

METRETEK TECHNOLOGIES INC
Form 10-Q
August 16, 2004

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2004

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission File Number 0-19793

METRETEK TECHNOLOGIES, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

84-1169358
(I.R.S. Employer
Identification No.)

303 East Seventeenth Avenue, Suite 660
Denver, Colorado
(Address of principal executive offices)

80203
(Zip code)

(303) 785-8080
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

As of August 2, 2004, 11,041,701 shares of the issuer's Common Stock were outstanding.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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METRETEK TECHNOLOGIES, INC.

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FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2004

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PART I.
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

METRETEK TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

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	JUNE 30, 2004	DECEMBER 31, 2003
	-----	-----
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 9,653,941	\$ 2,101,675
Trade receivables, net of allowance for doubtful accounts of \$361,287 and \$200,706, respectively	7,544,174	6,613,153
Other receivables	16,495	59,864
Inventories	4,944,816	3,984,223
Prepaid expenses and other current assets	167,303	489,253
	-----	-----
Total current assets	22,326,729	13,248,168
	-----	-----
PROPERTY, PLANT AND EQUIPMENT:		
Equipment	4,858,417	3,810,632
Vehicles	38,876	66,590
Furniture and fixtures	597,391	588,869
Land, building and improvements	758,148	754,167
	-----	-----
Total property, plant and equipment, at cost	6,252,832	5,220,258
Less accumulated depreciation and amortization	3,992,554	3,814,908
	-----	-----
Property, plant and equipment, net	2,260,278	1,405,350
	-----	-----
OTHER ASSETS:		
Goodwill	7,617,196	7,617,196
Patents and capitalized software development, net of accumulated amortization of \$1,084,379 and \$1,033,109, respectively	247,487	288,657
Investment in unconsolidated affiliate	1,731,605	691,100
Restricted cash investment	1,000,000	
Other assets	152,292	76,070
	-----	-----
Total other assets	10,748,580	8,673,023
	-----	-----
TOTAL	\$35,335,587	\$23,326,541
	=====	=====

See accompanying notes to unaudited consolidated financial statements.

METRETEK TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

LIABILITIES AND STOCKHOLDERS' EQUITY

JUNE 30,
2004

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CURRENT LIABILITIES:			
Accounts payable		\$	2,994,772
Accrued and other liabilities			4,420,574
Notes payable			1,104,423
Capital lease obligations			132,512

Total current liabilities			8,652,281

LONG-TERM NOTES PAYABLE			5,203,662

NON-CURRENT CAPITAL LEASE OBLIGATIONS			376,580

COMMITMENTS AND CONTINGENCIES			
MINORITY INTEREST IN SUBSIDIARIES			316,979

REDEEMABLE PREFERRED STOCK - SERIES B, \$.01 PAR VALUE; 1,000,000 SHARES AUTHORIZED; 4,500 AND 7,000 SHARES ISSUED AND OUTSTANDING, RESPECTIVELY, REDEMPTION VALUE \$1,000 PER SHARE			6,316,785

STOCKHOLDERS' EQUITY:			
Preferred stock - undesignated, \$.01 par value; 2,000,000 shares authorized; none issued and outstanding			
Preferred stock - Series C, \$.01 par value; 500,000 shares authorized; none issued and outstanding			
Common stock, \$.01 par value; 25,000,000 shares authorized; 10,951,701 and 6,043,469 shares issued and outstanding, respectively			109,517
Additional paid-in-capital			69,253,946
Accumulated deficit			(54,894,163)

Total stockholders' equity			14,469,300

TOTAL		\$	35,335,587
			=====

See accompanying notes to unaudited consolidated financial statements.

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METRETEK TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
2004	2003	2004	2003
-----	-----	-----	-----

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REVENUES:				
Sales and services	\$ 9,773,487	\$ 10,999,722	\$ 18,875,887	\$ 18,181,352
Other	321,098	151,225	930,423	352,000
	-----	-----	-----	-----
Total revenues	10,094,585	11,150,947	19,806,310	18,533,352
	-----	-----	-----	-----
COSTS AND EXPENSES:				
Cost of sales and services	7,403,691	7,855,108	14,359,637	13,631,000
General and administrative	1,607,435	1,611,142	3,357,985	3,224,000
Selling, marketing and service	513,321	451,552	1,009,353	674,000
Depreciation and amortization	197,516	174,927	369,467	347,000
Research and development	162,771	146,184	329,038	290,000
Interest, finance charges and other	87,762	83,229	167,951	148,000
	-----	-----	-----	-----
Total costs and expenses	9,972,496	10,322,142	19,593,431	18,317,000
	-----	-----	-----	-----
OPERATING INCOME	122,089	828,805	212,879	216,352
MINORITY INTEREST	(67,264)	(51,441)	(141,774)	(62,000)
INCOME TAXES	(12,016)	(12,016)	(23,971)	(32,000)
	-----	-----	-----	-----
NET INCOME	\$ 42,809	\$ 765,348	\$ 47,134	\$ 120,352
	=====	=====	=====	=====
NET INCOME (LOSS) PER COMMON				
SHARE ATTRIBUTABLE TO COMMON				
SHAREHOLDERS, BASIC AND DILUTED	\$ (0.07)	\$ 0.06	\$ (0.12)	\$ (0.00)
	=====	=====	=====	=====
WEIGHTED AVERAGE COMMON				
SHARES OUTSTANDING,				
BASIC AND DILUTED	9,217,416	6,043,469	7,664,681	6,043,000
	=====	=====	=====	=====

See accompanying notes to unaudited consolidated financial statements.

