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Conference Call Transcript

LIME - Q1 2009 Lime Energy Co. Earnings Conference Call

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Merriman - Analyst

David Bish

Private Investor

Richard Jarrett

Private Investor

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Private Investor

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the First Quarter 2009 Lime Energy Company Earnings Conference Call. My name is Keesha and I will be your operator for today. At this time, all participants are in listen-only mode. We will conduct a question-and-answer session towards the end of this conference.

(Operator Instructions)

I would now like to turn the call over to Mr. Glen Akselrod, Spokesperson. Please proceed.

Glen Akselrod - Bristol Capital Management - IR

Thank you, Keesha. Good afternoon, and thank you for taking the time to join us for our 2009 First Quarter Results Conference Call. With us today is David Asplund, CEO; Dan Parke, President; Jeff Mistarz, CFO; and John O'Rourke, COO. I hope all of you had a chance to review our earnings announcements released earlier today along with the 10-Q, which can be accessed on Lime's website, www.lime-energy.com, or for the 10-Q on the SEC website.

Before I had the discussion over to David, I want to remind everyone that our 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 to many uncertainties in the Company's operations and business environment.

I'll refer you to the complete forward-looking statement disclosure in our earnings release, which is also incorporated by reference for the purpose of this call. I'd also like to refer you to the disclosures made in the Company's quarterly and annual filings with the SEC.

Finally, 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 website and also Thomson CCBN Network. There will be a replay available on either website until August 12, 2009. With that, I'll hand the discussion over to David.

David Asplund - Lime Energy Co. - CEO

Thank you, Glen, and good afternoon, everyone. Thank you for taking the time for our First Quarter 2009 Earnings Call. This quarter represented another record-breaking quarter for us by virtually every parameter. Despite operating in one of the most difficult economic environments in history, our revenue increased 60% from the first quarter of 2008 on a pro forma basis, which assumes the acquisition of Applied Energy Management, or AEM, that we acquired last June had actually taken place on January 1, 2008.

Therefore, the 60% increase is all organic growth. What is particularly noteworthy is that our revenue from commercial and industrial customers more than doubled in the first quarter while our revenue from federal, state, and local governments through our energy service company, or ESCO Partners, was up over 40%.

In addition to top-line growth, we continued to see strong operating leverage with gross margins increasing by over 30%, while SG&A increased only 1.8%, resulting in a 40% improvement in our quarterly adjusted EBITDA loss. We expect this operating leverage to continue improving with our expected growth in revenue.

In addition to these financial accomplishments, we continued building upon and investing in our platform. As I mentioned on our last call, we expanded our executive management team to include John O'Rourke as our new Chief Operating Officer. Previously, John was the President of our AEM subsidiary.

There are very few people in our business with the vision, knowledge, and operational experience as John, who has over 20 years of management experience in the energy efficiency industry. Not only has he already proven to be a valuable member of our executive management team, focused on operations in engineering, he has enabled Dan Parke to focus more on sales and business development opportunities, particularly with our largest national accounts.

It is extremely important for us to be able to leverage Dan's time and his 30 years experience in building businesses and selling energy efficiency solutions to the C&I market. Our business continues to grow with large national companies and the major property management firms where our growth opportunities appear to be enormous.

We also promoted Jim Smith to President of AEM, responsible for oversight and management of our lighting, water, mechanical, weatherization, and renewable energy divisions for ESCO customers. Prior to joining AEM, Jim was the Director of Engineering and Operations for Ameresco, where he developed and managed multi-billion dollar contracts for a wide variety of industrial, commercial, and governmental clients.

Jim is an extremely accomplished manager with more than 18 years experience in engineering, constructing and maintaining facility energy production, distribution, and end-use systems and equipment with a specific focus on energy and environmental cost reduction. He is ideally suited to grow our business with ESCOs and implement the expected multi-billion dollar spending on energy efficiency by federal and state entities.

In addition to streamlining our management organization, we continued our investment in key experienced professionals. Adam Procell recently joined us as President of Energy Consulting and Technical Services. In this new position, Adam will lead our engineering division, guide strategic planning efforts that will enable Lime's expansion into new markets, and help the Company capitalize on the nation's unprecedented focus on energy efficiency and renewable energy.

