

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

**FORM 10-Q**

- Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended September 30, 2011; 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: 001-34289

**World Energy Solutions, Inc.**  
(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**04-3474959**

(I.R.S. Employer Identification Number)

**446 Main Street**

**Worcester, Massachusetts 01608**

(Address of principal executive offices)

**508-459-8100**

(Registrant's telephone number)

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 past 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 website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting Company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:  
As of October 28, 2011, the registrant had 10,852,447 shares of common stock outstanding.

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**PART I  
FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**WORLD ENERGY SOLUTIONS, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS**

<b>Assets</b>	<b>September 30, 2011 (Unaudited)</b>	<b>December 31, 2010</b>
<u>Current assets</u>		
Cash and cash equivalents	\$ 6,516,266	\$ 3,559,288
Trade accounts receivable, net	3,688,073	3,124,328
Prepaid expenses and other current assets	410,314	229,108
Total current assets	10,614,653	6,912,724
Property and equipment, net	202,557	287,191
Convertible note receivable	650,000	433,333
Intangibles, net	4,740,063	3,723,607
Goodwill	5,010,092	3,178,701
Other assets	174,460	191,238
Total assets	\$ 21,391,825	\$ 14,726,794
<b>Liabilities and Stockholders' Equity</b>		
<u>Current liabilities</u>		
Accounts payable	\$ 318,633	\$ 263,746
Accrued commissions	918,840	847,758
Accrued compensation	1,332,446	1,970,639
Accrued expenses	257,615	187,097
Deferred revenue and customer advances	179,365	229,539
Capital lease obligations	4,785	14,798
Total current liabilities	3,011,684	3,513,577
Capital lease obligations, net of current portion	—	1,205
Total liabilities	3,011,684	3,514,782
Commitments and contingencies		
<u>Stockholders' equity:</u>		
Preferred stock, \$0.0001 par value; 5,000,000 shares authorized; no shares issued or outstanding	—	—
Common stock, \$0.0001 par value; 30,000,000 shares authorized; 10,814,260 shares issued and 10,766,311 shares outstanding at September 30, 2011, and 9,200,306 shares issued and 9,155,281 shares outstanding at December 31, 2010	1,077	916
Additional paid-in capital	39,384,096	33,502,074
Accumulated deficit	(20,784,494)	(22,081,038)
Treasury stock, at cost; 47,949 shares at September 30, 2011 and 45,025 shares at December 31, 2010	(220,538)	(209,940)
Total stockholders' equity	18,380,141	11,212,012
Total liabilities and stockholders' equity	\$ 21,391,825	\$ 14,726,794

See accompanying notes to condensed consolidated financial statements.

**WORLD ENERGY SOLUTIONS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited)

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Revenue:				
Brokerage commissions and transaction fees	\$ 5,378,392	\$ 4,355,513	\$ 14,438,184	\$ 12,276,224
Management fees	246,678	295,479	741,956	793,854
Total revenue	<u>5,625,070</u>	<u>4,650,992</u>	<u>15,180,140</u>	<u>13,070,078</u>
Cost of revenue	<u>970,846</u>	<u>913,452</u>	<u>2,907,359</u>	<u>2,776,337</u>
Gross profit	<u>4,654,224</u>	<u>3,737,540</u>	<u>12,272,781</u>	<u>10,293,741</u>
Operating expenses:				
Sales and marketing	2,512,191	2,177,921	7,385,241	7,083,757
General and administrative	1,293,822	1,414,947	3,610,892	3,690,895
Total operating expenses	<u>3,806,013</u>	<u>3,592,868</u>	<u>10,996,133</u>	<u>10,774,652</u>
Operating income (loss)	848,211	144,672	1,276,648	(480,911)
Interest income, net	<u>14,183</u>	<u>2,555</u>	<u>41,646</u>	<u>45</u>
Income (loss) before income taxes	862,394	147,227	1,318,294	(480,866)
Income tax expense	<u>7,250</u>	<u>—</u>	<u>21,750</u>	<u>—</u>
Net income (loss)	<u>\$ 855,144</u>	<u>\$ 147,227</u>	<u>\$ 1,296,544</u>	<u>\$ (480,866)</u>
Net income (loss) per share:				
Net income (loss) per common share – basic and diluted	<u>\$ 0.08</u>	<u>\$ 0.02</u>	<u>\$ 0.13</u>	<u>\$ (0.05)</u>
Weighted average shares outstanding – basic	<u>10,762,417</u>	<u>9,083,807</u>	<u>10,187,755</u>	<u>9,054,317</u>
Weighted average shares outstanding – diluted	<u>10,809,144</u>	<u>9,189,776</u>	<u>10,247,294</u>	<u>9,054,317</u>

See accompanying notes to condensed consolidated financial statements.

**WORLD ENERGY SOLUTIONS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)

	<b>Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>
<u>Cash flows from operating activities:</u>		
Net income (loss)	\$ 1,296,544	\$ (480,866)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	945,598	1,107,578
Share-based compensation	488,897	541,986
Interest on note receivable	(43,701)	(3,740)
Changes in operating assets and liabilities, net of the effects of acquisition:		
Trade accounts receivable	(151,136)	(599,500)
Prepaid expenses and other current assets	(181,206)	(84,862)
Accounts payable	54,887	(8,901)
Accrued commissions	71,082	110,430
Accrued compensation	(638,193)	18,060
Accrued expenses	66,518	(6,411)
Deferred revenue and customer advances	(50,174)	(677,372)
Net cash provided by (used in) operating activities	1,859,116	(83,598)
<u>Cash flows from investing activities:</u>		
Increase in other assets	(43,610)	(1,986)
Net cash paid in acquisition of Co-eXprise	(4,000,000)	—
Advance against note receivable	(216,667)	(216,667)
Purchases of property and equipment	(13,331)	(20,920)
Net cash used in investing activities	(4,273,608)	(239,573)
<u>Cash flows from financing activities:</u>		
Proceeds from exercise of stock options	89,307	26,632
Proceeds from exercise of stock warrants	—	1,234
Proceeds from the sale of common stock, net	5,303,979	354,276
Purchase of treasury stock	(10,598)	(13,942)
Principal payments on capital lease obligations	(11,218)	(12,032)
Net cash provided by financing activities	5,371,470	356,168
Net increase in cash and cash equivalents	2,956,978	32,997
Cash and cash equivalents, beginning of period	3,559,288	2,046,909
Cash and cash equivalents, end of period	\$ 6,516,266	\$ 2,079,906
<u>Supplemental disclosure of cash flow information:</u>		
Net cash paid for interest	\$ (2,091)	\$ (3,678)
Net cash paid for income taxes	\$ (17,000)	\$ —

See accompanying notes to condensed consolidated financial statements.

**WORLD ENERGY SOLUTIONS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**September 30, 2011**

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

World Energy Solutions, Inc. (“World Energy” or the “Company”) is an energy management services company that applies a combination of people, process and technology to take the complexity out of energy management and turn it into bottom line impact for the businesses, institutions and governments the Company serves. The Company’s management believes that energy costs can be expressed in a simple equation  $E=P*Q-i$ . Energy costs are a function of commodity price times quantity used, minus any incentives realized. The Company helps customers optimize this equation by applying the Seven Levers of Energy Management™ - Planning, Sourcing, Risk Management, Efficiency, Sustainability, Incentives and Monitoring.

These Seven Levers are supported by state of the art technology developed or licensed by the Company. The Company has developed three online auction platforms, the World Energy Exchange®, the World Green Exchange® and the World DR Exchange®. On the World Energy Exchange®, retail energy consumers (commercial, industrial and government) and wholesale energy participants (utilities, electricity retailers and intermediaries) in North America (“listers”) are able to negotiate for the purchase or sale of electricity, natural gas and renewable energy resources from competing energy suppliers (“bidders”) who have agreed to participate on the Company’s auction platform. Although the Company’s primary source of revenue is from brokering electricity and natural gas, the Company adapted its World Energy Exchange® auction platform to accommodate the brokering of green power in 2003 (i.e., electricity generated by renewable resources), wholesale electricity in 2004 and certain other energy-related products in 2005. The Company also uses the exchange’s sophisticated monitoring, triggering and messaging tools to develop, support and implement comprehensive risk management strategies for its more sophisticated clients.

In 2007, the Company created the World Green Exchange® to support companies’ sustainability goals as well as provide a marketplace for project developers to sell their environmental credits. On the World Green Exchange®, bidders and listers negotiate for the purchase or sale of environmental commodities such as Renewable Energy Certificates, Verified Emissions Reductions, Certified Emissions Reductions and Regional Greenhouse Gas Initiative (“RGGI”) allowances.

In January 2010, the Company launched the World DR Exchange® to create an efficient, transparent and liquid marketplace to maximize incentive payments available to customers and provide a source of curtailment-ready customers for the industry’s curtailment service providers (“CSPs”). The World DR Exchange® created the industry’s first online marketplace for demand response (“DR”), enabling customers to source DR more efficiently and effectively bringing together CSPs and energy consumers in highly-structured auction events designed to yield price transparency, heighten competition, and maximize the energy consumers’ share of demand response revenues.

In July 2010, the Company entered into a convertible note agreement with Retroficiency, Inc. (“Retroficiency”), an emerging company that develops solutions for identifying and qualifying business energy efficiency measures. Leveraging Retroficiency’s platform, the Company launched a new product for the energy efficiency market, the Virtual Energy Audit™, enabling commercial property owners and managers to more efficiently identify, evaluate, execute and manage retrofit opportunities across their portfolios.

In September 2011, the Company acquired certain contracts owned by Co-eXprise, Inc. (“Co-eXprise”) pursuant to a Contract Purchase Agreement (the “Agreement”) between the Company and Co-eXprise, for a purchase amount of \$4.0 million. Pursuant to the Agreement, the Company acquired all of the contracts and assumed certain liabilities with respect to Co-eXprise’s energy procurement business. Co-eXprise, located in Wexford Pennsylvania, is a leading provider of enterprise sourcing software solutions for discrete manufacturers, enabling companies to effectively manage sourcing activities for direct material and complex indirect spend categories. The effect of the acquisition of the assumed liabilities, assets and acquired contracts are included in these financial statements from September 13, 2011. See Note 12 for further discussion of the acquisition.