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METRETEK TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	SIX MONTHS ENDED	
	JUNE 30,	
	2004	2003
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 47,134	\$ 120,760
Adjustments to reconcile net income to net cash		

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provided by operating activities:		
Depreciation and amortization	369,467	347,239
Minority interest	109,699	77,461
(Gain) Loss on disposal of property, plant and equipment	(340)	3,638
Equity in income of unconsolidated affiliate	(621,033)	(247,014)
Distributions from unconsolidated affiliate	528,132	271,594
Changes in operating assets and liabilities:		
Trade receivables, net	(931,021)	(2,304,166)
Inventories	(960,593)	(601,519)
Other current assets	365,319	318,997
Other noncurrent assets	(76,222)	(15,000)
Accounts payable	1,016,546	1,299,516
Accrued and other liabilities	(109,575)	1,821,627
	-----	-----
Net cash (used in) provided by operating activities	(262,487)	1,093,133
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment in unconsolidated affiliate	(955,784)	
Increase in restricted cash investment	(1,000,000)	
Purchases of property, plant and equipment	(654,792)	(149,268)
Capitalized software purchases or development	(10,100)	(1,999)
Proceeds from sale of property, plant and equipment	5,200	
	-----	-----
Net cash used in investing activities	(2,615,476)	(151,267)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from private placement	9,849,146	
Proceeds from stock option exercises	298,517	
Net (payments) borrowings on line of credit	(481,528)	152,192
Proceeds from equipment loan	110,250	30,169
Proceeds from investment loan	960,784	
Principal payments on long-term notes payable	(259,125)	(27,658)
Payments on capital lease obligations	(47,815)	(24,727)
	-----	-----
Net cash provided by financing activities	10,430,229	129,976
	-----	-----
NET INCREASE IN CASH AND CASH EQUIVALENTS	7,552,266	1,071,842
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	2,101,675	884,843
	-----	-----
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 9,653,941	\$ 1,956,685
	=====	=====

See accompanying notes to unaudited consolidated financial statements.

METRETEK TECHNOLOGIES, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

As of June 30, 2004 and December 31, 2003 and
For the Three and Six Month Periods Ended June 30, 2004 and 2003

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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ORGANIZATION - The accompanying consolidated financial statements include the accounts of Metrotek Technologies, Inc. and its subsidiaries, primarily Southern Flow Companies, Inc. ("Southern Flow"), PowerSecure, Inc. ("PowerSecure"), and Metrotek, Incorporated ("Metrotek Florida") (and its majority-owned subsidiary, Metrotek Contract Manufacturing Company, Inc. ("MCM")), and Marcum Gas Transmission, Inc. ("MGT") (and its majority-owned subsidiary, Conquest Acquisition Company LLC ("CAC LLC")), collectively referred to as the "Company" or "we" or "us" or "our". These consolidated financial statements have been prepared pursuant to rules and regulations of the Securities and Exchange Commission. The accompanying consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2003.

In the opinion of the Company's management, all adjustments (all of which are normal and recurring) have been made which are necessary for a fair presentation of the consolidated financial position of the Company and its subsidiaries as of June 30, 2004 and the consolidated results of their operations and cash flows for the three and six month periods ended June 30, 2004 and June 30, 2003.

RECLASSIFICATION - Certain 2003 amounts have been reclassified to conform to current year presentation. Such reclassifications had no impact on the Company's net income or stockholders' equity.

INCOME (LOSS) PER SHARE - The Emerging Issues Task Force ("EITF") has issued EITF Issue No. 03-6, "Participating Securities and the Two-Class Method under FASB Statement No. 128, Earnings per Share" ("EITF 03-6"). The Company adopted EITF 03-6 as of April 1, 2004, and has retroactively adjusted prior periods pursuant to its provisions. EITF 03-6 provides guidance for the computation of earnings per share using the two-class method for enterprises with participating securities or multiple classes of common stock as required by Statement of Financial Accounting Standards No. 128. The two-class method allocates undistributed earnings to each class of common stock and participating securities for the purpose of computing basic earnings per share. The Company's Series B Redeemable Preferred Stock is a participating security under the provisions of EITF 03-6.

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The following table sets forth the calculation of basic and diluted earnings per share:

	THREE MONTHS ENDED JUNE 30,		
	2004	2003	2
Net income	\$ 42,809	\$ 765,348	\$
Less preferred stock deemed distribution (1)	(711,144)	(220,710)	(
Income (loss) to be allocated	(668,335)	544,638	(
Less allocation of undistributed earnings to participating preferred stock	-	(178,002)	-

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Net income (loss) attributable to common shareholders	\$ (668,335)	\$ 366,636	\$ (
	=====	=====	=====
Weighted average common shares outstanding, basic and diluted (2)	9,217,416	6,043,469	7,
	=====	=====	=====
Net income (loss) per common share, basic and diluted (3)	\$ (0.07)	\$ 0.06	\$
	=====	=====	=====

- (1) The preferred stock deemed distribution for the three and six month periods ended June 30, 2004 includes a non-cash charge (expense) of \$543,000, which represents the estimated fair market value of inducement conveyed to the converting Preferred Stockholders in connection with the Private Placement discussed further in Note 2.
- (2) The assumed conversion of stock options, convertible preferred stock and warrants has been excluded from weighted average shares outstanding because the effect would be anti-dilutive.
- (3) In its Quarterly Report on Form 10-Q dated June 30, 2003, the Company originally reported Net income per common share, basic and diluted, for the three month period ended June 30, 2003 of \$.09 per share. For purposes of the financial statements included in this Quarterly Report on Form 10-Q, the amount has been recalculated to reflect an allocation of earnings to participating preferred stock of \$178,000.

STOCK BASED COMPENSATION - The Company has three stock-based employee and director compensation plans, which it accounts for under the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees", and related Interpretations. Accordingly, the Company does not recognize compensation cost for stock option grants to employees and directors, as all options granted under those plans have exercise prices equal to or in excess of the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net loss and loss per share applicable to common shareholders if the Company had applied the fair value recognition provisions of FAS 123 for the three and six month periods ended June 30, 2004 and 2003:

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	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2004	2003	2004	2003
	-----	-----	-----	-----
Net income (loss) attributable to common shareholders - as reported	\$ (668,335)	\$ 366,636	\$ (895,753)	\$ (317,1
Deduct total stock-based employee compensation expense determined under fair value based method	(159,774)	(40,698)	(263,774)	(40,6
	-----	-----	-----	-----
Net income (loss) attributable to common shareholders - pro forma	\$ (828,109)	\$ 325,938	\$ (1,159,527)	\$ (357,8

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	=====	=====	=====	=====
Income (loss) per basic and diluted Common Share:				
As reported	\$ (0.07)	\$ 0.06	\$ (0.12)	\$ (0.00)
Pro forma	\$ (0.09)	\$ 0.05	\$ (0.15)	\$ (0.00)

The fair values of stock options were calculated using the Black-Scholes stock option valuation model with the following weighted average assumptions for stock option grants during the periods ended June 30, 2004 and 2003: stock price volatility of 53% and 106%, respectively; risk-free interest rate of 3.50% per year; dividend rate of \$0.00 per year; and an expected life of 4 years for options granted to employees and 10 years for options granted to directors.