Adam is a veteran of the industry with more than 20 years of experience in energy efficiency, renewable energy, sustainability, and the building/construction industry. He came to Lime following 12 years with AECOM Energy, part of the \$6 billion in revenue AECOM Corporation listed on the New York Stock Exchange, where he most recently served as their National Director of Energy Efficiency and Carbon Management.

With responsibility for strategic planning in business development, Adam led the development of AECOM's ESCO business and facilitated the growth of this organization across both geographic and vertical market expansion, serving institutional, government, utility, commercial, and industrial clients. During his tenure at AECOM Energy, this group developed or managed over \$2 billion worth of energy efficiency, renewable energy, and sustainability programs.

On top of all of this, Adam also currently serves as the Chairman of the National Association of Energy Services Companies, or commonly known as NAESCO, where he has been active in working with public government officials to develop regulations and legislation in the areas of energy efficiency, renewable energy, and sustainability. He has participated in a variety of work groups and committees and he speaks frequently at industry gatherings and conferences.

Now, in addition to our key hires in engineering, we also hired experienced senior sales executives in key markets including Chicago, Boston, Los Angeles, Dallas, Houston, Phoenix, and Denver. Hiring experienced professionals to fill each of these positions were important strategic initiatives that we set out at the beginning of this year to grow and solidify our platform.

Now only have we accomplished these initiatives, but it also highlights our ability to attract seasoned, experienced industry professionals who see the enormous opportunities the rest of us believe exists at Lime Energy.

Now as I mentioned on the last call, we also decided last quarter to focus on our core energy efficiency service business and announced our intent to sell our energy technology division. This was a difficult decision given the money we had invested and the fact we always have and remain convinced of the promise and future of this line of HVAC and lighting controls technology.

It's unique, proprietary, and provides recurring revenue for the monitoring service. Our customers include Fortune 500 companies who continue to deploy the technology and rely on the 24/7 monitoring service to track performance at their multi-site facilities. Although we hope to continue selling and installing the technology as part of our broader array of energy efficiency solutions, we concluded that we are not best suited to own, develop, and support the technology.

Over the last 60 days, we have had interest in this division and hope to have a transaction consummated over the next few months. We are now accounting for this division as a discontinued business.

Another major accomplishment to highlight for last quarter was the completion of the financial transactions we announced last September with the closing of \$10.4 million in capital funding all the working capital we expect to need this year for our growing business. This was a particularly notable achievement given the utter collapse of the capital markets.

Looking forward, we remain cautious, but optimistic despite the continued difficult and uncertain economic environment. We continue to sign business with new and existing corporate customers who are desperately looking for ways to cut operating expenses. We have had some customers defer or delay projects, some with as little as a year payback. However, we've also had other customers sign and initiate new projects, some with two and three-year paybacks.

The bulk of our C&I projects continue to be energy efficient lighting upgrades, which are becoming more complex and diverse, utilizing a variety of controls and sensors as well as the implementation of rapidly-evolving technology like LED lighting.

In addition to energy efficient lighting, however, we are also beginning to see interest from our corporate customers in other energy efficiency measures like HVAC, weatherization, and water conservation, given the expectation of carbon reduction initiatives by the Obama Administration as well as water shortages in areas around the country.

We are also seeing continued increases in our business with federal, state, and local governments through our ESCO partners. The US government has announced over \$80 billion in energy-saving performance contracts to finance energy efficiency projects over the next 10 years. We currently work with nine of the 16 ESCO companies approved by the DOE to participate in their \$80 billion program, so we believe we are well positioned to participate in this market.

In addition, the Obama Administration announced over \$30 billion in stimulus spending for energy efficiency projects. Although it still remains unclear exactly how the federal and/or state governments will get all of these energy efficiency projects implemented and installed, we do believe Lime Energy is well positioned to participate in this as well, particularly as it relates to the \$5 billion allocated for weatherization, \$3.2 billion in energy efficiency block grants, \$3 billion allocated to states, and \$5.5 billion for the GSA. However, we really do not expect to see much of the stimulus spending on energy efficiency until the fourth quarter, at the earliest.

Now looking at our second quarter, we are providing guidance of between \$16 million and \$18 million in revenue, which would be a 48% to 67% increase over the second quarter of 2008, again, on a pro forma basis. We expect to continue to realize benefits from operating leverage as we

May. 12. 2009 / 4:30PM ET, LIME - Q1 2009 Lime Energy Co. Earnings Conference Call

expand revenue and improve our gross margin while holding the growth in SG&A. We reaffirm our previous guidance for 2009 of between \$80 million and \$85 million with break-even deposit of adjusted EBITDA for the full year.