## 2. Interim Financial Statements

The December 31, 2010 condensed consolidated balance sheet has been derived from audited consolidated financial statements and the accompanying unaudited interim condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) regarding interim reporting. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America (“GAAP”) for complete financial statements and should be read in conjunction with the audited financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2010.

In the opinion of the Company’s management, the unaudited interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments consisting of normal recurring adjustments and accruals necessary for the fair presentation of the Company’s financial position as of September 30, 2011, and the results of its operations and cash flows for the three and nine months ended September 30, 2011 and 2010, respectively. The results of operations for the three and nine months ended September 30, 2011 are not necessarily indicative of the results to be expected for the fiscal year ending December 31, 2011. Certain prior year amounts have been reclassified to conform to the current year presentation.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

The Company’s most judgmental estimates affecting its condensed consolidated financial statements are those relating to revenue recognition and the estimate of actual energy delivered from the bidder to the lister of such energy; software development costs; share-based compensation; the valuation of intangible assets and goodwill; impairment of long-lived assets; and estimates of future taxable income as it relates to the realization of net deferred tax assets. The Company regularly evaluates its estimates and assumptions based upon historical experience and various other factors that the Company believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. To the extent actual results differ from those estimates, future results of operations may be affected.

## 3. Earnings (Loss) Per Share

As of September 30, 2011 and 2010, the Company only had one issued and outstanding class of stock – common stock. As a result, the basic earnings or loss per share for the three and nine months ended September 30, 2011 and 2010 is computed by dividing net earnings or loss available to common stockholders by the weighted average number of common shares outstanding for the period.

The following table provides a reconciliation of the denominators of the Company’s reported basic and diluted earnings per share computation for the three and nine months ended September 30, 2011 and 2010, respectively:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2011	2010	2011	2010
Weighted number of common shares - basic	10,762,417	9,083,807	10,187,755	9,054,317
Common stock equivalents	46,727	105,969	59,539	—
Weighted number of common and common equivalent shares - diluted	10,809,144	9,189,776	10,247,294	9,054,317

The computed loss per share does not assume conversion, exercise, or contingent exercise of securities that would have an antidilutive effect on loss per share. As the Company was in a net loss position for the nine month period ended September 30, 2010, all common stock equivalents in those periods were antidilutive.

The following represents issuable weighted average share information for the respective periods:

	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Common stock options	21,036	105,637	28,347	119,775
Common stock warrants	25,419	—	30,856	2,514
Unvested restricted stock	272	332	336	382
Total common stock equivalents	46,727	105,969	59,539	122,671

In addition, common stock options and unvested restricted stock of 597,401 shares and 2,277 shares, respectively, were excluded from the calculation of net earnings per share for the three and nine months ended September 30, 2011, as inclusion of such shares would be antidilutive due to exercise prices or value of proceed shares exceeding the average market price of the Company's common stock during that period.

Common stock options, common stock warrants and unvested restricted stock of 397,301 shares, 64,500 shares and 19,221 shares, respectively, were excluded from the calculation of net loss per share for the three and nine months ended September 30, 2010, as inclusion of such shares would be antidilutive due to exercise prices or value of proceed shares exceeding the average market price of the Company's common stock during that period.

#### **4. Concentration of Credit Risk and Off-Balance Sheet Risk**

Financial instruments that potentially expose the Company to concentrations of credit risk consist principally of cash and trade accounts receivable. The Company has no significant off-balance sheet risk such as foreign exchange contracts, option contracts, or other foreign hedging arrangements. The Company places its cash with primarily one institution, which management believes is of high credit quality. As of September 30, 2011, approximately \$3,151,000 of the Company's cash and cash equivalents was invested in a highly liquid, U.S. Treasury money market fund.

The Company earns commission payments from bidders based on transactions completed between listers and bidders. The Company provides credit in the form of invoiced and unbilled accounts receivable to bidders in the normal course of business. Collateral is not required for trade accounts receivable, but ongoing credit evaluations of bidders are performed. While the majority of the Company's revenue is generated from retail energy transactions where the winning bidder pays a commission to the Company, commission payments for certain auctions can be paid by the lister, bidder or a combination of both. Management provides for an allowance for doubtful accounts on a specifically identified basis, as well as through historical experience applied to an aging of accounts, if necessary. Trade accounts receivable are written off when deemed uncollectible. To date write-offs have not been material.

The following represents revenue and trade accounts receivable from bidders exceeding 10% of the total in each category:

<b>Bidder</b>	<b>Revenue For The Three Months Ended September 30,</b>		<b>Revenue For The Nine Months Ended September 30,</b>		<b>Trade Accounts Receivable As Of September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
A	4%	7%	4%	8%	9%	14%
B	10%	11%	11%	12%	8%	11%
C	13%	12%	13%	11%	22%	15%
D	17%	5%	9%	5%	1%	4%

In August 2011, the Company entered into an agreement with one of its energy suppliers for the payment of all amounts due to the Company subsequent to August 1, 2011 associated with expected future energy usage without recourse. As a result, the price became fixed and determinable and revenue was recognized. The net result was the receipt of approximately \$0.7 million of cash, which was recorded as revenue during the third quarter and reflected in the above table. In addition, third party and internal commission expense of \$0.3 million was recorded during the third quarter representing amounts due to channel partners and sales reps against this payment.

In addition to its direct relationship with bidders, the Company also has direct contractual relationships with listers for the online procurement of certain of their energy, demand response or environmental needs. These listers are primarily large businesses and government organizations and do not have a direct creditor relationship with the Company. For the three and nine months ended September 30, 2011 and 2010, no energy consumer represented more than 10% individually of the Company's aggregate revenue.

## 5. Trade Accounts Receivable, Net

The Company does not invoice bidders for the monthly commissions earned on retail electricity and demand response transactions and, therefore, reports a significant portion of its receivables as "unbilled." Unbilled accounts receivable represent management's best estimate of energy provided by the energy suppliers to the energy consumers for a specific completed time period at contracted commission rates.

The Company generally invoices bidders for commissions earned on retail natural gas and wholesale transactions, which are reflected as billed accounts receivable. The total commission earned on these transactions is recognized upon completion of the procurement event and is generally due within 30 days of invoice date. In addition, the Company invoices the bidder, lister or combination of both for certain auctions performed for environmental commodity product transactions. These transactions are earned and invoiced either upon lister acceptance of the auction results or, in some cases, upon delivery of the credits or cash settlement of the transaction. Trade accounts receivable, net consists of the following:

	<u>September 30, 2011</u>	<u>December 31, 2010</u>
Unbilled accounts receivable	\$ 3,456,929	\$ 2,852,930
Billed accounts receivable	312,710	395,004
	<u>3,769,639</u>	<u>3,247,934</u>
Allowance for doubtful accounts	(81,566)	(123,606)
Trade accounts receivable, net	<u>\$ 3,688,073</u>	<u>\$ 3,124,328</u>

## 6. Property and Equipment, Net

Property and equipment, net consists of the following:

	<u>September 30, 2011</u>	<u>December 31, 2010</u>
Leasehold improvements	\$ 65,451	\$ 65,451
Equipment	500,895	498,907
Furniture and fixtures	435,579	435,579
	<u>1,001,925</u>	<u>999,937</u>
Less: accumulated depreciation	(799,368)	(712,746)
Property and equipment, net	<u>\$ 202,557</u>	<u>\$ 287,191</u>

Depreciation expense for the three months ended September 30, 2011 and 2010 was approximately \$31,000 and \$34,000, respectively, and depreciation expense for the nine months ended September 30, 2011 and 2010 was approximately \$98,000 and \$106,000, respectively. Property and equipment purchased under capital lease obligations at September 30, 2011 and December 31, 2010 was approximately \$35,000 and \$46,000, respectively. Accumulated depreciation for property and equipment purchased under capital lease was approximately \$30,000 and \$32,000 at September 30, 2011 and December 31, 2010, respectively.

## 7. Common and Preferred Stock

### *Common Stock*

On April 11, 2011 the Company issued approximately 1.5 million shares of common stock at \$3.60 per share yielding proceeds of approximately \$5.3 million, net of \$0.2 million of expenses, to several accredited institutional investors. A shelf registration statement related to these securities was declared effective on April 21, 2010 by the SEC. The Company anticipates using the new capital for strategic initiatives, including investments and acquisitions in the energy management space.

### ***Treasury Stock***

In connection with the vesting of restricted stock granted to employees the Company withheld shares with value equivalent to employees' minimum statutory obligation for the applicable income and other employment taxes, and remitted the cash to the appropriate taxing authorities. The total shares withheld of 2,924 and 4,769 for the nine months ended September 30, 2011 and 2010, respectively, were based on the value of the restricted stock on their vesting date as determined by the Company's closing stock price. Total payment for employees' tax obligations was approximately \$11,000 and \$14,000 for the nine months ended September 30, 2011 and 2010. These net-share settlements had the effect of share repurchases by the Company as they reduced the number of shares that would have otherwise been issued as a result of the vesting and did not represent an expense to the Company.

### ***Common Stock Warrants***

On March 1, 2011, the Company issued warrants to consultants for the purchase of 300,000 shares of the Company's common stock at a per share price of \$3.00. The warrants vest ratably on a quarterly basis over a twelve month period and have a one year life.

The following table summarizes the Company's warrant activity for the nine months ended September 30, 2011:

	<u>Shares</u>	<u>Weighted Average Exercise Price</u>
Warrants outstanding, December 31, 2010	64,500	\$ 3.03
Granted	300,000	\$ 3.00
Exercised	—	\$ —
Canceled/expired	—	\$ —
Warrants outstanding, September 30, 2011	<u>364,500</u>	\$ 3.00

The weighted average remaining contractual life of warrants outstanding is 0.96 years as of September 30, 2011.

## **8. Share-Based Compensation**

For the nine months ended September 30, 2011 and 2010, share-based awards consisted of grants of stock options and stock warrants, respectively. The Company recognizes the compensation from share-based awards on a straight-line basis over the requisite service period of the award. The vesting period of share-based awards is determined by the board of directors, and is generally four years for employees. The restrictions on the restricted stock lapse over the vesting period, which is typically four years. The per-share weighted-average fair value of stock options granted during the nine months ended September 30, 2011 was \$2.13 on the date of grant, using the Black-Scholes option-pricing model with the following weighted-average assumptions and an estimated forfeiture rate of 10%:

<u>Nine months ended September 30,</u>	<u>Expected Dividend Yield</u>	<u>Risk-Free Interest Rate</u>	<u>Expected Life</u>	<u>Expected Volatility</u>
2011	—	0.88%	4.75 years	100%

The per-share weighted-average fair value of stock warrants granted during the nine months ended September 30, 2011 was \$0.83 on the date of grant, using the Black-Scholes option-pricing model with weighted-average assumptions for the risk-free interest rate, expected life and expected volatility of 0.16%, 0.75 years and 59%, respectively, and no estimated forfeiture rate for the nine months ended September 30, 2011.

