained outstanding on December 9, 2004 at a redemption price equal to the liquidation preference of \$1,000 per share plus accumulated and unpaid dividends. Our remaining redemption obligation at March 31, 2007, to

**Table of Contents**

holders of outstanding shares of Series B preferred stock that have not been redeemed, is approximately \$104,000.

*Separation and Corporate Office Relocation Obligations.* On April 16, 2007, our two founders, W. Phillip Marcum, our former Chairman of the Board, President and Chief Executive Officer, and A. Bradley Gabbard, our former Executive Vice President and Chief Financial Officer, retired from and terminated their employment with us. In conjunction with those retirements, on April 16, 2007, the Board of Directors elected and appointed Sidney Hinton, the President and Chief Executive Officer of PowerSecure, Inc., as our President and Chief Executive Officer. Mr. Hinton will also retain his positions with PowerSecure.

In connection with their retirements, Messrs. Marcum and Gabbard each entered into a Separation Agreement and Release with us (the *Separation Agreements* ). The Separation Agreements were approved by the Compensation Committee of our Board of Directors. Under the Separation Agreements, we will pay Messrs. Marcum and Gabbard severance payments, for a period of three years for Mr. Marcum and two years for Mr. Gabbard, on regular payroll dates in aggregate amounts equal to \$2,810,990, for Mr. Marcum, and \$1,310,540 for Mr. Gabbard. The severance payments are payable as follows: \$468,498 plus interest thereon of \$11,712 to Mr. Marcum, and \$327,635 plus interest thereon of \$8,191 to Mr. Gabbard, are due on October 18, 2007 (the *Initial Payment Date* ) and the remainder are due in equal installments over the severance period on our regular payroll dates. These severance payments were required by, and were established in accordance with Employment Agreements of Messrs. Marcum and Gabbard.

We will also pay to Messrs. Marcum and Gabbard the *Incentive Compensation* (as such term is defined in their Employment Agreements) payments required by their Employment Agreements in an aggregate amount of \$4,400,000 to Mr. Marcum and \$3,600,000 to Mr. Gabbard. The Incentive Compensation to Messrs. Marcum and Gabbard is payable as follows: (i) \$3,382,500 to Mr. Marcum and \$2,767,500 to Mr. Gabbard (which amounts include interest at the simple rate of 5% per annum) on the Initial Payment Date, and (ii) the remaining \$1,100,000 to Mr. Marcum and the remaining \$900,000 to Mr. Gabbard on June 15, 2008, plus interest at the simple rate of five percent (5%) per annum.

These Incentive Compensation payments are required under Messrs. Marcum's and Gabbard's Employment Agreements and were intended, when originally entered into in 1991, to provide incentives for Messrs. Marcum and Gabbard to align their interests with the interests of stockholders and to enhance stockholder value. The formula for these payments was ten percent (10%) of the excess of the fair market value of our Common Stock upon termination over \$10.08, which was our initial public offering price attributable to our Common Stock, as adjusted for the 1998 1-for-4 reverse stock split, multiplied by the number of our Common Stock equivalents outstanding. Only Messrs. Marcum and Gabbard were entitled to payments under the Incentive Compensation Fund, which was triggered by their termination of employment.

**Table of Contents**

The Compensation Committee set \$15.00 as the fair market value of the Common Stock for purposes of determining the Incentive Compensation payable to Messrs. Marcum and Gabbard under their Employment Agreements. In establishing the fair market value of our Common Stock, the Compensation Committee received and relied upon a written opinion by Harris Williams & Co., dated April 16, 2007, (the Harris Williams Opinion ). Based on this opinion, the Compensation Committee set \$15.00 per share, which was the midpoint of the valuation range opined upon in the Harris Williams Opinion, as the fair market value of our Common Stock. The Compensation Committee then rounded the resulting Incentive Compensation amount down to the nearest million dollars (\$8 million).