In conclusion, we are and remain extremely excited about the platform we have built and our opportunity going forward. We are vertically integrated with a robust sales force, an experienced energy engineering team, and a skilled construction force serving a large, diverse, and growing customer base.

Our footprint is national with regional presences in virtually every major market. Our financials continue to improve, showing our operating leverage, growing margins, and scalability. So with that, let me open it up to questions.

QUESTION AND ANSWER

Operator

(Operator Instructions) Your first question comes from the line of Craig Irwin with Merriman. Please proceed.

Craig Irwin - Merriman - Analyst

Thank you. Good afternoon, gentlemen. Congratulations on the strong growth there.

David Asplund - Lime Energy Co. - CEO

Thanks.

Craig Irwin - Merriman - Analyst

I just wanted to talk a little bit more about the macro. You mentioned that you didn't expect any significant impact from the stimulus until at least the fourth quarter of this year, but you're posting solid growth, 60% this quarter, the outlook for continued solid growth over the next couple of quarters. What do you think the stimulus does as far as driving potential revenue growth for these guys? Does this maintain the opportunity for north of 50% growth in 2010 and 2011?

David Asplund - Lime Energy Co. - CEO

Let me answer that first and then I'll give it to John O'Rourke. But clearly what the stimulus does is it highlights energy efficiency. President Obama is the best energy efficiency salesman we have in the world and clearly the government has focused on this because they do understand that it creates green jobs. There is an immediate, instantaneous, verifiable return on investment on taxpayer money.

It helps them reduce -- meet some of their own self-imposed initiatives on reducing energy demand. It not only reduces it, it eliminates it. It doesn't move it around. It doesn't take it off peak periods. It eliminates energy off the grid permanently, so it also eliminates green -- emissions. So it is a bully pulpit showing the benefits of energy efficiency. That is not lost on the C&I market either.

So much of this business, though, before the Obama Administration even came into power, the DOE had increased the ESPC program from \$2 billion to \$80 billion back in I think it was December, and so these programs are ongoing. They last for 10 years; you can read about it on the Department of Energy website. So to us, the stimulus money is just additive to all the other government initiatives that don't get the kind of press as the stimulus. John, do you want to add to that?

John O'Rourke - Lime Energy Co. - COO

May. 12. 2009 / 4:30PM ET, LIME - Q1 2009 Lime Energy Co. Earnings Conference Call

I might add that certainly our business plan is not built around stimulus funding, but we certainly expect that stimulus funding will affect it to a fair degree in 2010 and 2011 and we're looking forward to stimulus funding being a catalyst for projects that have been developed and are in the pipeline with our ESCO customers at federal and state facilities.

Craig Irwin - Merriman - Analyst

All right, thank you. If I could ask about the SG&A, Jeff, this quarter was actually a few hundred thousand dollars lower than what I was looking for. Impressive delivery on sort of restrained spending there. Was hoping you could frame out for us the variable expenses on the SG&A line, how we should look for progression over the next couple of quarters as revenue ramps quite significantly?

Jeff Mistarz - Lime Energy Co. - CFO

We did give some detail on the changes in SG&A and NB&A of the 10-Q. We were able to increase our labor a small amount during the quarter through some hires -- annualization of some hires from last year -- and keep our total costs down by reducing some of our other expenses, non-labor-related. And we're really focusing on finding those opportunities for reducing costs going forward.

We don't feel that we need a big investment in additional labor. We're pretty much set right now in terms of our staffing and don't expect to add significantly to it the balance of the year. We really expect that SG&A growth will be very constrained for the balance of the year, primarily just annualization of some hires that have occurred late last year and couple early this year.

Craig Irwin - Merriman - Analyst

Great. And then my next question was around capacity. Obviously, there's tremendous demand out there. You mentioned the \$80 billion IDIQ that Johnson Controls was awarded. We all know about the stimulus money. But what do you envision is the potential capacity of the Company? What revenue book do you think you could execute on in a given year with the existing capacity? And what would you need to do to maybe double it over the next couple of years?

David Asplund - Lime Energy Co. - CEO

John, that's an operations area. You want to answer that?