The Company elected to use the Black-Scholes option pricing model to determine the weighted average fair value of options and warrants granted. The Company determined the volatility for stock options based on the reported closing prices of the Company's stock since its initial public offering in November 2006. The expected life of stock options and stock warrants has been determined utilizing the "simplified" method as prescribed by the SEC's Staff Accounting Bulletin No. 107, "Share-Based Payment". The risk-free interest rate is based on a treasury instrument whose term is consistent with the expected life of the stock options and stock warrants. The Company has not paid and does not anticipate

paying cash dividends on its common stock; therefore, the expected dividend yield is assumed to be zero. In addition, guidance from the Financial Accounting Standards Board requires companies to utilize an estimated forfeiture rate when calculating the expense for the period. As a result, the Company applied estimated forfeiture rates to unvested share-based compensation of 10% for stock options and restricted stock for each of the nine month periods ended September 30, 2011 and 2010, respectively, in determining the expense recorded in the accompanying consolidated statements of operations.

The approximate total share-based compensation expense for the periods presented is included in the following expense categories:

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
Cost of revenue	\$ 12,000	\$ 18,000	\$ 56,000	\$ 55,000
Sales and marketing	116,000	57,000	289,000	175,000
General and administrative	43,000	112,000	144,000	312,000
Total share-based compensation	<u>\$ 171,000</u>	<u>\$ 187,000</u>	<u>\$ 489,000</u>	<u>\$ 542,000</u>

As of September 30, 2011, there was approximately \$848,000 of unrecognized compensation expense related to share-based awards, including approximately \$770,000 related to non-vested stock option awards that is expected to be recognized over a weighted-average period of 2.56 years, approximately \$20,000 related to non-vested restricted stock awards that is expected to be recognized over a weighted average period of 0.62 years and approximately \$58,000 related to non-vested stock warrants that is expected to be recognized over a weighted average period of 0.42 years.

## 9. Employee Benefit Plans

### *Stock Options*

The Company has two stock incentive plans: the 2003 Stock Incentive Plan, or the 2003 Plan, and the 2006 Stock Incentive Plan, or the 2006 Plan. There were 743,108 shares of common stock reserved for issuance under these plans at September 30, 2011. As of September 30, 2011, 102,201 shares of common stock, representing outstanding stock options, were reserved under the 2003 Plan. No further grants are allowed under the 2003 Plan. As of September 30, 2011, 640,907 shares of common stock were reserved under the 2006 Plan representing 560,080 outstanding stock options, 2,927 shares of restricted stock outstanding and 77,900 shares available for grant. A summary of stock option activity under both plans for the nine months ended September 30, 2011 is as follows:

	<u>Number of Stock Options</u>	<u>Weighted Average Exercise Price</u>
Outstanding at December 31, 2010	704,906	\$ 3.96
Granted	66,000	\$ 3.15
Cancelled	(31,687)	\$ 3.80
Exercised	(76,938)	\$ 1.16
Outstanding at September 30, 2011	<u>662,281</u>	\$ 4.21

A summary of common stock options outstanding and common stock options exercisable as of September 30, 2011 is as follows:

<u>Range of Exercise Prices</u>	<u>Options Outstanding</u>			<u>Options Exercisable</u>		
	<u>Options</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Aggregate Intrinsic Value</u>	<u>Number Of Shares Exercisable</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Aggregate Intrinsic Value</u>
\$2.00 - \$2.40	64,880	3.79 Years	\$ 60,134	45,946	3.63 Years	\$ 41,768
\$2.41 - \$3.15	271,600	6.22 Years	26,586	19,050	5.18 Years	75
\$3.16 - \$5.03	214,100	4.55 Years	—	113,884	3.98 Years	—
\$5.04 - \$13.40	111,701	2.39 Years	—	106,233	2.28 Years	—
	<u>662,281</u>	4.79 Years	<u>\$ 86,720</u>	<u>285,113</u>	3.37 Years	<u>\$ 41,843</u>

The aggregate intrinsic value of options exercised during the nine months ended September 30, 2011 was

approximately \$176,000. At September 30, 2011, the weighted average exercise price of common stock options outstanding and exercisable was \$4.21 and \$5.82, respectively.

### ***Restricted Stock***

A summary of restricted stock activity under the 2006 Plan for the nine months ended September 30, 2011 is as follows:

	<u>Shares</u>	<u>Weighted Average Grant Price</u>
Outstanding at December 31, 2010	13,828	\$10.10
Granted	8,364	\$ 3.14
Cancelled	(2,250)	\$10.76
Vested	(17,015)	\$ 7.02
Outstanding at September 30, 2011	<u>2,927</u>	<u>\$ 7.59</u>

### ***401(k) Plan***

The Company's 401(k) savings plan covers the majority of the Company's employees. Employees of the Company may participate in the 401(k) Plan after reaching the age of 21. The Company may make discretionary matching contributions as determined from time to time. Employee contributions vest immediately, while Company matching contributions begin to vest after one year of service and continue to vest at 20% per year over the next five years. To date, the Company has not made any discretionary contributions to the 401(k) Plan.

## **10. Convertible Note Receivable**

In July 2010, the Company made a \$650,000 strategic investment in the form of a two-year convertible note with Retroficiency. The convertible note bears interest at 9% per annum with principal and interest due at the end of the term on July 22, 2012. It includes optional and automatic conversion rights to convert into Retroficiency shares at \$0.54 per share and is subject to adjustment in certain circumstances. The Company evaluated the value of its conversion feature and determined it to be immaterial. As of September 30, 2011, approximately \$57,000 of interest receivable has been accrued and is reflected in other assets in the accompanying condensed consolidated balance sheet.

## **11. Credit Arrangement**

On March 8, 2011, the Company entered into a Second Loan Modification Agreement (the "Second Modification Agreement") with Silicon Valley Bank ("SVB"). The Second Modification Agreement amended and extended the Loan and Security Agreement with SVB dated September 8, 2008, as amended on September 30, 2009 (the "Loan Agreement"), through March 6, 2012. Under the Second Modification Agreement, SVB has committed to make advances to the Company in an aggregate amount of up to \$3,000,000, subject to availability against certain eligible accounts receivable and eligible retail backlog. The credit facility bears interest at a floating rate per annum based on the prime rate plus 1.25% on advances made against eligible accounts receivable and prime rate plus 2.00% on advances made against eligible retail backlog, with the prime rate being subject to a 4.00% floor. These interest rates are subject to change based on the Company's maintenance of an adjusted quick ratio of one-to-one.

The Company has not taken advances under the facility and there were no outstanding borrowings at September 30, 2011. As of September 30, 2011, the Company was in compliance with its covenants under the facility.

## **12. Acquisition**

In September 2011, the Company acquired certain contracts and assumed certain liabilities of the Co-eXprise energy procurement business pursuant to a Contract Purchase Agreement between the Company and Co-eXprise. The purchase price was \$4.0 million in cash, subject to certain escrowing provisions. Co-eXprise, located in Wexford Pennsylvania, is a leading provider of enterprise sourcing software solutions for discrete manufacturers, enabling companies to effectively manage sourcing activities for direct material and complex indirect spend categories.

The effect of the acquisition of the assumed liabilities, assets and acquired contracts are included in these financial statements from September 13, 2011. The cost of the acquisition was allocated to the assets and liabilities assumed based on

estimates of their respective fair values at the date of acquisition resulting in net assets of \$4.0 million. The goodwill recognized is attributable primarily to expected synergies of Co-eXprise. The excess purchase price of \$1.8 million has been recorded as goodwill which is fully deductible for tax purposes. The purchase price is not finalized as the Company has not yet determined fair value for certain net assets acquired which may affect the closing balance sheet. The Company does not believe that any adjustments to the fair values will materially modify the purchase price allocation. Management is responsible for the valuation of net assets acquired and considered a number of factors, including valuations and appraisals, when estimating the fair values and estimated useful lives of acquired assets and liabilities.

The Company has allocated the purchase price for the acquisition as follows:

Unbilled receivables	\$ 412,609
Current Liabilities	(4,000)
Intangible assets:	
Non-compete agreements	170,000
Customer relationships	580,000
Customer contracts	1,010,000
Goodwill	1,831,391
Net assets acquired	<u>\$ 4,000,000</u>

The intangible assets, excluding goodwill, are being amortized on a straight-line basis over their weighted average lives as follows: non-compete agreements – five years; customer relationships – seven years; and customer contracts – two and one half years. Pursuant to Accounting Standards Codification (“ASC”) 350-20-28, goodwill is tested for impairment on an annual basis and between annual tests in certain circumstances, with any excess of the carrying value of a reporting unit’s goodwill over the implied fair value of the goodwill recorded as an impairment loss.

The following unaudited pro forma information assumes that the acquisition of the Co-eXprise contracts had been completed as of the beginning of 2010:

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
Revenues	\$ 6,286,395	\$ 5,190,181	\$ 17,459,031	\$ 14,958,028
Net income (loss)	1,127,330	281,567	2,191,714	(114,625)
Net income (loss) per share:				
Net income (loss) per share – basic	\$ 0.10	\$ 0.03	\$ 0.22	\$ (0.01)
Net income (loss) per share – diluted	\$ 0.10	\$ 0.03	\$ 0.21	\$ (0.01)
Weighted average shares outstanding - Basic	10,762,417	9,083,807	10,187,755	9,054,317
Weighted average shares outstanding - Diluted	10,809,144	9,189,776	10,247,294	9,054,317

The pro forma financial information is not necessarily indicative of the results to be expected in the future as a result of the acquisition of the Co-eXprise contracts. Transaction costs of \$0.2 million have been reflected in the consolidated statements of operations for the three- and nine-months ended September 30, 2011 as a component of general and administrative expenses.