Messrs. Marcum and Gabbard have also entered into consulting agreements with us, pursuant to which they have agreed to provide their consulting services to us, as requested by us, for up to 25 hours per month, cumulative up to 50 hours, for a total gross consulting fee of \$8,000 per month for Mr. Marcum and \$7,500 for Mr. Gabbard. The consulting period is three years for Mr. Marcum and two years for Mr. Gabbard. We will pay the consulting fee as follows: \$49,200 to Mr. Marcum and \$46,125 to Mr. Gabbard will be payable upon the Initial Payment Date, and thereafter the consulting fee will be paid over the remainder of the consulting period on our regular payroll dates.

On April 24, 2007, we deposited into an escrow account with Zions First National Bank, as escrow agent, the sum of \$1,630,272 for Mr. Marcum and \$1,303,880 for Mr. Gabbard pursuant to an escrow agreement. The amounts represent the amounts payable to Messrs. Marcum and Gabbard on the Initial Payment Date less required tax withholdings. The escrowed funds will be released from escrow on the Initial Payment Date and paid over to Messrs. Marcum and Gabbard by the escrow agent.

The Separation Agreements also contain customary provisions regarding such matters as accelerated payments in the event of a change in control, interest and fees on late payments due, and similar matters.

In connection with the restructuring, we have relocated our corporate headquarters to PowerSecure's offices in Wake Forest, North Carolina. We expect to record a pre-tax non-recurring restructuring charge in the amount of approximately \$14.1 million during the second quarter of 2007, which includes all amounts payable under the Separation Agreements as well as certain related costs. The restructuring charge also includes amounts we are obligated to pay to certain employees who are not relocating to the new corporate headquarters in Wake Forest, North Carolina, as well as early lease termination penalties we are obligated to pay on our existing office lease in Denver, Colorado.

*Contractual Obligations and Commercial Commitments.* We incur various contractual obligations and commercial commitments in our normal course of business. We lease certain office space, operating facilities and equipment under long-term lease agreements. To the extent we borrow under our credit facility or under the Caterpillar equipment line, we are obligated to make future payments under those facilities. Also, as discussed in Note 3, *Income Taxes* of the Notes to the Consolidated Financial Statements, we adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* an interpretation of FASB Statement No. 109 as of January 1, 2007. At March 31, 2007, we had a liability for unrecognized tax benefits and payment of related interest and penalties totaling \$348,000.

We do not expect a significant payment related to these obligations within the next year and we are unable to make a reasonably reliable estimate when cash settlement with a taxing authority will occur. Accordingly, the table information below, which is as of March 31, 2007, does not include the liability for unrecognized tax benefits nor does it include



**Table of Contents**

the effects of separation and corporate office relocation obligations incurred in April 2007, upon the retirement of W. Phillip Marcum and A. Bradley Gabbard:

	<b>Total</b>	<b>Payments Due by Period (1)</b>			
		<b>Remainder of 2007</b>	<b>Years 2008-2009</b>	<b>Years 2010-2011</b>	<b>After 2011</b>
<b>Contractual Obligations</b>					
Credit Facility (2)	\$	\$	\$	\$	\$
Capital Lease Obligations	14,000	4,000	6,000	4,000	
Operating Leases	4,274,000	680,000	1,425,000	753,000	1,416,000
Series B Preferred Stock	104,000	104,000			
Caterpillar Equipment Line (2)					
<b>Total</b>	<b>\$ 4,392,000</b>	<b>\$ 788,000</b>	<b>\$ 1,431,000</b>	<b>\$ 757,000</b>	<b>\$ 1,416,000</b>

(1) Does not include interest that may become due and payable on such obligations in any future period.

(2) Total repayments are based upon borrowings outstanding as of March 31, 2007, not projected borrowings under the Credit Facility.

*Off-Balance Sheet Arrangements.* During the first quarter 2007, we did not engage in any material off-balance sheet activities or have any relationships or arrangements with unconsolidated entities established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities nor do we have any commitment or intent to provide additional funding to any such entities.

