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LIME - Q3 2011 Lime Energy Co Earnings Conference Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Third Quarter 2011 Lime Energy Company Earnings Conference Call. My name is Derrick and I will be your operator for today. At this time all participants are in a listen-only mode. We will facilitate a question-and-answer session at the end of the conference.

(Operator Instructions)

As a reminder this call is being recorded for replay purposes. I would not like to turn the conference over to Mr. Glen Akselrod, spokesperson. You may proceed.

Glen Akselrod - *Lime Energy Co. - IR*

Thank you, Derrick; and good afternoon, everybody, and thank you for taking the time to join us for our 2011 Third Quarter Results Conference Call. With us today is John O'Rourke, CEO; and Jeff Mistarz, CFO. I hope all of you have had a chance to review the earnings announcement released earlier today and which can be accessed on Lime's Web site at www.lime-energy.com or for the 10Q on the SEC Web site.

Before I hand the discussion over to John, I want to remind everyone that the call today will include some statements that will be considered forward-looking regarding the Company's strategy, operations and financial performance. Those statements are subject many uncertainties in the Company's operations and business environment. I refer you to the complete forward-looking statements disclosure in the earnings release which is also incorporated by reference for purposes of this call. I'd also like to refer you to the disclosures made by the Company's quarterly and annual filings with the SEC.

And before we get started I want to mention that this call is being broadcast live over the Internet, and can be accessed on the Lime Energy Web site and also Thompson/CCBN networks. There will be a replay available on either Web site until February 8, 2012. With that, I'll hand the discussion over to John.

John O'Rourke - *Lime Energy Co. - President, CEO*

Good afternoon, everyone, and thank you for taking the time for our third quarter call. This was a strong third quarter for us, revenue and gross margins improved over the levels achieved during the second quarter resulting in our first ever third quarter GAAP-positive operating result.

Improved revenue and margins coupled with the continued focus on controlled SG&A growth were the key contributors to this quarter's performance. Our consolidated revenue increased 14.7% to $32.2 million, our gross profit margin for the quarter picked up from 21.3% to 21.9% while our SG&A increased only $122,000, all of which was attributable to our utility program management expansion business.

We expect our fourth quarter to be a record quarter in terms of revenue and earnings with revenue projected to be between $47 million and $53 million. We currently have about $227 million in backlog of which approximately $80 million is expected to convert to revenue in 2012. This means we have about half of our expected 2012 revenue already under contract which puts us in a much stronger position than this time last year.

Our revenue growth year-over-year is tracking at 30% while at the same time we are continuing to add to our record backlog position. Jeff will discuss our financials in more detail, so I will first go over some of the highlights of the quarter.

Our public sector and institutional markets continue to operate near capacity developing new contract opportunities with our ESCO clients. We believe that many of these opportunities will convert to contracts over the next 12 to 18 months continuing to drive the growth in this market. We had significant revenue contributions this past quarter from our FRR Government Direct group and expect a strong finish in our ESCO business as we approach the end of the year.

Our optimism of this market is rooted in the underlying budget neutral solution that ESCOs present to state and municipal clients at a time when these entities are starving for investments in an aging infrastructure whose upkeep has been virtually ignored since the onset of the economic crisis. We also expect continued momentum in the Federal Government business driven by ESPC contract clarity received earlier in the year and the urgency of Federal Agencies to meet executive order mandates in their drive to a net zero energy state.

Our Private Sector markets which include our utility, small commercial and industrial clients and our large national and strategic commercial and industrial accounts have outperformed and underperformed respectively.

As we continue to transition our strategy on customer acquisition in the private markets, we expect continued strong performance in our small commercial and industrial market segment supported by custom regional utility programs, and improved performance in our national and strategic account segments as a direct result of our recent reorganization which integrated our sales, marketing and operation groups across our platform and across the country.