### 13. Subsequent Events

On October 13, 2011 the Company acquired substantially all of the assets and certain obligations of Northeast Energy Solutions, LLC (“NES”) for approximately \$4.8 million, pursuant to an Asset Purchase Agreement. NES is a regional provider of energy efficiency services based in Cromwell, Connecticut. The purchase price consists of approximately \$1.0 million in cash, \$3.0 million payable in the form of a promissory note, 83,209 shares of the Company’s common stock and up to a \$0.5 million earn-out. The promissory note is payable in three installments in the third and fourth quarters of 2012 and earns interest at 5.0 %.

On October 31, 2011 the Company acquired substantially all of the assets and certain obligations of GSE Consulting, LP (“GSE”) for approximately \$8.6 million pursuant to an Asset Purchase Agreement. GSE is a Texas based energy management and procurement company. The purchase price of \$8.6 million consists of approximately \$3.9 million in cash, \$1.5 million paid to retire a note payable held by GSE, and 1.0 million shares of the Company’s common stock. GSE may earn up to an additional \$4.5 million in cash based on earn-outs to be measured over a two-year period through October 2013. These earn-outs are based on GSE achieving certain annualized new bookings and renewal rates for the remainder of 2011 and for the 12-month periods ending October 31, 2012 and 2013, respectively. The maximum payouts under these earn-outs are \$2.0 million at January 31, 2012, \$1.5 million at January 15, 2013, and \$1.0 million at January 15, 2014. As of the date of filing, the purchase price allocations for NES and GSE assets have not been completed.

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

*This quarterly report on Form 10-Q including this Item 2, contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which involve risks and uncertainties. Readers can identify these statements by forward-looking words such as “may,” “could,” “should,” “would,” “intend,” “will,” “expect,” “anticipate,” “believe,” “estimate,” “continue” or similar words. The Company’s actual results and the timing of certain events may differ significantly from the results and timing discussed in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed or referred to in this report and in the “Risk Factors” section of our Annual Report on Form 10-K and any later publicly available filing with the Securities and Exchange Commission. The following discussion and analysis of the Company’s financial condition and results of operations should be read in light of those factors and in conjunction with the Company’s accompanying consolidated financial statements and notes thereto.*

### Overview

World Energy is an energy management services company that applies a combination of people, process and technology to take the complexity out of energy management and turn it into bottom line impact for the businesses, institutions and governments we serve. We believe that energy costs can be expressed in a simple equation  $E=P*Q-i$ . Energy costs are a function of commodity price times quantity used, minus any incentives realized. We help customers optimize this equation by applying the Seven Levers of Energy Management™ - Planning, Sourcing, Risk Management, Efficiency, Sustainability, Incentives and Monitoring.

These Seven Levers are supported by state of the art technology developed or licensed by the Company. We have developed three online auction platforms, the World Energy Exchange®, the World Green Exchange® and the World DR Exchange®. On the World Energy Exchange®, retail energy consumers (commercial, industrial and governmental) and wholesale energy participants (utilities, electricity retailers, and intermediaries) in North America (“listers”) are able to negotiate for the purchase or sale of electricity, natural gas and renewable energy resources from competing energy suppliers (“bidders”) who have agreed to participate on our auction platform. The World Energy Exchange® is supplemented with information about market rules, pricing trends, energy consumer usage and load profiles. Our energy management staff uses this platform to conduct auctions, analyze results, guide energy consumers through contracting, and track their contracts, sites, accounts and usage history. The team also uses the exchange’s sophisticated monitoring, triggering and messaging tools to develop, support and implement comprehensive risk management strategies for our more sophisticated clients.

In 2007, we created the World Green Exchange® to support companies’ sustainability goals as well as provide a marketplace for project developers to sell their environmental credits. On the World Green Exchange®, bidders and listers negotiate for the purchase or sale of environmental commodities such as Renewable Energy Certificates (“RECs”), Verified Emissions Reductions (“VERs”), Certified Emissions Reductions (“CERs”) and Regional Greenhouse Gas Initiative (“RGGI”) allowances.

In January 2010, we launched the World DR Exchange® to create an efficient, transparent and liquid marketplace to maximize incentive payments available to customers and provide a source of curtailment-ready customers for the industry’s curtailment service providers (“CSPs”). The World DR Exchange® created the industry’s first online marketplace for demand response (“DR”), enabling customers to source DR more efficiently and effectively bringing together CSPs and energy consumers in highly-structured auction events designed to yield price transparency, heighten competition, and maximize the energy consumers’ share of demand response revenues.

In July 2010, we made a strategic investment in the form of a two-year convertible note with Retroficiency, Inc. (“Retroficiency”), an emerging company that develops solutions for identifying and qualifying business energy efficiency measures. Leveraging Retroficiency’s platform, we launched a new product for the energy efficiency market, the Virtual Energy Audit™, enabling commercial property owners and managers to more efficiently identify, evaluate, execute and manage retrofit opportunities across their portfolios.

In April 2011, we issued approximately 1.5 million shares of common stock to several accredited institutional investors at \$3.60 per share, yielding net proceeds of approximately \$5.3 million. We anticipate using the new capital for strategic initiatives, including investments and acquisitions in the energy management space.

In September 2011, we acquired certain contracts owned by Co-eXprise, Inc. (“Co-eXprise”) pursuant to a Contract Purchase Agreement (the “Agreement”) between the Company and Co-eXprise. Pursuant to the Agreement, we purchased

all of the contracts and assumed certain obligations with respect to Co-eXprise's energy procurement business. The purchase price was \$4.0 million in cash, subject to certain escrowing provisions.

We have significantly grown our employee base from 20 at our initial public offering ("IPO") in November 2006 to a high of 66 during the second quarter of 2008. This planned investment allowed us to execute against our strategic initiatives and has resulted in revenue growth of over 200% to \$18 million in 2010. We aggressively invested in all of our product lines including building out a direct sales force, expanding our channel partner network, acquiring one of our largest competitors, and building our wholesale and green teams. As we made these infrastructure investments in advance of revenue growth, our operating losses increased significantly in 2007 and 2008. These investments began to generate incremental revenue in the fourth quarter of 2007 and the scalability inherent in our business model returned to our pre-IPO levels resulting in gross margins of approximately 80% today and net income for five consecutive quarters. We have generated positive adjusted EBITDA in nine of the last eleven quarters including each of the last eight quarters. Over the last eight quarters we have generated positive adjusted EBITDA of \$4.9 million, including \$3.5 million over the last four quarters and \$1.3 million in our most recent quarter. Our fixed operating cost structure has remained flat over this period and we believe it will remain at these levels in the short-term. However, a portion of our total operating cost structure, including channel partner and internal commission costs, is variable in nature and will increase as revenue levels increase. We will continue to be opportunistic and invest in our current product lines and pursue acquisitions both within our existing product lines and new product lines. These activities may increase our operating costs both in the short and long-term.

## **Operations**

### *Revenue*

#### Retail Electricity Transactions

We earn a monthly commission on energy sales contracted through our online auction platform from each bidder or energy supplier based on the energy usage transacted between the bidder and lister or energy consumer. Our commissions are not based on the retail price for electricity; rather on the amount of energy consumed. Commissions are calculated based on the volume of energy usage transacted between the energy supplier and energy consumer multiplied by our contractual commission rate. Our contractual commission rate is negotiated with the energy consumer on a procurement-by-procurement basis based on energy consumer specific circumstances, including the size of auction, the effort required to organize and run the respective auction and competitive factors, among others. Once the contractual commission is agreed to with the energy consumer, all energy suppliers participating in the auction agree to that rate. That commission rate remains fixed for the duration of the contractual term regardless of energy usage. Energy consumers provide us with a letter of authorization to request their usage history from the local utility. We then use this data to compile a usage profile for that energy consumer that will become the basis for the auction. This data may also be used to estimate revenue on a going forward basis, as noted below.

Historically, our revenue and operating results have varied from quarter-to-quarter and are expected to continue to fluctuate in the future. These fluctuations are primarily due to the buying patterns of our wholesale and natural gas customers, which tend to have large, seasonal purchases during the fourth and first quarters and electricity usage having higher demand in our second and third quarters. In addition, the activity levels on the World Energy Exchange® can fluctuate due to a number of factors, including market prices, weather conditions, energy consumers' credit ratings, the ability of suppliers to obtain financing in credit markets, and economic and geopolitical events. To the extent these factors affect the purchasing decisions of energy consumers our future results of operations may be affected. Contracts between energy suppliers and energy consumers are signed for a variety of term lengths, with a one year contract term being typical for commercial and industrial energy consumers, and government contracts typically having two to three year terms. Our revenue has grown over the last three years through new participants utilizing our World Energy Exchange® as well as existing energy consumers increasing the size or frequency of their transactions on our exchange platform.

We do not invoice our electricity energy suppliers for monthly commissions earned and, therefore, we report a substantial portion of our receivables as "unbilled." Unbilled accounts receivable represents management's best estimate of energy provided by the energy suppliers to the energy consumers for a specific completed time period at contracted commission rates and is made up of two components. The first component represents energy usage for which we have received actual data from the supplier and/or the utility, but for which payment has not been received at the balance sheet date. The majority of our contractual relationships with energy suppliers require them to supply actual usage data to us on a monthly basis and remit payment to us based on that usage. The second component represents energy usage for which we have not received actual data, but for which we have estimated usage. Commissions paid in advance by certain bidders are recorded as deferred

revenue and amortized to commission revenue on a monthly basis on the energy exchanged that month.

#### Retail Natural Gas Transactions

There are two primary fee components to our retail natural gas services: transaction fees and management fees. Transaction fees are billed to and paid by the energy supplier awarded business on the platform. These fees are established prior to award and are the same for each supplier. For the majority of our natural gas transactions, we bill the supplier upon the conclusion of the transaction based on the estimated energy volume transacted for the entire award term multiplied by the transaction fee. Management fees are paid by our energy consumers and are generally billed on a monthly basis for services rendered based on terms and conditions included in contractual arrangements. While substantially all of our retail natural gas transactions are accounted for in accordance with this policy, a certain percentage is accounted for as the natural gas is consumed by the energy consumer and recognized as revenue in accordance with the retail electricity transaction revenue recognition methodology described above.