*Liquidity.* Based upon our plans and assumptions as of the date of this report, we currently believe that our capital resources, including our cash and cash equivalents, proceeds from our 2006 private placement, amounts available under our credit facility, along with funds expected to be generated from our operations, will be sufficient to meet our anticipated cash needs, including for working capital, research and development, capital expenditures, severance and incentive compensation obligations, and debt service commitments, for at least the next 12 months. However, any projections of future cash needs and cash flows are subject to substantial risks and uncertainties. See Cautionary Note

Regarding Forward-Looking Statements below in this Item and Part II, Item 1A Risk Factors below. We also continually evaluate opportunities to expand our current, or to develop new, products, services, technology and businesses that could increase our capital needs. In addition, from time to time we consider the acquisition of, or the investment in, complementary businesses, products, services and technology that might affect our liquidity requirements. We cannot provide any assurance that our actual cash requirements will not be greater than we currently expect or that these sources of liquidity will be available when needed.

**Table of Contents**

**Recent Accounting Pronouncements**

In February 2006, the Financial Accounting Standards Board ( FASB ) issued FAS No. 155, Accounting for Certain Hybrid Financial Instruments-an amendment of FASB Statements No. 133 and 140 ( FAS 155 ). FAS 155 eliminates the exemption from applying FASB Statement No.133 to interests in securitized financial assets. FAS 155 became effective for us on January 1, 2007. The adoption of FAS 155 had no effect on our financial position or results of operations.

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109 ( FIN 48 ). FIN 48 clarifies the accounting for uncertainty in income taxes by prescribing a minimum recognition threshold for a tax position taken or expected to be taken in a tax return that is required to be met before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The cumulative effect of adopting FIN 48 of \$348,000 was recorded as an increase to our accumulated deficit, which would otherwise have increased our income tax expense in prior periods.

In September 2006, the FASB issued FAS No. 157, Fair Value Measurements ( FAS 157 ). FAS 157 defines fair value to measure assets and liabilities, establishes a framework for measuring fair value, and requires additional disclosures about the use of fair value. FAS 157 is applicable whenever another accounting pronouncement requires or permits assets and liabilities to be measured at fair value. FAS 157 does not expand or require any new fair value measures. FAS 157 will become effective for us on January 1, 2008. We are currently evaluating the impact that the adoption of FAS 157 will have on our financial position and results of operations.

In February 2007, the FASB issued FAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ( FAS 159 ), which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. FAS 159 will be effective for us on January 1, 2008. We are currently evaluating the impact that the adoption of FAS 159 will have on our financial position and results of operations.

**Cautionary Note Regarding Forward-Looking Statements**

This Quarterly Report on Form 10-Q (this Report ) contains forward-looking statements within the meaning of and made under the safe harbor provisions of Section 27A of the Securities Act of 1933, as amended (the Securities Act ), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act ). From time to time in the future, we may make additional forward-looking statements in presentations, at conferences, in press releases, in other reports and filings and otherwise. Forward-looking statements are all statements other than statements of historical fact, including statements that refer to plans, intentions, objectives, goals, strategies,

**Table of Contents**

hopes, beliefs, projections, prospects, expectations or other characterizations of future events or performance, and assumptions underlying the foregoing. The words may, could, should, would, will, project, intend, continue, anticipate, estimate, forecast, expect, plan, potential, opportunity and scheduled, variations of such words and comparable terminology and similar expressions are often, but not always, used to identify forward-looking statements. Examples of forward-looking statements include, but are not limited to, statements about the following:

our prospects, including our future revenues, expenses, net income, margins, profitability, cash flow, liquidity, financial condition and results of operations;

our products and services and our markets, including market position, market share, market demand and benefits to customers;

our ability to successfully develop, operate and grow our operations and businesses;

our business plans, strategies, goals and objectives;

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

industry trends and customer preferences;

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

business acquisitions, combinations, sales, alliances, ventures and other similar business transactions and relationships;

the effects on our business, financial condition and results of operations of litigation and other claims and proceedings that arise from time to time; and

future economic, business, market and regulatory conditions.