John O'Rourke - Lime Energy Co. - COO

Yes. I think that we've got a -- what we have today is a very broad platform of operating entities in 14 different locations. We've had considerable investment in putting the regional infrastructure in place in most major areas that where we would be serving -- where we would be implementing large implementation projects. We expect that it would not be difficult for us to add at least 30% to 40% more revenue without any increase in additional SG&A. In actual fact, the additional SG&A would be a component of job cost as it relates to developing and implementing the projects.

Craig Irwin - Merriman - Analyst

Excellent. Thank you very much.

Dan Parke - Lime Energy Co. - President

I second that. I think it's at least that. The building that we've leased out and the people that we've hired. We've been building this business, as we've said all along, to take advantage of all the work that we've got pending and into 2010. So I don't see hardly anymore SG&A increase needed to maximize -- to get to our maximum potential, which I would say is at least 50% of our current projections.

Craig Irwin - Merriman - Analyst

May. 12. 2009 / 4:30PM ET, LIME - Q1 2009 Lime Energy Co. Earnings Conference Call

Excellent. Thank you, Dan and John. Thank you.

Operator

Your next question comes from the line of [David Bish], a private investor. Please proceed.

David Bish *Private Investor*

Good afternoon. You've talked in the past that the process of selling to the C&I customer market, it's a very long sales and pre-sales process of getting all the approvals done and there's a certain seasonality to this. Is the ESCO business similar?

David Asplund - *Lime Energy Co. - CEO*

John, you want to --

John O'Rourke - *Lime Energy Co. - COO*

Sure. Yes, the ESCO business can be a 12 to 18-month sales cycle. At the time that we get engaged as a supply chain partner to an ESCO, that pipeline is considerably shorter since those folks are already down the road -- are 50% down the road with the time that it takes to sell that project.

So from our perspective in the ESCO arena, we're looking at somewhere between eight to 12 months at the outside. Now, we do expect that those sales lead times will shrink significantly and that would definitely be as a result of the effect of stimulus funding in the next two years.

David Asplund - *Lime Energy Co. - CEO*

But Dan, do you want to address that premise about the C&I?

Dan Parke - *Lime Energy Co. - President*

Yes. Typically, we've said in the past that C&I customers from start to finish can take that long as well -- 12 to 18 months. But the good thing is we're learning how to qualify a lot better and learning how to ask the questions, so we don't spend a lot of time wasting their time to waste our customers' time.

We're prescreening, we're doing our research, and now what's happening is a lot of our customers are national in scope and we have maybe done one or two buildings or one or two of their facilities. And they may have 40 to 50 facilities behind them and the one or two or three facilities that we've done is a test where they're verifying the savings.

And then we're working very closely with these accounts to develop a roll-out program and we help prioritize that. We have a database where we can access to all utility information -- utility rebates, utility rates, what happens when there's a peak demand charge in the summertime. We go through their list of facilities as to how long their leases are to what buildings they own and what the value of doing an energy upgrade would do to the building.

So much more comprehensive approach and that's what we've been shooting for is to earn our stripes with these customers. And corporate America today is looking for an energy efficient partner. They know that they need to do something; they just don't know what to do and who to do it with.

And by the backfill that we've done and all of the hires of our great engineering team, we're able to go into these facilities and what we call identify the energy leaks and help prioritize the measures, so it helps them in making decisions.

May. 12. 2009 / 4:30PM ET, LIME - Q1 2009 Lime Energy Co. Earnings Conference Call

David Bish *Private Investor*

Okay.

Dan Parke - *Lime Energy Co. - President*

And I just see the cycle going much shorter now.

David Bish *Private Investor*

Okay, thank you. And as far as the seasonality, is there a seasonality for when you're involved in the ESCO side?

Unidentified Company Representative

No, there is no seasonality around the ESCO side; it just depends on where you're at in the cycle with any given ESCO.

David Bish *Private Investor*

Okay, great. Finally, the gross margin percentage. I know it's been dropping as you have more of the ESCO kind of business coming onboard; we're down to around 20% this quarter. Is that a number that's likely to be stable or do you think it will continue to drop as you have more ESCO stuff?

Jeff Mistarz - *Lime Energy Co. - CFO*

Actually, no. We're working very hard to get it to increase and we did see a significant increase even over pro forma the first quarter of 2008, so it's definitely an area of focus. I think that we believe we will see a steady rise in the gross margin throughout the balance of this year and into next year.

David Bish *Private Investor*

Okay, great. That's all I have. Thank you.