STATEMENT OF CASH FLOWS - The Company considers all highly liquid and unrestricted investments with a maturity of three months or less from the date of purchase to be cash equivalents. During the six months ended June 30, 2004, the company incurred capital lease obligations in the aggregate amount of \$485,731 in connection with the acquisition of manufacturing equipment at Metretek Florida.

2. PRIVATE PLACEMENT

In May 2004, the Company completed a private placement to institutional and accredited investors of 3,510,548 shares of its common stock and warrants to purchase 702,109 shares of its common stock (the "Private Placement"), raising gross proceeds of \$10,883,000. The price paid in the Private Placement was \$3.10 per unit, each unit consisting of one share of common stock and a warrant to purchase 0.2 shares of common stock. Roth Capital Partners, LLC acted as placement agent in the Private Placement.

The Company received net cash proceeds of \$9,849,000 from the Private Placement, after deducting transaction expenses including the placement agent's fee. The net proceeds from the Private Placement are intended to be used by the Company principally to meet its mandatory redemption obligations related to its Series B Preferred Stock, par value \$.01 per share ("Series B Preferred Stock"), which matures on December 9, 2004 (the "Mandatory Redemption Date"), and for other business commitments and initiatives.

The warrants issued in the Private Placement have an exercise price of \$3.41 per share of common stock and expire in May 2009. The warrants are callable by the Company commencing

one year after issuance if the trading price of the common stock is at least two times the warrant exercise price for 30 consecutive trading days and certain other conditions are satisfied. In addition to the warrants issued to the investors, the Company issued warrants to purchase up to 351,055 shares of common stock to the placement agent, which warrants are on the same basic terms as the warrants issued to the investors. The Company filed a registration statement with the Securities and Exchange Commission (the "SEC"), which registration statement has been declared effective by the SEC, covering resales from time to time of shares of common stock issued in the Private Placement or upon the exercise of the warrants.

In addition, as a condition precedent to the closing of the Private

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Placement, certain holders of the Company's outstanding shares of Series B Preferred Stock converted a total of 2,500 shares of Series B Preferred Stock, including accrued and unpaid dividends thereon. The purpose of this conversion was to reduce the Company's potential preferred stock mandatory redemption liability at the Mandatory Redemption Date from approximately \$10.3 million to approximately \$6.6 million, a reduction of \$3.7 million. Upon conversion, the converting Preferred Stockholders received 1,209,133 shares of common stock (inclusive of 55,871 additional shares of common stock ("Additional Shares") intended to compensate the converting Preferred Stockholders for dividends that they would otherwise receive on the converted preferred shares between the Private Placement closing date and the Mandatory Redemption Date) and new warrants to purchase 1,209,133 shares of common stock. The new warrants may be exercised at a strike price of \$3.0571 per share of common stock and expire on June 9, 2005. The strike price of the new warrants is the same price as the conversion price of the Series B Preferred Stock. The Company included both the Additional Shares and the shares of common stock issuable upon exercise of the new warrants in the registration statement filed with the SEC in connection with the Private Placement.

As a result of the Preferred Stock conversion described in the immediately preceding paragraph, the Company recorded a second quarter of 2004 non-cash charge (expense) in the amount of \$543,000 as an additional preferred stock deemed dividend. This charge represents the approximate fair market value of inducement conveyed to the converting Preferred Stockholders. The inducement amount relates principally to the estimated fair market values of the new warrants and the Additional Shares. See also Note 1 - "Income (Loss) per Share."

3. INVESTMENT IN UNCONSOLIDATED AFFILIATE

During the first quarter of 2004, additional equity interests in MGT's unconsolidated affiliate, Marcum Midstream 1995-2 Business Trust ("MM 1995-2"), were acquired at a purchase price of \$956,000, with an effective date of the acquisition of January 1, 2004. To facilitate the acquisition of the additional equity interests, MGT formed CAC LLC, a majority-owned subsidiary. Financing of the acquired equity interests was provided by a \$961,000 term loan from a commercial bank to CAC LLC. The loan is secured by CAC LLC's and MGT's collective interests in MM 1995-2, and the Company has provided a guaranty of \$625,000 of the term loan. The term loan provides for 60 monthly payments of principal and interest (at a rate of

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5.08%) in the amount of approximately \$18,500 per month. Cash distributions from MM 1995-2 to CAC LLC will be used to fund the monthly payments on the term loan.

Upon formation, MGT acquired 73.75% of CAC LLC. CAC LLC accounts for its interests in MM1995-2 under the equity method of accounting. The minority shareholder's interest in CAC LLC at June 30, 2004, is included in minority interest in the accompanying consolidated financial statements.

Summarized financial information for MM 1995-2 at June 30, 2004 and December 31, 2003 and for the three and six months ended June 30, 2004 and 2003, are as follows:

	JUNE 30, 2004	DECEMBER 31, 2003
	-----	-----
Total current assets	\$ 1,431,412	\$ 1,510,302

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Property, plant and equipment, net	4,708,097	4,681,899
Total other assets	19,853	23,801
	-----	-----
Total assets	\$ 6,159,362	\$ 6,216,002
	=====	=====
Total current liabilities	\$ 808,874	\$ 795,599
Long-term note payable	724,220	1,020,561
Total shareholders' equity	4,626,268	4,399,842
	-----	-----
Total liabilities and shareholders' equity	\$ 6,159,362	\$ 6,216,002
	=====	=====

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2004	2003	2004	2003
	-----	-----	-----	-----
Total revenues	\$1,650,244	\$1,228,292	\$3,558,910	\$2,626,061
Total costs and expenses	866,391	555,144	1,632,483	1,125,595
	-----	-----	-----	-----
Net income	\$ 783,853	\$ 673,148	\$1,926,427	\$1,500,466
	=====	=====	=====	=====

4. RESTRICTED CASH INVESTMENT

At April 30, 2004, Metretek Florida was not in compliance with certain financial covenants in its credit agreement with Wells Fargo Business Credit ("Wells Fargo"). Wells Fargo waived the financial covenants and the Metretek Florida credit agreement was amended to establish less restrictive financial covenants. As a condition to the waiver of default and amendment to the credit agreement, the Company agreed to purchase a \$1,000,000 certificate of deposit (the "Restricted Cash Investment"), in which Wells Fargo has been granted a security interest. The Restricted Cash Investment is held in the Company's name in a depository account at Wells Fargo and it matures on December 4, 2004, subject to renewal at the instruction of Wells Fargo Business Credit. The Restricted Cash Investment is carried at cost, which approximates fair value, and is restricted as to withdrawal or use by the Company, except as may be permitted by Wells Fargo. The Restricted Cash Investment has been classified as a non-current asset in the accompanying consolidated balance sheet at June 30, 2004, because its use

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has been restricted.