#### Demand Response Transactions

Demand response transaction fees are recognized when we have received confirmation from the CSP that the energy consumer has performed under the applicable Regional Transmission Organization (“RTO”) or Independent System Operator (“ISO”) program requirements. The energy consumer is either called to perform during an actual curtailment event or is required to demonstrate its ability to perform in a test event during the performance period. For the PJM Interconnection (“PJM”), an RTO that coordinates the movement of wholesale electricity in all or parts of 13 states and the District of Columbia, the performance period is June through September in a calendar year. Test results are submitted to the PJM by the CSPs and we receive confirmation of the energy consumer’s performance in the fourth quarter. CSPs typically pay us ratably on a quarterly basis throughout the demand response fiscal (June to May) year. As a result, a portion of the revenue we recognize is reflected as unbilled accounts receivable.

#### Wholesale Transactions

Wholesale transaction fees are invoiced upon the conclusion of the auction based on a fixed fee. These revenues are not tied to future energy usage and are recognized upon the completion of the online auction. For reverse auctions where our customers bid for a consumer’s business, the fees are paid by the bidder. For forward auctions where a lister is selling energy products, the fees are typically paid by the lister. While substantially all wholesale transactions are accounted for in this fashion, a small percentage of our wholesale revenue is accounted for as electricity or gas is delivered, similar to the retail electricity transaction methodology described above.

#### Environmental Commodity Transactions

Environmental commodity transaction fees are accounted for utilizing two primary methods. For regulated allowance programs like RGGI, fees are paid by the lister and are recognized quarterly as revenue as auctions are completed and approved. For all other environmental commodity transactions both the lister and the bidder pay the transaction fee and revenue is recognized upon the consummation of the underlying transaction as credits are delivered by the lister and payment is made by the bidder.

#### ***Cost of revenue***

Cost of revenue consists primarily of:

- salaries, employee benefits and share-based compensation associated with our auction management services, which are directly related to the development and production of the online auction and maintenance of market-related data on our auction platform and monthly management fees (our supply desk function);
- amortization of capitalized costs associated with our auction platform and acquired developed technology; and
- rent, depreciation and other related overhead and facility-related costs.

#### ***Sales and marketing***

Sales and marketing expenses consist primarily of:

- salaries, employee benefits and share-based compensation related to sales and marketing personnel;
- third party commission expenses to our channel partners;
- travel and related expenses;
- amortization related to customer relationships and contracts;
- rent, depreciation and other related overhead and facility-related costs; and
- general marketing costs such as trade shows, marketing materials and outsourced services.

***General and administrative***

General and administrative expenses consist primarily of:

- salaries, employee benefits and share-based compensation related to general and administrative personnel;
- accounting, legal, and other professional fees; and
- rent, depreciation and other related overhead and facility-related costs.

***Interest income, net***

Interest expense, net consists primarily of:

- interest income earned on cash held in the bank and notes receivable; and
- interest expense related to capital leases.

***Income tax expense***

We recorded income tax expense of approximately \$22,000 for the nine months ended September 30, 2011. We did not record an income tax benefit for the nine months ended September 30, 2010 as we provided a full valuation allowance against our deferred tax assets due to uncertainty regarding the realization of those deferred tax assets, primarily net operating loss carryforwards, in the future. The income tax expense in 2011 reflects an alternative minimum tax liability anticipated to be incurred in calendar 2011.

**Results of Operations**

The following table sets forth certain items as a percent of revenue for the periods presented:

	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
Revenue.....	100%	100%	100%	100%
Cost of revenue.....	<u>17</u>	<u>20</u>	<u>19</u>	<u>21</u>
Gross profit .....	83	80	81	79
Operating expenses:				
Sales and marketing.....	45	47	49	55
General and administrative.....	<u>23</u>	<u>30</u>	<u>24</u>	<u>28</u>
Operating income (loss) .....	15	3	8	(4)
Interest income, net .....	—	—	1	—
Income tax expense .....	—	—	—	—
Net income (loss).....	<u>15%</u>	<u>3%</u>	<u>9%</u>	<u>(4)%</u>

*Comparison of the Three Months Ended September 30, 2011 and 2010*

*Revenue*

	<b>For the Three Months Ended September 30,</b>		<b>Increase</b>	
	<b>2011</b>	<b>2010</b>		
Revenue.....	\$ 5,625,070	\$ 4,650,992	\$ 974,078	21%

Revenue increased 21% for the three months ended September 30, 2011 as compared to the same period in 2010 primarily due to increased auction activity in our retail product line. This increase was partially offset by declines in our wholesale and environmental commodities product lines. The retail product line increase reflects an agreement with one of our energy suppliers for the payment of all amounts due us subsequent to August 1, 2011 associated with expected future energy usage without recourse. The net incremental increase in revenue was approximately \$0.7 million. In addition, the retail product line reflected new customer wins with a concentration in the Pennsylvania electricity market and further growth in our channel partner network. Our wholesale product line decreased primarily due to the timing of transactions in the third quarter of 2011 compared to the same period in 2010.

*Cost of revenue*

	<b>For the Three Months Ended September 30,</b>				<b>Increase</b>	
	<b>2011</b>		<b>2010</b>			
	<b>\$</b>	<b>% of Revenue</b>	<b>\$</b>	<b>% of Revenue</b>		
Cost of revenue.....	\$970,846	17%	\$ 913,452	20%	\$ 57,394	6%

Cost of revenue increased 6% for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010 as increases in payroll and commission costs were partially offset by a decrease in amortization of capitalized software. Payroll costs increased due to a net increase of three supply desk employees during the quarter ended September 30, 2011 versus the same period last year. Commission costs increased due to the 21% increase in revenue. Cost of revenue as a percent of revenue decreased 3% due to the 21% increase in revenue.

*Operating expenses*

	<b>For the Three Months Ended September 30,</b>				<b>Increase/(Decrease)</b>	
	<b>2011</b>		<b>2010</b>			
	<b>\$</b>	<b>% of Revenue</b>	<b>\$</b>	<b>% of Revenue</b>		
Sales and marketing.....	\$ 2,512,191	45%	\$ 2,177,921	47%	\$ 334,270	15%
General and administrative.....	1,293,822	23	1,414,947	30	(121,125)	(9)
Total operating expenses.....	\$ 3,806,013	68%	\$ 3,592,868	77%	\$ 213,145	6%

Sales and marketing expenses increased 15% for the three months ended September 30, 2011 as compared to the same period in 2010. This increase was primarily due to increases in channel partner commission costs from the 21% increase in revenue during the quarter. Sales and marketing expense as a percentage of revenue decreased 2% due to the 21% increase in revenue.

The 9% decrease in general and administrative expenses for the three months ended September 30, 2011 as compared to the same period in 2010 was primarily due to decreases in costs associated with bad debt and investor relations activities. These decreases were offset by transaction costs associated with the acquisition of Co-eXprise. General and administrative expenses as a percent of revenue decreased 7% due to the 21% increase in revenue and the cost decreases noted above.

*Interest income, net*

Interest income, net was approximately \$14,000 for the three months ended September 30, 2011 compared to interest income, net of approximately \$3,000 for the three months ended September 30, 2010. The increase in interest income in the third quarter of 2011 was primarily due to interest earned on a convertible note receivable with Retroficiency.

*Income tax expense*

We recorded income tax expense of approximately \$7,000 for the three months ended September 30, 2011. We did not record an income tax benefit for the three months ended September 30, 2010 as we provided a full valuation allowance against our deferred tax assets due to uncertainty regarding the realization of those deferred tax assets, primarily net

operating loss carryforwards, in the future. The income tax expense in 2011 reflects an alternative minimum tax liability anticipated to be incurred in calendar 2011.

*Net income*

Net income increased \$0.7 million to \$0.9 million for the three months ended September 30, 2011 primarily due to the 21% increase in revenue described above.

***Comparison of the Nine Months Ended September 30, 2011 and 2010***

*Revenue*

	<b>For the Nine Months Ended September 30,</b>		<b>Increase</b>	
	<b>2011</b>	<b>2010</b>		
Revenue .....	\$ 15,180,140	\$ 13,070,078	\$ 2,110,062	16%

Revenue increased 16% for the nine months ended September 30, 2011 as compared to the same period in 2010 primarily due to increased auction activity in our retail product line. This increase was partially offset by declines in our wholesale and environmental product lines. The retail product line increase reflects an agreement with one of our energy suppliers for the payment of all amounts due us subsequent to August 1, 2011 associated with expected future energy usage without recourse. The net incremental increase in revenue was approximately \$0.7 million. In addition, the retail product line reflected new customer wins with a concentration in the Pennsylvania electricity market and further growth in our channel partner network. Our wholesale and environmental commodities product lines decreased primarily due to the timing of transactions in the first nine months of 2011 compared to the same period in 2010.

*Cost of revenue*

	<b>For the Nine Months Ended September 30,</b>					
	<b>2011</b>		<b>2010</b>		<b>Increase</b>	
	<b>\$</b>	<b>% of Revenue</b>	<b>\$</b>	<b>% of Revenue</b>		
Cost of revenue.....	\$ 2,907,359	19%	\$ 2,776,337	21%	\$ 131,022	5%

Cost of revenue increased 5% for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010 as increases in payroll and commission costs were partially offset by a decrease in amortization of capitalized software. Payroll costs increased due to an increase in supply desk employees during the nine months ended September 30, 2011 versus the same period last year. Commission costs increased due to the 16% increase in revenue. Cost of revenue as a percent of revenue decreased 2% due to the 16% increase in revenue.

*Operating expenses*

	<b>For the Nine Months Ended September 30,</b>					
	<b>2011</b>		<b>2010</b>		<b>Increase/(Decrease)</b>	
	<b>\$</b>	<b>% of Revenue</b>	<b>\$</b>	<b>% of Revenue</b>		
Sales and marketing.....	\$ 7,385,241	49%	\$ 7,083,757	55%	\$ 301,484	4%
General and administrative.....	3,610,892	24	3,690,895	28	(80,003)	(2)
Total operating expenses .....	\$ 10,996,133	73%	\$ 10,774,652	83%	\$ 221,481	2%

The 4% increase in sales and marketing expense for the nine months ended September 30, 2011 as compared to the same period in 2010 primarily reflects an increase in channel partner commission costs associated with the 16% increase in revenue. Sales and marketing expense as a percentage of revenue decreased 6% due to the 16% increase in revenue.

