

LIME ENERGY CO.
Form 10-K/A
October 11, 2013

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

Form 10-K/A

Amendment No. 1

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

For the fiscal year ended: December 31, 2012

**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 001-16265

LIME ENERGY CO.

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of incorporation or organization)

36-4197337
(I.R.S. Employer Identification No.)

16810 Kenton Drive, Suite 240, Huntersville, NC
(Address of principal executive offices)

28078-4845
(Zip Code)

Registrant's telephone number, including area code **(704) 892-4442**

Securities registered pursuant to Section 12(b) of the Exchange Act:

Title of each class	Name of each exchange on which registered
Common Stock \$0.0001 par value	NASDAQ

Securities registered pursuant to Section 12(g) of the Exchange Act: **None**

Indicate by checkmark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by checkmark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company (as defined in Rule 12b-2 of the Act).

Large Accelerated Filer

Accelerated Filer

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Non-Accelerated Filer

Smaller reporting company

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

The aggregate market value of the registrant's common stock held by non-affiliates was \$8,596,386 based on the reported last sale price of common stock on June 29, 2012, which was the last business day of the registrant's most recently completed second fiscal quarter. For purposes of this computation, all executive officers, directors and 10% stockholders were deemed affiliates. Such a determination should not be construed as an admission that such executive officers, directors or 10% stockholders are affiliates.

As of October 9, 2013, there were 25,152,693 shares of common stock, \$0.0001 par value, of the registrant issued and outstanding.

EXPLANATORY NOTE

We are amending our Annual Report on Form 10-K for the year ended December 31, 2012, filed with the Securities and Exchange Commission on July 31, 2013, to include a discussion of the years ended December 31, 2008, 2009 and 2010 in Management's Discussion and Analysis of Financial Condition and Results of Operations. As described below, and in the original filing of this Report, we restated our financial statements for those years, as well as our financial statements for the year ended December 31, 2011 and the quarter ended March 31, 2012. Note 3 of the Notes to Consolidated Financial Statements in Item 15 of the original filing of this Report contained a restatement of all line items in our 2008, 2009 and 2010 financial statements requiring restatement, as well as a reconciliation of those restated amounts to our previously filed financial statements for those years.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that are based on management's current expectation, estimates, and projections about our business and operations. Our actual results may differ materially from those currently anticipated and expressed in such forward-looking statements as a result of numerous factors, including those we discuss under Risk Factors and elsewhere in this report.

Restatement

As discussed in the Explanatory Note at the beginning of this Report, we are restating our financial statements for the years ended December 31, 2008, 2009, 2010 and 2011 and for the quarter ended March 31, 2012. As a consequence of that restatement, we were unable to timely file our Annual Report for the year ended December 31, 2012, and our Quarterly Reports for the quarters ended June 30, 2012, September 30, 2012, and March 31, 2013. This Report contains our restated financial statements for the year ended December 31, 2011, and a reconciliation of those restated financial statements to those we previously filed for the same period, and a restatement of all line items in our 2008, 2009 and 2010 financial statements requiring restatement, as well as a reconciliation of those restated amounts to our previously filed financial statements for those years. Additional information regarding the restatement, the events that necessitated the restatement and our response to those events is contained in the Explanatory Note at the beginning of this Report.

Presentation of Discontinued Operations

The results of our Public Sector and Asset Development businesses have been reported as discontinued operations in the accompanying financial statements; they have been included, however in continuing operations in the financial statements presented in Note 3 Restatement of Financial Statements in order to provide the reader with a better understanding of the changes to the historical financial statements resulting from the restatement. Consistent with the presentation of these businesses in the financial statements, the discussion of the results of operations that follows has included the results of these businesses in discontinued operations for the comparison of 2012 results to 2011 results, while including them in continuing operations for comparisons of 2011 to 2010, 2010 to 2009 and 2009 to 2008.

Overview

General

We are a leader in designing and implementing energy efficiency programs that enable our utility clients to reach their underserved markets and achieve their energy reduction goals. We provide our energy efficiency program delivery services exclusively within the utility sector, and our clients include two of the five largest investor-owned utilities in the country. We focus on deploying direct install energy efficiency solutions for small and mid-size commercial and industrial business programs that improve energy efficiency, reduce energy-related expenditures and lessen the impact of energy use on the environment. Currently, these solutions include energy efficient lighting upgrades and energy efficient mechanical upgrades. Our small business direct install (SBDI) programs provide a cost-effective avenue for our utility clients to offer products and services to a hard-to-reach customer base while satisfying aggressive state-mandated energy reduction goals. The direct install model is a turnkey solution under which we contract with the utility clients to design and market their small and mid-sized efficiency programs within a defined territory, perform the technical audits, sell the solution to the end-use customer and oversee the implementation of the energy efficiency measures. The model makes it easy and affordable for small businesses to upgrade to energy efficiency equipment and is a dependable and cost effective way for our utility clients to achieve their energy efficiency goals.