5. COMMITMENTS AND CONTINGENCIES

CLASS ACTION LITIGATION - As described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2003 ("2003 Form 10-K"), in January 2001, Douglas W. Heins (the "Class Action Plaintiff"), individually and on behalf of a class of other persons similarly situated, filed a complaint (the

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"Class Action") in the District Court for the City and County of Denver, Colorado (the "Denver Court") against the Company, Marcum Midstream 1997-1 Business Trust (the "1997 Trust"), Marcum Midstream-Farstad, LLC ("MMF"), MGT, Marcum Capital Resources, Inc. ("MCR"), W. Phillip Marcum, Richard M. Wanger and Daniel J. Packard (the foregoing, collectively, the "Metretek Defendants"), Farstad Gas & Oil, LLC ("Farstad LLC") and Farstad Oil, Inc. ("Farstad Inc." and, collectively with Farstad LLC, the "Farstad Entities"), and Jeff Farstad ("Farstad" and, collectively with the Farstad Entities, the "Farstad Defendants").

On March 27, 2003, the Company, along with the Class Action Plaintiff, filed a Stipulation of Settlement, which contains the terms and conditions of a proposed settlement intended to fully resolve all claims by the Class Action Plaintiff against the Company and the other Metretek Defendants in the Class Action. On March 2, 2004, the Company and the Class Action Plaintiff filed a revised Stipulation of Settlement, which revises certain terms of the settlement (as revised, the "Heins Settlement"). The terms and conditions of the Heins Settlement are set forth in the 2003 Form 10-K.

The Heins Settlement was granted final approval by the Denver Court on June 11, 2004 and became effective on July 26, 2004. The Heins Settlement creates a settlement fund (the "Heins Settlement Fund") for the benefit of the Class. In settlement of the Interpleader Action discussed below, \$2,375,000 in proceeds of the Company's directors' and officers' insurance policy (the "Policy") was used in the Heins Settlement. Pursuant to the Heins Settlement, the Company has paid \$375,000, and has issued a note payable to the Heins Settlement Fund in the amount of \$3.0 million (the "Heins Settlement Note"), and commenced payments thereunder on June 30, 2004. The Heins Settlement Note bears interest at the rate of prime plus three percent (prime + 3%), payable in 16 quarterly installments, each of \$187,500 principal plus accrued interest, and is guaranteed by the 1997 Trust and all of the Company's subsidiaries.

On March 28, 2003, Gulf Insurance Company ("Gulf"), who issued the Policy, filed an interpleader complaint against the Metretek Defendants, the Farstad Defendants and the Class Action Plaintiff (the "Interpleader Action") in the Denver Court, seeking a determination by the Denver Court as to the proper beneficiaries of the Policy. In March 2004, we settled the Interpleader Action with Gulf and the Farstad Defendants (the "Interpleader Settlement"). Pursuant to the terms of the Interpleader Settlement, Gulf paid \$2,375,000 for use in the Heins Settlement, and has paid the remainder of the Policy proceeds to the Farstad Defendants. In exchange, the Company and the Farstad Defendants have fully released Gulf from all further claims under the Policy. The Interpleader Action was dismissed on April 2, 2004.

The Company and the Metretek Defendants intend to vigorously pursue appropriate

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cross-claims and third party claims.

6. SEGMENT INFORMATION

The Company's reportable segments are strategic business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. The Company's reportable business segments include: natural gas measurement services; distributed generation; and automated energy data management.

The operations of the Company's natural gas measurement services segment are conducted by Southern Flow. Southern Flow's services include on-site

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field services, chart processing and analysis, laboratory analysis, and data management and reporting. These services are provided principally to customers involved in natural gas production, gathering, transportation and processing.

The operations of the Company's distributed generation segment are conducted by PowerSecure. PowerSecure commenced operations in September 2000. The primary elements of PowerSecure's distributed generation products and services include project design and engineering, negotiation with utilities to establish tariff structures and power interconnects, generator acquisition and installation, process control and switchgear design and installation, and ongoing project monitoring and servicing. PowerSecure markets its distributed generation products and services directly to large end-users of electricity and through outsourcing partnerships with utilities. Through June 30, 2004, the vast majority of PowerSecure's revenues have been generated from sales of distributed generation systems on a "turn-key" basis, where the customer acquires the systems from PowerSecure. To date, PowerSecure has also generated a small portion of its revenues from "company-owned" distributed generation assets that are leased to customers on a long-term basis.

The operations of the Company's automated data collection and telemetry segment are conducted by Metretek Florida. Metretek Florida's manufactured products fall into the following categories: field devices, including data collection products and electronic gas flow computers; data collection software products (such as InvisiConnect(TM), DC2000 and PowerSpring); and communications solutions that can use public networks operated by commercial wireless carriers to provide real time IP-based wireless internet connectivity, traditional cellular radio, 900 MHz unlicensed radio or traditional wire-line phone service to provide connectivity between the field devices and the data collection software products. Metretek Florida also provides data collection, M2M telemetry connectivity and post-sale support services for its manufactured products and turn-key solutions. In June 2002, Metretek Florida formed MCM to conduct and expand its circuit board contract manufacturing operations.

The Company evaluates the performance of its operating segments based on income (loss) before minority interest, income taxes, nonrecurring items and interest income and expense. Intersegment sales are not significant.

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Summarized financial information concerning the Company's reportable segments is shown in the following table. The amounts shown as "Other" include corporate related items, equity in earnings of unconsolidated affiliate, results of insignificant operations and, as it relates to segment profit or loss, income and expense not allocated to reportable segments.