Finally, our Asset Development business, LEAD, has had a very busy couple of weeks. It celebrated the grand opening of its first renewable project on October 14th, the Zemel Road natural gas to electricity facility located in Punta Gorda in Florida. Construction of this project was completed earlier in the month and the facility went into commercial operations selling its output under a 20-year contract to a local utility. Last week LEAD also closed on a term loan and filed for a US Treasury Grant, both of which will reimburse us for a significant part of the cost of building the Zemel Road facility. Jeff will go into this more in a minute.

LEAD was created to develop, manage, and in some situations own energy-producing assets. These assets may include natural gas or electricity, combined heat and power, onsite generation, solar photo-voltaic, solar thermal biomass and geothermal energy projects. Utilities are actively looking for ways to comply with energy efficiency resource standards and renewable portfolio standards. Public Sector customers like municipalities are looking to monetize assets and comply with the Energy Policy Act of 2005, creating significant demand for services from this group.

We believe there is a significant opportunity to leverage our existing customer-base and our platform of expertise in engineering implementation and project finance resulting in a growing profitable business with recurring revenue. And so, with that, I'll hand it over to Jeff to go over the financials. Jeff?

Jeff Mistarz - *Lime Energy Co. - CFO*

Thanks, John; and good afternoon, everyone. As John mentioned, I'll provide a brief overview of financial results for the third quarter and the first nine months of 2011. Our revenue for the third quarter increased 14.7% to $32.2 million when compared to the $28.1 million earned during the third quarter of 2010. This increase was driven by higher revenue from my Utility Program Management business and to a lesser extent by revenue from contracts under the Army Corps of Engineers, FRR Program.

Revenue under both of these markets roughly doubled from the levels generated during the third quarter of 2010. We entered into our first contract in both of these markets in late 2009 and added additional contracts in 2010 and 2011 in both businesses which has contributed to their continued growth. Third quarter revenue from our CNI market was flat to the earlier period while revenue from our public sector market was down slightly relative to last year due to the timing of projects. For the first nine months of the year, revenue increased $18 million or 31.4% to $75.4 million from $57.4 million for the first nine months of 2010.

Increased revenue from our Utility Management business was responsible for most of this increase, but revenue from the FRR Program and from our Public Sector market also contributed. Revenue from our CNI market was about 8% from the revenue earned during the first nine months of 2010. It appears that our CNI clients are pulling back and becoming more cautious about making significant expenditures due the current economic uncertainty, so we are expecting this market to be tough for the balance of the year. Fortunately our other markets continue to perform well and will more than make up for the softness in the CNI market, proving the benefits and lower risk profile of our diversified platform.

Gross profit for the third quarter increased $1.1 million or 18% to $7.1 million from $6 million earned during the third quarter of 2010; a gross profit margin increase from 21.3% during the third quarter of 2010 to 21.9% during the most recent period. Improving our gross margin was the result of a shift in the mix of our revenue to include a higher percentage of revenue from our Utility business and improved margins in our Utility, public sector and federal markets. We earned gross profit of $15.2 million during the nine-month period ended September 30, 2011, a $3.1 million or 26.1% improvement over the $12 million earned during the same period in 2010.

Our gross profit margin slipped from 21% to 21.1%, the result of lower margins earned earlier in the year relative to last year. We expect our consolidated gross margin to continue to improve during the fourth quarter and to end the year close to, if not slightly higher than last year's gross margin.

Our SG&A for the third quarter was $6.4 million which was 1.9% or $122,000 higher than the $6.3 million recorded during the third quarter of 2010. Our SG&A for the nine-moth period increased $1.6 million or 8.3% to $20.4 million from $18.89 million during the year earlier period.

All of the increase in our SG&A expense was related to the continued growth of our Utility Program Management business and our new Asset Development business. SG&A associated with all of other markets and our corporate overhead declined relative to last year. The SG&A reductions in these areas were largely the result of the restructure we implemented in May of this year, and our continued focus in controlling the growth of our SG&A. We expect that our SG&A during the fourth quarter to be higher than the third quarter SG&A due in part to the startup of operations in Long Island to support our new LIPA, SPDIF contract.