Approximately 12% of our 2012 revenue was generated from work for the Army Corps of Engineers and from our regional service business. We provide services to the Army Corps of Engineers under its Facility Repair and Renewal (FRR) program. We are one of three contractors qualified to bid for work under this program. As part of this program we provide project investigation, and design-build execution for all types of facility repairs, conversions, renovations, alterations, additions, construction and equipment installation in the federal buildings in the U.S. and U.S. territories. Our regional service business is located in Bethlehem Pennsylvania and offers HVAC service to local commercial and industrial clients. This group has been working with our New Jersey utility program to offer HVAC maintenance services to customers of this utility program who upgrade their HVAC equipment utilizing incentives available through the program.

Revenue and Expense Components

Revenue

We generate the majority of our revenue from the sale of our services and the products that we purchase and resell to our clients.

We charge our utility clients based on an agreed to rate schedule based on the item installed or the savings generated. Our contracts with the Army Corps of Engineers are all fixed-price contracts under which we bill the Army Corps on a monthly basis for work completed in the prior month as specified in the contract. A typical project for a small business utility client can take anywhere from a few hours to a few weeks to complete, whereas our projects for the Army Corps can take six months to two years to complete.

Our revenues are somewhat seasonal with the strongest sales occurring in the second half of the year.

Revenue Recognition

We recognize our revenue when all four of the following criteria are met: (i) persuasive evidence has been received that an arrangement exists; (ii) delivery of the products and/or services has occurred; (iii) the selling price is fixed or determinable; and (iv) collectability is reasonably assured. In addition, we follow the provisions of the SEC's Staff Accounting Bulletin No. 104, *Revenue Recognition*, which sets forth guidelines for the timing of revenue recognition based upon factors such as passage of title, installation, payments and client acceptance. Any amounts received prior to satisfying our revenue recognition criteria are recorded as billings in excess of costs and estimated earnings on uncompleted contracts.

We recognize the revenue utilizing the percentage of completion method of revenue recognition. Under the percentage of completion method we recognize revenue throughout the term of the project based on the percentage of costs incurred. Any anticipated losses on contracts are charged to operations as soon as they are determinable.

Revenue Concentration

During 2012 our three largest utility clients, Niagara Mohawk (National Grid), the New Jersey Board of Public Utilities and Long Island Power, were responsible for 32%, 15% and 12% of our consolidated revenue, respectively, while revenue generated from the Army Corps generated 12% of our consolidated revenue (all figures exclude discontinued operations). During 2011, our two largest utility clients, Niagara Mohawk and the New Jersey Board of Public Utilities, were responsible for 43% and 17% of our consolidated revenue, respectively, while the Army Corps was responsible for 25% of our consolidated revenue.

We expect that contracts with large utilities will continue to be a significant and growing source of revenue for us in the future, while the Army Corps will continue to be responsible for a smaller portion of our total revenue.

Gross Profit

Gross profit equals our revenue less cost of sales. Our cost of sales consists primarily of materials, our internal labor and the cost of subcontracted labor.

Gross profit is a key metric that we use to examine our performance. Gross profit depends in part on the volume and mix of products and services that we sell during any given period. We subcontract the vast majority of our installation and construction work, therefore our cost of goods sold consists almost exclusively of variable costs. Accordingly, our cost of sales will vary directly with changes in revenue.

Selling, General and Administrative Expense

Selling, general and administrative expense includes the following components:

- direct labor and commission costs related to our employee sales force;
- expenses related to our management, supervisory and staff salaries and employee benefits, including the costs of stock-based compensation;

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- costs related to insurance, travel and entertainment, office supplies and utilities;
- costs related to marketing and advertising our products;
- legal and accounting expenses; and
- costs related to administrative functions that serve to support our existing businesses, as well as to provide the infrastructure for future growth.