SUMMARIZED SEGMENT FINANCIAL INFORMATION (ALL AMOUNTS REPORTED IN THOUSANDS)

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2004	2003	2004	2003
REVENUES:				
Southern Flow	\$ 3,232	\$ 2,839	\$ 6,328	\$ 5,823
PowerSecure	4,348	4,398	8,550	7,422
Metretek Florida	2,194	3,763	3,998	4,937
Other	321	151	930	352

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Total	\$ 10,095	\$ 11,151	\$ 19,806	\$ 18,534
SEGMENT PROFIT (LOSS):				
Southern Flow	\$ 550	\$ 320	\$ 908	\$ 640
PowerSecure	308	364	532	463
Metrotek Florida	(402)	666	(836)	104
Other	(334)	(521)	(391)	(991)
Total	\$ 122	\$ 829	\$ 213	\$ 216
CAPITAL EXPENDITURES:				
Southern Flow	\$ 94	\$ 10	\$ 121	\$ 39
PowerSecure	328	68	493	74
Metrotek Florida	(92)	12	48	34
Other	2	4	3	4
Total	\$ 332	\$ 94	\$ 665	\$ 151
DEPRECIATION AND AMORTIZATION:				
Southern Flow	\$ 31	\$ 32	\$ 61	\$ 65
PowerSecure	24	16	45	29
Metrotek Florida	130	122	246	242
Other	12	5	17	11
Total	\$ 197	\$ 175	\$ 369	\$ 347

	JUNE 30,	
	2004	2003
TOTAL ASSETS:		
Southern Flow	\$ 9,119	\$ 8,414
PowerSecure	6,278	5,121
Metrotek Florida	8,545	8,410
Other	11,393	704
Total	\$ 35,335	\$ 22,649

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

INTRODUCTION

The following discussion of our results of operations for the three and six month periods ended June 30, 2004 (referred to herein as the "second quarter 2004" and "six month period 2004", respectively) and for the three and six month periods ended June 30, 2003 (referred to herein as the "second quarter 2003" and "six month period 2003", respectively) and of our financial condition as of June

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30, 2004 should be read in conjunction with our consolidated financial statements and related notes thereto included elsewhere in this report.

OVERVIEW

We are a diversified provider of energy technology products, services and data management systems primarily to industrial and commercial users and suppliers of natural gas and electricity. As a holding company, we conduct our operations and derive our revenues through our three operating subsidiaries, each of which operates a separate business:

- Southern Flow, which provides natural gas measurement services;
- PowerSecure, which designs, sells and manages distributed generation systems; and
- Metretek Florida, which designs, manufactures and sells data collection and energy measurement monitoring systems and provides contract manufacturing services.

In addition to these operating subsidiaries, we also own an approximate 26% economic interest in an unconsolidated business, the Marcum Midstream 1995-2 Business Trust (MM 1995-2). We acquired additional equity interests in MM 1995-2 during the first quarter of 2004. As a result, the income from this equity investment is becoming a more significant part of our operating results.

We commenced operations in 1991 as an energy services holding company, owning subsidiaries with businesses designed to exploit service opportunities primarily in the natural gas industry. Since then, our business has evolved and expanded through acquisitions of companies, businesses and new product lines that have allowed us to reach not only a broader portion of the energy market (including the electricity market) but also markets outside of the energy field. Over the past two years, we have focused our efforts on growing our businesses by offering new and enhanced products, services and technologies, and by entering new markets, within a framework emphasizing the goal of achieving profitable operations on a sustained basis.

During the second quarter 2004, we took substantial steps to improve our balance sheet and liquidity. In May 2004, we completed a Private Placement to institutional and accredited investors of 3,510,548 shares of our Common Stock and warrants to purchase 702,109 shares of our Common Stock, raising gross proceeds of \$10,883,000. We received net cash proceeds of

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\$9,849,000 from the Private Placement, after deducting transaction expenses including the placement agent's fee. The net proceeds from the Private Placement are intended to be used principally to meet our mandatory redemption obligations related to our Series B Preferred Stock and for other business commitments and initiatives.

In addition, certain holders of our outstanding shares of Series B Preferred Stock converted a total of 2,500 shares of Preferred Stock, including accrued and unpaid dividends thereon. As a result of the conversion of these shares of Series B Preferred Stock, our maximum aggregate redemption obligation at December 9, 2004 was reduced from \$10.3 million to approximately \$6.6 million, and the deemed distribution on the Series B Preferred Stock will be reduced for future periods as a result of the reduction in shares of Series B Preferred Stock outstanding. See "-Liquidity and Capital Resources" below in this Item for further discussion concerning the Private Placement and the conversion of Preferred Stock.

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During the second quarter 2004, Metretek Florida showed a substantial decline over the second quarter 2003 in its revenues and segment profitability. These declines were principally due to a significant project involving the sale of field devices that were recorded in the second and third quarter 2003. No similar sized projects were included in sales in the second quarter 2004 that were comparable to the approximate \$2 million of the 2003 project revenues that were included in the second quarter 2003. PowerSecure's revenues and segment profit during the second quarter 2004 were slightly less than reported in its second quarter 2003. Southern Flow's revenues and segment profit showed significant improvement during the second quarter 2004, as compared to the second quarter 2003, as a result of generally improved market conditions.

Due principally to the decline in revenues at Metretek Florida, our consolidated revenues during the second quarter 2004 decreased by \$1,056,000, representing a 9% decrease over second quarter 2003 consolidated revenues. We recorded net income of \$43,000 during the second quarter 2004, which represents a reduction as compared to net income of \$765,000 during the second quarter 2003.

During the second quarter 2004, we recorded a deemed distribution on our Series B Preferred Stock of \$711,000 compared to \$221,000 during the second quarter 2003. The second quarter 2004 deemed distribution increased over the second quarter 2003 due to a \$543,000 non-cash inducement to Preferred Stockholders who converted a total of 2,500 shares of Series B Preferred Stock (including accrued and unpaid dividends) in connection with the Private Placement discussed above.

After the non-cash preferred stock deemed distribution and allocation of undistributed earnings to participating preferred stock, our net loss attributable to common shareholders in the second quarter 2004 increased to \$668,000 as compared to \$367,000 net income attributable to common shareholders in the second quarter 2003. The primary reasons for the change in net income (loss) attributable to common shareholders were the non-cash inducement amount of \$543,000 included in second quarter 2004 as additional preferred stock deemed distribution, and the reduction in segment profitability at Metretek Florida due to the reduction in the sale of field devices as described above. These factors are partially offset by significantly better segment

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profitability at our Southern Flow subsidiary, and an increase in other revenues principally related to our unconsolidated investment in MM 1995-2.