We expect the growth of the SG&A on a full-year basis to be less than 10%. During the second quarter of 2010 we reorganized our operations to realign our CNI business to reduce cost, increase efficiency and better integrate it with the operations of our public sector and Utility markets. This permitted us to consolidate marketing and certain accounting and administrative functions thereby allowing us to reduce -- also reduce our corporate overhead.

We established a restructuring reserve during the quarter to cover the anticipated cost related to this reorganization incurring a restructuring charge of $1.1 million. During the most recent quarter we recorded an additional restructuring charge of $172,000. Almost all of this charge is related to the sale of our former headquarters building at Elk Grove Village, Illinois.

As mentioned earlier we are already seeing savings from this reorganization and expect it to reduce our SG&A by approximately $3 million on an annual basis beginning in 2012. Increased revenue and higher gross profit margin, in combination with the controlled growth of our SG&A resulted in the $775,000 improvement in our operating profits for the third quarter and a $303,000 improvement for the first nine months of 2011 and compared to the same periods in 2010. Our net interest income declined $34,000 to $15,000 during the third quarter of 2011 from $49,000 during the third quarter of 2010.

This decline was the result of higher interest expense due to the inclusion of the unused line fee for our line of credit which we put in place in March, and lower interest income earned during the period due to lower average, invested cash balances and lower average balances on our long-term receivables held by (inaudible) finance.

These same factors contributed to a $69,000 decline in our net interest income for the nine-month period. Our net income for the third quarter was $359,000 or $0.02 per share on a basic and diluted basis. This compared to a loss $382,000 or $0.02 per share through our third quarter of 2010. The net loss for the first nine months of 2011 was $6.9 million or $0.29 compared to $7.1 million or $0.30 per share for the year earlier period.

The third quarter was the first GAAP profitable quarter in the Company's history, and we feel it represents another milestone in our efforts to move the Company into consistent profitability. Our adjusted EBITDA which excludes the impact of the restructuring charge, increased $1.1 million to $1.3 million for the three -- third quarter of 2011 when compared to income of $180,000 through the third quarter of 2010; the nine-month period, the adjusted EBITDA loss was $3.6 million compared to a loss of $5.3 million for the year earlier-period.

We expect our fourth quarter adjusted EBITDA to exceed last year's figure and believe that it could potentially more than offset all of the loss that we have accumulated through the first nine months of the year, resulting in a positive adjusted EBITDA on a full-year basis. Adjusted EBITDA is a non-GAAP financial measure we are providing because we believe that it provides a meaningful comparison of operating results to prior period results. For information on the calculation of adjusted EBITDA please refer to our earnings announcement which is available on our Form-AK filed this afternoon and connects us with the SEC, so at their Web site or through our Web site.

We ended the quarter with about $4.3 million of cash including $725,000 restricted cash. This represents a decline of $3 million from the balances at the end of June. Operating activities before changes and working capital generated $1.3 million during the quarter compared to generating $244,000 last year. Changes in working capital consumed cash of $1.8 million during the recent quarter compared to consuming $3.4 million during the third quarter of 2010. We feel that we've largely resolved the collection issues we had earlier this year in one of our Utility programs, which has helped improve our receivables turnover.

Investing activities consumed $2.5 million during the third quarter of 2011 compared to consuming $203,000 the year earlier. Financing in -- financing activities generated $36,000 of cash during the third quarter of 2011 compared to consuming $28,000 during the same period in 2010. We received about $64,000 from the exercise of employee options during the recent quarter which was partially offset by scheduled principal payments of $28,000.

We also had $28,000 of scheduled principal payments on our debt during the third quarter of last year, of the $2.5 million used in investing activities during the third quarter about $2.3 million was used to fund the construction of the Zemel Road landfill gas to electricity project.

