

ELECTRIC CITY CORP
Form 10KSB
March 31, 2003

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

Form 10-KSB

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

For the fiscal year ended December 31, 2002

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

Commission file number 000-2791

ELECTRIC CITY CORP.

(Name of small business issuer in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

36-4197337

(I.R.S. Employer Identification No.)

1280 Landmeier Road, Elk Grove Village, IL

(Address of principal executive offices)

60007-2410

(Zip Code)

Issuer's telephone number (847) 437-1666

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

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
----------------------------	--

Securities registered under Section 12(g) of the Exchange Act:

Common Stock \$0.0001 par value

(Title of class)

(Title of class)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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. ý Yes o No

Check if disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this

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Form 10-KSB or any amendment to this Form 10-KSB.

State issuer's revenues for its most recent fiscal year. \$11,766,272

The aggregate market value of the voting and non-voting stock held by non-affiliates of the registrant as of February 28, 2003 was approximately \$27,589,089. For purposes of this computation, all executive officers, directors and 10% stockholders were deemed affiliates. Such a determination should not be construed as an admission that such executive officers, directors or 10% stockholders are affiliates.

As of February 28, 2003, there were 33,370,292 shares of common stock, \$0.0001 par value, of the Company issued and outstanding.

As of February 28, 2003, there were 2,171,192 shares of Series A Convertible Preferred Stock, \$0.01 par value, of the Company issued and outstanding.

As of February 28, 2003, there were 211,643 shares of Series C Convertible Preferred Stock, \$0.01 par value, of the Company issued and outstanding.

Transitional Small Business Disclosure Format (Check one): Yes No

TABLE OF CONTENTS

PART I		1
ITEM 1.	DESCRIPTION OF BUSINESS	1
ITEM 2.	DESCRIPTION OF PROPERTY	15
ITEM 3.	LEGAL PROCEEDINGS	15
ITEM 4.	SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS	15
PART II		16
ITEM 5.	MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS	16
ITEM 6.	MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION	18
ITEM 7.	FINANCIAL STATEMENTS	29
ITEM 8.	CHANGE IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE	29
PART III		30
ITEM 9.	DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT	30
ITEM 10.	EXECUTIVE COMPENSATION	34
ITEM 11.	SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT	39
ITEM 12.	CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS	42
ITEM 13.	EXHIBITS AND REPORTS ON FORM 8-K	44
ITEM 14.	CONTROLS AND PROCEDURES	49
SIGNATURES		50

PART I

Item 1. Description of Business

Included in this report, exhibits and associated documents are "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, as well as historical information. Although we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurances that such

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expectations reflected in such forward-looking statements will prove to be correct. Our actual results could differ materially from those anticipated in forward-looking statements as a result of certain factors, including matters described in the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations." Forward-looking statements include those that use forward-looking terminology, such as the words "anticipate," "believe," "estimate," "expect," "intend," "may," "project," "plan," "will," "shall," "should," and similar expressions, including when used in the negative. Although we believe that the expectations reflected in these forward-looking statements are reasonable and achievable, such statements involve risks and uncertainties and no assurance can be given that the actual results will be consistent with these forward-looking statements.

Unless the context otherwise requires, "Electric City," the "Company," "we," "our," "us" and similar expressions refers to Electric City Corp. and its subsidiaries.

Overview/History

We are a developer, manufacturer and integrator of energy saving technologies and custom electric switchgear. Our premier energy saving product is the EnergySaver system, which reduces energy consumed by lighting, typically by 20% to 30%, with minimal lighting level reduction. This technology has applications in commercial buildings, factories and office structures, as well as street lighting and parking lot lighting. In addition to our EnergySaver system, we manufacture, through our subsidiary, Switchboard Apparatus, Inc. ("Switchboard Apparatus"), custom electric switchgear and electrical distribution panels. We also provide, through our subsidiary, Great Lakes Controlled Energy Corp. ("Great Lakes"), integrated building and environmental control solutions.

On December 5, 1997, we were initially formed as Electric City LLC, a Delaware limited liability company, by Joseph C. Marino, one of our principal stockholders, and NCVC, LLC, an entity controlled by Victor Conant, Kevin McEneely and DYDX Consulting LLC (which is controlled by Nikolas Konstant). In May 1998, Mr. Marino assigned his membership interest in us to Pino Manufacturing, LLC, an entity controlled by Mr. Marino.

On June 5, 1998, we changed from a limited liability company into a corporation by merging Electric City LLC into Electric City Corp., a Delaware corporation. In connection with our merger, NCVC, LLC and Pino Manufacturing, LLC received shares of common stock in Electric City Corp. in exchange for their membership interests in Electric City LLC.

On June 10, 1998, Electric City issued 1,200,272 shares of its common stock with a fair market value of \$1,200,272 representing approximately six (6%) percent of Electric City's issued and outstanding common stock, to the approximately 330 shareholders of Pice Products Corporation ("Pice"), an inactive, unaffiliated company with minimal assets, pursuant to merger agreement under which Pice was merged with and into Electric City. The number of shares issued to Pice was determined and negotiated with the principals of Pice by the Company's Board of Directors as a whole and was concluded by the Board to be an "arm's length transaction" in that none of the Board of Directors was in any way affiliated with, or related to the principals of Pice. The purpose of the merger was to substantially increase the number of our shareholders to facilitate the establishment of a public trading market for our common stock. Trading in our common stock commenced on August 14, 1998 through the OTC Bulletin Board under the trading symbol "ECCC".

1

In May 1999, we purchased most of the assets of Marino Electric, Inc., an entity controlled by Mr. Marino, for \$1,792,000 in cash and 1,600,000 shares of our common stock. Marino Electric was engaged in the business of designing and manufacturing custom electrical switchgear and distribution panels. Under the terms of the purchase agreement, we were obligated to pay the cash portion of the purchase price upon the closing of our private issuance of common stock that commenced in July 1999. In May 2000, Mr. Marino waived this requirement and instead received a payment of \$820,000 in cash and a subordinated secured term note for the principal amount of \$972,000 at an interest rate of 10% per annum, payable in equal installments over 24 months. This note was repaid in full in May 2002.

On August 31, 2000, pursuant to an Agreement and Plan of Merger among us, Switchboard Apparatus, Inc. and Switchboard Apparatus's stockholders, Dale Hoppensteadt, George Miller and Helmut Hoppe, we purchased all of the issued and outstanding shares of capital stock of Switchboard Apparatus. In connection with the acquisition, Switchboard Apparatus was merged into our wholly-owned subsidiary, with our subsidiary continuing as the surviving corporation under the name Switchboard Apparatus, Inc. The aggregate purchase price of \$1,941,750 was paid in the form of 551,226 shares of our common stock.

Effective December 4, 2000, Joseph P. Marino, one of our founders and former Chairman of the Board of Directors, resigned his position as Chairman and terminated his employment with us. Concurrent with his resignation, Mr. Marino became a distributor for our EnergySaver products in the states of California, Arizona and Nevada (See, "Item 12 Certain Relationships and Related Transactions").

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On June 7, 2001, pursuant to an Agreement and Plan of Merger by and among us, Electric City Great Lakes Acquisition Corporation, Great Lakes Controlled Energy Corporation ("Great Lakes") and Great Lakes stockholders, Eugene Borucki and Denis Enberg, we acquired Great Lakes. Great Lakes is an independent systems integrator and facilities support specialist and focuses on building automation controls for lighting and HVAC systems for commercial applications. Great Lakes is also a national representative and distributor of select energy metering and control systems. In connection with the acquisition, Great Lakes was merged into our wholly-owned subsidiary Electric City Great Lakes Acquisition Corporation, with our subsidiary continuing as the surviving corporation under the name Great Lakes Controlled Energy Corp. The aggregate purchase price of \$678,500 was paid to the Sellers in the form of 212,904 shares of Electric City common stock.

Products And Services

The Company currently manufactures products or provides services under three distinct business segments. The energy technology segment includes the EnergySaver and GlobalCommander product lines manufactured and sold by Electric City Corp. The power management business segment includes switchgear and related products manufactured by one of our subsidiaries, Switchboard Apparatus, Inc. The switchgear product line includes those products previously manufactured by Marino Electric, which product lines were merged into Switchboard Apparatus during 2000. The building control and automation business segment is served by our other subsidiary, Great Lakes Controlled Energy Corp., which specializes in the installation and maintenance of building control and automation systems. See note 19 to the consolidated financial statements for additional information regarding the various segments of our business.

EnergySaver

The EnergySaver system is a state-of-the-art lighting control system that reduces energy consumption in indoor and outdoor commercial, institutional and industrial ballasted lighting systems, while maintaining appropriate lighting levels. The EnergySaver is a freestanding enclosure that contains control panels with electrical parts and is connected between the power line and the building's

2

electrical lighting circuits. The EnergySaver also contains a computer with software that allows the customer to control the amount of energy savings desired which, depending on the application, can be as high as 50%, and provides self-diagnosis and self-correction. The customer can access the EnergySaver's computer directly or remotely via modem, network or two-way radio.

The EnergySaver is manufactured to varying sizes and capacities to address differing lighting situations. We can interface our EnergySaver products with new and existing lighting panels, ballasts and lamps without modification. In addition, the EnergySaver system reduces the power consumed by lamps and ballasts and reduces power spikes, drops and surges inherent in any power supply, resulting in a reduction of heat generated within the lighting system, which enhances ballast and lamp life and reduces the amount of air conditioning necessary to cool the building.

GlobalCommander

The GlobalCommander system is an advanced lighting controller capable of providing large-scale demand side management and savings measurement and verification without turning off the user's lights. The GlobalCommander bundles the EnergySaver technology with an area-wide communication package to allow for maximum energy reductions across entire systems in response to the guidelines of a customer's facility manager. In addition, the GlobalCommander has the ability to measure and store the actual savings generated from the use of the EnergySaver. This information, which can be viewed in a tabular or graphical format and can be downloaded to a user's computer, is often required for a customer to qualify for utility incentives for energy savings and curtailment. The GlobalCommander also allows customers to control their facilities' loads and lighting requirements from a single control point. This single-point control is available for a virtually unlimited number of remote facilities and can be accessed through the Internet, intranet or over standard telephone lines through dial-up modems.

Custom Electrical Switchgear

We design and manufacture a wide range of commercial and industrial custom electrical switching gear and distribution panels that serve to distribute electricity from the electric utility's main power bus to the various electrical requirements within a building. We have built a reputation for custom manufacturing of 120/208, 120/240 and 277/480V single- and three-phase switchgear for virtually any application. Our focus on custom manufacturing allows us to design and assemble these custom panels more quickly than manufacturers who must deviate from standard assembly line production.

Typical customers of custom switchgear are electrical contractors who provide installations for commercial and industrial building projects. Most custom switchgear contracts involve the custom manufacturing of electrical switching gear and distribution panels for both new

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construction and retrofit projects. Our product line includes main distribution panels, electrical boxes and assembled circuit breakers, bus bars and switches. In addition, we are an authorized re-seller and original equipment manufacturer (OEM) for Siemens and Cutler-Hammer.

Building Control and Automation

Through our wholly-owned subsidiary, Great Lakes Controlled Energy Corp., we provide integration of building and automation control systems for commercial and industrial customers. Great Lakes has been providing building automation services for over 20 years and is an authorized distributor for Delta Controls, WattStopper and Power Measurement Ltd., and is a dealer for Novar Controls and ABB Drives.

Marketing, Sales And Distribution

We have established relationships with distributors (also referred to as "State Representatives") to market and distribute our EnergySaver products to end-users. As of December 31, 2002, we had eight

3

distributor/state representative agreements covering Arizona, California, Illinois, Indiana, Nevada, New Jersey, Pennsylvania, and Texas. Each distributor is responsible for developing and managing a sales network within its respective territory. Typically the distributor does this by establishing direct relationships with end-users or through dealerships within the territory and overseeing the sales, installation and maintenance of our products by those dealerships. If a distributor sells any of our products outside its territory, such distributor operates as a dealer, meaning it manages end-user sales only. The distributor earns a commission on any sale of our products in its territory whether initiated by the distributor itself, a dealer, or by us.

Our standard distribution agreement gives the distributor certain exclusive rights of distribution in a particular territory, includes sales quotas that increase periodically throughout the term of the agreement, and requires the distributor to make payment to us within 30 to 60 days of product shipment. The agreement contains penalties for failure to meet quotas or make payments, including the loss of certain exclusive rights of distribution. Currently, a number of our distributors have violated the terms of their agreements for failing to meet their quotas and are delinquent in payments due Electric City. We are working with our distributors to address these issues. In addition, the standard distribution agreement has a term of 10 years after which it is renewable at our discretion. The standard distribution agreement can be terminated at our discretion if the distributor fails to meet the terms of the distribution agreement.

National accounts (such as chain stores, and large multi-site corporations), municipalities and other large campus customers are managed by our corporate sales engineering group. This group concentrates its sales efforts on the energy engineering staffs of these types of entities, which analyze and recommend the purchase of products like ours for their multiple sites. The sales force also supports, coordinates and manages multiple sales channels.

The product lines manufactured by our subsidiary, Switchboard Apparatus, are sold directly by Switchboard's sales staff to original equipment manufacturers and to end-users.

The building and automation controls systems installed and serviced by our subsidiary, Great Lakes Controlled Energy, are sold directly to end-users, typically commercial office buildings.

Customers

During 2002, sales to our top five EnergySaver customers accounted for 79% of total EnergySaver sales. The top customers for 2002 included Electric City of Pennsylvania, The Illinois Department of Central Management Services, LGI Energy Solutions, M&A Railroad Supply and PSEG Energy Technologies, all but one of who are dealers or distributors of the Company's products. The end user customers of these dealers and distributors include Linens 'N Things, Toyota Motors, Lifetime Fitness. Other end user customers for the EnergySaver during 2002 included, but was not limited to Bunzl Distribution, Gillette, Reckitt Benckiser, Sage Products, the US Post Office and Union Pacific. During 2001, sales to our top five EnergySaver customers comprised 59% of total EnergySaver sales. Four of these top five EnergySaver customers included Electric City of Southern California, Electric City of Illinois, Electric City of Indiana and Electric City of Pennsylvania, who are our distributors. Most EnergySaver units are installed by electrical contractors hired by the end-user customer upon receipt of the product. Electric City of Southern California is owned by Joseph Marino, our former Chairman and Director (See, "Item 12 Certain Relationships and Related Transactions").

During 2002, sales to the top five customers of Switchboard Apparatus comprised 47% of total switchgear sales, which customers included ASCO Services, Inc., Comtel Electric, EOFF Electric Co., Wood Dale Electrical Construction and Zenith Controls, Inc. During 2001, sales to

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the top five customers of Switchboard Apparatus comprised 41% of total switchgear sales, which customers included Electrical Controls Inc., G.E. Supply Co., KMC Telecom, Malko Electric and Zenith Controls, Inc. Roscoe Young, who served as a director of Electric City Corp. from April 2000 through

4

February 2002, is President of KMC Telecom, one of the top five customers of Switchboard Apparatus for both 2000 and 2001. Sales to KMC Telecom were made on the same basis as sales to any other third party purchaser.