Amortization of Intangibles

When we acquire other companies we are required to allocate the purchase price between identifiable tangible and intangible assets, with any remaining value allocated to goodwill. The value allocated to intangible assets is amortized over the estimated life of the related asset. The acquisitions we completed within 2006, 2007 and 2008 resulted in approximately \$8.3 million of intangible assets, the substantial majority of which has already been amortized or has been reclassified to discontinued operations. The acquisition of the Zemel Road gas rights also resulted in the creation of an intangible

asset of \$2.6 million. We were amortizing this asset over the 20 year term of the contract; however, during the fourth quarter of 2012 we determined that the fair-market value of our investment in the Zemel Road facility was less than our carrying value. Therefore, as part of reducing the carrying value to the fair-market value, we wrote-off the remaining value of this intangible asset. Based on the value of our remaining intangible assets, we expect to record amortization expense of \$10,000 in 2013, after which our intangible assets will be fully amortized.

Interest Expense, Net

Net interest expense consists of interest expense net of interest income. Net interest expense represents the interest costs associated with our subordinated convertible term notes (including amortization of the related debt discount and issuance costs), the term note used to finance the construction of the Zemel Road generating facility, our line of credit, the mortgage on our headquarters building, and various vehicle loans. We repaid the mortgage in October 2011.

Interest income includes earnings on our invested cash balances and amortization of the discount on our long-term receivables.

General Business Trends and Recent Developments

The trends, events, and uncertainties set out in this section have been identified as those we believe are reasonably likely to materially affect the comparison of historical operating results reported in this report to either other past period results or to future operating results. These trends, events and uncertainties include:

Restatement of Prior Financial Statements

In July 2012, we discovered that certain members of our accounting and operations staff worked together to prematurely recognize revenue, and in some circumstances recognize revenue when no valid customer contract existed. Upon making this discovery, we initiated an in-depth review of all material revenue transactions and discovered that these activities began in 2008. As a result, we have restated our financial statements for the periods from January 2008 through March 31, 2012. The restated annual financial statements are included in the accompanying financial statements, along with information regarding changes to financial statement accounts resulting from the restatement. Restated quarterly financial statements for 2011 and the first quarter of 2012 are included in Quarterly Report on Form 10-Q for the nine-month period ended September 2012. Investors should not rely on previously filed financial statements for the period from January 2008 through March 2012. For additional information regarding the restatement please refer to Note 3 in the accompanying financial statements.

Sale of our ESCO business and shut-down of Lime Energy Asset Development

Most of the projects for public sector clients require that we post surety bonds to insure that we pay our subcontractors and perform our obligations under the contract. Prior to the announcement of the need to restate our financial statements in July 2012, we were able to obtain these bonds without the need to post any type of collateral. After announcing that our prior financial statements should not be relied upon, some

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of the surety companies that had been providing our surety bonds refused to issue any new bonds until our restated financial statements were available, while others started requiring collateral of between 30% and 100% of the amount of the bond. Having recently been awarded a significant number of new public sector contracts that would require bonds, and knowing that we would not be able to meet the sureties' collateral requirements without impairing our working capital position, we decided to sell the public sector business. On February 28, 2013, we sold all of the public sector business, except for the FRR contract with the Army Corps of Engineers and our regional HVAC service business located in Bethlehem, Pennsylvania. The portion of the business that was sold is commonly referred to as the ESCO

business because it is the portion whose primary customers were the large energy service companies. This business represented about half of our 2012 revenue. Compared to the utility business that we have retained, the ESCO business was growing at a slower rate, was less profitable and required higher levels of working capital. Utilizing the sale price we received for this business as an indicator of its fair value, we determined that our carrying value of this business exceeded the fair value. Accordingly, we reduced the carrying value to the estimated fair value during the fourth quarter of 2012, incurring a \$3.2 million impairment charge as a result. The ESCO business has been reported as discontinued operations in the accompanying financial statements.

We have also included our Asset Development group in discontinued operations. Lime Energy Asset Development (LEAD) was established in 2010 to develop, construct and operate renewable and alternative energy projects. This group was focused on leveraging the existing engineering and construction expertise contained in our public sector business to secure design-build contracts for projects ranging in size from \$1 million to \$20 million. The Zemel Road landfill-gas to electricity facility was built in part to demonstrate our ability to develop these types of projects. While LEAD found many opportunities to develop projects of the type it was targeting, it was unable to find a source of capital to finance the projects. After having completed an extensive search for a source of capital, and given the decision to sell the public sector business, we decided to shut down the Asset Development business in the fourth quarter of 2012, though we continue to own and operate the Zemel Road facility.