During the six month period 2004, the distributed generation business and operations of PowerSecure expanded significantly. PowerSecure's revenues during the six month period 2004 were 15% greater than its six month period 2003 revenues. PowerSecure's growth reflects an increase in the number of projects awarded to PowerSecure as well as an expansion of its professional services. Southern Flow's revenues and segment profit also showed significant improvement during the six month period 2004, as compared to the six month period 2003, as a result of generally improved market conditions. Metretek Florida showed a substantial decline over the six month period 2003 in its revenues and segment profitability, which resulted primarily from a reduction in sales of field devices and data collection software products in the second quarter 2004 as described above.

Overall, our consolidated revenues during the six month period 2004 increased by \$1,272,000, representing a 7% increase over six month period 2003 consolidated revenues. We recorded net income of \$47,000 during the six month period 2004 compared to net income of \$121,000 during the six month period 2003.

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During the six month period 2004, we recorded a non-cash deemed distribution on our Series B Preferred Stock of \$943,000 compared to \$438,000 during the six month period 2003. The six month period 2004 deemed distribution increased over the six month period 2003 due to a \$543,000 non-cash inducement to Preferred Stockholders who converted a total of 2,500 shares of Series B Preferred Stock (including accrued and unpaid dividends) in connection with the Private Placement discussed above. After the non-cash preferred stock deemed distribution and allocation of undistributed earnings to participating preferred stock, our net loss attributable to common shareholders in the six month period 2004 increased to \$896,000 as compared to a \$317,000 net loss attributable to common shareholders in the six month period 2003. The primary reason for this decrease was the charge for the non-cash deemed dividend inducement to the converting Preferred Stockholders in connection with the Private Placement and the decline in the performance of Metretek Florida.

Also during the six month period 2004, we acquired additional equity interests in our unconsolidated affiliate, Marcum Midstream 1995-2 Business Trust ("MM 1995-2"), at a purchase price of \$956,000. We financed the acquisition of the additional equity interests through a \$961,000 term loan from a commercial bank to a newly formed majority owned subsidiary, CAC LLC. The additional equity income from MM1995-2 increased our other revenues substantially during the six month period 2004. We expect cash distributions from MM 1995-2 to CAC LLC will be sufficient to fund the monthly payments on the term loan, as well as provide cash for other business commitments and initiatives.

Unless the holders of our remaining Series B Preferred Stock elect to convert their Preferred Stock to Common Stock, the terms of our Series B Preferred Stock will require us to redeem all shares of our Series B Preferred Stock that remain outstanding on December 9, 2004 at a redemption price equal to the liquidation preference of \$1,000 per share plus accumulated

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and unpaid dividends. The Series B Preferred Stock is convertible, at the option of the holders thereof, into Common Stock at the conversion rate of approximately \$3.06 per share of Common Stock. While the conversion of shares of Series B Preferred Stock into shares of Common Stock prior to the redemption date will reduce our redemption obligation, we cannot determine at this time how many shares, if any, of Series B Preferred Stock will ultimately be converted. As of June 30, 2004, the total redemption obligation was approximately \$6.3 million, and due to additional accrued dividends may rise to a maximum redemption obligation of \$6.6 million on the December 9, 2004 mandatory redemption date.

Another important factor in our liquidity relates to the settlement of the Class Action lawsuit. On June 11, 2004, the Denver Court granted final approval of the Heins Settlement, which became effective on July 26, 2004. Under the Heins Settlement, we commenced payments on a four year \$3 million promissory note on June 30, 2004. See "Part II, Item 1. Legal Proceedings" in this Report and "-Liquidity and Capital Resources" below in this Item.

CRITICAL ACCOUNTING POLICIES

Management's discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets

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and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates, including those related to revenue recognition and percentage of completion, fixed price contracts, product returns, warranty obligations, bad debt, inventories, cancellations costs associated with long term commitments, investments, intangible assets, assets subject to disposal, income taxes, restructuring, service contracts, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making estimates and judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Estimates, by their nature, are based on judgment and available information. Therefore, actual results could differ from those estimates and could have a material impact on our consolidated financial statements, and it is possible that such changes could occur in the near term.

We have identified the accounting principles which we believe are most critical to understanding our reported financial results by considering accounting policies that involve the most complex or subjective decisions or assessments. These accounting policies are described in our Annual Report on Form 10-K for the year ended December 31, 2003 in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations."

RESULTS OF OPERATIONS

The following table sets forth selected information related to our primary business segments and is intended to assist you in an understanding of our results of operations for the

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periods presented.

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2004	2003	2004	2003
(all amounts reported in thousands)				
REVENUES:				
Southern Flow	\$ 3,232	\$ 2,839	\$ 6,328	\$ 5,823
PowerSecure	4,348	4,398	8,550	7,422
Metretek Florida	2,194	3,763	3,998	4,937
Other	321	151	930	352
	-----	-----	-----	-----
Total	\$ 10,095	\$ 11,151	\$ 19,806	\$ 18,534
	=====	=====	=====	=====
GROSS PROFIT:				
Southern Flow	\$ 847	\$ 662	\$ 1,623	\$ 1,341
PowerSecure	1,296	1,159	2,434	1,836
Metretek Florida	227	1,324	459	1,373
	-----	-----	-----	-----
Total	\$ 2,370	\$ 3,145	\$ 4,516	\$ 4,550
	=====	=====	=====	=====
SEGMENT PROFIT (LOSS):				
Southern Flow	\$ 550	\$ 320	\$ 908	\$ 640

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PowerSecure	308	364	532	463
Metretek Florida	(402)	666	(836)	104
Other	(334)	(521)	(391)	(991)
	-----	-----	-----	-----
Total	\$ 122	\$ 829	\$ 213	\$ 216
	=====	=====	=====	=====

Our reportable segments are strategic business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. Our reportable business segments include: natural gas measurement services; distributed generation; and automated energy data management.

The operations of our natural gas measurement services segment are conducted by Southern Flow. Southern Flow's services include on-site field services, chart processing and analysis, laboratory analysis, and data management and reporting. These services are provided principally to customers involved in natural gas production, gathering, transportation and processing.