During the fourth quarter we invested in an additional $700,000 to complete the construction of that facility. We announced this morning that last week we closed down a $3.6 million loan that will reimburse us for a portion of our investment in this project. In addition we've also filed for an application for a $1.88 million US Treasury Grant related to that facility, which we expect to receive before the end of the year. These two sources of cash will significantly reduce the funds we have invested in this asset and with the facility going into commercial operation in mid-October it's now expected to be a consistent generator of cash for the next 20 years.

We've not had to tap our $7 million line of credit since we put it in place back in March, and currently don't believe we will need to in the foreseeable future, though it remains fully available and we have adequate borrowing base to use the entire facility if necessary. We believe that the continued improvement in our profitability in combination with the proceeds from the recently-closed term loan and the US Treasury Grant will provide sufficient liquidity to meet our needs until we begin to generate consistent profitability, hopefully, beginning next year. With that, I'll now turn it back over to John.

John O'Rourke - *Lime Energy Co. - President, CEO*

Thanks, Jeff. Before opening this up for questions, I would like to summarize the call's salient points.

One is to expect continued 30% growth year-over-year. Two, is expect increased visibility, or increasing visibility around future earnings potential as we continue to execute in all of our markets and continue to build backlog. Expect a clear demonstration of our business leverage in 2012. And so, with that, I will open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Questions will be taken in the order received. And our first question is coming from the line of Philip Shen from ROTH Capital Partners. Please proceed.

Philip Shen - *ROTH Capital Partners - Analyst*

Good afternoon, everyone. Thanks for taking my questions. My first question is related to something you guys had discussed at your Analyst day earlier this year, you highlighted that one of your goals was to increase overall transaction sizes. In the current economic environment can you help us understand the progress you're making on the score, and your ability to convert one-off projects into multi-measure relationships that drive multiple client touches?

John O'Rourke - *Lime Energy Co. - President, CEO*

Hi, Phil, this is John. I think that we have not converted a project since the Analyst Day, that's a multi-measure or multi-million project, although we have several in our development -- in our pipeline and fully expect, if not before the end of the year, but early on in the year to be announcing one, if not two, of those very same projects.

Philip Shen - *ROTH Capital Partners - Analyst*

Great. And then just as a quick follow up here, in terms of the economic climate, can you give us a sense for how the current economic outlook is affecting each of your business segments? I know you touched upon CNI and that the business may be a bit challenged through year end, but can you speak to, in more detail, the public and utility segments? I know [GCIs] fiscal Q4, backlog for building efficiency, kind of was flat and it has been flat for a few quarters. Help us understand how the economic climate is affecting the business in the [overall] economy.

Jeff Mistarz - *Lime Energy Co. - CFO*

As I briefly touched on, it's having the biggest impact on our commercial and industrial business. We are unsure right now exactly how much impact it will have. This is really a key time in that market in terms of contract signings, but there is some general concerns so we will see how that plays out here in the next few weeks.

The other markets actually have not been impacted, the Public Sector market, the ESPC Program is very attractive in the current economic environment with all of the government entities coming under budget pressure because it allows them to implement without requiring budget allocations. So it's an attractive program in the current market for those types of customers and we are seeing that in our development activity. As we mentioned, we are running at pretty much at capacity in terms of development in that market, so we expect that that will start to come through next year as those opportunities move from development to, hopefully, contract.

Utility side of the business has also not been impacted there, continues to execute well and grow with existing contracts -- within existing contracts and new opportunities for hopefully new contracts in the future.

Philip Shen - *ROTH Capital Partners - Analyst*

You mentioned on the call that CNI business was down or actually flat year-over-year, and then the Utility business -- sorry the Public business as down slightly. Can you give us some more color in terms of the year-over-year growth rates that the Utility business experienced in Q3?

Jeff Mistarz - *Lime Energy Co. - CFO*

We said that it double, Q3 this was roughly double what it was a year ago.