For additional information regarding discontinued operations please refer to Note 8 in the accompanying financial statements.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions. Critical accounting policies are defined as those that involve significant judgments and uncertainties, and potentially result in materially different results under different assumptions and conditions. We believe that our most critical accounting policies are limited to those described below. For a detailed discussion on the application of these and other accounting policies, see Note 4 in the notes to our consolidated financial statements.

Use of Estimates

Preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions affecting the reported amounts of assets, liabilities, revenues and expenses and related contingent liabilities. On an on-going basis, we evaluate our estimates, including those related to revenues, bad debts, warranty accrual, income taxes and contingencies and litigation. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

Revenue and Profit Recognition

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Since the acquisition of Applied Energy Management in June 2008, most of our revenue has been recognized using the percentage of completion method of revenue recognition. Under the percentage of completion method, we recognize revenue based on the percentage of costs incurred. Under this method

of revenue recognition, any anticipated losses on contracts are charged to operations as soon as they are determinable.

Allowance for Doubtful Accounts

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our clients to make required payments. The allowance is largely based upon specific knowledge of clients from whom collection is determined to be doubtful and our historical collection experience with such clients. If the financial condition of our clients or the economic environment in which they operate were to deteriorate, resulting in an inability to make payments, or if our estimates of certain clients' ability to pay are incorrect, additional allowances may be required. Under certain of our utility contracts, we offer extended payment terms of 12 or 24 months to our small-business customers for the portion of the cost of the work we perform that is not covered by utility incentives. We require that most of these customers provide us with a credit card or e-check authorization that we can charge for their monthly payment. This reduces our administrative cost of invoicing and collecting many small monthly payments and also gives us an earlier indication of a potential collection issue. As these programs have expanded and we have gained additional experience dealing with them we have increased our allowance for doubtful accounts. During 2012 we increased our allowance by \$869 thousand from \$150 thousand to \$1.0 million. As of December 31, 2012, our allowance for doubtful accounts was equal to approximately 11% of our outstanding accounts receivable. We will continue to monitor our collections experience with these small-business customers and adjust our allowance accordingly.

Amortization of Intangibles

We account for acquisitions of companies in accordance with ASC 805, *Accounting for Business Combinations*. We allocate the purchase price to tangible assets and intangible assets based on their fair values, with the excess of purchase price being allocated to goodwill. The determination of the fair values of these intangible assets is based on a number of significant assumptions as determined by us, including evaluations of the future income producing capabilities of these assets and related future expected cash flows or replacement cost of the asset. We also make estimates about the useful lives of the acquired intangible assets. Should different conditions result in the determination that the value of the acquired intangible assets has been impaired, we could incur write-downs of intangible assets, or changes in the estimation of useful lives of those intangible assets. In accordance with ASC 350, *Goodwill and Other Intangible Assets*, goodwill is not amortized, but is subject to annual impairment testing which is discussed in greater detail below.

Intangible assets included acquired technology and software, customer and contractual relationships and gas rights. Acquired technology was initially recorded at its fair value based on the estimated after tax cost to replace the asset and is amortized over its estimated useful life on a straight-line basis. Customer and contractual relationships represent contractual and separable relationships that we have with certain customers and partners. These contractual relationships were initially recorded at their fair value based on the present value of expected future cash flows of the contractual relationships and are amortized over their estimated useful life. The gas rights intangible asset represented the cost of acquiring the gas rights to the Zemel Road landfill. This asset was being amortized over the term of the gas rights agreement, which is 20 years.

All of our intangible assets, other than the technology and software and gas rights, are associated with the public sector business and therefore included in discontinued operations in the accompanying financial statements. Utilizing the price we received in February 2013 for the sale of the ESCO business as an indicator of its fair value, we determined that our carrying value of this business exceeded the fair value as of the end of 2012. In adjusting the carrying value of this business to reflect its indicated fair value we reduced the carrying value of the associated intangibles to \$0 during the fourth quarter of 2012,

which resulted in an impairment charge of \$1.6 million. Also during the fourth quarter of 2012, we reduced the carrying value of the Zemel Road gas rights to \$0 as part of our decision to reduce the carrying value of the Zemel Road assets to their fair-market value which resulted in an impairment charge of \$2.5 million. As of December 31, 2012, the only intangible asset remaining in continuing operations was the technology and software intangible, which will become fully amortized during the first half of 2013.

Impairment Loss

We evaluate all of our long-lived assets, including intangible assets other than goodwill and fixed assets, periodically for impairment in accordance with ASC 360-10-35, Accounting for the Impairment or Disposal of Long-Lived Assets. We record impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of those items. Our cash flow estimates are based on historical results adjusted to reflect our best estimate of future market and operating conditions. The net carrying value of assets not recoverable is reduced to fair value. Our estimates of fair value represent our best estimate based on industry trends and reference to market rates and transactions.