During 2002, sales to the top five customers of Great Lakes Controlled Energy accounted for 88% of Great Lake's sales. Great Lake's top five customers for 2002 included 5445 Edgewater Plaza Condo Association, BBM Engineering, Golub & Company, Jacobson-Power, and Teschky, Inc. Jacobson-Power is the general contractor for the Discover Card project. For the period beginning June 2000, following our acquisition of Great Lakes Controlled Energy Corp., through December 31, 2001, the top five customers of Great Lakes comprised 78% of its sales, which customers included 2800 Lake Shore Drive Condominium Association, College of Pathologists, Hill Mechanical Corp., National Heat & Power Corp. and U.S. Power Corp.

Competition

There are a number of products on the market that directly or indirectly compete with the EnergySaver products. These competing products can be categorized into three general types:

those that convert AC to DC at a central location,

those that pulsate the power to the lighting system; and

other control products similar to the EnergySaver system.

Products that fall into the first category convert AC to DC at a central location and do so more efficiently than it is done by the standard electronic ballast in each light fixture. The main drawback to this technology is that the transmission of DC power over any distance is generally less efficient and more dangerous than transmitting AC power. This technology also requires the rewiring of every light fixture on the circuit.

Products that pulsate the power in the lighting system turn the power off and on so quickly (120 times/second) that the lights remain on. This process, which is generally known as "wave chopping," distorts the AC waveform and thereby produces harmonics in a building's electrical system that can damage other electrical components such as electric motors and electronic devices. The process also contributes to the reduction of life of lamps and ballasts in lighting fixtures.

Control products control power consumption at the lights, at the lighting circuit or at the control panel. Products that control the power at the lights or at the lighting circuit must be wired to each fixture or to each circuit, resulting in high installation cost, which makes these products less economically competitive. The EnergySaver controls power consumption at the lighting panel, making it much simpler and less expensive to install and maintain. There are other products on the market that also control power consumption at the lighting panel, but the EnergySaver is the only product that we are aware of that offers total real-time variability of savings levels, remote communications and savings measurement and verification capabilities. We also believe that the EnergySaver has the largest installed base of any lighting control power reduction system of its type.

Our primary competitors in the switchgear and distribution panel market are national suppliers of electrical switchboards, such as Seimens and Cutler-Hammer. The principal competitive factors in this industry are price and project completion time. We believe that we can generally complete custom projects more quickly than our national competitors because we handle each project individually, as compared to our competitors, who generally do not customize projects.

Great Lakes Controlled Energy competes against both large national controls companies and smaller regional distributors of building controls. Two of the large national controls companies that Great Lakes competes with are Siemens and Johnson Controls, both of whom have significantly more

5

6

financial and operating resources than Great Lakes. Great Lakes sells its products and services based on system capabilities, experience and price.

Manufacturing

Our EnergySaver product line is manufactured at our facilities in Elk Grove Village, Illinois, with manufacturing and assembly scaled to order demand. The primary components for the EnergySaver are sourced from multiple manufacturers. We are in continuous discussion with additional parts suppliers, seeking to ensure lowest cost pricing and reliability of supply.

Our switchgear product line is manufactured at the facilities of Switchboard Apparatus in Broadview, Illinois. The key components for our switchgear product line are sourced from multiple manufacturers with the goal of achieving competitive pricing and reliability of supply.

Our key suppliers of components used in our products include Cutler-Hammer, Delta Controls, General Electric and Siemens.

Compliance With Environmental Laws

Neither the Company's production nor sales of its products in any material way generate activities or materials that that would require compliance with federal, state or local environmental laws.

Research and Development

The Company, through the day-to-day use of the EnergySaver and its components, and its use at various testing sites around the country, develops modifications and improvements to its products. Total research and development costs charged to operations were approximately \$65,000 and \$289,000 for the years ended December 31, 2002 and December 31, 2001, respectively.

Intellectual Property

Certain technologies underlying the EnergySaver products have been patented in the U.S. and Italy by Giorgio Reverberi. A U.S. patent application was filed by Mr. Reverberi in November 1997, and a patent was issued in June 2000.

Since January 1, 1998, we, along with Mr. Reverberi and Mr. Marino, have entered into a number of agreements relating to the license of the EnergySaver technology, which grant us the exclusive license rights of Mr. Reverberi's patent of the EnergySaver technology in all of North America, Central America, South America (excluding the countries of Argentina, Brazil, Chile, Paraguay and Uruguay) and the Caribbean (except Cuba), as well as Africa (excluding the countries of Algeria, Libya, Morocco and Tunisia). Our license expires upon the expiration of Mr. Reverberi's last expiring patent, which we expect to be on or around November 2017. If either party materially breaches the license and fails to cure the breach within 180 days after notice by the other party of the breach, the other party can terminate the license. We pay Mr. Reverberi a royalty of \$200 and Mr. Marino a royalty of \$100 for each EnergySaver product we make or sell in territories in which Mr. Reverberi holds a valid patent.

We have applied for registration of the name EnergySaver pursuant to a U.S. trademark application filed September 15, 2000. In addition, we filed with the U.S. Patent and Trademark Office an intent-to-use trademark application for each of GlobalCommander, Virtual Negawatt Power Plant and VNPP on November 13, 2000. During January 2002, we were notified that the application for the name VNPP had been approved. We abandoned efforts to register the name Virtual Negawatt Power Plant because of existing trademarks that included similar terms.

During March 2001, we established a new policy that requires all non-union employees to sign an Employee Innovations and Proprietary Rights Assignment Agreement. This agreement is intended to

ensure that any intellectual property or know-how developed as part of an employee's work for the Company is and remains the property of the Company. All current non-union employees have signed such an agreement.

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On April 12, 2001, Denis Enberg assigned his rights to any technology developed by him for, or on behalf of the Company or Switchboard Apparatus to the Company. Mr. Enberg had been working for the Company on the GlobalCommander Technology. Mr. Enberg was also a shareholder and director of Great Lakes, which we acquired on June 7, 2001.

Employees

As of February 28, 2003, we had 73 full time employees, of which eight were management and corporate staff, five were engineers, 12 were engaged in sales and marketing, seven were engaged in field service and 48 were engaged in manufacturing. Of those employees engaged in manufacturing, 37 are covered by collective bargaining agreements between each of Electric City and Switchboard Apparatus and the International Brotherhood of Electrical Workers ("IBEW"), which is affiliated with the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO). In May of 2002 we renewed and combined the collective bargaining agreements into one contract covering all union employees. The new agreement will expire on May 31, 2005.

Risk Factors

We caution you that the following risk factors may not be exhaustive. We operate in a continually changing business environment and may as a result enter into new businesses and product lines. We cannot predict new risk factors that may arise in the future, and we cannot assess the impact, if any, of these new risk factors on our businesses or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those projected in any forward-looking statements. Accordingly, you should not rely on forward-looking statements as a prediction of actual results. In addition, our estimates of future operating results are based on our current complement of businesses, which is constantly subject to change as we continue to assess and refine our business strategy. If any of the following risks actually occur, our business, results of operations, and financial condition could be adversely affected in a material manner.

Risks Related to Our Business

We were formed in December 1997. To date, we have only generated limited revenues from the sale of our products and do not expect to generate significant revenues until we sell a significantly larger number of our products. Accordingly, we have only a limited operating history upon which you can base an evaluation of our business and prospects. The likelihood of our success must be considered in light of the risks and uncertainties frequently encountered by early stage companies like ours in an evolving market. If we are unsuccessful in addressing these risks and uncertainties, our business will be materially harmed.

We have incurred substantial net losses in each year since we commenced operations in December 1997. We must overcome significant manufacturing and marketing hurdles to sell large quantities of our products. In addition, we may be required to reduce the prices of our products in order to increase sales. If we reduce product prices, we may not be able to reduce product costs sufficiently to achieve acceptable profit margins. As we strive to grow our business, we expect to spend significant funds (1) for general corporate purposes, including working capital, marketing, recruiting and hiring additional personnel; (2) for research and development; and (3) to acquire complementary products, technologies and services. To the extent that our revenues do not increase as quickly as these costs and expenditures, our results of operations and liquidity could be materially adversely affected. If we experience slower than anticipated revenue growth or if our operating expenses exceed our

expectations, we may not achieve profitability. Even if we achieve profitability in the future, we may not be able to sustain it.

Our auditors have modified their opinion to our audited financial statements for the year ended December 31, 2002 to include an emphasis paragraph, stating that our continuing losses and negative cash flow from operations raise substantial doubt about our ability to continue as a going concern. Our management has developed a plan that includes restructuring or possibly disposing of the Power Management segment of our business, increasing sales of our Energy Technology products and raising additional capital. If we are unsuccessful in accomplishing any of these three tasks, our ability to continue to operate as a going concern could be in doubt.

We have entered into a license agreement with Giorgio Reverberi, who holds a U.S. patent and who has applied for several patents in other countries. Pursuant to the terms of the license, Mr. Reverberi granted to us the exclusive right to manufacture and sell products containing the load reduction technology claimed under Mr. Reverberi's U.S. patent or any other related patent held by him in the U.S., the remainder of North America, parts of South America and parts of Africa. However, the exclusive rights that we received from Mr. Reverberi may not have any value in territories where Mr. Reverberi does not have or does not obtain protectable rights. The term of the license expires when the last of these patents expires. We expect that these patents will expire in or around November 2017. Mr. Reverberi may terminate our license agreement if we materially breach its terms and fail to cure the breach within 180 days after we are notified of the breach. If our license with Mr. Reverberi

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is terminated, that could impact our ability to manufacture, sell or otherwise commercialize products in certain countries in the event that Mr. Reverberi has valid patent(s) in those countries with one or more patent claims that cover those products.

We regard our intellectual property rights, such as patents, licenses of patents, trademarks, copyrights and trade secrets, as important to our success. Although we entered into confidentiality and rights to inventions agreements with our non-union employees and consultants during March 2001, the steps we have taken to protect our intellectual property rights may not be adequate. Third parties may infringe or misappropriate our intellectual property rights or we may not be able to detect unauthorized use and take appropriate steps to enforce our rights. Failure to take appropriate protective steps could materially adversely affect our competitive advantage in the energy management market. Our license to use Mr. Reverberi's patents may have little or no value to us if Mr. Reverberi's patents are not valid. In addition, patents held by third parties may limit our ability to manufacture, sell or otherwise commercialize products and could result in the assertion of claims of patent infringement against us. If that were to happen, we could try to modify our products to be non-infringing, but such modifications might not be successful to avoid infringing on the intellectual property rights of third parties.

Claims of patent infringement, regardless of merit, could result in the expenditure of significant financial and managerial resources by us. We may be forced to seek to enter license agreements with third parties (other than Mr. Reverberi) to resolve claims of infringement by our products of the intellectual property rights of third parties. These licenses may not be available on acceptable terms or at all. The failure to obtain such licenses on acceptable terms could have a negative effect on our business.

Our future success will depend significantly upon the continued contributions of certain members of our senior management, including John P. Mitola, our Chief Executive Officer, because he is critical to obtaining and retaining customers and managing our growth. Our future success will also depend upon our ability to attract and retain highly qualified technical, operating and marketing personnel. We believe that there is intense competition for qualified personnel in the power management industry. If we cannot hire, train and retain qualified personnel or if a significant number of our current employees depart, we may be unable to successfully manufacture and market our products.

8

We have experienced rapid growth, which has been primarily through acquisitions of other businesses, and we are subject to the risks inherent in the expansion and growth of a business enterprise. This significant growth, if sustained, will continue to place a substantial strain on our operational and administrative resources and increase the level of responsibility for our existing and new management personnel. To manage our growth effectively, we will need to:

further develop and improve our operating, information, accounting, financial and other internal systems and controls on a timely basis;

improve our business development, marketing and sales capabilities; and

expand, train, motivate and manage our employee base.

Our current senior management has limited experience managing a publicly traded company. Our systems currently in place will not be adequate if we continue to grow at our current pace and will need to be modified and enhanced. The skills of management currently in place may not be adequate if we continue to grow at our current pace.

Our operations have not generated positive cash flow since the inception of the Company in 1997. We have funded our operations through the issuance of common and preferred stock and secured bank debt. Our ability to continue to operate until our cash flow turns positive will depend on our ability to continue to raise funds through the issuance of equity or debt. If we are not successful in raising additional funds, we might have to significantly scale back or delay our growth plans, or possibly cease operations altogether. Any reduction or delay in our growth plans could materially adversely affect our ability to compete in the marketplace, take advantage of business opportunities and develop or enhance our products.

Customer engagements involve the installation of energy management equipment that we design to help our clients reduce energy/power consumption and/or increase energy/power reliability. We rely on outside contractors to install our EnergySaver products. Any defects in this equipment and/or its installation or any other failure to meet our customers' expectations could result in:

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delayed or lost revenues due to adverse customer reaction;

requirements to provide additional products and/or services to a customer at no charge;

negative publicity regarding us and our products, which could adversely affect our ability to attract or retain customers; and

claims for substantial damages against us, regardless of our responsibility for such failure.

Our recent growth is due in part to acquisitions. Our future growth may depend, in part, on our ability to identify opportunities to acquire companies with complementary technologies, products and/or services and to successfully negotiate the terms of any acquisitions we want to make. Our management, including our Board of Directors, will have discretion in identifying and selecting companies to be acquired by us and in structuring and negotiating these acquisitions. In general, our common stockholders will not have the opportunity to approve these acquisitions (The holders of our Series A Convertible Preferred Stock and Series C Convertible Preferred Stock have certain rights to approve acquisitions). In addition, in making acquisition decisions, we will rely, in part, on financial projections developed by our management and the management of potential target companies. These projections will be based on assumptions and subjective judgments. The actual operating results of any acquired company or the combination of us and an acquired company may significantly fall short of these projections.

We may be unable to acquire companies that we identify for various reasons, including:

our inability to interest such companies in a proposed transaction;

9

our inability to agree on the terms of an acquisition;

incompatibility between our management and management of a target company; and

our inability to obtain required approvals of the holders of our Series A Convertible Preferred Stock and Series C Convertible Preferred Stock.

If we cannot consummate acquisitions on a timely basis or agree on terms at all, or if we cannot continue to acquire companies with complementary technologies, products and/or services on terms acceptable to us, our growth may be impaired.

During our limited operating history, we have acquired Switchboard Apparatus Inc., which forms the core of our Power Management business unit, and Great Lakes Controlled Energy Corp., which is a national representative and installer of select energy metering and control systems. Our future growth may depend, in part, upon our ability to successfully acquire other complementary businesses. We may encounter problems associated with such acquisitions, including the following:

difficulties in integrating acquired operations and products with our existing operations and products;

difficulties in meeting operating expectations for acquired businesses;

diversion of management's attention from other business concerns;

adverse impact on earnings of amortization or write-offs of goodwill and other intangible assets relating to acquisitions; and

issuances of equity securities that may be dilutive to existing stockholders to pay for acquisitions.