Any forward-looking statements we make are based on our current plans, intentions, objectives, goals, strategies, hopes, beliefs, projections and expectations, as well as assumptions made by and information currently available to management. You are cautioned not to place undue reliance on any forward-looking statements, any or all of which could turn out to be wrong. Forward-looking statements are not guarantees of future performance or events, but are subject to and qualified by substantial risks, uncertainties and other factors, which are difficult to predict and are often beyond our control. Forward-looking statements will be affected by assumptions we might make that do not materialize or prove to be incorrect and by known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from those expressed, anticipated or implied by such forward-looking statements. These risks, uncertainties and other factors include, but are not limited to, those identified in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006, as amended or supplemented in subsequently filed Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, as well as other risks, uncertainties and other factors discussed elsewhere in this Report and in our other reports and documents filed from time to time with the SEC.

Any forward-looking statements contained in this Report speak only as of the date of this Report, and any other forward-looking statements we make from time to time in the future

**Table of Contents**

speaks only as of the date it is made. We undertake no duty or obligation to update or revise any forward-looking statement for any reason, whether as a result of changes in our expectations or the underlying assumptions, the receipt of new information, occurrence of future or unanticipated events, circumstances or conditions or otherwise.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

We are exposed to certain market risks arising from transactions we enter into in the ordinary course of business. These market risks are primarily due to changes in interest rates, foreign exchange rates and commodity prices, which may adversely affect our financial condition, results of operations and cash flow.

Our exposure to market risk resulting from changes in interest rates relates primarily to income from our investments in short-term interest-bearing marketable securities, which is dependent upon the interest rate of the securities held, and to interest expenses attributable to our credit facility, which is based on floating interest rates as described in Item 2. Management's Discussion and Analysis of Financial Conditions and Results of Operations of this report.

At March 31, 2007, our cash and cash equivalent balance was approximately \$14.9 million and our credit facility had a zero balance. All of our cash equivalents are currently invested in money market mutual funds, short-term time deposits, and government agency and corporate obligations, the income of which generally increases or decreases in proportion to increases or decreases, respectively, in interest rates. We do not believe that changes in interest rates have had a material impact on us in the past or are likely to have a material impact on us in the foreseeable future. For example, a change of 1% (100 basis points) in the interest rate on either our investments or any future reasonably likely borrowings would not have a material impact on our financial condition, results of operations or cash flow.

Since substantially all of our revenues, expenses and capital spending are transacted in U.S. dollars, we are not exposed to significant foreign exchange risk. However, from time to time we are subject to market risk from fluctuating commodity prices in certain raw materials we use.

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

**Item 4. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of March 31, 2007, the end of the period covered by this Report. Based upon that evaluation, our Chief Executive Officer and our Chief

**Table of Contents**

Financial Officer have concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our chief executive officer and our chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

**Changes in Internal Control over Financial Reporting**

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the first quarter 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Limitations in Control systems**

Because of its inherent limitations, any control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, no evaluation of controls and procedures can provide absolute assurance that all errors, control issues and instances of fraud will be prevented or detected. The design of any system of controls and procedures is also based in part on certain assumptions regarding the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

**Table of Contents**

**PART II  
OTHER INFORMATION**

**Item 1. Legal Proceedings**

From time to time, we are involved in disputes and legal proceedings. There has been no material change in our pending legal proceedings as described in Item 3. Legal Proceedings in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

**Item 1A. Risk Factors**

Our business and operating results are subject to many risks, uncertainties and other factors. If any of these risks were to occur, our business, affairs, assets, financial condition, results of operations, cash flows and prospects could be materially and adversely affected. These risks, uncertainties and other factors include the information discussed elsewhere in this Report as well as the risk factors set forth in Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006, which have not materially changed as of the date of this Report.

**Item 6. Exhibits**

- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Filed herewith.)
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Filed herewith.)
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 and Rule 13a-14(b) or 15d-14(b) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Filed herewith.)
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 and Rule 13a-14(b) or 15d-14(b) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Filed herewith.)

**Table of Contents**

**SIGNATURES**

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

METRETEK TECHNOLOGIES, INC.

Date: May 10, 2007

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

Date: May 10, 2007

By: /s/ Gary Zuiderveen  
Gary Zuiderveen  
Vice President and Chief Financial  
Officer