The operations of our distributed generation segment are conducted by PowerSecure. The primary elements of PowerSecure's distributed generation products and services include project design and engineering, negotiation with utilities to establish tariff structures and power interconnects, generator acquisition and installation, process control and switchgear design and installation, and ongoing project monitoring and servicing. PowerSecure markets its distributed generation products and services directly to large end-users of electricity and through outsourcing partnerships with utilities. Through June 30, 2004, the vast majority of PowerSecure's revenues

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have been generated from sales of distributed generation systems on a "turn-key" basis, where the customer purchases the systems from PowerSecure. PowerSecure has also generated a small portion of its revenues from "company-owned" distributed generation assets that are leased to customers on a long-term basis.

The operations of our automated data collection and telemetry segment are conducted by Metretek Florida. Metretek Florida's manufactured products fall into the following categories: field devices, including data collection products and electronic gas flow computers; data collection software products (such as InvisiConnect(TM), DC2000 and PowerSpring); and communications solutions that can use public networks operated by commercial wireless carriers to provide real time IP-based wireless internet connectivity, traditional cellular radio, 900 MHz unlicensed radio or traditional wire-line phone service to provide connectivity between the field devices and the data collection software products. Metretek Florida also provides data collection, M2M telemetry connectivity and post-sale support services for its manufactured products and turn-key solutions. In June 2002, Metretek Florida formed MCM to conduct and expand its PCB contract manufacturing operations.

We evaluate the performance of our operating segments based on operating income (loss) before taxes, nonrecurring items and interest income and expense. Other revenues and profit (loss) amounts in the table above include corporate related items, equity income in an unconsolidated affiliate, results of insignificant operations, and income and expense including non-recurring charges not allocated to its operating segments. Intersegment sales are not significant.

SECOND QUARTER 2004 COMPARED TO SECOND QUARTER 2003

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Revenues. Our revenues are derived almost entirely from the sales of products and services by our subsidiaries. Our consolidated revenues for the second quarter 2004 decreased \$1,056,000, or 9%, compared to the second quarter 2003. The decrease was due principally to a decrease in revenues by Metretek Florida, partially offset by an increase in revenues by Southern Flow as well as an increase in equity income from our investment in MM 1995-2.

The 42% decrease in Metretek Florida's revenues during the second quarter 2004 compared to the second quarter 2003 was almost entirely attributable to a decrease in domestic sales of \$1,474,000. The decrease in Metretek Florida's domestic sales was the net result of a decrease of \$2,373,000 in domestic sales of field devices, data collection software products, and communications solutions products, partially offset by an increase of \$899,000 in its domestic contract manufacturing sales. The decrease in domestic sales of field devices, data collection software products, and communications solutions products was due to the effects of a significant order from a single customer in the second quarter 2003, which resulted in the recognition of approximately \$2 million in sales. There was no comparable order in the second quarter 2004. The increase in domestic circuit board contract manufacturing sales was due primarily to higher sales to MCM's largest circuit board contract manufacturing customers. As discussed below under "--Quarterly Fluctuations", Metretek Florida's revenues have fluctuated significantly in the past and are expected to continue to fluctuate significantly in the future.

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PowerSecure's revenues during the second quarter 2004 showed a nominal decrease compared to the second quarter 2003. PowerSecure had 68 projects completed or in process during the second quarter 2004 compared to 24 projects completed or in process during the second quarter 2003. PowerSecure's average revenue per project for completed and in-process projects was \$60,000 during the second quarter 2004 compared to \$182,000 during the second quarter 2003. PowerSecure's completed or in process projects during the second quarter 2004 included 31 switchgear projects compared to 2 switchgear projects during the second quarter 2003. Switchgear projects are typically smaller than distributed generation projects, but generally yield higher profit margins compared to distributed generation projects. PowerSecure's second quarter 2004 revenues also included \$268,000 of service related revenues, as compared to \$23,000 during the second quarter 2003. As discussed below under "--Quarterly Fluctuations", PowerSecure's revenues are influenced by the number, size and timing of various projects and have fluctuated significantly in the past and are expected to continue to fluctuate significantly in the future.

Southern Flow's revenues increased by 14% during the second quarter 2004, as compared to the second quarter 2003. This increase in Southern Flow's revenues was primarily attributable to a generally improved market for its services due principally to a higher level of natural gas wellhead prices.

Other revenues increased \$170,000 during the second quarter 2004, as compared to the second quarter 2003. This increase was comprised principally of an increase in equity income earned from our unconsolidated investment in MM 1995-2, that operates three water processing and deep injection facilities in northeastern Colorado. The increase was due to higher levels of natural gas production activity in its operating area as well as the additional equity interests that we acquired in the first quarter of 2004.

Costs and Expenses. The following table sets forth our costs and expenses during the periods indicated:

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	QUARTER ENDED JUNE 30,		QUARTER-OVER-QUARTER DIFFERENCE	
	2004	2003	\$	%
(IN THOUSANDS)				
COSTS AND EXPENSES:				
Costs of Sales and Services				
Southern Flow	\$2,384	\$2,177	\$ 207	10%
PowerSecure	3,052	3,239	(187)	-6%
Metrotek Florida	1,967	2,438	(471)	-19%
Total	7,403	7,854	(451)	-6%
General and administrative	1,607	1,611	(4)	0%
Selling, marketing and service	513	452	61	13%
Depreciation and amortization	198	175	23	13%
Research and development	163	146	17	12%
Interest, finance charges and other	88	83	5	6%
Income taxes	12	12	-	0%

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Costs of sales and services include materials, personnel and related overhead costs incurred to manufacture products and provide services. The 6% decrease in cost of sales and services for the second quarter 2004, compared to the second quarter 2003, was attributable almost entirely to reduced sales activity at Metrotek Florida.

The 10% increase in Southern Flow's costs of sales and services in the second quarter 2004 reflects the 14% increase in its revenues. Southern Flow's gross profit margin was 26.2% for the second quarter 2004, compared to 23.3% during the second quarter 2003. The improved gross profit margin reflects generally improved market conditions.

The 6% decrease in PowerSecure's costs of sales and services in the second quarter 2004 is a combined result of the 1% decrease in PowerSecure's revenues, cost efficiencies in project installation and construction, and a higher percentage of professional service revenues, with higher associated profit margins, in the second quarter 2004 compared to the second quarter 2003. As a result, PowerSecure's gross profit margin increased to 29.8% during the second quarter 2004, as compared to 26.3% during the second quarter 2003.