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If we cannot successfully manage the businesses we acquire and integrate them into our existing business our growth may be impaired and our business may suffer.

We have been marketing and selling our products in Mexico and may expand our international operations into other countries in which we have been granted license rights. Under our license with Messrs. Reverberi and Marino, we have been granted exclusive rights to manufacture and sell products containing his patented load reduction technology in North America, parts of South America and parts of Africa. While we have no current plans to do so, our future expansion into international markets beyond Mexico will require significant management attention and financial resources and could adversely affect our business, operating results and financial condition. In order to expand international sales successfully, we must establish additional foreign operations and joint ventures, hire additional personnel and recruit additional international distributors. We may not be able to do so in a timely or cost efficient manner, and our failure to do so may limit our international sales growth.

There are certain risks inherent in international business activities including:

changes in foreign currency exchange rates;

tariffs and other trade barriers;

costs of localizing products for foreign countries;

lack of acceptance of localized products in foreign countries;

longer accounts receivable payment cycles;

difficulties in managing international operations;

difficulties enforcing agreements in foreign jurisdictions;

potentially adverse tax consequences, including restrictions on repatriating earnings;

weaker intellectual property protection in foreign countries; and

the burden of complying with a wide variety of foreign laws.

10

These factors may have a material adverse effect on our future international sales and, consequently, our business, operating results and financial condition.

The manufacture and sale of our products creates a risk of product liability claims. Any product liability claims, with or without merit, could result in costly litigation and reduced sales, cause us to incur significant liabilities and divert our management's time, attention and resources. We do have product liability insurance coverage; however, there is no assurance that such insurance is adequate to cover all potential claims. The successful assertion of any such large claim against us could materially harm our liquidity and operating results.

Our EnergySaver products are manufactured at our facilities. To be financially successful, we must manufacture our products, including our EnergySaver products, in substantial quantities, at acceptable costs and on a timely basis. While we have produced over 800 EnergySaver units over the past six years, we have never approached what we believe is our production capacity. To produce larger quantities of our EnergySaver products at competitive prices and on a timely basis, we will have to further develop our processing, production control, assembly, testing and quality assurance capabilities. We may also have to hire contract-manufacturers and outsource the manufacturing of some or all of our products.

We have had discussions with several potential contract-manufacturers and they have produced several units on a trial basis, but their ability to deliver significant quantities of product on a timely basis is still unproven. We may be unable to manufacture our EnergySaver products in sufficient volume and may incur substantial costs and expenses in connection with manufacturing larger quantities of our EnergySaver products. If we are unable to make the transition to large-scale commercial production successfully, our business will be negatively affected. We could encounter substantial difficulties if we decide to outsource the manufacturing of our products, including delays in manufacturing and poor production quality.

Sales and margins of our Power Management business have been negatively impacted by a slowdown in construction spending and a cut back in capital expenditures by the Telecom industry. During 2002 we reduced our cost of manufacturing, primarily through reductions in labor costs, but the segment is continuing to lose money and consume cash. We are currently evaluating several strategic alternatives, including restructuring the business once again in an attempt to further reduce costs, or possibly selling or otherwise disposing of the business altogether. If we attempt to restructure the business there is a chance that our efforts may not be successful in returning it to profitability. If we decide to sell the business it is likely that we will not recoup our investment, resulting in a significant charge related to the disposal. If we fail to find a solution quickly the business will likely continue to strain our already weakened liquidity.

Risks Related to Our Industry

In the energy management market, we compete with other manufacturers of switching and monitoring systems and manufacturers of traditional energy management products that are currently used by our potential customers. Many of these companies have substantially greater financial resources, larger research and development staffs and greater manufacturing and marketing capabilities than us. Our competitors may provide energy management products at lower prices and/or with superior performance. Failure of our products to reduce energy usage and cost sufficiently and reliably to achieve commercial acceptance or to otherwise successfully compete with conventional and new technologies would materially harm our business.

One of the challenges we face in commercializing our energy management products is demonstrating the advantages of our products over more traditional products and competitive products. As we grow, we will need to further develop our marketing and sales force. In addition to our internal sales force, we rely on third parties to market and sell our products. We currently maintain a number of relationships and have a number of agreements with third parties regarding the marketing and

distribution of our EnergySaver products and are dependent upon the efforts of these third parties in marketing and selling these products. Maintenance of these relationships is based primarily on an ongoing mutual business opportunity and a good overall working relationship. The current contracts associated with certain of these relationships allow the distributors to terminate the relationship upon 30 days' written notice. Without these relationships, our ability to market and sell our EnergySaver products could be harmed and we may need to divert even more resources to increasing our internal sales force. If we are unable to expand our internal sales force and maintain our third party marketing relationships, our ability to generate significant revenues could be seriously harmed.

The distribution rights we have granted to third parties in specified geographic territories may make it difficult for us to grow our business in such territories if those distributors do not successfully market and support our products in those territories. We have in the past been, and may in the future be, involved in disputes with distributors that have distribution rights in specified geographic territories, but are achieving sales results that do not meet goals. During 2000, we repurchased for cash and stock consideration the distribution rights for Arizona, Colorado, Florida, Georgia, Michigan, Nebraska, North Carolina, Ohio, South Carolina and Virginia from three distributors that were not meeting our sales goals. We may have to expend additional funds, incur debt or issue additional securities in the future to repurchase other distribution rights that we have granted or may grant in the future.

During 2001, we announced our "Virtual Negawatt Power Plant" concept and our "Shared Savings" program. The concept of the Virtual Negawatt Power Plan program is the creation of "Negawatts" which are reductions in demand for electric power. Negawatts are made possible by the installation of our EnergySaver units, which result in such reductions in demand for electric power. The concept of the "Shared Savings" program calls for a type of lease arrangement whereby the end-user allocates a share of its electric savings to a pay-down of lease financing arranged by a third party. We plan to advance the distribution of our EnergySaver products and increase the profitability of our EnergySaver product line through these new projects. While we have begun to implement these projects we do not know at this time if they will be commercially successful. If these projects are unsuccessful, our plans to significantly increase the distribution of our EnergySaver product line, especially in markets where electricity has been deregulated, may not develop and our growth may be impaired.

The construction industry is cyclical and is frequently affected by changes in general and local economic conditions, including:

employment levels;

availability of financing for customers;

interest rate fluctuations; and

consumer confidence.

A decline in construction activity may decrease our ability to sell our products. We have no control over these economic conditions. Any significant downturn in construction activity could reduce demand for our products and could affect the sales of our products.

Our principal products, our EnergySaver products, have the greatest profit potential in areas where commercial electric rates are relatively high. However, retail electric rates for commercial establishments in the United States may not remain at their current high levels. Due to a potential overbuilding of power generating stations throughout certain regions of the United States, wholesale power prices may decrease in the future. Because the price of commercial retail electric power is largely attributed to the wholesale cost of power, it is reasonable to expect that commercial retail rates may decrease as well. In addition, much of the wholesale cost of power is directly related to the price of certain fuels, such as natural gas, oil and coal. If the prices of those fuels decrease, the prices of the

12

wholesale cost of power may also decrease. This could result in lower electric retail rates and less of a demand for energy saving devices such as our EnergySaver products.

To date, we have not sold our EnergySaver product line in very large quantities and a sufficient market may not develop for it. Significant marketing will be required in order to establish a sufficient market for the EnergySaver products. The technology underlying these products may not become a preferred technology to address the energy management needs of our customers and potential customers. Failure to successfully develop, manufacture and commercialize products on a timely and cost-effective basis will have a material adverse effect on our ability to compete in the energy management market.

Risks Related to Our Common Stock

Our common stock began trading on the American Stock Exchange on December 12, 2000. Previously our securities traded in the over-the-counter market on the OTC Bulletin Board. If an active and liquid trading market does not exist for our common stock on AMEX, you may have difficulty selling your shares.

Our operations have not generated positive cash flow since the inception of the Company in 1997. We have funded our operations through the issuance of common and preferred stock and secured bank debt. Our ability to continue to operate until our cash flow turns positive will depend on our ability to continue to raise funds through the issuance of equity or debt. If we are not successful in raising additional funds, we might have to significantly scale back or delay our growth plans, or possibly cease operations altogether. Any reduction or delay in our growth plans could materially adversely affect our ability to compete in the marketplace, take advantage of business opportunities and develop or enhance our products.

We need to obtain additional funds to grow our product development, manufacturing, marketing and sales activities at the pace that we intend. If we are not successful in raising additional funds, we might have to significantly scale back or delay our growth plans, reduce staff and delay planned expenditures on research and development and capital expenditures in order to continue as a going concern. Any reduction or delay in our growth plans could materially adversely affect our ability to compete in the marketplace, take advantage of business opportunities and develop or enhance our products. If we receive additional funds or acquire additional businesses through the issuance of equity securities, our existing stockholders will likely experience dilution of their present equity ownership position and voting rights. Depending on the number of shares issued and the terms and conditions of the issuance, new equity securities could have rights, preferences, or privileges senior to those of our common stock.

Our senior management is currently attempting to raise an additional \$2 million to \$4 million of additional capital during 2003, in order to add to our liquidity and cash availability until our operations begin to produce positive cash flow. We also believe that our future growth may

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depend, in part, on our ability to acquire businesses with complementary technologies. If we are successful in raising additional capital or if we acquire additional businesses (both of which may require stockholder approval), our existing stockholders will likely experience dilution of their present equity ownership position and voting rights, depending upon the number of shares issued and the terms and conditions of the issuance. The new equity securities will likely have rights, preferences or privileges senior to those of our common stock.

Over the past 18 months we have issued and sold a total of 2,100,000 shares of our preferred stock, which is convertible into our common stock at the ratio of 10 shares of common stock for each share of preferred stock. These shares of preferred stock are accruing dividends at the rate of 10% per year and during the first three years following issuance we can pay these dividends either in cash or additional shares of preferred stock. To date we have issued an additional 282,835 shares of convertible

13

preferred stock in satisfaction of accrued dividends. The preferred stock holders all have rights that are superior to the rights of our common shareholders, including:

a liquidation preference of \$20 per share,

special approval rights in respect of certain actions by the Company, including any issuance of shares of capital stock by the Company (other than to pay dividends on the preferred and under certain other limited exceptions) and any acquisition, sale, merger, joint venture, consolidation or reorganization involving the Company or any of its subsidiaries,

a conversion price that is below the current market price of our common stock,

the right to elect up to four directors (out of a board membership of 12),

the right to vote with the holders of common stock on an "as converted" basis on all matters on which holders of our common stock are entitled to vote, except for the election of directors or as otherwise provided by law,

a right of first offer on the sale of equity by the Company in a private transaction, and

anti-dilution protection that would adjust the conversion price on their preferred shares and the exercise price on their common stock warrants in the event we issue equity at a price which is less than the conversion price or exercise price of their securities.

There are 33,370,292 shares of our common stock outstanding as of February 28, 2003, of which Joseph C. Marino beneficially owns approximately 27%, NCVC beneficially owns approximately 14% and DYDX beneficially owns approximately 10%, of our currently outstanding common stock (each of the aforementioned percentages includes stock options that are currently exercisable). Kevin P. McEneely, who is one of our directors, and Victor Conant, share voting and investment power with respect to the shares of common stock held by NCVC. As a result of their significant ownership, Mr. Marino, NCVC and DYDX have the ability to exercise a controlling influence over our business and corporate actions requiring stockholder approval, including the election of our directors (other than those directors to be chosen by the holders of our preferred stock), a sale of substantially all of our assets, a merger between us and another entity or an amendment to our certificate of incorporation. This concentration of ownership could delay, defer or prevent a change of control and could adversely affect the price investors might be willing to pay in the future for shares of our common stock. Also, in the event of a sale of our business, Mr. Marino and NCVC and DYDX could elect to receive a control premium to the exclusion of other stockholders.

A significant percentage of the outstanding shares of our common stock, including the shares beneficially owned by Mr. Marino, NCVC or DYDX, can be sold in the public market from time to time, subject to limitations imposed by Federal securities laws and by trading agreements entered into with us. The market price of our common stock could decline as a result of sales of a large number of our presently outstanding shares of common stock by Mr. Marino, NCVC, DYDX or other stockholders in the public market or due to the perception that these sales could occur. This could also make it more difficult for us to raise funds through future offerings of our equity securities.

Provisions of our charter and by-laws may make it more difficult for a third party to acquire control of our company, even if a change in control would benefit our stockholders. In particular, shares of our preferred stock have been issued and may be issued in the future without further stockholder approval and upon those terms and conditions, and having those rights, privileges and preferences, as our Board of Directors may determine. The rights of the holders of our common stock will be subject to, and may be adversely affected by, the rights of the holders of any of our preferred stock which is currently outstanding or which may be issued in the future. The issuance of our preferred stock, while providing desirable flexibility in pursuing possible acquisitions and other corporate purposes, could have the effect of making it more difficult for a third party to acquire

control of us. This could limit the price that certain investors might be willing to pay in the future for shares of our common stock and discourage these investors from acquiring a majority of our common stock. In addition, the price that future investors may be willing to pay for our common stock may be lower due to the conversion price and exercise price granted to investors in any such private financing.

Item 2. Description of Property

Our headquarters and the EnergySaver system production facility are located at 1280 Landmeier Road in Elk Grove Village, Illinois. This facility is approximately 13,000 square feet and houses the corporate headquarters, manufacturing operations and warehouse. We acquired this facility in August 1998 for a purchase price of \$1,140,000, \$800,000 of which we financed through a mortgage and \$340,000 of which we paid by issuing to the sellers 340,000 shares of our common stock. The mortgage was refinanced in May 2002, bears interest at the rate of prime plus 0.5%, and is payable in monthly installments of \$3,000 plus interest, until a final balloon payment which is due on April 30, 2004. There is no penalty for prepayment of the mortgage. As of February 28, 2003, the outstanding principal amount of the mortgage was \$708,000.

Switchboard Apparatus currently conducts business from a facility located in Broadview, Illinois, which is approximately 19,000 square feet and houses Switchboard's office and manufacturing operations. We assumed the lease for this facility in August 2000 in connection with the acquisition of Switchboard Apparatus. The building is owned by a partnership that includes, among others, some of the former owners of Switchboard Apparatus, one of which is currently an employee of the Company. The lease provides for monthly payments of \$9,250 per month during the first three years of the lease term, beginning on May 1, 1999, with payments increasing to \$10,000 per month during the last two years of the lease term. The lease expires April 30, 2004, unless sooner terminated in accordance with the lease provisions.