Utilizing the price we received in February 2013 for the sale of the ESCO business as an indicator of its fair value, we determined that our carrying value of this business exceeded the fair value as of the end of 2012. Accordingly, we reduced the carrying value to the estimated fair value during the fourth quarter of 2012, incurring a \$3.2 million impairment charge as a result. This charge included \$129 thousand related to the write-off of property, plant and equipment.

During early 2012, the quality and quantity of gas coming from the well field on the Zemel Road landfill began to deteriorate, in part due to a fire in the well field. During the fourth quarter of 2012, we updated our projections for future cash flows from the facility given the lower gas flow rates and higher anticipated operating expenses and determined that the fair-market value was less than our current carrying value. As a result, we recorded a \$3.5 million impairment charge during the fourth quarter to reduce the value of this asset to our estimate of fair-market value. This charge included \$1.1 million related to the write-down of the carrying value of property, plant and equipment.

Goodwill

We have made acquisitions in the past that included a significant amount of goodwill and other intangible assets. In accordance with ASC 350, goodwill is subject to an annual (or under certain circumstances more frequent) impairment test based on its estimated fair value. Estimated fair value is less than value based on undiscounted operating earnings because fair value estimates include a discount factor in valuing future cash flows. Many assumptions and estimates underlie the determination of an impairment loss, including economic and competitive conditions, operating costs and efficiencies. Another estimate using different, but still reasonable, assumptions could produce a significantly different result.

The price we received in February 2013 for the sale of the ESCO business indicated that the carrying value of the assets associated with this business was impaired. In adjusting the carrying value to the indicated fair value, we reduced the value of goodwill associated with this business by \$1.4 million during the fourth quarter of 2012.

During the fourth quarter of 2011 we completed our analyses for the C&I and AEM reporting units and concluded that the implied fair value of the AEM reporting unit, based on the discounted current value of the estimated future cash flows, substantially exceeded the carrying value,

indicating that the

goodwill was not impaired. However, due to a significant decline in the performance of the C&I reporting unit during 2011, we determined that the fair value of its goodwill had declined to \$923,000. As a result, we reduced the carrying value of the goodwill from \$6.7 million to \$923,000, incurring a \$5.8 million impairment loss during the period.

Our utility business was established in 2009 utilizing resources we acquired as part of the acquisition of Applied Energy Management. With the decision to sell most of the original AEM business, while retaining the utility business, we have allocated the goodwill associated with the AEM reporting unit between the public sector business and the utility business based on their relative fair values as of December 31, 2012. The portion of goodwill allocated to the public sector business has been included in discontinued operations in the accompanying financial statements.

During the fourth quarter of 2012, we completed an impairment analysis of the goodwill associated with the utility reporting unit and found that based on the discounted current value of the estimated future cash flows, the implied fair value substantially exceeded the carrying value, indicating that goodwill was not impaired.

We considered various factors in determining the fair value of the testing units, including discounted cash flows from projected earnings, values for comparable companies and the market price of our common stock. We will continue to monitor for any impairment indicators such as underperformance of projected earnings, net book value compared to market capitalization, declining stock price and significant adverse economic and industry trends. In the event that either testing unit does not achieve projected results, or, as the result of changes in facts or circumstances, we could incur an additional goodwill impairment charge in a future period.

Share-Based Compensation

We have stock incentive plans that provide for stock-based employee and director compensation, including the granting of stock options and shares of restricted stock, to certain key employees and non-employee directors. These plans are more fully described in Notes 22 and 23 to our consolidated financial statements. Consistent with ASC 718, *Share-Based Payment*, we record stock compensation expense for equity-based awards granted, including stock options and restricted stock unit grants, over the service period of the equity-based award based on the fair value of the award at the date of grant. We recognized \$1.8 million and \$2.2 million of stock compensation related to employee options expense, employee stock purchase plan and restricted stock grants during 2012 and 2011, respectively.

Results of Operations

Revenue

We generate the majority of our revenue from the sale of our services as well as the sale of the products that we purchase and resell to our clients. All of our revenue is earned in the United States.

We charge our utility customers utilizing an agreed to rate schedule based on the item installed or the savings generated. Our contracts with the Army Corps of Engineers are all fixed-price contracts. Under these fixed-price contracts, we bill the Army Corps on a monthly basis for work

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completed in the prior month as specified in the contract. A typical project for a small business utility customer can take anywhere from a few hours to a few weeks to complete, whereas our projects for the Army Corps can take six months to two years to complete.