The 2% decrease in general and administrative expenses related to the nine months ended September 30, 2011 as compared to the same period in 2010 was primarily due to decreases in costs associated with investor relations activities and compliance costs. General and administrative expenses as a percent of revenue decreased 4% due to the 16% increase in revenue.

*Interest income, net*

Interest income, net was approximately \$42,000 for the nine months ended September 30, 2011. Interest income substantially offset interest expense for the nine months ended September 30, 2010. The increase in interest income, net in the first nine months of 2011 was primarily due to interest earned on a convertible note receivable with Retroficiency.

### *Income tax expense*

We recorded income tax expense of approximately \$22,000 for the nine months ended September 30, 2011. We did not record an income tax benefit for the nine months ended September 30, 2010 as we provided a full valuation allowance against our deferred tax assets due to uncertainty regarding the realization of those deferred tax assets, primarily net operating loss carryforwards, in the future. The income tax expense in 2011 reflects an alternative minimum tax liability anticipated to be incurred in calendar 2011.

### *Net income (loss)*

We reported net income for the nine months ended September 30, 2011 of approximately \$1.3 million as compared to a net loss of approximately \$0.5 million for the nine months ended September 30, 2010. The \$1.8 million increase in net income is primarily due to the 16% increase in revenue net of increases for variable costs such as third party commissions associated with the increase in revenue.

## **Liquidity and Capital Resources**

At September 30, 2011, we had no commitments for material capital expenditures. We have identified and executed against a number of strategic initiatives that we believe are key components of our future growth, including: expanding our community of listers, bidders and channel partners on our exchanges; strengthening and extending our long-term relationships with government agencies; entering into other energy-related markets including wholesale transactions with utilities, the environmental commodities markets and demand response market; making strategic acquisitions; and growing our direct and inside sales force. As of September 30, 2011, our workforce numbered 60 reflecting the same number that we employed at December 31, 2010. At September 30, 2011, we had 22 professionals in our sales and marketing and account management groups, 26 in our supply desk group and 12 in our general and administrative group. While we did not add any employees associated with the Co-eXprise acquisition, we do anticipate our workforce increasing with our subsequent acquisitions of NES and GSE. The NES acquisition includes the repayment of \$3.0 million in a note payable to the seller in three equal installments during the second half of 2012 and earn-out provisions of \$0.25 million in each of the first and fourth quarters of 2012. The GSE acquisition requires up to a total of \$4.5 million of future potential payments in the first quarters of 2012, 2013 and 2014 based on certain performance criteria in the form of earn-outs. We believe we have the resources to meet our long-term obligations under these arrangements based on cash on-hand, operating cash flows both from our base and recently acquired businesses, and availability under our current line-of-credit.

### *Comparison of September 30, 2011 to December 31, 2010*

	<u>September 30,</u> <u>2011</u>	<u>December 31,</u> <u>2010</u>	<u>Increase</u>	
Cash and cash equivalents .....	\$ 6,516,266	\$ 3,559,288	\$ 2,956,978	83%
Trade accounts receivable .....	\$ 3,688,073	\$ 3,124,328	\$ 563,745	18
Days sales outstanding.....	64	58	6	10
Working capital .....	\$ 7,602,969	\$ 3,399,147	\$ 4,203,822	124
Stockholders' equity .....	\$ 18,380,141	\$ 11,212,012	\$ 7,168,129	64

Cash and cash equivalents increased 83% primarily due to net proceeds of \$5.3 million received from the sale of common stock in April 2011 and positive adjusted EBITDA of approximately \$2.7 million for the nine months ended September 30, 2011. These increases were partially offset by the acquisition of Co-eXprise's energy procurement business in September 2011 for \$4.0 million and associated expenses. Trade accounts receivable increased 18% due to higher revenue in the third quarter versus the fourth quarter of 2010 and the inclusion of \$0.4 million of Co-eXprise receivables. Days sales outstanding (representing accounts receivable outstanding at September 30, 2011 divided by the average sales per day during the current quarter, as adjusted for non-recurring items) increased 10% due to the timing of revenue recognized within the third quarter of 2011 as compared to the fourth quarter of 2010. Revenue from bidders representing 10% or more of our revenue increased to 24% from two bidders during the nine months ended September 30, 2011, from 23% from the same bidders during the same period in 2010.

Working capital (consisting of current assets less current liabilities) increased 124%, primarily due to the sale of common stock during the second quarter and net income of \$1.3 million for the nine months ended September 30, 2011, partially offset by the acquisition of Co-eXprise's energy procurement business in September 2011. Stockholders' equity increased

64% for the nine months ended September 30, 2011 due to the sale of common stock in April 2011, and net income of \$1.3 million and share-based compensation of \$0.5 million for the nine months ended September 30, 2011.

Cash provided by operating activities for the nine months ended September 30, 2011 was \$1.9 million as compared to a negative \$0.1 million in 2010. This improvement was primarily due to positive adjusted EBITDA of \$2.7 million in the first nine months of 2011 versus \$1.2 million during the same period in 2010. Cash provided by investing and financing activities for the nine months ended September 30, 2011 was \$1.1 million primarily due to net proceeds of \$5.3 million received from the sale of common stock significantly offset by \$4.0 million paid in the acquisition of Co-eXprise's energy procurement business. Cash provided by investing and financing activities for the nine months ended September 30, 2010 was \$0.1 million primarily due to \$0.4 million in net proceeds from the sale of common stock, partially offset by a \$0.2 million advance against a convertible note receivable with Retroficiency.

Adjusted EBITDA, representing net income or loss before interest, income taxes, depreciation, amortization, and share-based compensation charges for the nine months ended September 30, 2011 was a positive \$2.7 million as compared to a positive \$1.2 million for the same period in the prior year. This increase was primarily due to the \$1.8 million improvement in net income as we recorded \$1.3 million of net income during first nine months of 2011 compared to a net loss of \$0.5 million for the same period in 2010. We have generated positive adjusted EBITDA for eight straight quarters resulting in a cumulative total of \$4.9 million, including \$3.5 million over the last four quarters. Please refer to the section below referencing "non-GAAP financial measures" for a reconciliation of non-GAAP measures to the most directly comparable measure calculated and presented in accordance with accounting principles generally accepted in the United States of America ("GAAP").

In this Quarterly Report on Form 10-Q, we provide certain "non-GAAP financial measures". A non-GAAP financial measure refers to a numerical financial measure that excludes (or includes) amounts that are included in (or excluded from) the most directly comparable financial measure calculated and presented in accordance with GAAP in our financial statements. In this Quarterly Report on Form 10-Q, we provide adjusted EBITDA as additional information relating to our operating results. This non-GAAP measure excludes expenses related to share-based compensation, depreciation related to our fixed assets, amortization expense related to acquisition-related assets and capitalized software, interest expense on capital leases, interest income on invested funds and notes receivable, and income taxes. Management uses this non-GAAP measure for internal reporting and bank reporting purposes. We have provided this non-GAAP financial measure in addition to GAAP financial results because we believe that this non-GAAP financial measure provides useful information to certain investors and financial analysts in assessing our operating performance due to the following factors:

- We believe that the presentation of a non-GAAP measure that adjusts for the impact of share-based compensation expenses, depreciation of fixed assets, amortization expense related to acquisition-related assets and capitalized software, interest expense on capital leases, interest income on invested funds and notes receivable, and income taxes, provides investors and financial analysts with a consistent basis for comparison across accounting periods and, therefore, is useful to investors and financial analysts in helping them to better understand our operating results and underlying operational trends;
- Although share-based compensation is an important aspect of the compensation of our employees and executives, share-based compensation expense is generally fixed at the time of grant, then amortized over a period of several years after the grant of the share-based instrument, and generally cannot be changed or influenced by management after the grant;
- We do not acquire intangible assets on a predictable cycle. Our intangible assets relate solely to business acquisitions. Amortization costs are fixed at the time of an acquisition, are then amortized over a period of several years after the acquisition and generally cannot be changed or influenced by management after the acquisition;
- We do not regularly incur capitalized software costs. Our capitalized software costs relate primarily to the build-out of our exchanges. Amortization costs are fixed at the time the costs are incurred and are then amortized over a period of several years and generally cannot be changed or influenced by management after the initial costs are incurred;
- We do not regularly invest in fixed assets. Our fixed assets relate primarily to computer and office equipment and furniture and fixtures. Depreciation costs are fixed at the time of purchase and are then depreciated over several years and generally cannot be changed or influenced by management after the purchase;

- We do not regularly enter into capital leases. Our capital leases relate primarily to computer and office equipment. Interest expense is fixed at the time of purchase and recorded over the life of the lease and generally cannot be changed or influenced by management after the purchase;
- We do not regularly earn interest on our cash accounts and notes receivable. Our cash is invested in U.S. Treasury funds and has not yielded material returns to date and these returns generally cannot be changed or influenced by management; and
- We do not regularly pay federal or state income taxes due to our net operating loss carryforwards. Our income tax expense reflects the anticipated alternative minimum tax liability based on statutory rates that generally cannot be changed or influenced by management.

Pursuant to the requirements of the SEC, we have provided below a reconciliation of the non-GAAP financial measure used to the most directly comparable financial measure prepared in accordance with GAAP. This non-GAAP financial measure is not prepared in accordance with GAAP. This measure may differ from the GAAP information, even where similarly titled, used by other companies and therefore should not be used to compare our performance to that of other companies. The presentation of this additional information is not meant to be considered in isolation or as a substitute for net income (loss) prepared in accordance with GAAP.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
GAAP net income (loss)	\$ 855,144	\$ 147,227	\$ 1,296,544	\$ (480,866)
Less: Interest income, net	(14,183)	(2,555)	(41,646)	(45)
Add: Share-based compensation	171,389	186,677	488,897	541,986
Add: Amortization	292,572	300,878	847,633	1,001,302
Add: Depreciation	30,941	34,499	97,965	106,276
Add: Income taxes	7,250	—	21,750	—
Non-GAAP adjusted EBITDA	<u>\$ 1,343,113</u>	<u>\$ 666,726</u>	<u>\$ 2,711,143</u>	<u>\$ 1,168,653</u>

### ***Critical Accounting Policies***

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Accordingly, actual results could differ from these estimates.