On June 7, 2001, we acquired Great Lakes Controlled Energy Corporation ("Great Lakes"). Great Lakes currently operates its business from a facility located in Elk Grove Village, Illinois, which is approximately 10,000 square feet. In connection with our acquisition of Great Lakes, we entered into a three-year lease beginning on the date of the acquisition at a monthly rate of \$10,000, with an option to purchase the facility. The building is owned by the former shareholders of Great Lakes, Eugene Borucki and Denis Enberg, both of whom are currently employed by the Company.

We believe that the space and location of our current facilities are sufficient to reach a level of production projected for the current year.

Item 3. Legal Proceedings

From time to time, the Company has been a party to routine pending or threatened legal proceedings and arbitrations that are routine and incidental to its business. Based upon information presently available, and in light of legal and other defenses available to the Company, management does not consider the liability from any threatened or pending litigation to be material to the Company.

Item 4. Submission of Matters to a Vote of Security Holders

There were no matters submitted to a vote of security holders during the three months ended December 31, 2002.

PART II

Item 5. Market for Common Equity and Related Stockholder Matters

Our common stock has traded since December 12, 2000 on the American Stock Exchange under the symbol "ELC."

The following table sets forth the quarterly high and low closing prices for our common stock as reported on The American Stock Exchange since January 1, 2001.

	Common Stock	
	High	Low
Fiscal Year Ended December 31, 2001:		
Fiscal Quarter Ended March 31, 2001	\$ 3.72	\$ 2.00
Fiscal Quarter Ended June 30, 2001	\$ 4.45	\$ 1.80
Fiscal Quarter Ended September 30, 2001	\$ 4.08	\$ 1.49
Fiscal Quarter Ended December 31, 2001	\$ 1.80	\$ 1.01
Fiscal Year Ended December 31, 2002:		
Fiscal Quarter Ended March 31, 2002	\$ 2.29	\$ 1.15
Fiscal Quarter Ended June 30, 2002	\$ 1.68	\$ 1.15
Fiscal Quarter Ended September 30, 2002	\$ 1.60	\$ 1.10
Fiscal Quarter Ended December 31, 2002	\$ 1.15	\$ 0.75

Holdings

As of February 28, 2003, we had approximately 5,900 holders of record of our common stock and 33,370,292 shares of common stock outstanding.

Securities Authorized for Issuance Under Equity Compensation Plans

The following information reflects certain information about our equity compensation plans as of December 28, 2002:

Plan Category	Equity Compensation Plan Information		
	(a)	(b)	(c)
	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	493,913	\$ 1.27	806,087
Equity compensation plans not approved by security holders	8,654,935	\$ 3.96	
Total	9,148,848	\$ 3.78	806,087

See item 10 below (34-38) for additional information.

Dividends

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Dividends on our Series A and Series C Convertible Preferred Stock are payable when declared by our Board of Directors, but will continue to accrue at an annual rate of 10% of the gross sale amount, are cumulative and will be paid prior to any dividends paid on our common stock. For the three

16

months ended December 31, 2002, we declared and paid the following dividends on our Series A Convertible Preferred Stock:

On September 18, 2002, the Board of Directors declared and paid dividends on our Series A and Series C Convertible Preferred Stock for the third calendar quarter ending September 30, 2002 to shareholders of record of our Series A Convertible Preferred Stock and our Series C Convertible Preferred Stock as of September 30, 2002. The dividends were paid in additional shares of Series A Convertible Preferred Stock to the holders as follows: 10,951 shares to EP Power Finance, L.L.C., 10,860 shares to Newcourt Capital USA, Inc., 10,404 shares to Morgan Stanley Dean Witter Equity Funding, Inc., 548 shares to Originators Investment Plan, L.P., 10,951 shares to Duke Capital Partners, LLC, and 7,950 shares to Leaf Mountain Company, LLC. We also paid dividends to Richard Kiphart, the holder of the Series C Convertible Preferred Stock, in 5,036 additional shares of Series C Convertible Preferred Stock. Each share of Series A and Series C Convertible Preferred Stock is convertible into 10 shares of our common stock.

On November 20, 2002, the Board of Directors declared dividends payable on our Series A and Series C Convertible Preferred Stock for the fourth calendar quarter ending December 31, 2002 to shareholders of record of our Series A Convertible Preferred Stock and Series A Convertible Preferred Stock as of December 31, 2001. The dividends were paid on December 31, 2002 in additional shares of Series A Convertible Preferred Stock to the holders as follows: 11,225 shares to EP Power Finance, L.L.C., 11,132 shares to Newcourt Capital USA, Inc., 10,664 shares to Morgan Stanley Dean Witter Equity Funding, Inc., 561 shares to Originators Investment Plan, L.P., 11,225 shares to Duke Capital Partners, LLC and 8,148 shares to Leaf Mountain Company, LLC. We also paid dividends to Richard Kiphart, the holder of the Series C Convertible Preferred Stock, in 5,162 additional shares of Series C Convertible Preferred Stock. Each share of Series A and Series C Convertible Preferred Stock is convertible into 10 shares of our common stock.

For a further discussion regarding preferred stock dividends, see "Item 6 Management's Discussion and Analysis or Plan of Operations Preferred Stock Dividends."

We have never declared or paid any cash dividends on our common stock and we do not anticipate paying any cash dividends in the foreseeable future. See "Item 6 Management's Discussion and Analysis of Results of Operations and Financial Condition Liquidity and Capital Resources."

Recent Sales of Unregistered Securities

During the three months ended December 31, 2002, we issued the securities listed below (in addition to those securities listed under the preceding "Dividends"):

On December 16, 2002, we entered into a securities purchase agreement with the Munder Power Plus Fund ("Munder"), whereby we issued in exchange for \$1,000,000 in gross proceeds, a package of securities that included 1,086,957 shares of our common stock and a five year warrant to purchase 300,000 additional shares of our common stock at an initial exercise price of \$0.92 per share. We are required to reduce the exercise price on the warrant to \$0.75 per share if on the date that we file our Report 10-KSB for fiscal year 2003 with the Securities and Exchange Commission (i) our consolidated revenue reported in such 10-KSB is less than \$25 million and (ii) the closing price of our Common Stock on such date of filing is less than \$2.00 per share.

The holders of the Series A Convertible Preferred stock and the Series C Convertible Preferred stock waived their rights to adjust the conversion price of their preferred shares and the exercise price on their warrants as a result of the issuance price of the common stock and the exercise price of the warrant issued in this transaction. Also, as a condition to the sale we agreed to file a registration

17

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statement with the Securities and Exchange Commission within 90 days for the resale of Munder's shares.

The Company also issued a three-year warrant to purchase 50,000 shares of its common stock at \$1.00 per share and paid \$65,000 to Capstone Investments and \$15,000 to TheStockpage.com as commissions on this transaction.

The financing was exempt from registration under the Securities Act of 1933, as amended, pursuant to Regulation D under the Securities Act.

Item 6. Management's Discussion and Analysis or Plan of Operation

The following discussion regarding us and our business and operations contains "forward looking statements" within the meaning of the Private Securities Litigation Act of 1995. Such statements consist of any statement other than a recitation of historical fact and can be identified by the use of forward-looking terminology such as "may," "expect," "anticipate," "estimate" or "continue" or the negative of such terms or other variations of such terms or comparable terminology. You are cautioned that all forward-looking statements are necessarily speculative and there are certain risks and uncertainties that could cause actual events or results to differ materially from those referred to in such forward-looking statements. We do not have a policy of updating or revising forward-looking statements and, therefore, you should not assume that our silence over time means that actual events are bearing out as estimated in such forward looking statements.

We have a short operating history. All risks inherent in a new and inexperienced enterprise are inherent in our business.

Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that effect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions. Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and potentially result in materially different results under different assumptions and conditions. We believe that our critical accounting policies are limited to those described below. For a detailed discussion on the application of these and other accounting policies, see Note 3 in the notes to the consolidated financial statements.

Use of Estimates

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

Revenue Recognition

The Company recognizes revenue when all four of the following criteria are met: (i) persuasive evidence has been received that an arrangement exists; (ii) delivery of the products and/or services has

occurred; (iii) the selling price is fixed or determinable; and (iv) collectibility is reasonably assured. In addition, the Company follows the provisions of the Securities and Exchange Commission's Staff Accounting Bulletin No. 101, Revenue Recognition, which sets forth guidelines in the timing of revenue recognition based upon factors such as passage of title, installation, payments and customer acceptance. Any amounts received or invoiced prior to satisfying the Company's revenue recognition criteria is recorded as deferred revenue in the accompanying balance sheet.

Allowance for Doubtful Accounts

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. The allowance is largely based upon specific knowledge of customers from whom collection is determined to be doubtful and the

Company's historical collection experience with such customers. If the financial condition of our customers or the economic environment in which they operate were to deteriorate, resulting in an inability to make payments, or if our estimates of certain customer's ability to pay are incorrect additional allowances may be required.

Impairment of Long-Lived Assets.

We record impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of those items. Our cash flow estimates are based on historical results adjusted to reflect our best estimate of future market and operating conditions. The net carrying value of assets not recoverable is reduced to fair value. Our estimates of fair value represent our best estimate based on industry trends and reference to market rates and transactions. The Company had made acquisitions in the past that included a significant amount of goodwill and other intangible assets. Under generally accepted accounting principles in effect through December 31, 2001, these assets were amortized over their estimated useful lives, and were tested periodically to determine if they were recoverable from operating earnings on an undiscounted basis over their useful lives. Effective in 2002, goodwill is no longer amortized but is subject to an annual (or under certain circumstances more frequent) impairment test based on its estimated fair value. Other intangible assets that meet certain criteria will continue to be amortized over their useful lives and will also be subject to an impairment test based on estimated fair value. Estimated fair value is less than values based on undiscounted operating earnings because fair value estimates include a discount factor in valuing future cash flows. There are many assumptions and estimates underlying the determination of an impairment loss, including economic and competitive conditions, operating costs and efficiencies. Another estimate using different, but still reasonable, assumptions could produce a significantly different result. During the year ended December 31, 2002 the Company determined that the estimated fair value of goodwill associated with its power management business exceeded the carrying value and as a result recognized an impairment loss of \$4,103,872, which was recorded as a cumulative effect of a change in an accounting principle. As part of our 2002 year-end assessment of the fair value of our goodwill we determined that the carrying value of the goodwill associated with the building automation and control business exceeded the fair value by \$108,000. This difference between the carrying value and the estimated fair value of the goodwill was recorded as an impairment loss in 2002. It is possible that upon completion of future impairment tests, as the result of changes in facts or circumstances, we may have to take additional charges in future periods to recognize a further write-down of the value of the goodwill attributed to our acquisitions to their estimated fair values.

Results of Operations

Our revenues reflect the sale of our products and services, net of allowances for returns and other adjustments. Electric City's sales are generated from the sale of products and services, primarily in the

U.S. No single customer accounted for more than 10% of our consolidated sales during the year ended December 31, 2002, while one customer accounted for 13% of our total consolidated sales in 2001.

Our cost of goods sold consist primarily of materials and labor. Also included in our cost of goods sold are freight, the costs of operating our manufacturing facilities, charges for potential future warranty claims and royalty costs related to EnergySaver sales. Cost of goods sold also include the wages and expenses of our engineering group at Switchboard Apparatus.

Sales and gross profits depend in part on the volume and mix of products sold during any given period. Generally, products that we manufacture have a higher gross profit margin than products that we purchase and resell. In addition, manufactured products that are proprietary, such as the EnergySaver and the GlobalCommander, generally have higher gross margins than non-proprietary products such as switchgear or distribution panels.

A portion of our operating expense is relatively fixed, such as the cost of our facilities. Accordingly, an increase in the volume of sales will generally result in an increase to our gross margins since these fixed expenses do not increase proportionately with sales. We have never fully utilized the manufacturing capacity of our facilities and, therefore, believe that the fixed nature of some of our expenses would contribute to an increase in our gross margin in future periods if sales volumes increase. In particular we believe that our facility in Elk Grove Village can support a sales level of EnergySavers of approximately \$15 million to \$20 million without a significant investment in fixed assets.

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

direct labor and commission costs related to our employee sales force;

commission costs related to our independent sales representatives and our distributors;

expenses related to our non-manufacturing management, supervisory and staff salaries and employee benefits;

costs related to insurance, travel and entertainment and office supplies costs and the cost of non-manufacturing utilities;

costs related with marketing and advertising our products;

research and development expenses;

costs related to administrative functions that serve to support the existing businesses of the Company, as well as to provide the infrastructure for future growth.

Interest expense includes the costs and expenses associated with working capital indebtedness, the mortgage on our headquarters building, an equipment loan, the Senior Subordinated Convertible Promissory Notes, a note to the sellers of Marino Electric, a note to a seller of Switchboard Apparatus, notes to the sellers of Great Lakes, and a note to the sellers of certain distributor territories that we repurchased in June 2000, all as reflected on our current and prior financial statements. Also included in interest expense for 2001 is amortization of the debt discount based on the fair value of the warrants issued to Newcourt Capital Securities as part of the issuance of the Senior Subordinated Convertible Promissory Notes, and the amortization of deferred financing costs.

Audited Twelve-Month Period Ended December 31, 2002 Compared With the Audited Twelve-Month Period Ended December 31, 2001

Revenue. Our revenue increased approximately \$2.1 million, or 22%, to \$11.8 million for the year ended December 31, 2002 as compared to \$9.6 million for the year ended December 31, 2001. Revenue from the sale of the EnergySaver and GlobalCommanders increased 54% or \$945 thousand, to

20

\$2.69 million in 2002 from \$1.74 million in 2001. EnergySaver unit sales increased 87% from 175 units in 2001 to 328 units in 2002. The average selling price per EnergySaver unit sold declined from \$8,600 in 2001 to \$8,000 in 2002. This reduction in the average selling price is a reflection of change in the mix of models sold, as well as discounts on larger orders. Based on the current level of active sales opportunities, we believe the EnergySaver product line will continue to achieve strong year-over-year growth in revenue through 2003, though our projections for 2003 growth could be negatively impacted by current uncertainties being experienced in the overall economy, which may cause some potential customers to defer their purchase decisions until these economic uncertainties are resolved.

Sales of switchgear and distribution panels manufactured by Switchboard Apparatus, decreased \$1.23 million, or 16%, to \$6.23 million during 2002 compared to \$7.46 million in 2001. Revenue for this segment of our business has been impacted by a slowdown in general construction spending and a severe contraction in construction spending in the telecom industry. At the same time there has been an increase in competition as Switchboard Apparatus and manufacturers of switchgear and distribution panels compete for a smaller pool of available business. Switchboard Apparatus successfully stabilized its revenue during 2002, but its margins have suffered. We expect 2003 revenues for this segment of the business to remain unchanged, to slightly lower than those realized in 2002.