Philip Shen - *ROTH Capital Partners - Analyst*

And then in terms of -- I know John mentioned, we should expect aggressive 30% year-over-year growth rate going forward and I think that's great. Can you help us understand where -- how that growth is going to be divided among the three different sub-segments or segments of your business?

Jeff Mistarz - *Lime Energy Co. - CFO*

We expect continued strong growth in most of our markets. Utilities, the Public Sector business, from Asset Development Business, and (inaudible - microphone inaccessible) contract business. Now we kind of look at it now with reorganization which is split between Private and Public, the CNI and Utility business being in -- our Private, and the Public Sector, FRR Federal contracts being in our -- Federal, and we expect both of those sides of the businesses to experience growth next year, so both sides will be contribution.

Philip Shen - *ROTH Capital Partners - Analyst*

Great, and that's all I have for now. Congrats on a solid Q3.

Jeff Mistarz - *Lime Energy Co. - CFO*

Thank you.

John O'Rourke - *Lime Energy Co. - President, CEO*

Thank you.

Operator

Your next question is coming from the line of Craig Irwin from Wedbush Securities. Please Proceed.

Craig Irwin - *Wedbush Securities - Analyst*

Good evening, gentlemen. Thank you for taking my question.

Jeff Mistarz - *Lime Energy Co. - CFO*

Hi, Craig.

John O'Rourke - *Lime Energy Co. - President, CEO*

Hi, Craig.

Craig Irwin - *Wedbush Securities - Analyst*

Hi, John. So the first question I have is the $69 million in implied bookings in the third quarter. Can you give us an idea on the breadth of customers that contributed those bookings? Whether or not it was more public or private customers and whether or not those books are of projects that are in long-term agreements like your Zemel Road agreement are likely to burn over the next 12 to 18 months.

Jeff Mistarz - *Lime Energy Co. - CFO*

Well this is he first quarter we have given any indication as to what portion of our backlog we expect will convert to revenue, you know, in a defined period. So we said that about $80 million of it -- of the backlog will convert to revenue in 2012. Just to give you an idea, a year ago our backlog -- our total backlog was $88 million so our total backlog which included multi-year contracts was about equal to what we expect to convert to revenue next year.

The revenue -- the increase in the backlog was -- all of our markets experienced some increase in backlog, and we do have the addition of the contract for the Zemel Road, which we've included in backlog as well. So that was part of the contribution of the increase in this quarter's backlog, but it's a combination of the Zemel Road contract, the Utilities contracts, and Public Sector contracts and some CNI contracts.

Craig Irwin - *Wedbush Securities - Analyst*

Great. You mentioned $80 million in backlog burning next year; can you give us an approximate number for the fourth quarter? Is the majority of fourth quarter revenue likely to burn off backlog, or can you provide some color there?

Jeff Mistarz - *Lime Energy Co. - CFO*

Yes, the shortest -- the quickest turning pieces is our CNI which is also our smallest piece of the total. The majority of what we expect that we will book in the fourth quarter will come out of backlog.

Craig Irwin - *Wedbush Securities - Analyst*

Okay, excellent. You also mentioned in your prepared comments that the CNI market, I guess the Private market, appears to be a little bit sticky right now with customers deferring decisions on different projects. Can you comment whether or not this is likely to impact your typical first quarter margin flush that you see? Should we have temperate expectations as far as potential margins in the fourth quarter, and do you think that this could impact margins as we move into 2012?

Jeff Mistarz - *Lime Energy Co. - CFO*

Well the CNI market, if there was a large contributor, would have resulted in higher margins, but we are still expecting higher margins in the fourth quarter than we had in the third quarter, so we expect fourth quarter margins to pull up the average for the year to close to maybe slightly higher than where they were a year ago.