The most judgmental estimates affecting our consolidated financial statements are those relating to revenue recognition and the estimate of actual energy delivered from the bidder to the lister of such energy; software development costs; share-based compensation; the valuation of intangible assets and goodwill; impairment of long-lived assets; and estimates of future taxable income as it relates to the realization of our net deferred tax assets. We regularly evaluate our estimates and assumptions based upon historical experience and various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. To the extent actual results differ from those estimates; our future results of operations may be affected. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements. Refer to Note 2 of our consolidated financial statements within our Annual Report on Form 10-K as filed on February 17, 2011 for a description of our accounting policies.

### ***Revenue Recognition***

#### Retail Electricity Transactions

We earn a monthly commission on energy sales contracted through our online auction platform from each bidder or energy supplier based on the energy usage transacted between the bidder and lister or energy consumer. Our commissions are not based on the retail price for electricity; rather on the amount of energy consumed. Commissions are calculated based on the energy usage transacted between the energy supplier and energy consumer multiplied by our contractual commission rate. Revenue from commissions is recognized as earned on a monthly basis over the life of each contract as energy is consumed,

provided there is persuasive evidence of an arrangement, the sales price is fixed or determinable, collection of the related receivable is reasonably assured, and customer acceptance criteria, if any, has been successfully demonstrated.

We record brokerage commissions based on actual usage data obtained from the energy supplier for that accounting period, or to the extent actual usage data is not available, based on the estimated amount of electricity and gas delivered to the energy consumers for that accounting period. We develop our estimates on a quarterly basis based on the following criteria:

- Payments received prior to the issuance of the financial statements;
- Usage updates from energy suppliers;
- Usage data from utilities;
- Comparable historical usage data; and
- Historical variances to previous estimates.

To the extent usage data cannot be obtained, we estimate revenue as follows:

- Historical usage data obtained from the energy consumer in conjunction with the execution of the auction;
- Geographic/utility usage patterns based on actual data received;
- Analysis of prior year usage patterns; and
- Specific review of individual energy supplier/location accounts.

In addition, we analyze this estimated data based on overall industry trends including prevailing weather and usage data. Once the actual data is received, we adjust the estimated accounts receivable and revenue to the actual total amount in the period during which the payment is received. Based on management's current capacity to obtain actual energy usage, we currently estimate four to six weeks of revenue at the end of our accounting period. Differences between estimated and actual revenue have been within management's expectations and have not been material to date.

We do not invoice our electricity energy suppliers for monthly commissions earned and, therefore, we report a substantial portion of our receivables as "unbilled." Unbilled accounts receivable represents management's best estimate of energy provided by the energy suppliers to the energy consumers for a specific completed time period at contracted commission rates and is made up of two components. The first component represents energy usage for which we have received actual data from the supplier and/or the utility but for which payment has not been received at the balance sheet date. The majority of our contractual relationships with energy suppliers require them to supply actual usage data to us on a monthly basis and remit payment to us based on that usage. The second component represents energy usage for which we have not received actual data, but for which we have estimated usage. Commissions paid in advance by certain energy suppliers are recorded as deferred revenue and amortized to commission revenue on a monthly basis on the energy exchanged that month.

#### Retail Natural Gas Transactions

There are two primary fee components to our retail natural gas services: transaction fees and management fees. Transaction fees are billed to and paid by the energy supplier awarded business on the platform. These fees are established prior to award and are the same for each supplier. For the majority of our natural gas transactions, we bill the supplier upon the conclusion of the transaction based on the estimated energy volume transacted for the entire award term multiplied by the transaction fee. Management fees are paid by our energy consumers and are generally billed on a monthly basis for services rendered based on terms and conditions included in contractual arrangements. While substantially all of our retail natural gas transactions are accounted for in accordance with this policy, a certain percentage are accounted for as the natural gas is consumed by the customer and recognized as revenue in accordance with the retail electricity transaction revenue recognition methodology described above.

#### Demand Response Transactions

Demand response transaction fees are recognized when we have received confirmation from the CSP that the energy consumer has performed under the applicable RTO or ISO program requirements. The energy consumer is either called to perform during an actual curtailment event or is required to demonstrate its ability to perform in a test event during the performance period. For PJM the performance period is June through September in a calendar year. Test results are submitted to PJM by the CSPs and we receive confirmation of the energy consumer's performance in the fourth quarter. CSPs typically pay us ratably on a quarterly basis throughout the demand response fiscal (June to May) year. As a result, a portion of the revenue we recognize is reflected as unbilled accounts receivable.

### Wholesale Transactions

Wholesale transaction fees are invoiced upon the conclusion of the auction based on a fixed fee. These revenues are not tied to future energy usage and are recognized upon the completion of the online auction. For reverse auctions where our customers bid for a consumer's business, the fees are paid by the bidder. For forward auctions where a lister is selling energy products, the fees are typically paid by the lister. While substantially all wholesale transactions are accounted for in this fashion, a small percentage of our wholesale revenue is accounted for as electricity or gas is delivered, similar to the retail electricity transaction methodology described above.

### Environmental Commodity Transactions

Environmental commodity transaction fees are accounted for utilizing two primary methods. For regulated allowance programs like RGGI, fees are paid by the lister and are recognized as revenue quarterly as auctions are completed and approved. For most other environmental commodity transactions both the lister and the bidder pay the transaction fee and revenue is recognized upon the consummation of the underlying transaction as credits are delivered by the lister and payment is made by the bidder.

### Channel Partner Commissions

We pay commissions to our channel partners at contractual rates based on monthly energy transactions between energy suppliers and energy consumers. The commission is accrued monthly and charged to sales and marketing expense as revenue is recognized. We pay commissions to our salespeople at contractual commission rates based upon cash collections from our customers.

### Revenue Estimation

Our estimates in relation to revenue recognition affect revenue and sales and marketing expense as reflected on our statements of operations, and trade accounts receivable and accrued commission accounts as reflected on our balance sheets. For any quarterly reporting period, we may not have actual usage data for certain energy suppliers and will need to estimate revenue. We initially record revenue based on the energy consumers' historical usage profile. At the end of each reporting period, we adjust this historical profile to reflect actual usage for the period and estimate usage where actual usage is not available. For the nine months ended September 30, 2011, we estimated usage for approximately 12% of our revenue resulting in a positive 0.2%, or approximately \$30,000, adjustment to increase revenue. This increase in revenue resulted in an approximate \$7,000 increase in sales and marketing expense related to third party commission expense associated with those revenues. Corresponding adjustments were made to trade accounts receivable and accrued commissions, respectively. A 1% difference between this estimate and actual usage would have an approximate \$18,000 effect on our revenue for the nine months ended September 30, 2011.

### Allowance for Doubtful Accounts

We provide for an allowance for doubtful accounts on a specifically identified basis, as well as through historical experience applied to an aging of accounts, if necessary. Trade accounts receivable are written off when deemed uncollectible. To date write-offs have not been material.

### *Capitalized Software*

Certain acquired software and significant enhancements to our software are capitalized in accordance with guidance from the Financial Accounting Standards Board ("FASB"). No internally developed software costs were capitalized during the nine months ended September 30, 2011 and 2010, respectively. We amortize internally developed and purchased software over the estimated useful life of the software (generally three years). During the nine months ended September 30, 2011 and 2010, approximately \$95,000 and \$214,000 were amortized to cost of revenues, respectively. Accumulated amortization was approximately \$1,185,000 and \$1,090,000 at September 30, 2011 and December 31, 2010, respectively. At September 30, 2011 and December 31, 2010, capitalized software costs, net was approximately \$36,000 and \$131,000, respectively.

Our estimates for capitalization of software development costs affect cost of revenue and other assets as reflected on our consolidated statements of operations and on our consolidated balance sheets. During the nine months ended September 30, 2011, amortization expense was approximately 3.3% of cost of revenue. To the extent the carrying amount of the capitalized

software costs may not be fully recoverable or that the useful lives of those assets are no longer appropriate, we may need to record an impairment (non-cash) charge and write-off a portion or all of the capitalized software balance on the balance sheet.

### ***Goodwill***

We use assumptions in establishing the carrying value and fair value of our goodwill. Goodwill represents the excess of the purchase price over the fair value of identifiable net assets of acquired businesses. We account for goodwill that results from acquired businesses in accordance with guidance with the FASB, under which goodwill and intangible assets having indefinite lives are not amortized but instead are assigned to reporting units and tested for impairment annually or more frequently if changes in circumstances or the occurrence of events indicate possible impairment.

We perform an annual impairment review during the fourth fiscal quarter of each year, or earlier, if indicators of potential impairment exist. The impairment test for goodwill is a two-step process. Step one consists of a comparison of the fair value of a reporting unit with its carrying amount, including the goodwill allocated to each reporting unit. If the carrying amount is in excess of the fair value, step two requires the comparison of the implied fair value of the reporting unit whereby the carrying amount of the reporting unit's goodwill over the implied fair value of the reporting unit's goodwill will be recorded as an impairment loss. We performed our annual impairment analysis in December 2010 and determined that no impairment of our goodwill existed. There have been no indicators of potential impairment during 2011.

### ***Intangible Assets***

We use assumptions in establishing the carrying value, fair value and estimated lives of our intangible assets. The criteria used for these assumptions include management's estimate of the asset's continuing ability to generate positive income from operations and positive cash flow in future periods compared to the carrying value of the asset, as well as the strategic significance of any identifiable intangible asset in our business objectives. If assets are considered impaired, the impairment recognized is the amount by which the carrying value of the assets exceeds the fair value of the assets. Useful lives and related amortization expense are based on an estimate of the period that the assets will generate revenues or otherwise be used by us. Factors that would influence the likelihood of a material change in our reported results include significant changes in the asset's ability to generate positive cash flow, a significant decline in the economic and competitive environment on which the asset depends and significant changes in our strategic business objectives.

Intangible assets consist of customer relationships and contracts, purchased technology and other intangibles, and are stated at cost less accumulated amortization. Intangible assets with a finite life are amortized using the straight-line method over their estimated useful lives, which range from one to ten years.

### ***Impairment of Long-Lived and Intangible Assets***

In accordance with guidance from the FASB, we periodically review long-lived assets and intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable or that the useful lives of those assets are no longer appropriate. Recoverability of these assets is determined by comparing the forecasted undiscounted net cash flows of the operation to which the assets relate to the carrying amount. No impairment of our long-lived assets was recorded as no change in circumstances indicated that the carrying value of the assets was not recoverable during 2011.