Revenue from building controls and automation increased \$2.20 million, to \$2.48 million in 2002 from \$281,000 in 2001. We acquired Great Lakes Controlled Energy Corp. in June 2001, as a result the 2001 results only included seven months results for this segment. The bulk of the increase in 2002 revenue was the result of a contract to install building automation controls in new buildings being constructed as part of the expansion of the Discover Card headquarters in Riverwoods, Illinois. While the profit earned on this contract will not cover all of Great Lakes fully allocated costs, it was a strategically important contract for Great Lakes because we believe the building automation system installed by Great Lakes is one of the most sophisticated systems ever completed. The success with this project has already afforded Great Lakes opportunities to bid on other projects of similar size, but with better profit margins. Due to constraints on Great Lakes' capacity to handle additional business, we expect revenue to remain relatively unchanged for 2003, but it is our hope that we can increase the capacity of this division in order to realize increased revenue in future periods.

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Other revenue increased by \$222,000 or 157% to \$363,000 in 2002 compared to \$141,000 recorded in 2001. Other revenue includes revenue from the installation of EnergySavers, freight, the pro-rata recognition of a one time payment received for the right to certain distributorships, etc.

Gross Profit. Our consolidated gross profit decreased approximately \$131,000, or 30%, to \$306,000 for 2002 compared to \$437,000 for 2001. Our gross profit as a percentage of sales decreased to 2.6% during 2002 compared to 4.5% during 2001. The gross margin earned on EnergySaver sales, including ancillary products and service, increased from 6.2% in 2001 to 10.8% in 2002. The increase in the EnergySaver gross margin was primarily the result better capacity utilization of our manufacturing facility. The division achieved an 87% increase in EnergySaver unit sales with only a 20% increase in EnergySaver manufacturing expense. The benefit of improved capacity utilization was partially offset by a shift in sales to smaller less profitable units and discounts given on larger orders. The shift in product mix to smaller units was mostly the result of one large order. We believe that the division still has a significant amount of unused capacity, which would allow it to continue to increase production without a corresponding increase in manufacturing costs. We also expect the product mix to shift back toward larger, more profitable units in future periods, though discounting for large orders is likely to continue.

The gross margin earned on switchgear and distribution panel sales declined from 2.8% in 2001 to 1.7% in 2002. The division was able to cut the cost to manufacture its products by 25% during the year, mostly through reductions in labor, but competitive pressures caused a decline in product margins which more than offset the reductions in manufacturing costs leading to the decline in the overall profit margin. In the current competitive and economic environment it will be necessary for this division to

21

further cut its costs in order to improve its margins. We are currently reviewing potential restructuring alternatives for this business. If we feel we will not be able to reduce costs to the level necessary for this business to at least breakeven, we are prepared to explore selling or otherwise disposing of the business.

Our building automation and controls business incurred a loss at the gross profit line during 2002 and 2001 of approximately \$159,000 and \$46,000, respectively. The division was very aggressive in bidding for some strategically important projects that were largely responsible for the 2002 loss. We believe winning these projects was important to positioning Great Lakes Controlled Energy as a player in the market for larger building automation controls projections. The success with the technically sophisticated project for Discover Card has allowed Great Lakes to bid on and win other projects with improved margins, which it will be working on beginning in 2003. The loss in 2001 was primarily due to an underutilization of Great Lake's capacity.

SG&A Expenses. SG&A expense declined 28.1% or \$2,796,281 to \$7,150,043 for the year ended December 31, 2002 from \$9,946,324 during the year ended December 31, 2001. Labor expense was reduced by \$1.1 million as a result of the annualization of layoffs implemented in 2001 and further reductions in labor during 2002. Travel expense and utility expenses declined approximately \$600,000, primarily as a result in the reductions in headcount. Outside services, which include legal, engineering, accounting and investor relation declined approximately \$800,000. The reduction in engineering expense is the result of the acquisition of Great Lakes Controlled Energy in June of 2001, from whom we previously purchased engineering services. The higher legal and accounting fees in 2001 were due primarily to the costs associated with the acquisition of Great Lakes Controlled Energy and the issuance of the Series A Preferred during 2001. Investor relation costs in 2001 included a \$336,000 non-cash charge related to the extension of a warrant issued to one of our investor relations firms. This same warrant was extended again in 2002 and resulted in a non-cash charge of \$80,000. During 2002 we implemented FAS 142, which eliminated the amortization of goodwill. During 2001 we recorded amortization expense related to goodwill of \$555,000. These reductions in SG&A were partially offset by an increase in sales commissions of \$278,000. The increase in sales commissions was the result of increased sales of EnergySavers by third party dealers and sales by the Company into territories owned by state distributors.

Impairment Loss. The Company reported an impairment loss of \$108,000 during 2002 related to the reduction in the carrying value of the goodwill associated with the acquisition of Great Lakes Controlled Energy to its estimated fair value. Under SFAS 142 we are required to assess our goodwill for impairment at least annually. We used a discounted cash flow valuation to determine the estimated fair value of the goodwill utilizing assumptions based on known facts and circumstances and estimates of future revenues and profits for the business. As a result of the losses incurred by the building automation and controls segment of our business during 2002, we adjusted our estimates for future profitability, which led to the reduction in the estimated fair value of the goodwill.

Other Non-Operating Income (Expense). Other non-operating expense is comprised of interest expense and interest income. Interest expense declined \$3,453,932 to \$79,008 during 2002 as compared to \$3,532,940 for the year ended December 31, 2001. As is more fully explained in note 9 to the consolidated financial statements, included in the 2001 interest expense was the cost of issuance and the value of the warrants issued in connections with the Senior Subordinated Promissory Notes. The costs of issuance were \$187,000 and the value ascribed to the warrants was \$2,917,000. The actual 2001 cash interest on the senior subordinated promissory notes was \$76,000. Other components of 2001 interest expense included \$108,000 on the distributor note, \$79,000 on our lines of credit, \$63,000 on our mortgage, \$67,000 on notes payable to

the sellers of Marino Electric, Switchboard Apparatus and Great Lakes Controlled Energy, \$34,000 on equipment loans and \$2,000 on various auto loans. During 2002, we recorded interest expense of \$48,000 on our mortgage, \$5,500 on the Marino term note,

\$3,000 on our working capital line, \$19,000 on equipment loans, and approximately \$3,600 on other miscellaneous notes.

Interest income earned during the year ended December 31, 2002 decreased \$48,047 or 67% to \$23,275 from \$71,322 earned during the same period in 2001. The decline in interest income was the result in lower average cash balances during 2002 as compared to 2001.

Cumulative Effect of Accounting Change. On January 1, 2002, we adopted Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets" effective for fiscal years beginning after December 15, 2001. In accordance with SFAS No. 142, we completed our transitional impairment testing of intangible assets during the second quarter of fiscal 2002. Subsequent to the first quarter of fiscal 2002, with the assistance of a third-party valuation firm, we finalized the testing of goodwill subject to SFAS 142. The testing resulted in a write-down of recorded goodwill in the amount of \$4,103,872, which was recorded as a cumulative effect of a change in an accounting principle.

Preferred Stock Dividends. There were three series of our convertible preferred stock issued and outstanding at various times during 2001 and 2002, including our Series B Convertible Preferred Stock ("Series B Preferred Stock") issued during October 2000 and converted to common stock in June 2001, our Series A Convertible Preferred Stock ("Series A Preferred Stock"), which was issued during September 2001 and November 2001, and our Series C Convertible Preferred Stock ("Series C Preferred Stock"), which was issued during June 2002.

On October 17, 2000, we raised \$2 million through the issuance of our Series B Preferred Stock. On June 15, 2001 the holder of the Series B Preferred Stock elected to convert all of the shares Series B Preferred Stock into common stock. The dividend accrued on the Series B Preferred Stock from the issuance date of October 17, 2000 through the conversion date of June 15, 2001, totaled \$106,082, of which \$73,206 was attributable to 2001. We elected to pay the accrued dividend through the issuance of additional shares of Series B Preferred Stock, which the holder converted to common stock on the conversion date. The shares of Series B Preferred Stock received as payment of the accrued dividend were considered to have a beneficial conversion feature because they were convertible into shares of common stock at a price below the market price on the date of issuance, which was deemed to be equivalent to a non-cash preferred dividend. As a result, we recorded a deemed dividend of \$92,024 on the date of issuance of the dividend shares.

On September 7, 2001 we received \$16 million of gross proceeds through the issuance of our Series A Preferred Stock (See, Footnote 10 to "Item 11 Security Ownership of Certain Beneficial Owners and Management"). On November 29, 2001, we received an additional \$3 million of gross proceeds through the sale of additional shares of Series A Preferred Stock (See, Footnote 11 to "Item 11 Security Ownership of Certain Beneficial Owners and Management"). The Series A Preferred Stock is considered to have a beneficial conversion feature because it permits the holders to convert their shares of Series A Preferred Stock into shares of common stock at a price, which on the date of issuance, was lower than the market price for the common stock. The value of this beneficial conversion feature, along with the value of the common stock and warrants issued as part of these transactions, was considered to be a non-cash deemed dividend, the value of which was capped at the \$19 million of gross proceeds.

The Series A Preferred Stock accrues a dividend at the rate of 10%, which is payable during the first three years following initial issuance at our option in cash or additional shares of Series A Preferred Stock. We accrued dividends on the shares of Series A Preferred Stock totaling \$669,933 and \$2,041,992 during 2001 and 2002, respectively, which we elected to pay by issuing additional shares of Series A Preferred Stock. We recognized a deemed dividend of \$283,776 in 2001 and \$495,589 in 2002, due to the beneficial conversion feature associated with the additional shares of Series A Convertible Preferred Stock that we issued in satisfaction of the accrued dividends.

The Series C Preferred Stock accrues a dividend at the rate of 10%, which is payable during the first three years following initial issuance at our option in cash or additional shares of Series C Preferred Stock. During 2002 we accrued dividends on the shares of Series C Preferred Stock of \$116,426, which we elected to pay by issuing additional shares of Series C Preferred Stock. We recognized a deemed dividend of \$12,403 in 2002, due to the beneficial conversion feature associated with the additional shares of Series C Convertible Preferred Stock that we issued in satisfaction of the accrued dividends.

The dividend expense recognized during 2002 and 2001 is comprised of the following:

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	Year ended December 31,	
	2002	2001
Deemed dividend associated with beneficial conversion feature of Series A Convertible Preferred Stock	\$	\$ 19,000,000
Accrual of Dividend on Series A Convertible Preferred	2,041,992	669,933
Deemed dividend associated with beneficial conversion price on shares issuable in satisfaction of Series A Convertible Preferred dividend	495,589	283,776
Accrual of Series B Preferred dividend		73,206
Deemed dividend associated with beneficial conversion price on shares issued in satisfaction of Series B Preferred dividend		92,024
Deemed dividend associated with beneficial conversion feature of Series C Convertible Preferred Stock dividend	1,444,697	
Accrual of Series C Preferred dividend	116,426	
Deemed dividend associated with beneficial conversion price on shares issued in satisfaction of Series C Preferred dividend	12,403	
Total	\$ 4,111,107	\$ 20,118,939

Liquidity and Capital Resources

During the twelve-month period ended December 31, 2002, we incurred a net loss before the cumulative effect of an accounting change of \$7.07 million and used \$6.88 million of cash for operating activities. Primarily as a result of our continuing losses and lack of liquidity our independent certified public accountants modified their opinion on our December 31, 2002 Consolidated Financial Statement to contain a paragraph wherein they expressed a substantial doubt about our ability to continue as a going concern. We have taken steps to improve our current liquidity and provide the growth capital necessary to fund our plan for future growth. Our efforts to raise additional capital are discussed below.

As of December 31, 2002, we had cash and cash equivalents of \$1,555,904, compared to cash and cash equivalents of \$5,486,073 on December 31, 2001. Our debt obligations as of December 31, 2002 consisted of a mortgage in the amount of \$714,000 on our facility in Elk Grove Village Illinois, an equipment loan of \$340,500 and vehicle loans totaling \$35,291. In addition we had a \$2 million line of credit with \$500,000 outstanding as of December 31, 2002.

The Company's principal cash requirements are for operating expenses, including employee costs, the costs related to research and development, advertising costs, the cost of outside services including

those providing accounting, legal, engineering and electrical contracting services, and the funding of inventory and accounts receivable, and capital expenditures. The Company has financed its operations since inception primarily through the private placement of its common stock and preferred stock.

Net cash decreased \$3,930,169 during the year ended December 31, 2002 while net cash increased \$4,856,637 during the year ended December 31, 2001. Operating activities consumed \$6,880,511 and \$9,839,575 during the twelve-month periods ended December 31, 2002 and December 31, 2001, respectively. Cash used to fund the net loss, calculated at the net loss less non-cash charges declined \$2,151,395 in 2002 to \$6,183,865 from \$8,335,260 in 2001. The improvement in cash used to fund the net loss is primarily due to a \$2.1 million reduction in SG&A expense, and a \$246,000 reduction in cash interest expense.

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During 2002 we used \$696,646 of our cash to fund changes in working capital, as compared to using \$1,504,315 in 2001. Increases in our accounts receivable consumed \$252,138 during 2002 as compared to consuming \$138,758 in 2001. The Energy Technology segment of our business is responsible for most of the increase in our accounts receivable. This segment generally experiences a slower turn on its receivables than our other businesses, thus receivables are expected to grow faster than consolidated revenue as the Energy Technology segment becomes a larger portion of the total revenue. Increases in inventories consumed cash of \$941,584 in 2002 as compared to generating cash \$370,719 in 2001. Most of this increase in inventory in 2002 is related to product shipped to three large EnergySaver customers for whom all of our revenue recognition requirements have not been satisfied. Once all the criteria revenue recognition are met we will move the product from inventory to cost of goods sold. Inventory declined in 2001 as we shifted to a "make to order" rather than a "make to inventory" process in the manufacture of our EnergySaver products. Increases in accounts payable and accruals generated cash of \$972,034 during 2002, as compared to consuming \$2,295,643 during 2001. During 2001, we used some of the cash raised through the issuance of our preferred stock to pay overdue payables and to satisfy a portion of our accrued expenses. The increase in payables and accruals in 2002 is in part due to the increase in sales activities in the Energy Technology and Building Automation Controls segments and partially due to some extended payment terms negotiated with a supplier to Switchboard Apparatus relative to a large government project that Switchboard is supplying. Deferred revenue declined \$487,597 in 2002 and increased \$387,596 during 2001. During 2001, we invoiced several customers for product and services for which we had not satisfied all of our revenue recognition criteria (see note 3 to the consolidated financial statements for a summary of our revenue recognition policies), accordingly we did not recognize the amounts invoiced as revenue, but instead recorded them as deferred revenue. During 2002, we completed everything necessary for us to recognize the revenue on these invoices.

Investing activities consumed cash of \$6,987 during 2002 as compared to consuming cash of \$69,487 during 2001. During 2002 we spent \$17,487 on new equipment, but this use of cash was partially offset by \$10,500 generated through the sale of equipment we no longer used. During 2001 we spent \$121,586 on new equipment, but generated \$52,099 through the sale of equipment that we no longer needed.