Operator

(Operator Instructions). Your next question comes from the line of Richard Jarrett, a private investor.

Richard Jarrett *Private Investor*

Congratulations, guys, on a great quarter and the progress. Three really quick questions. The first one, wondering if you could provide any color on some of the challenges going on in the REIT market. Is that impacting your pipeline? I noticed on the investor presentation on your website Heinz and CB and some of the other REITS were on there and so wondering if that was having any impact, whether good or bad.

Secondly, on the tech division sale, will that have any material impact to your cash position or not? I know you probably can't give a lot of color, but is there anything there we should look for in terms of degree of magnitude. And finally, any concern on the stock price and listing requirements as you go forward? Thanks a lot.

Jeff Mistarz - *Lime Energy Co. - CFO*

May. 12. 2009 / 4:30PM ET, LIME - Q1 2009 Lime Energy Co. Earnings Conference Call

I'll address, first of all, in regard to the REIT. The Real Estate Investment Trust, the publicly traded companies, are different than the property managers like Heinz and CBRE and Grubb & Ellis, and I'll let Dan address what we're doing with the property managers, because it's really something we believe is an enormous opportunity for us considering that we do work with virtually all the majors and expanding that, but I'll let Dan address that.

In terms of the sale of the energy technology division, you're right, there's not much I can say about that. We'll have to -- we're into the process; we are encouraged. Whether it's material or not, we'll have to see. We do think it's a very unique proprietary technology in a space that is very, very strong and that's frankly why we have kept it for so long. But we're not that suited -- owning and developing supporting technology is a different world and it obviates our technology-agnostic position.

As far as the stock price, to my knowledge there's no concern, no issue in regards to our NASDAQ listing whatsoever that we're aware of. So, Dan, do you want to address the property managers?

Dan Parke - Lime Energy Co. - President

Yes. I think it's important to note when we cut our teeth 25 years ago, that was where we focused most of our attention in the commercial office space. It got very competitive, but one of the things -- it's also that they needed to help rent property, whether it's a triple-net lease or whether it's a gross lease.

With REITS, if they own the buildings then you can reduce \$0.30, \$0.40, \$0.50, \$0.60 a square foot. That has a direct impact on the value of the asset. Generally, it increases it. But if you're reducing \$0.50 a square foot of operating cost, you're increasing the value of the building by \$5.00 a foot.

The hard part in today's environment is being able to educate the financial decision maker on what the impacts are. At the end of the day, what we sell, what our business sells and what people buy is return on investment, reduction in operating expense.

The problem is most CEOs, presidents, financial decision makers don't understand the language that gets it there and that's like BTUs and kilowatt consumption and lumen depreciation, and those are words that they don't understand. And what we've worked very hard, and I think we've come a long, long way, is to take and put a technical sale, put teams together that are what we call outcome sales people that can present the financial benefits.

We're hiring people that don't have a lot of energy experience, but have had an awful lot of property management experience and we're hiring them today. Couple that with the engineering people and to be able to present it in such a way that the facilities engineer and manager buys off on what we've done and it's explained to the CEO or financial decision maker so they can understand the value proposition, which is significant; it's quite significant.

David Asplund - Lime Energy Co. - CEO

The benefit of the property managers is because they have such a diverse customer base, let tenant base, where some business may not be doing well, others are or they're doing okay. So leveraging those property managers is a big initiative and opportunity for us.

The actual REITs like First Industrial here in Chicago, Prologics, Equity Residential Properties -- we've done work there and companies like First Industrial, we're not focusing on that because that has been difficult. Equity Residential Properties is a terrific, terrific REIT, but the majority of those are apartments. We've done some work on the larger ones, but we're putting more of our resources towards the property managers for scalable customers right now.

Operator

Your next question comes from the line of [Hendricks Xavia]. Please proceed.

Unidentified Company Representative

Can we take the next question, please?

May. 12. 2009 / 4:30PM ET, LIME - Q1 2009 Lime Energy Co. Earnings Conference Call

Operator

At this time, you have no questions in the queue. There's no further questions in the queue. I would like to turn the call back over to David Asplund for closing remarks. You may proceed.

David Asplund - Lime Energy Co. - CEO

Okay. Well, I thank everybody for their time and support and look forward to speaking to you in three months on our second quarter. Thank you.

Operator

Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Have a great day, everyone.

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