Craig Irwin - *Wedbush Securities - Analyst*

Great. Then if we could talk about new project activity, can you comment whether or not you're seeing greater activity on the Federal side and the municipal state, and hospital side, whether or not each of these markets are showing increased activity going into the end of the year, and have you seen any material benefit from the language change to the $80 billion IDIQ contract that most of the major ESPC projects are supposed to be funded by over the next couple years.

John O'Rourke - *Lime Energy Co. - President, CEO*

Hi, Craig; this is John. We are absolutely seeing increased activity and I think it was -- Phil said that -- mentioned something about flat[JCI] activity. Flat activity probably means that some of these larger projects and programs that are being developed by the ESP -- by the ESCOs are pushing from one quarter to the next; or from one reporting period to the next.

What we can tell you is that we've got a fairly big group inside Lime Energy that supports the ESCO community and I think I mentioned earlier, we are at or near our development in our operating capacity from a development standpoint, so we are seeing a significant ramp in activity -- in development activity behind the ESCOs.

Craig Irwin - *Wedbush Securities - Analyst*

Great, thank you. And one final question before I hop back into the queue. Jeff, with your restructuring materially complete now, can you update us? You mentioned $3 million in anticipated savings but can you update us on how we should be looking at SG&A over the next few quarters. I think you mentioned something about 10% growth; but is this 10% off current year minus three, or is this 10% off the current year reflecting the benefit of the cost savings?

Jeff Mistarz - *Lime Energy Co. - CFO*

The 10% referred to 2011 versus 2010, and it incorporated the savings that we expect to generate since we implemented the restructuring this year. Next we will expect that we are still going to be in that range in terms of growth and SG&A, hopefully, under 10% as we realize the full year benefit of the savings. And we still expect to need the continued support growth in certain markets that we shall be driving most of the increase in SG&A next year.

Craig Irwin - *Wedbush Securities - Analyst*

Okay, and actually a related question if I can just push another one in there. John mentioned just before that you're basically operating almost at capacity on your new project development side and you know, working for the other major ESPCs out there on the fund end of the other projects. What would have you choose to add additional project developers, additional headcount on the SG&A side over the next few quarters? Is this something that you've considered, or do you basically see the capacity you have now as ideally sized for the current marketplace?

Jeff Mistarz - *Lime Energy Co. - CFO*

That's something that we struggle with constantly because we are constantly trying to balance SG&A growth with our revenue growth and when you add developers there is a lag from when you add them to when you see the benefit, you know, it could be 18 to 24 months, and our focus is really getting to a sustainable profitability and then we could start to look at adding additional capacity to support the growth of that market. But it's a balancing act right now that we are struggling with or constantly dealing with.

John O'Rourke - *Lime Energy Co. - President, CEO*

And Craig, something else to consider is one of the big benefits of our recent reorganization is that it has freed up a lot of resources, so we are -- we have a lot of resources that probably will free up here to support coming out of parts of the market that weren't performing so well that we can use to support anytime the increase -- or a spike in development in the first and second quarters. So a lot of the recent reorganization has given us a tremendous flexibility in being able to support the utilization levels that change over quarter to quarter especially on the development side.

Craig Irwin - *Wedbush Securities - Analyst*

Great, thank you for taking my questions, and congratulations on a strong quarter.

John O'Rourke - *Lime Energy Co. - President, CEO*

Thank you.

Operator

(Operator Instructions)

At this time I'm showing no further audio questions in queue. I'd like to turn the call back over to Mr. John O'Rourke for any closing remarks.

John O'Rourke - *Lime Energy Co. - President, CEO*

Hi. We were very excited to get on the call today and to communicate to all of you that our employees work and perseverance is paying off. That our strategy has been, in fact, dead on, and to reinforce our deeply-felt commitment to all of our stakeholders as we continue to build a world class clean energy company. And with that, I'll say thank you all, very much, for joining us today.

Operator

ladies and gentlemen, that concludes today's conference. We thank you for your participation. You may now disconnect. Have a great day.