Financing activities generated cash of \$2,957,329 and \$14,765,699 during 2002 and 2001, respectively. During 2002 we issued preferred and common stock which generated net proceeds of \$2,800,257. We also refinanced the mortgage on our building and our equipment loan, generating \$22,000 after the repayment of the existing loans, and borrowed \$500,000 on our line of credit. Offsetting these sources of cash were scheduled payments of \$147,000 on our long-term debt and \$219,067 on the Marino Sellers note. During 2002 we also received \$1,300 from one of our 10% stockholders, which represented the short-swing profit inadvertently earned when he purchase shares of our stock within six months of selling shares, which is a violation of section 16(b) of the Securities Act of 1934.

During 2001, we raised \$18.2 million in gross proceeds through the issuance of our Series A Convertible Preferred Stock, of which \$3.2 million was raised through the issuance of three Senior

25

Subordinated Promissory Notes (which Notes were subsequently converted into shares of our Series A Convertible Preferred Stock) and \$15.0 million through the issuance of our Series A Convertible Preferred Stock. We also refinanced some equipment loans, raising an additional \$551,414. A portion of these funds was used to pay costs associated with raising the funds and to repay existing obligations. The costs of issuance attributable to the Senior Subordinated Notes and the Series A Convertible Preferred Stock totaled \$546,511. Funds used to retire or repay existing debt included \$1,356,660 for the note payable to distributors, \$852,200 to pay down our lines of credit, \$449,628 to retire an outstanding equipment loan with Oxford Bank, \$489,647 to pay down amounts owed the sellers of Marino Electric, \$75,000 for scheduled payments on a new equipment loan with American National Bank, \$19,962 for scheduled mortgage payments on our Elk Grove Village facilities, and \$9,454 of scheduled payments on various auto loans.

On May 29, 2002 we closed on a credit facility with American Chartered Bank. This facility included a \$400,000 equipment loan, a mortgage on our facility in Elk Grove Village Illinois in the amount of \$735,000, and a \$2,000,000 revolving line of credit. The revolving credit line replaced the expiring credit line we had with American National Bank. The American Chartered Bank revolver has a term of one year, with an interest rate equal to the prime rate plus $\frac{1}{4}\%$, and is secured by accounts receivable. As of December 31, 2002 the unused portion of the revolver was \$1.5 million and there was \$225,000 of borrowing base availability. The \$400,000 equipment loan has a term of two years, with an interest rate equal to the prime plus $\frac{1}{2}\%$ and is secured by a blanket lien on all of our assets. The proceeds from the equipment loan were used to repay an equipment loan with American National Bank. The mortgage has an initial term of two years, with an interest rate equal to the prime plus $\frac{1}{2}\%$, is secured by a first mortgage lien on the building and requires monthly payments of \$3,000 plus interest. The proceeds from the mortgage were used to repay an existing mortgage we had with CIB Bank. The new loan agreements contain covenants that require us to maintain a certain level of tangible net worth and working capital. As of December 31, 2002 we were in violation of the tangible net worth covenant, but American Chartered Bank waived the covenant violation.

Our ability to continue the development, manufacturing and the expansion of sales of our products, including the EnergySaver and the GlobalCommander, will require the continued commitment of significant funds. The actual timing and amount of our future funding requirements will depend on many factors, including the amount and timing of future revenues, the level and amount of product marketing and

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sales efforts, the magnitude of research and development, our ability to improve margins and the cost of any additional manufacturing equipment we may require to efficiently produce our products.

During the last two years we have raised \$21.2 million through the issuance of shares of our common and preferred stock, which has allowed us to continue to execute our business plan without any interruptions. Of the funds raised during the past two years, \$16.7 million has been consumed by operating activities, either used to fund our losses or working capital requirements. Another \$4.3 million has been used to repay debt or has been consumed in the support of our capital raising activities. As of December 31, 2002 our cash balance was \$1,555,904. Largely as a result of our current liquidity our management has identified the following priorities it must achieve if the Company is to continue as a going concern:

Continue to increase sales of EnergySavers. This is our most profitable product and represents the greatest potential for growth of any the product we sell. As demonstrated in 2002, we can increase our production of EnergySavers with very little increase in our manufacturing costs, thus as our sales volume increases our profitability should increase as well. We have a number of opportunities that we are currently pursuing which if we are successful in closing and implementing should contribute significantly to our goal of increasing the sales of EnergySavers. Unfortunately, as is true in all sales opportunities, there is still a risk that some or all of these opportunities will not result in a sale.

26

Evaluate the Power Management business and decide if it can be restructured in order to make it profitable in the current business environment and stagnant construction industry. We do not have the resources to carry this segment through a prolonged business slowdown at its current level of profitability. We are currently in the process of reviewing our alternatives for this business and anticipate making a decision regarding which alternative to pursue during the second quarter of 2003.

Build on the recent project successes at Great Lakes Controlled Energy to make the Building Controls and Automation business grow and become profitable. Great Lakes has recently been awarded some new business which should contribute to an improvement in this segment's profitability. This segment must execute effectively in order to realize the profitability potential of this new business.

Continue to aggressively manage our costs in order to conserve cash. While we made significant progress in reducing our costs during 2002, we must not only keep our costs down, but we need to continue to find new ways to cut costs in order to efficiently utilize the capital resources available to us.

Raise additional capital to continue to fund operations until the business starts to generate positive cash flow, consistent with the plan presented to shareholder in July 2001. In February 2003, we successfully raised an additional \$1 million through the sale of a package of securities that included shares of our common stock and a common stock warrant. Our current objective is to raise an additional \$2 million to \$4 million during 2003, beyond the \$1 million raised in February.

Our projections indicate that if we are successful in achieving these priorities we should have sufficient liquidity to allow us to operate until our operations turn cash flow positive. These projections contain certain key assumptions, which may or may not occur. If, for one reason or another we do not raise additional capital in the near future or certain key assumptions contained in our projections are proven to be wrong, we may begin to experience a liquidity shortage later this year which could force us to scale back our growth plans, or in the worst case cease operations.

If we are successful in raising additional capital (which may require stockholder approval), our existing stockholders will likely experience dilution of their present equity ownership position and voting rights, depending upon the number of shares issued and the terms and conditions of the issuance. The new equity securities will likely have rights, preferences or privileges senior to those of our common stock.

Recent Accounting Pronouncements

On January 1, 2002, we adopted Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets" effective for fiscal years beginning after December 15, 2001. In accordance with SFAS No. 142, we completed our transitional impairment testing of intangible assets during the second quarter of fiscal 2002. The impairment testing was performed in two steps: first, determining

whether there was an impairment, based upon the fair value of a reporting unit as compared to its carrying value, and second, if there was an impairment, the determination of the impairment loss by comparing the implied fair value of goodwill with the carrying amount of that goodwill. Subsequent to the first quarter of fiscal 2002, with the assistance of a third-party valuation firm, we finalized the testing of goodwill subject to SFAS 142. Using conservative, but realistic assumptions to model our power management business and building control and automation business, we determined that the carrying value of the power management business was greater than the derived fair value, indicating an impairment in the recorded goodwill. To determine fair value, we relied on a discounted cash flow analysis. For goodwill valuation purposes only, the revised fair value of this unit was allocated to the assets and liabilities of the reporting unit to arrive at an implied fair value of goodwill, based upon known facts and circumstances, as if the acquisition occurred currently. The allocation resulted in a write-down of recorded goodwill associated with the power management

segment in the amount of \$4,103,872, which was recorded as a cumulative effect of a change in an accounting principle during the quarters ended March 31, 2002 and June 30, 2002, and a write-down of the recorded goodwill associated with the building automation controls business in the amount of \$108,000 during the fourth quarter of 2002.

In addition, SFAS 142 provides that goodwill no longer be amortized, and as a result, we recorded no goodwill amortization during 2002, whereas we had recorded approximately \$555,000 of goodwill amortization during 2001.

In August 2001, the FASB issued SFAS No. 143, "Accounting For Asset Retirement Obligations." This statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. It applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or the normal operation of a long-lived asset, except for certain obligations of lessees. This standard requires entities to record the fair value of a liability for an asset retirement obligation in the period incurred. SFAS No. 143, which is effective for fiscal years beginning after June 15, 2002, is not expected to have a material impact on the Company.

In April 2002, the FASB issued SFAS No. 145 "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS No. 145 covers, among other things, the rescission of SFAS No. 4, "Reporting Gains and Losses from Extinguishment of Debt." Under SFAS No. 4, all gains and losses from the extinguishment of debt were required to be aggregated and, if material, classified as an extraordinary item in the statement of operations. By rescinding SFAS 4, SFAS No. 145 eliminates the requirement for treatment of extinguishments as extraordinary items. Most of the transition provisions of SFAS No. 145 are effective for fiscal years beginning after May 15, 2002 and certain provisions are effective for transactions entered into after May 15, 2002. At this time, we do not believe that this new standard will have a material effect on our financial statements.

In July 2002, the FASB issued SFAS No. 146, "Accounting Costs Associated with Exit or Disposal Activities". SFAS No. 146 revises the accounting for exit and disposal activities under Emerging Issues Task Force Issue 94-3 "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity" (EITF Issue No. 94-3), by spreading out the reporting of expenses related to restructuring activities. Commitment to a plan to exit an activity or dispose of long-lived assets will no longer be sufficient to record a one-time charge for most anticipated costs. Instead, companies will record exit or disposal costs when they are "incurred" and can be measured at fair value, and they will subsequently adjust the recorded liability for changes in estimated cash flows. The provisions of SFAS No. 146 are effective prospectively for exit or disposal activities initiated after December 31, 2002. Companies may not restate previously issued financial statements for the effect of the provisions of SFAS No. 146 and liabilities that a company previously recorded under EITF Issue No. 94-3 are grandfathered. We expect that the effects of adoption, if any, would relate solely to exit or disposal activities undertaken after December 31, 2002.

In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation Transition and Disclosure" ("SFAS No. 148"), which amends Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123") to provide alternative methods of transition for an entity that voluntarily changes to the fair value method of accounting for stock-based employee compensation. It also amends the disclosure provisions of SFAS No. 123 to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation. Finally, SFAS No. 148 amends Accounting Principles Board Opinion No. 28, "Interim Financial Reporting" ("APB Opinion No. 28") to require disclosure about those effects in interim financial information. SFAS No. 148's amendment of the transition and disclosure requirements of SFAS No. 123 are effective for fiscal years ending after December 15, 2002, with earlier application permitted. SFAS No. 148's amendment of the disclosure requirements of APB Opinion No. 28 is

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effective for interim periods beginning after December 15, 2002. We do not plan to change to the fair value method of accounting, but we do plan to adopt the disclosure requirements of SFAS No. 148 during 2003.

In November 2002, FASB Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" was issued. FIN 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and initial measurement provisions of this Interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The required disclosures and a roll-forward of product warranty liabilities are effective for financial statements of interim or annual periods ending after December 15, 2002. At this time, we do not believe that the adoption of this interpretation will have a material effect on our financial statements.

In January 2003, the FASB issued Interpretation No. 46 ("FIN 46"), Consolidation of Variable Interest Entities, an interpretation of ARB 51. The primary objectives of FIN 46 are to provide guidance on the identification of entities for which control is achieved through means other than through voting rights ("variable interest entities" or "VIEs") and how to determine when and which business enterprise should consolidate the VIE (the "primary beneficiary"). This new model for consolidation applies to an entity in which either (1) the equity investors (if any) do not have a controlling financial interest or (2) the equity investment at risk is insufficient to finance that entity's activities without receiving additional subordinated financial support from other parties. In addition, FIN 46 requires that both the primary beneficiary and all other enterprises with a significant variable interest in a VIE make additional disclosures. We are currently evaluating the impact of FIN 46 on our financial statements, but do not expect that there will be any material impact.

Item 7. Financial Statements

Index to Financial Statements

F-1	Report of Independent Certified Public Accountants
F-2 - F-3	Consolidated Balance Sheets as of December 31, 2001 and December 31, 2000
F-4	Consolidated Statements of Operations for the years ended December 31, 2001 and December 31, 2000
F-5	Statements of Stockholders' Equity for the years ended December 31, 2001 and December 31, 2000
F-6 - F-8	Statements of Consolidated Cash Flows for the years ended December 31, 2001 and December 31, 2000
F-9 - F-35	Notes to Consolidated Financial Statements

Item 8. Change in and Disagreements with Accountants on Accounting and Financial Disclosure

None

29

PART III

Item 9. Directors, Executive Officers, Promoters and Control Persons; Compliance with Section 16(a) of the Exchange Act

The table below shows certain information about our directors, executive officers and significant employees:

Name	Age	Principal Positions
<i>Directors and Executive Officers</i>		
John P. Mitola	38	Chief Executive Officer and Director
Jeffrey R. Mistarz	44	Executive Vice President, Chief Financial Officer, Treasurer and

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Name	Age	Principal Positions
		Assistant Secretary
Denis Enberg	54	Senior Vice President, Engineering
Eric G. Pitcher	50	Senior Vice President, Marketing and Sales
Michael S. Stelter	46	Vice President, Sales and Director
David Asplund	44	Director
Frederic F. Brace	45	Director(3)
W. Scott Harlan	40	Director(4)
Robert J. Manning	60	Director(1)(2)
Kevin P. McEneely	54	Director
Gerald A. Pientka	47	Director(1)(2)
Robert D. Wagner, Jr.	61	Director(1)(2)(3)

- (1) Member of our Audit Committee.
- (2) Member of our Compensation Committee.
- (3) Messrs. Brace and Wagner were appointed effective October 17, 2001 by the holders of our Series A Convertible Preferred Stock. Mr. Brace was appointed collectively by Morgan Stanley Dean Witter Equity Funding, Inc. and Originators Investment Plan, L.P., and Mr. Wagner was appointed by Duke Capital Partners, LLC. Newcourt Capital USA, Inc. has not yet appointed a director.
- (4) Mr. W. Scott Harlan was appointed by EP Power Finance, L.L.C. effective June 1, 2002. Mr. Harlan is a Managing Director of EP Power Finance, L.L.C. Mr. Harlan recently announced his intent to resign from the Board effective March 31, 2003.

Our Board of Directors is currently authorized for a membership of twelve directors. As of February 28, 2003, our Board of Directors had three vacancies, of which one is to be appointed by the holders of our Series A Convertible Preferred Stock.

John P. Mitola has been one of our directors since November 1999 and has been our chief executive officer since January 2000. From August 1993 until joining us, Mr. Mitola was with Unicom Thermal Technologies (now Exelon Thermal Technologies), Unicom (now Exelon) Corporation's largest (at that time) unregulated subsidiary, serving most recently as vice president and general manager. Mr. Mitola led the growth of Unicom Thermal through the development of Unicom Thermal's Northwind ice technology and through thermal energy joint ventures between Unicom Thermal and several leading electric utility companies across North America. Prior to his appointment at Unicom Thermal, Mr. Mitola was director of business development for Commonwealth Edison Company, the local electric utility serving Chicago, Illinois and the northern Illinois region.