Our revenues are somewhat seasonal with the strongest sales occurring in the second half of the year.

Gross Profit

Gross profit equals our revenue less costs of sales. The cost of sales consists primarily of materials, our internal labor and the cost of subcontracted labor.

Gross profit is a key metric that we use to examine our performance. Gross profit depends in part on the volume and mix of products and services that we sell during any given period. Since we subcontract almost all of our construction work to independent contractors there is very little fixed cost included in our cost of sales. The gross margin earned in our different markets and from different programs within markets varies, with our work under the FRR contract generating the lowest margins. The mix of business generated from our various markets and programs will change throughout the year, due in part to varying activity levels under existing programs and the growth of new programs, which will affect our consolidated gross margin.

Selling, General and Administrative Expenses

Selling, general and administrative expenses (SG&A) include the following components:

- direct labor and commission costs related to our employee sales force;
- costs of our management, supervisory and staff salaries and employee benefits, including the costs of stock-based compensation;
- costs related to insurance, travel and entertainment, office supplies and utilities;
- costs related to marketing and advertising our products;
- legal and accounting expenses; and
- costs related to administrative functions that serve to support our existing businesses, as well as to provide the infrastructure for future growth.

Amortization of Intangibles

We incur expenses related to the amortization of identifiable assets that we have capitalized in connection with our acquisitions.

Other Expense

Other expense consists of interest expense, net of interest earned on our investments. Interest expense represents the interest costs and fees associated with our subordinated convertible term notes (including amortization of the related debt discount and issuance costs), our lines of credit, the mortgage on our headquarters building, term notes and various vehicle loans.

Interest income includes earnings on our invested cash balances and amortization of the discount on our long term receivables. We offer certain customers extended payment terms. When we record receivables with payments terms of more than 12 months we are required to discount them using a market rate of interest and amortize the discount over the term of the receivable. This amortization is recognized as interest income.

Twelve-Month Period Ended December 31, 2012

Compared With the Twelve-Month Period Ended December 31, 2011 (restated)

Consolidated Results

	Twelve Months Ended		Change	
	12/31/2012	12/31/2011 (restated)	\$	%
Revenue	\$ 43,412	\$ 41,928	\$ 1,484	3.5%
Cost of sales	35,516	35,221	295	0.8%
Gross profit	7,896	6,707	1,189	17.7%
Selling, general and administrative	24,257	14,607	9,650	66.1%
Amortization of intangibles	257	196	61	31.1%
Restructuring charge		1,281	(1,281)	-100.0%
Impairment loss	3,547		3,547	0.0%
Operating loss	(20,165)	(9,377)	(10,788)	115.0%
Total other (expense) income	(408)	18	(426)	-2366.7%
Loss from continuing operations	(20,573)	(9,359)	(11,214)	119.8%
Loss from operation of discontinued businesses (1)	(11,239)	(9,574)	(1,665)	0.0%
Net Loss	\$ (31,812)	\$ (18,933)	\$ (12,879)	68.0%

The following table presents the percentage of certain items to revenue:

	Twelve Months Ended	
	12/31/2012	12/31/2011 (restated)
Revenue	100.0%	100.0%
Cost of sales	81.8%	84.0%
Gross profit	18.2%	16.0%
Selling, general and administrative	55.9%	34.8%
Amortization of intangibles	0.6%	0.5%
Restructuring charge	0.0%	3.1%
Impairment loss	8.2%	0.0%
Operating loss	-46.5%	-22.4%
Total other income	-0.9%	0.0%
Loss from continuing operations	-47.4%	-22.3%
Loss from operation of discontinued businesses (1)	-25.9%	-22.8%

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Net Loss	-73.3%	-22.3%
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(1) *Includes the results of the Public Sector and Asset Development businesses*

Revenue

Our revenue for the twelve-month period ended December 31, 2012, increased \$1.5 million, or 3.5%, to \$43.4 million from \$41.9 million for the same period during 2011. A \$5.7 million or 19% increase in revenue from our utility business was partially offset by a \$4.8 million decline in revenue generated under the FRR contract. The utility business benefited from a full year of contributions from our program with Long Island Power and the start-up of the Central Hudson and NStar programs, but this was partially offset by lower revenue from the National Grid program. Most of our utility contracts have annual goals. During 2011 we met our goal for National Grid by early fall and were given additional goals to make up for under-performing territories being run by other companies. During 2012, we again met our goal by early fall, but did not receive as much additional goal for the year, contributing to the decline in revenue for this program over the prior year.