### ***Income Taxes***

In accordance with guidance from the FASB, deferred tax assets and liabilities are determined at the end of each period based on the future tax consequences that can be attributed to net operating loss carryforwards, as well as differences between the financial statement carrying amounts of the existing assets and liabilities and their respective tax basis. Deferred income tax expense or credits are based on changes in the asset or liability from period to period. Valuation allowances are provided if, based on the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. The realization of deferred tax assets is dependent upon the generation of future taxable income. In determining the valuation allowance, we consider past performance, expected future taxable income, and qualitative factors which we consider to be appropriate in estimating future taxable income. Our forecast of expected future taxable income is for future periods that can be reasonably estimated. Results that differ materially from current expectations may cause us to change our judgment on future taxable income and adjust our existing tax valuation allowance.

Our estimates in relation to income taxes affect income tax benefit and deferred tax assets as reflected on our statements of operations and balance sheets, respectively. The deferred tax assets are reduced by a valuation allowance if it is more likely than not that the tax benefits will not be realized in the near term. As of September 30, 2011, we had net deferred tax assets of approximately \$7.3 million against which a full valuation allowance has been established. To the extent we determine that it is more likely than not that we will recover all of our deferred tax assets, it could result in an approximate \$7.3 million non-cash tax benefit.

### ***Share-Based Compensation***

In accordance with guidance from the FASB, we recognize the compensation cost of share-based awards on a straight-line basis over the requisite service period of the award. For the nine months ended September 30, 2011, share-based awards consisted of stock options and stock warrants, respectively. The vesting period of share-based awards is determined by the board of directors, and is generally four years for employees.

The per-share weighted-average fair value of stock options granted during the nine months ended September 30, 2011 was \$2.13, on the date of grant, using the Black-Scholes option-pricing model with the following weighted-average assumptions and estimated forfeiture rates of 10%:

<u>Nine months ended September 30,</u>	<u>Expected Dividend Yield</u>	<u>Risk-Free Interest Rate</u>	<u>Expected Option Life</u>	<u>Expected Volatility</u>
2011	—	0.88%	4.75 years	100%

The per-share weighted-average fair value of stock warrants granted during the nine months ended September 30, 2011 was \$0.83 on the date of grant, using the Black-Scholes option-pricing model with weighted-average assumptions for the risk-free interest rate, expected life and expected volatility of 0.16%, 0.75 years and 59%, respectively, and no estimated forfeiture rate for the nine months ended September 30, 2011.

### **Item 3. Quantitative and Qualitative Disclosure about Market Risk**

#### **Market Risk**

Market risk is the potential loss arising from adverse changes in market rates and prices, such as foreign currency rates, interest rates, and other relevant market rates or price changes. In the ordinary course of business, we are exposed to market risk resulting from changes in foreign currency exchange rates, and we regularly evaluate our exposure to such changes. Our overall risk management strategy seeks to balance the magnitude of the exposure and the costs and availability of appropriate financial instruments.

#### **Impact of Inflation and Changing Prices**

Historically, our business has not been materially impacted by inflation. We provide our service at the inception of the service contract between a bidder and lister. Our fee is set as a fixed dollar amount per unit of measure and fluctuates with changes in energy demand over the contract period.

#### **Foreign Currency Fluctuation**

Our commission revenue is primarily denominated in U.S. dollars. Therefore, we are not directly affected by foreign exchange fluctuations on our current orders. However, fluctuations in foreign exchange rates do have an effect on listers' access to U.S. dollars and on pricing competition. We have entered into non-U.S. dollar contracts but they have not had a material impact on our operations. We do not believe that foreign exchange fluctuations will materially affect our results of operations.

#### **Item 4. Controls and Procedures**

##### Evaluation of Disclosure Controls and Procedures

As required by Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), the Company carried out an evaluation under the supervision and with the participation of the Company’s management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company’s disclosure controls and procedures as of December 31, 2010. In designing and evaluating the Company’s disclosure controls and procedures, the Company and its management recognize that there are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their desired control objectives. Additionally, in evaluating and implementing possible controls and procedures, the Company’s management was required to apply its reasonable judgment. Based upon the required evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that as of September 30, 2011, the Company’s disclosure controls and procedures were effective at the reasonable assurance level to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, and procedures also were effective in ensuring that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is accumulated and communicated to its management, including the Company’s Chief Executive Officer and Chief Financial Officer as appropriate, to allow timely decisions regarding required disclosure.

##### Changes in Internal Control Over Financial Reporting

There was no change in the Company’s internal control over financial reporting that occurred during the three months ended September 30, 2011 that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

**PART II**  
**OTHER INFORMATION**

**Item 1. Legal Proceedings**

None.

**Item 1A. Risk Factors**

No material changes.

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

In connection with the vesting of restricted stock granted to employees, we withheld shares with value equivalent to employees' minimum statutory obligations for the applicable income and other employment taxes. A summary of the shares withheld to satisfy employee tax withholding obligations for the three months ended September 30, 2011 is as follows:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased As Part of Publicly Announced Plans Or Programs	Maximum Number of Shares That May Yet Be Purchased Under The Plan
7/01/11 – 7/31/11.....	—	\$ —	—	—
8/01/11 – 8/31/11.....	71	\$ 3.41	—	—
9/01/11 – 9/30/11.....	475	\$ 3.09	—	—
Total	<u>546</u>	<u>\$ 3.13</u>	<u>—</u>	<u>—</u>

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Removed and Reserved**

**Item 5. Other Information**

None.

**Item 6. Exhibits**

- 10.1 Amendment No. 1 to Asset Purchase Agreement and Promissory Note, effective October 20, 2011, by and between the Company and Northeast Energy Solutions, LLC.
- 31.1 Certification of the Chief Executive Officer pursuant to §302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer pursuant to §302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002.

## 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.

World Energy Solutions, Inc.

Dated: November 3, 2011

By: /s/ Richard Domaleski  
Richard Domaleski  
Chief Executive Officer

Dated: November 3, 2011

By: /s/ James Parslow  
James Parslow  
Chief Financial Officer

## **EXHIBIT INDEX**

<u>Exhibit</u>	<u>Description</u>
10.1	Amendment No. 1 to Asset Purchase Agreement and Promissory Note, effective October 20, 2011, by and between the Company and Northeast Energy Solutions, LLC
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32.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002

**AMENDMENT No. 1  
TO  
ASSET PURCHASE AGREEMENT AND PROMISSORY NOTE**

This Amendment No. 1 (the "Amendment No. 1") to the Asset Purchase Agreement and the Promissory Note is made and entered into between World Energy Solutions, Inc., a Delaware corporation (the "Buyer"), and Northeast Energy Solutions, LLC, a Connecticut limited liability company (the "Seller") (together with World Energy, the "Parties") as of October 20, 2011. Capitalized terms used herein have the respective meanings ascribed thereto in the Asset Purchase Agreement dated October 13, 2011 unless otherwise defined herein.

**RECITALS**

- A. The Buyer and the Seller previously entered into the Asset Purchase Agreement effective October 13, 2011.
- B. The Buyer issued a Promissory Note to the order of the Seller pursuant to the terms and conditions of the Asset Purchase Agreement.
- C. The Parties wish to modify certain terms of the Asset Purchase Agreements and the Promissory Note, subject to conditions set forth in this Amendment No. 1.

**NOW THEREFORE**, in consideration of mutual covenants, agreements and representations contained in this Amendment No. 1, the Asset Purchase Agreement, and the Promissory Note, the Parties hereto agree as follows:

1. The last paragraph of Section 1.6 of the Asset Purchase Agreement shall be amended to read as follows:

"Upon attainment of the 2011 and/or 2012 earnout goals, the Seller will receive payment in the form of cash."
2. The third paragraph on the first page of the Promissory Note shall be removed in its entirety and replaced as follows:

"Except as otherwise provided below, on each of, July 2, 2012, October 1, 2012, and December 28, 2012 (each, a "**Payment Date**"), the Maker shall pay Payee, in lawful money of the United States by check payable to Payee and delivered to the Payee's address stated above or at such other place as the Payee may designate, \$1,000,000 of the unpaid principal amount of this Note, together with the accrued but unpaid interest on the unpaid principal balance of this Note (each such payment of principal and interest, a "**Cash Payment**")."
3. Conflict. In the event of any conflict between the provisions of this Amendment No. 1 and the provisions of the Asset Purchase Agreement and/or the Promissory Note, the provisions of this Amendment No. 1 shall prevail and the provisions of the Asset Purchase Agreement and/or the Promissory Note shall be deemed modified by this Amendment No. 1 as necessary to resolve such conflict.
4. Effect of Amendment. Except as expressly amended by this Amendment No. 1 and/or by the preceding sentence, the terms and provisions of the Asset Purchase Agreement and the Promissory Note shall continue in full force and effect.

[SIGNATURE PAGE FOLLOWS]



**CERTIFICATION PURSUANT TO  
§302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Richard Domaleski, certify that:

1. I have reviewed this quarterly report on Form 10-Q of World Energy Solutions, Inc. (the "Registrant");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting;

and

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Dated: November 3, 2011

By: /s/ Richard Domaleski  
Richard Domaleski  
Chief Executive Officer

**CERTIFICATION PURSUANT TO  
§302 OF THE SARBANES-OXLEY ACT OF 2002**

I, James Parslow, certify that:

1. I have reviewed this quarterly report on Form 10-Q of World Energy Solutions, Inc. (the "Registrant");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting;

and

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Dated: November 3, 2011

By: /s/ James Parslow  
James Parslow  
Chief Financial Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. §1350, AS ADOPTED  
PURSUANT TO §906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the quarterly report of World Energy Solutions, Inc (the "Company") on Form 10-Q (the "Report") for the period ended September 30, 2011 as filed with the Securities and Exchange Commission on the date hereof, I, Richard Domaleski, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 3, 2011

By: /s/ Richard Domaleski  
Richard Domaleski  
Chief Executive Officer

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signatures that appear in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

**CERTIFICATION PURSUANT TO 18 U.S.C. §1350, AS ADOPTED  
PURSUANT TO §906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the quarterly report of World Energy Solutions, Inc. (the "Company") on Form 10-Q (the "Report") for the period ended September 30, 2011 as filed with the Securities and Exchange Commission on the date hereof, I, James Parslow, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 3, 2011

By: /s/ James Parslow

James Parslow  
Chief Financial Officer

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signatures that appear in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.