30

Jeffrey R. Mistarz has been our chief financial officer since January 2000, our treasurer since October 2000 and our assistant secretary since February 2003. From January 1994 until joining us, Mr. Mistarz served as chief financial officer for Nucon Corporation, a privately held manufacturer of material handling products and systems, responsible for all areas of finance and accounting, managing capital and shareholder relations. Prior to joining Nucon, Mr. Mistarz was with First Chicago Corporation (now Bank One Corporation) for 12 years where he held several positions in corporate lending, investment banking and credit strategy.

Denis Enberg has been our Senior Vice President of Engineering since Electric City acquired his company, Great Lakes Controlled Energy, in June 2001. Mr. Enberg co-founded Great Lakes Controlled Energy Corp in 1985. From 1975 to 1985 he was president of C.E. Electric Incorporated, a Chicago licensed commercial and industrial electrical contracting firm that also specialized in industrial automation and controls. Mr. Enberg is a charter life member of the Association of Energy Engineers and holds certifications as "Certified Energy Manager", "Certified Lighting Efficiency Professional" and "Certified Demand-Side Management" professional and is considered one of the early pioneers in the building automation industry.

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Eric G. Pitcher has been with Electric City Corp. since November 2002 when he joined the organization as Senior Vice President, Marketing and Sales. From December 2001 until he joined us, Mr. Pitcher served as the Director, National Account Sales for Tractebel Energy Services, a subsidiary of the multi-billion dollar Suez Corporation, a multi-national conglomerate of energy, water and waste management companies. From 1997 to 2001, Mr. Pitcher was Director of Account Management-Midwest Region, at Enron Energy Services, Inc. From 1990-1997, Mr. Pitcher served as Manager, International Business Development and Principal, Business Development for Northern Indiana Public Service Co. (NIPSCO), a wholly owned subsidiary of Nisource, Inc.

Michael S. Stelter is one of our co-founders and has been one of our directors since our incorporation in June 1998. Since our organization as a limited liability company in December 1997, Mr. Stelter has served as our Vice President of Sales. Mr. Stelter was our Corporate Secretary from June 1998 until October 2000. From 1986 until May 1999, Mr. Stelter served as Vice President of Marino Electric.

David R. Asplund was nominated to our board of directors during June 2002. Mr. Asplund is, and has been, the founder and President of Delano Group Securities, LLC since October 1999. From March 1995 through October 1999, Mr. Asplund was employed by Bear, Stearns and Company, Inc., serving as a Senior Managing Director from July 1997 until October 1999.

Frederic F. Brace has been one of our directors since October 2001 and is an appointee of the holders of our Series A Convertible Preferred Stock. Mr. Brace is, and has been, the Senior Vice President and Chief Financial Officer of UAL Corporation, the parent of United Airlines since September 2001. From July 1999 through September 2001, Mr. Brace was Senior Vice President and Treasurer of United Airlines and its Vice President of Finance from October 1996 through July 1999.

W. Scott Harlan was appointed a director during June 2002 by the holders of our Series A Convertible Preferred Stock. Mr. Harlan is currently Vice President of EP Power Finance, L.L.C. and Managing Director of El Paso Merchant Energy Company North America, a merchant energy subsidiary of El Paso Corporation. Mr. Harlan has been with EP Power Finance and El Paso Merchant Energy since November 2000. Mr. Harlan previously served as a vice-president of Cinergy Capital Services from July 1997 to October 1999, and served in several electricity marketing positions with Koch Energy Services from September 1995 to July 1997. Prior to joining Koch, Mr. Harlan served for ten years in a number of positions in the power generation, marketing and demand-side management for Delmarva Power and Light Company.

31

Robert J. Manning has been one of our directors since May 2000 and Chairman of our Board of Directors since January 2001. Mr. Manning is a co-founder and a member of Groupe Manning LLC, an energy consulting company. From April 1997 until his retirement in January 2000, Mr. Manning served as executive vice president of Exelon Corporation and its largest subsidiary, Commonwealth Edison Company, where his responsibilities included managing the sale of Commonwealth Edison's fossil generating fleet. During his thirty-five year career at Exelon, Mr. Manning directed all aspects of electric generation, consumer service and transmission and distribution operations.

Kevin P. McEneely has been one of our directors since our incorporation in June 1998. Mr. McEneely was our Senior Executive Vice President and Chief Operating Officer from our organization as a limited liability company in December 1997 to December 1999. From 1985 to his retirement in December 1999, Mr. McEneely was Chief Operating Officer and an Executive Vice President of Nightingale-Conant Corporation. Mr. McEneely is also a member of NCVC.

Gerald A. Pientka has been one of our directors since May 2000. Mr. Pientka is a co-founder of Higgins Development Partners, LLC, a national real estate development company headquartered in Chicago, Illinois. Mr. Pientka has served as President of the company since its inception in May 1999 when the Pritzker family interest purchased a controlling interest in Higgins Development Partners, LLC (formerly Walsh, Higgins & Company). Mr. Pientka served as President of Walsh, Higgins & Company from May 1992 until May 1999. Mr. Pientka is also a member of Leaf Mountain Company, LLC, who is an investor in our Series A Convertible Preferred Stock (See, "Recent Sales of Unregistered Securities").

Robert D. Wagner, Jr. has been one of our directors since October 2001 and is an appointee of the holders of our Series A Convertible Preferred Stock. Mr. Wagner is currently a partner of Rivington Capital, an NASD registered broker/dealer specializing in debt and equity placements for independent oil and gas producers. Mr. Wagner served as Managing Director the corporate finance group of Arthur Andersen LLP from May 1999 until his retirement in April 2001. From June 1998 through May 1999, Mr. Wagner served as Managing Director of M2 Capital. From April 1989 through June 1998, Mr. Wagner served as Managing Director for Bankers Trust/BT Alex Brown.

Board Committees

Our board of directors currently has the following committees:

The Audit Committee oversees and monitors our financial reporting process and internal control system, reviews and evaluates the audit performed by our outside auditors and reports any substantive issues found during the audit to the Board. The Audit Committee is also directly responsible for the appointment, compensation and oversight of the work of our independent auditors. In addition, the committee also reviews and approves all transactions with affiliated parties and performs such other duties as are specified in the Audit Committee Charter, as amended from time to time. The members of the audit committee are Messrs. Manning, Pientka, and Wagner, all of who are independent directors.

We do not, at the present time, have a "financial expert", as that term is defined in the SEC Regulation S-B, on our Audit Committee. Only one member of our Board would qualify as a financial expert, but he is currently unable to serve on our audit committee due to other time commitments. We are attempting to find an individual who would meet the requirements for a financial expert and is willing to become a director and to serve on our audit committee.

Compensation Committee. The Compensation Committee is responsible for establishing, administering and reviewing compensation programs for the Company's executive and senior management, subject to approval of the Board as a whole. The members of the compensation committee are Messrs. Manning, Pientka, and Wagner.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's officers and directors, and persons who own more than 10% of a registered class of the Company's equity securities, to file with the Securities Exchange Commission and the American Stock Exchange reports of ownership of Company securities and changes in reported ownership. Officers, directors and greater than 10% shareholders are required by SEC rules to furnish the Company with copies of all Section 16(a) reports filed.

Based solely upon a review of the reports furnished to the Company, or written representations from reporting persons that all reportable transactions were reported, the Company believes that during 2002 the Company's officers, directors and greater than 10% owners timely filed all reports they were required to file under Section 16(a), except that: Mr. Stelter was late in reporting two transactions; Mr. Hoppensteadt was late in reporting one transaction; Mr. Pitcher was late in reporting one transaction; Mr. McEneely was late in reporting two transactions; Mr. Conant was late in reporting two transaction; NCVK was late in reporting two transactions; DYDX was late in reporting two transactions.

Item 10. Executive Compensation

Summary Compensation Table

The following table summarizes the total compensation paid or awarded to each of our executive officers and to other officers whose total compensation exceeded \$100,000 during the fiscal year ended December 31, 2002. There were no bonuses awarded for the fiscal year ended December 31, 2001.

Name and Principal Position	Year Ended	Annual Compensation			Long Term Compensation
		Salary (\$)	Bonus (\$)	Other Annual Compensation (\$)	Securities Underlying Options (#)
John P. Mitola(1) <i>our chief executive officer</i>	12/31/02	\$ 345,900		\$ 5,325(5)	
	12/31/01	\$ 350,000		\$ 14,370(5)	
	12/31/00	\$ 350,000	\$ 140,000	\$ 9,190(5)	1,000,000
William A. Karambelas(2) <i>our senior vice president of sales</i>	12/31/02	\$ 202,789		\$ 1,575(6)	
		\$		\$ (6)	

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		Annual Compensation				Long Term
						Compensation
	12/31/01		167,197		110	150,000
	12/31/00					
Greg Rice(3)	12/31/02	\$	147,692	\$	40,000	\$
<i>Our senior vice president and general counsel</i>	12/31/01	\$	150,000			882(7)
	12/31/00	\$	75,000			150,000
Jeffrey R. Mistarz(4)	12/31/02	\$	172,308			7,945(8)
<i>our chief financial officer and treasurer</i>	12/31/01	\$	175,000			7,657(8)
	12/31/00	\$	175,000	\$	70,000	\$
						2,320(8)
						200,000

- (1) Mr. Mitola, entered into an employment agreement with us on November 18, 1999 for a term of three years which became effective on January 3, 2000 and ending on December 31, 2002. Effective as of January 1, 2000, options with an exercise price of \$7.00 per share that vest over the term of the agreement were granted to Mr. Mitola pursuant to his employment agreement.
- (2) Mr. Karambelas' employment with the Company became effective on April 1, 2001. Mr. Karambelas is not an executive officer of the Company but is included for purposes of compensation disclosure. As part of Mr. Karambelas' offer of employment, he was granted options with an exercise price of \$7.00 per share that vest over a four-year period.
- (3) Mr. Rice's employment with the Company became effective on July 5, 2000. Mr. Rice is not an executive officer of the Company but is included for purposes of compensation disclosure. As part of Mr. Rice's offer of employment he was granted options with exercise prices between \$7.00 and \$9.00 per share that vest over a three-year period.
- (4) Mr. Mistarz entered into an employment agreement with us effective January 14, 2000 for a term of three years beginning as of January 1, 2000 and ending on December 31, 2002. As part of the employment agreement, Mr. Mistarz was granted options with an exercise price of \$7.00 per share that vest over the term of the agreement.
- (5) This represents a monthly auto allowance of \$550 and the cost of life insurance and long-term disability insurance for Mr. Mitola.
- (6) This represents the cost of long-term disability insurance for Mr. Karambelas.
- (7) This represents the cost of long-term disability insurance for Mr. Rice.
- (8) This represents the cost of life insurance and long-term disability insurance for Mr. Mistarz.

Employment Agreements

Effective January 3, 2000, we entered into an employment agreement with John Mitola, our chief executive officer, for a three-year period ending on December 31, 2002. The agreement provided for a base salary of \$350,000 per year and a discretionary bonus of up to forty percent (40%) of his annual salary payable if we meet or exceed the terms of our annual business plan. The agreement also provides for a monthly automobile allowance of \$550.00 and the reimbursement of Mr. Mitola's business-related cellular phone calls.

Under the employment agreement, we granted to Mr. Mitola an option to purchase 1,000,000 shares of our common stock at \$7.00 per share, which became exercisable with respect to 333,334 shares on December 31, 2000, 333,333 shares on December 31, 2001 and which will become exercisable with respect to 333,333 shares on December 31, 2002. Mr. Mitola has piggyback registration rights with respect to all shares

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of our stock obtained through the exercise of these options but has waived such rights with respect to registrations undertaken on behalf of the holders of our Series A Convertible Preferred Stock.

Effective January 1, 2003, we entered into a new employment agreement with John Mitola for a three-year period ending on December 31, 2005. The new agreement, which was structured to place more emphasis on achieving important corporate milestones, reduced Mr. Mitola's base salary to \$250,000 per year, but provides for a discretionary bonus of up to one hundred percent of his annual salary payable if he meets or exceeds certain annual goals as established by the Board of Directors, and a guaranteed bonus of \$250,000 upon the achievement of two consecutive calendar quarters of positive net income by the Company (such net income to be that as reflected in the Company's quarterly reports filed with the Securities and Exchange Commission). The agreement also provides for a monthly automobile allowance of \$550.00 and the reimbursement of Mr. Mitola's business-related expenses.

Under the new employment agreement, we granted to Mr. Mitola an option to purchase 750,000 shares of our common stock at a price per share of \$0.845, which is equal to the average closing price of the Company's common stock as measured over the thirty (30) trading day period prior to the effective date of the contract. The options granted under the employment contract vest 250,000 shares on each December 31st of 2003, 2004 and 2005.

The employment agreement imposes on Mr. Mitola non-competition, non-solicitation and confidentiality agreements.

On January 14, 2000, we entered into an employment agreement with Jeffrey Mistarz, our chief financial officer and treasurer, for a term of three years commencing on January 1, 2000 and ending on December 31, 2002. The agreement provided for a salary of \$175,000 per year and a discretionary bonus payable if Mr. Mistarz attained established performance goals agreed upon by Mr. Mistarz and our chief executive officer.

Under the employment agreement, we granted to Mr. Mistarz an option to purchase 200,000 shares of our common stock at \$7.00 per share which vested with respect to 66,667 shares on December 31, 2000, 66,667 shares on December 31, 2001 and with respect to 66,666 shares on December 31, 2002. Upon vesting, the options become exercisable over a three-year period beginning on the vesting date.

The employment agreement imposes on Mr. Mistarz non-competition, non-solicitation and confidentiality agreements.

Mr. Mistarz and the Company are currently negotiating a renewal of his employment contract which is expected to run through December 31, 2005.

35

2002 Option Grants

The following table sets forth information regarding stock option grants made to each of the above named executive and principal officers during the fiscal year ended December 31, 2002.

Name	Number of Shares Underlying Options Granted (#)	Percent of Total Options Granted to Employees in Period	Exercise Price (\$/Share)	Expiration Date
John P. Mitola	0			
William A. Karambelas	0			
Greg Rice	0			
Jeffrey R. Mistarz	0			

2002 Option Values

The following table sets forth information regarding the number and value of unexercised options held by each of the above named executive and principal officers as of December 31, 2002. None of our named executive or principal officers hold any stock appreciation rights and none of them exercised any options during the fiscal year ended December 31, 2002.