Increased revenue contributions from Central Hudson and NStar, in combination with contributions from our new AEP Ohio and Duke Energy contracts and to a lesser extent, the Efficiency Maine contract, are all expected to contribute to higher revenue from the utility business in 2013. We also continue to bid on new contracts in different regions of the country, which if we are successful in winning, could also contribute to increased revenue.

We have two utility contracts up for renewal in 2013: National Grid and New Jersey Direct. We have been the top performer under both of these programs in every year we have been a part of the program, consequently, we believe that there is a good possibility that these contracts will be retained, however, this is not assured. Combined these two contracts were responsible for approximately 60% of our 2012 revenue.

Revenue under the FRR program varies depending on the number of projects we are working on at any particular time and the stage the project is in. We had fewer active projects during 2012 than we did during 2011 and these projects were either wrapping up or in the design phase for much of the year. This all contributed to the decline in revenue under this program for 2012, when compared to 2011. We expect that FRR will generate between \$3 million and \$5 million in revenue during 2013, but we currently have no expectation for this program to generate any significant revenue in 2014.

Revenue from GES-Port Charlotte increased \$622 thousand, to \$893 thousand in 2012 from \$270 thousand in 2011. The facility began generating electricity in November 2011 with sufficient gas flow to operate both generators at capacity. During 2012 the gas flow declined, in part due to a fire in the collection system, to the point where the generators were only able to operate at 60% to 70% of capacity. Charlotte County, the owner of the gas collection system, has recently completed some work on the collection system that has helped to improve the gas flow, however we expect that we will have to invest \$100,000 to \$200,000 to make additional changes to the system in order to increase the gas flow to a level that will permit us to operate our generators at capacity. We are currently seeking proposals for this work and hope to have it completed by the end of September 2013.

Although we expect our quarterly revenue will be higher during 2013 on a year-over-year basis, we expect between 60% and 70% of our revenue will be earned during the second half of the year as new utility programs continue to grow and our FRR projects move from the design phase into construction.

Gross Profit

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Our gross profit increased \$1.2 million, or 17.7%, to \$7.9 million during the twelve months ended December 31, 2012, when compared to the \$6.7 million earned during 2011. Our gross profit margin improved from 16.0% in 2011 to 18.2% in 2012. The increase in the gross margin was the result of a

reduction in the portion of total consolidated revenue generated by the low margin FRR program, combined with an increase in the gross margin earned by the utility business, which benefited from improvements in operating efficiencies. We believe that our gross margin should continue to improve as new utility programs begin to contribute more to our total revenue and we continue to implement improvements to increase efficiencies within the programs.

Selling, General & Administrative Expense

Our SG&A expense increased \$9.7 million, or 66.1%, to \$24.3 million during the twelve months ended December 31, 2012, from \$14.6 million during the year earlier period. SG&A as a percent of revenue increased from 34.8% in 2011 to 55.9% in 2012. Costs related to the restatement and related stockholder lawsuits contributed \$2.8 million to the 2012 increase in SG&A. The balance of the increase in SG&A was due to the start-up of new utility programs and the annualized costs associated with programs started in 2011. As we entered 2012 we were operating under three utility programs: National Grid which started in late 2009, New Jersey Direct, which started in the spring of 2010 and Long Island Power, which began operation during the fourth quarter of 2011. During 2012 we started-up, or were in the process of starting-up: Central Hudson, NStar, AEP Ohio, Duke Energy, and Efficiency Maine. When we start-up a new program we incur several months of expenses before we start to generate any revenue, as we open an office in the territory, hire a program manager and staff, train the staff, prepare a marketing plan and materials and start calling on customers. It usually takes three to six months before a program's revenue reaches the level necessary to generate a profit. During 2012, we had five programs in various stages of start-up, contributing to the increase in SG&A as a percentage of revenue. We expect that SG&A as a percentage of revenue will decline during 2013, as revenue from new programs ramps up. We also expect to incur an additional \$2.0 million to \$2.5 million in costs related to the restatement and stockholder lawsuits during 2013.

Amortization of Intangibles

Amortization expense increased \$61 thousand, to \$257 thousand during 2012, from \$196 thousand during 2011. The increase was due to the inclusion of a full year of amortization expense for the Zemel Road gas rights. The gas rights were written off at the end of 2012, therefore the only remaining intangible asset as of the end of 2012 was technology and software, which will become fully amortized during the first half of 2013.

Restructuring Charge

During 2011, we initiated a restructuring to reduce costs, streamline our organization and better integrate our operations. As part of this we moved our corporate headquarters to Huntersville, North Carolina, sold our former headquarters building in Elk Grove Village, Illinois, and consolidated certain accounting and administrative functions in Huntersville. In connection with this restructuring we incurred a restructuring charge of approximately \$1.3 million consisting primarily of severance related costs and costs associated with the sale of our building. Included in the \$1.3 million charge is approximately \$487 thousand of non-cash share-based compensation expense incurred when the vesting of equity based compensation was accelerated due to involuntary terminations.

Impairment Loss

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During the fourth quarter of 2012, we updated our projections for the Zemel Road landfill-gas to electricity facility based on the first year of operating results and expectations regarding planned improvements to the gas collection system. The discounted expected future cash flows for the facility indicated that the current carrying value of this asset exceeded its estimated fair-market value by \$3.5 million. We recorded an impairment charge of an equal amount during the fourth quarter of 2012 to

reduce the carrying value to our estimated fair-market value. Also, utilizing the price we received for the sale of the ESOC business in February 2013 as an indicator of its fair value, we determined that the carrying value of the assets associated with this business were impaired. In adjusting the carrying value to the fair value we incurred a \$3.2 million impairment charge during the fourth quarter of 2012.

Other Income

Other non-operating expense increased from \$18 thousand of net income during 2011 to \$408 thousand of net expense for 2012. Interest expense increased \$373 during the year-ended December 31, 2012 to \$496 thousand from \$123 thousand during the year-earlier period. The components of interest expense for the years ended December 31, 2012 and 2011 are as follows (in thousands):

Year ended December 31,	2012		2011	
Line of credit	\$	21	\$	17
Term Note		212		15
Mortgage note				15
Subordinated convertible notes		137		
Other		8		7
Change in value of interest rate swap		22		43
Amortization of deferred issuance costs and debt discount		103		32
Total Interest Expense	\$	503	\$	129
Less discontinued operations		7		6
Continuing operations	\$	496	\$	123

Total contractual interest expense (the interest on outstanding loan balances) increased \$324 thousand, to \$378 thousand during 2012 from \$54 thousand in 2011. The increase in contractual interest expense was primarily the result of the term note added in November 2011, and the subordinated convertible notes, which were put in place in October 2012.

We have deferred certain costs associated with the issuance of the term loan, subordinated convertible Notes and our line of credit. These costs are being amortized over the terms of the associated debt. We incurred \$103 thousand and \$32 thousand of amortization expense during 2012 and 2011, respectively.

In December 2011, we entered into an interest rate swap agreement to fix the interest rate on \$1.9 million of the \$3.6 million original balance on the term note. This interest rate swap was not designated for hedge accounting under ASC 815, therefore we record changes in its fair value as non-operating interest income or expense with an offsetting entry to a swap asset or swap liability. We recorded expense of \$22 thousand and \$43 thousand due to a decline in the fair-market value of this interest rate swap during 2012 and 2011, respectively.

Our interest income decreased \$53 thousand to \$88 thousand during 2012, from \$141 thousand during 2011. All of the income recorded during 2012 was amortization of the discount on our long-term receivables, while approximately \$137 thousand of the 2011 interest income was amortization of the discount on our long-term receivables. The decline in amortization is due to a reduction in our long-term receivables, which had historically been used by our C&I customers. We expect these balances to increase in the future due to increased use of extended payment terms by customers under some of our utility programs.

Twelve-Month Period Ended December 31, 2011(restated)

Compared With the Twelve-Month Period Ended December 31, 2010 (restated)

Consolidated Results

	Twelve Months Ended		Change	
	12/31/2011 (restated) (1)	12/31/2010 (restated)		
Revenue	\$ 99,373	\$ 83,341	\$ 16,032	19.2%
Cost of sales	82,400	65,542	16,858	25.7%
Gross profit	16,973	17,799	(826)	-4.6%
Selling, general and administrative	28,156	25,753	2,403	9.3%
Amortization of intangibles	635	589	46	7.8%
Restructuring charge	1,281		1,281	0.0%
Impairment loss	5,846		5,846	0.0%
Operating loss	(18,945)	(8,543)	(10,402)	121.8%
Total other (expense) income	12	172	(160)	-93.0%
Net Loss	(18,933)	(8,371)	(10,562)	126.2%

The following table presents the percentage of certain items to revenue:

Twelve Months Ended