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Name	Number of Shares Underlying Unexercised Options at December 31, 2002 (#)		Value of Unexercised In-the-Money Options at December 31, 2002 (\$)	
	Exercisable	Unexercisable	Exercisable	Unexercisable
John P. Mitola	1,000,000	0	\$ 0	\$ 0
William A. Karambelas	37,500	112,500	\$ 0	\$ 0
Greg Rice	37,500	112,500	\$ 0	\$ 0
Jeffrey R. Mistarz	133,334	66,666	\$ 0	\$ 0

Stock Options and Incentive Compensation

During the Company's annual meeting of shareholders held on August 30, 2001, our shareholders approved the adoption of the 2001 Stock Incentive Plan (the "Plan"), which provides that up to 800,000 shares of the Company's common stock, par value \$0.0001 ("Common Stock") may be delivered under the Plan to certain employees of the Company or any of its subsidiaries. In addition, the Plan provides for an additional 500,000 shares of Common Stock to be reserved on January 1 of each succeeding year, beginning January 1, 2002. The awards to be granted under the Plan may be incentive stock options eligible for favored treatment under Section 422 of the Internal Revenue code of 1986, as amended from time to time, or non-qualified options that are not eligible for such treatment or stock of the Company, which may be subject to contingencies or restrictions. Approximately 40 employees, officers and directors of the Company are currently eligible to participate in the Plan.

The exercise price for any incentive stock option ("ISO") may not be less than 100% of the fair market value of the stock on the date the option is granted, except that with respect to a participant who owns more than 10% of the Common Stock the exercise price must be not less than 110% of fair market value. The exercise price of any non-qualified option shall be in the sole discretion of the Committee or Board. The aggregate fair market value of the shares that may be subject to any ISO

granted to any participant may not exceed \$100,000 on the date of grant. There is no comparable limitation with respect to non-qualified stock options.

The term of all options granted under the Plan will be determined by the Committee or Board in their sole discretion, provided, however, that the term of each ISO shall not exceed 10 years from the date of grant thereof and, further provided, that if, at the time an ISO is granted, the optionee owns (or is deemed to own under Section 424(d) of the Code) stock possessing more than 10% of the total combined voting power of all classes of stock of the Company, of any of its Subsidiaries or of a Parent, the term of the ISO shall not exceed five years from the date of grant. The right of exercise will be cumulative, so that shares that are not purchased in one year may be purchased in a subsequent year. The options may not be assigned. Upon exercise of any option, in whole or in part, payment in full is required (unless the applicable award contract permits installment payments or cashless exercise) for the number of shares purchased. Payment may be made in cash, by delivery of shares of the Common Stock of equivalent fair market value or by any other form of legal consideration that is acceptable to the Board.

In addition to the ISOs and non-qualified options, the Plan permits the Committee, consistent with the purposes of the Plan, to grant shares of Common Stock to non-employee directors and such employees (including officers and directors who are employees) of, or consultants to, the Company or any of its Subsidiaries, as the Committee may determine, in its sole discretion. The grant may require the holder to pay such price per share therefore, if any, as the Committee may determine. Such shares may be subject to such contingencies and restrictions as the Committee may determine.

If an employee's employment is terminated by reason of death, disability or retirement, either the employee or his or her beneficiary will have the right for eighteen months to exercise the option to the extent the option was exercisable on the date of death or disability, but in no event after the date the award would otherwise have expired. If a Plan participant's relationship with the Company is terminated for any reason other than death, disability or retirement and other than for cause or without the Company's consent (in which case the option shall terminate immediately), he or she may, for a period of one year, exercise the option to the extent that it was exercisable on the date of termination, but in no event after the date the award would otherwise have expired.

The Plan is administered by the Board, which is authorized to interpret the Plan, to prescribe, amend and rescind rules and regulations relating to the Plan and to determine the employees to whom, and the time, terms and conditions under which, options are to be granted. The Board is also authorized to adjust the number of shares available under the Plan, the number of shares subject to outstanding options and the option prices to take into account the Company's capitalization by reason of a stock dividend, recapitalization, merger, consolidation, stock split, combination or exchange of shares or otherwise.

The Board may amend, suspend or terminate the Plan in any respect at any time. However, no amendment may (i) increase the number of shares reserved for option under the Plan, (ii) modify the requirements for participation in the Plan, or (iii) modify the Plan in any way that would require stockholder approval under the rules and regulations under the Exchange Act.

Under current Federal law, no taxable income will be recognized by the recipient of an incentive stock option within the meaning of Section 422 of the Code upon either the grant or exercise of the incentive stock option (provided the exercise occurs while the participant is an employee of the Company or within three months after termination of employment), nor will a deduction be allowed the Company by reason of the grant or exercise, provided the employee does not dispose of the shares issued upon exercise within two years from the date the option was granted and within one year from the date the shares were issued. If the recipient fails to satisfy these holding period requirements, the difference between the amounts realized upon disposition of the shares and the adjusted basis of the

shares is includible as compensation in the recipient's gross income and the Company will be entitled to a deduction in that amount.

Under current law, the holder of a non-qualified stock option is taxable at the time of exercise on the difference between the exercise price and the fair market value of the shares on the date of exercise. Upon disposition of the stock, the stockholder is taxable upon the difference between the basis of the stock (which is equal to the fair market value at the time the option was exercised) and the amount realized upon the disposition.

A grant of shares of Common Stock that is subject to no vesting restrictions will result in taxable income for federal income tax purposes to the recipient at the time of grant in an amount equal to the fair market value of the shares awarded. The Company would be entitled to a corresponding deduction at that time for the amount included in the recipient's income.

Generally, a grant of shares of Common Stock under the Plan subject to vesting and transfer restrictions will not result in taxable income to the recipient for federal income tax purposes or a tax deduction to the Company in the year of the grant. The value of the shares will generally be taxable to the recipient as compensation income in the years in which the restriction on the shares lapse. Such value will be the fair market value of the shares on the dates the restrictions terminate. Any recipient, however, may elect pursuant to Section 83(b) of the Code to treat the fair market value of the shares on the date of such grant as compensation income in the year of the grant of restricted shares, provided the recipient makes the election within 30 days after the date of the grant. In any case, the Company will receive a deduction for federal income tax purposes corresponding in amount to the amount of compensation included in the recipient's income in the year in which that amount is so included.

As of December 31, 2002, there were 1,300,000 shares of Common Stock reserved under the Plan. The Company granted options to purchase 295,238 under the plan during 2002, and options to purchase 493,913 shares were outstanding under the Plan as of December 31, 2002.

Director Compensation

Effective April 1, 2000, the Company adopted a stock option plan for all independent directors. The plan provides that eligible directors receive an initial option grant upon being appointed to our Board of Directors to purchase 75,000 shares of our common stock at a price equal to the greater of the closing price of our common stock on the grant date, and \$1.00. These options have a term of ten years and vest in three equal amounts, beginning on the grant date and each of the next two anniversary dates of the grant, assuming the individual is still a member of the Board of Directors on such anniversary date. Mr. Asplund received options pursuant to this provision of our director's option plan.

Eligible directors are also granted additional options to purchase 25,000 shares of our common stock on the anniversary of their appointment to the Board, if they are still a member of the Board of Directors on such anniversary date. These options have an exercise price equal to the greater of the closing price of our common stock on the grant date, and \$1.00. These options also have a term of ten years and vest in three equal amounts, beginning on the grant date and each of the next two anniversary dates of the grant, assuming the individual is still a member of the Board of Directors on such anniversary date. Messrs. Brace, Harland, Manning, Pientka and Wagner received options pursuant to this provision of our director's option plan.

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Directors who are also employees of the Company receive no additional compensation for their services as directors. Directors who are not employees of the Company (excluding founder-directors), in addition to stock options, are reimbursed for travel expenses and other out-of-pocket costs incurred in connection with their attendance at such meetings.

38

Item 11. Security Ownership of Certain Beneficial Owners and Management

The following tables list certain information, as of February 28, 2003, regarding the beneficial ownership of our outstanding common stock by (1) each of our directors and named executive officers, the persons known to us to beneficially own greater than 5% of our common stock and our directors and executive officers, as a group. Beneficial ownership is determined in accordance with the rules of the SEC. Except as otherwise noted, (1) the persons or entities named have sole voting and investment power with respect to all shares shown as beneficially owned by them and (2) the address of each person listed in the following table (unless otherwise noted) is c/o Electric City Corp., 1280 Landmeier Road, Elk Grove Village, Illinois 60007-2410.

Name	Shares Directly Held	Shares Issuable Upon Exercise of Preferred Stock	Shares Issuable Upon Exercise of Warrants	Shares Issuable Upon Exercise of Options	Total	%
<i>Directors, Executive Officers and 5% Holders</i>						
Joseph C. Marino	7,379,754(1)			2,150,000(2)	9,529,754	26.83%
Pino Manufacturing, LLC	6,819,888			2,150,000	8,561,852	24.29%
NCVC, L.L.C.(3)	3,962,699			1,000,000(5)	4,966,699	14.44%
Victor Conant	3,962,699			1,000,000(5)	4,966,699	14.44%
Kevin P. McEneely	3,962,699(4)			1,000,000(5)	4,966,699	14.44%
DYDX Consulting LLC(6)	2,730,500(8)			947,546(7)	3,864,000	10.38%
Nikolas Konstant	2,730,500			947,546(7)	3,864,000	10.38%
Newcourt Capital Securities, Inc.(9)	80,217	4,564,101	4,064,830		8,709,148	20.74%
Newcourt Capital USA, Inc.(10)	80,217	4,564,101	4,064,830(11)		8,709,148	20.74%
EP Power Finance, L.L.C.(10)	80,217	4,602,317	750,000	58,334(13)	5,490,868	14.16%
Duke Capital Partners, LLC(10)	80,217	4,602,317	750,000		5,432,534	14.03%
Morgan Stanley Dean Witter Equity Funding, Inc.(10)(12)	80,217	4,602,317	750,000		5,432,534	14.03%
Leaf Mountain Company, LLC(10)	45,122	3,340,874	421,875		3,807,871	10.25%
Richard Kiphart(14)	30,082	2,116,426	500,000	281,250	2,927,758	8.07%
John P. Mitola(15)	18,456			1,000,000	1,018,456	2.96%
Jeffrey R. Mistarz	9,200			133,333	142,533	*
William A Karambelas(16)	1,000			75,000	76,000	*
Greg Rice(16)				50,000	50,000	*
Michael S. Stelter	1,117,652				1,117,652	3.35%
David Asplund	57,412				47,412	*
Frederic F. Brace				58,334	58,334	*
W. Scott Harlan				(13)		*
Robert J. Manning	2,000			75,001	77,001	*
Gerald A. Pientka(10)	22,000			75,001	97,001	*
Robert D. Wagner, Jr.				58,334	58,334	*
All directors and executive officers as a group (13 persons)**	5,182,419			2,525,003	7,707,422	21.47%

*

Denotes beneficial ownership of less than 1%.

**

Eliminates duplication

(1)

Includes 6,819,888 shares held of record by Pino Manufacturing, LLC ("Pino"). Mr. Marino holds a 100% membership interest in Pino and, in such capacity, has sole voting and investment power with respect to the shares of common stock held by Pino and, therefore, is deemed to be the beneficial owner of these shares.

(2)

Includes options to acquire 1,700,000 shares of common stock at \$1.10 per share held by Pino. In addition, Mr. Marino holds options to acquire 450,000 shares of common stock at \$3.50 per share, which he received as our Chairman prior to his resignation in December 2000.

39

(3)

The business address of NCVC, L.L.C. ("NCVC") is 6245 West Howard St., Niles, Illinois 60714.

(4)

Includes 3,966,699 shares held of record by NCVC. Messrs. Conant and McEneely are managers and members of NCVC, and, in said capacities, share voting and investment power with respect to shares of common stock held by NCVC. Therefore, they are deemed to be the beneficial owners of these shares.

(5)

Includes options to acquire 1,000,000 shares of common stock at \$1.10 per share held by NCVC.

(6)

The business address of DYDX Consulting, LLC ("DYDX") is 221 N. LaSalle Street, Suite 3900, Chicago, Illinois 60601.

(7)

Includes options to acquire 947,546 shares of common stock at \$1.10 per share held by DYDX.

(8)

Includes 2,730,500 shares held of record by DYDX. Mr. Konstant holds a 100% membership interest in DYDX and, in such capacity, has sole voting and investment power with respect to the shares of common stock held by DYDX and, therefore, is deemed to be the beneficial owner of these shares.

(9)

Newcourt Capital Securities, Inc. ("Newcourt Capital Securities"), a registered broker-dealer, was issued warrants to purchase 3,314,830 shares of the Company's Common Stock at a price of \$1.00 per share in consideration for purchasing \$3,200,000 of Convertible Senior Subordinated Promissory Notes from the Company during the second quarter of 2001 and for acting as placement agent for the Company's issuance of its Series A Convertible Preferred Stock, which transaction closed on September 7, 2001 (see following note). Newcourt Capital Securities, Inc. is a wholly owned subsidiary of Newcourt Capital USA, Inc. Accordingly, Newcourt Capital USA is deemed to be the beneficial owner of shares held by Newcourt Capital Securities.

(10)

On September 7, 2001, we closed our Series A Convertible Preferred Stock transaction with a group of investors and issued the following securities for an aggregate purchase price of \$16,000,000:

400,000 shares of our Series A Convertible Preferred Stock ("Series A Preferred Stock") to each of Newcourt Capital USA, Inc. ("Newcourt"), Duke Capital Partners, LLC ("Duke Capital"), and EP Power Finance, L.L.C. ("EPP"), 380,000 shares of our Series A Convertible Preferred Stock to Morgan Stanley Dean Witter Equity Funding, Inc. ("Morgan Stanley") and 20,000 shares of our Series A Convertible Preferred Stock to Originators Investment Plan, L.P. ("OIP"). OIP is an affiliate of Morgan Stanley and therefore, Morgan Stanley is deemed to

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be the beneficial owner of shares held by OIP. Each share of Series A Preferred Stock is convertible into 10 shares of our common stock.

Warrants to purchase 100,000 shares of our Series A Preferred Stock to each of Newcourt, Duke Capital and EPP, warrants to purchase 95,000 shares of our Series A Preferred Stock to Morgan Stanley and warrants to purchase 5,000 shares of our Series A Preferred Stock to OIP. These warrants expired unexercised on September 7, 2002.

80,217 shares of our Common Stock to each of Newcourt, Duke Capital and EPP, 76,206 shares of our Common Stock to Morgan Stanley and 4,011 shares of our common stock to OIP.

Warrants to purchase 750,000 shares of our Common Stock to each of Newcourt, Duke Capital and EPP, warrants to purchase 712,500 shares of our Common Stock to Morgan Stanley and warrants to purchase 37,500 shares of our Common Stock to OIP. These warrants are initially exercisable at \$1.00 per share.

The Company has declared and paid dividends on the aforementioned preferred stock in the form of additional shares of preferred stock. As of December 31, 2002, the additional shares of Series A Preferred Stock issued as dividends total 237,105 shares.

Additional information regarding each of these investors is as follows:

The business address of Newcourt Capital USA, Inc. is 1211 Avenue of the Americas, 22nd Floor, New York, New York 10036.

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