The 19% decrease in Metrotek Florida's costs of sales and services in the second quarter 2004 was likewise a direct result of the 42% decrease in Metrotek Florida's revenues. Metrotek Florida's gross profit margin decreased to 10.3% for the second quarter 2004, compared to 35.2% for the second quarter 2003. The primary causes of this decrease in Metrotek Florida's gross profit margin were a change in the mix of products sold, represented by a significant decrease in higher margin sales of field devices, data collection and communications solutions products, but offset by an increase in lower margin contract manufacturing sales, and a net decrease in overall sales, that resulted in a lower sales denominator over which to spread our fixed production overhead.

General and administrative expenses include personnel and related overhead costs for the support and administrative functions. The less than 1% decrease in general and administrative expenses in the second quarter 2004, as

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compared to the second quarter 2003, was primarily due to a reduction in legal expenses associated with the Company's Class Action lawsuit, which has been settled. This decrease was partially offset by increases in personnel and related overhead costs associated with the development and growth of PowerSecure's business necessitating an expansion of PowerSecure's workforce.

Selling, marketing and service expenses consist of personnel and related overhead costs, including commissions for sales and marketing activities, together with advertising and promotion costs. The 13% increase in selling, marketing and service expenses in the second quarter 2004, as compared to the second quarter 2003, was due entirely to increased personnel, commission costs, and business development expenses associated with the development and growth of the business of PowerSecure during the second quarter 2004.

Depreciation and amortization expenses include the depreciation of property, plant and equipment and the amortization of certain intangible assets including capitalized software development costs and other intangible assets that do not have indefinite useful lives. The 13%

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increase in depreciation and amortization expenses in the second quarter 2004, as compared to the second quarter 2003, primarily reflects an increase in depreciable equipment at PowerSecure and Metretek Florida as well as amortization of the premium paid for the Company's additional investment in its unconsolidated affiliate early in 2004.

Research and development expenses, all of which relate to activities at Metretek Florida, include payments to third parties, wages and related expenses for personnel, materials costs and related overhead costs related to product and service development, enhancements, upgrades, testing and quality assurance. The 12% increase in research and development expenses in the second quarter 2004, as compared to the second quarter 2003, primarily reflects additional personnel and associated costs at Metretek Florida that were specifically directed toward further development of our new InvisiConnect suite of M2M products.

Interest, finance charges and other expenses include interest and finance charges on our Credit Facility as well as other non-operating expenses. The 6% increase in interest, finance charges and other expenses in the second quarter 2004, as compared to the second quarter 2003, reflects the additional bank finance charges and interest on borrowings related to PowerSecure's line of credit, which commenced in September 2003, as well as additional interest costs related to a PowerSecure project loan and the term loan used to finance our additional equity interest in our unconsolidated affiliate, both of which commenced in the first quarter of 2004.

Income tax expenses include state income taxes in various state jurisdictions in which we have taxable activities. We incur no federal income tax expense because of our consolidated net operating losses. The estimated state income tax expense during the second quarter 2004 was unchanged from our estimate of state income tax expense during the second quarter 2003.

SIX MONTH PERIOD 2004 COMPARED TO SIX MONTH PERIOD 2003

Revenues. Our consolidated revenues for the six month period 2004 increased \$1,272,000, or 7%, compared to the six month period 2003. The increase was due to increases in revenues by PowerSecure and by Southern Flow as well as an increase in equity income from our investment in an unconsolidated affiliate. These revenue increases were partially offset by a decrease in revenues by Metretek Florida.

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PowerSecure's revenues increased \$1,128,000, or 15%, during the six month period 2004 compared to the six month period 2003. The increase in PowerSecure's revenues was due to a significant increase in the number of PowerSecure's completed and in-process projects during the six month period 2004 compared to the six month period 2003, although the effect on revenues of this increased volume of projects was partially offset due to the reduced size of PowerSecure's projects during the six month period 2004 compared to the six month period 2003. While PowerSecure had 79 projects completed or in process during the six month period 2004 compared to 36 projects completed or in process during the six month period 2003, PowerSecure's average revenue per project for completed and in-process projects was \$101,000 during the six month period 2004 compared to \$203,000 during the six month period 2003. In addition, PowerSecure's revenues during the six month period 2004 included \$547,000 of

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professional service revenue compared to \$101,000 of professional service revenue during the six month period 2003. As discussed below under "Quarterly Fluctuations", PowerSecure's revenues are influenced by the number, size and timing of various projects and have fluctuated significantly in the past and are expected to continue to fluctuate significantly in the future.

Southern Flow's revenues increased \$505,000, or 9%, during the six month period 2004, as compared to the six month period 2003. The increase in Southern Flow's revenues was primarily attributable to a generally improved market for its services due principally to a higher level of natural gas prices.

Metretek Florida's revenues decreased \$939,000, or 19%, during the six month period 2004 compared to the six month period 2003, consisting of a decrease in domestic sales of \$775,000, together with a decrease in international sales of \$164,000. The decrease in Metretek Florida's domestic sales was the net result of a decrease of \$2,101,000 in sales of field devices, data collection software products, and communications solutions products, partially offset by a \$1,326,000 increase in its contract manufacturing sales. The decrease in domestic sales of field devices, data collection software products, and communications solutions products was due to the effects of a significant order from a single customer in the six month period 2003, which resulted in the recognition of approximately \$2 million in sales. There was no comparable order in the six month period 2004. The increase in domestic circuit board contract manufacturing sales was attributable primarily to the continued growth and emphasis on that portion of Metretek Florida's operations in 2004.

Other revenues increased \$578,000 during the six month period 2004, as compared to the six month period 2003. This increase was comprised principally of an increase in equity income earned from our unconsolidated investment in MM 1995-2 that operates three water processing and deep injection facilities in northeastern Colorado. The increase is due to higher levels of natural gas production activity in its operating area as well as the additional equity interests that we acquired in the first quarter of 2004.

Costs and Expenses. The following table sets forth our costs and expenses during the periods indicated:

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SIX MONTHS ENDED	PERIOD-OVER-PERIOD
JUNE 30,	DIFFERENCE

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	2004	2003	\$	%
(IN THOUSANDS)				
COSTS AND EXPENSES:				
Costs of Sales and Services				
Southern Flow	\$ 4,704	\$ 4,482	\$ 222	5%
PowerSecure	6,116	5,586	530	9%
Metretek Florida	3,539	3,564	(25)	-1%
Total	14,359	13,632	727	5%
General and administrative	3,358	3,225	133	4%
Selling, marketing and service	1,009	675	334	49%
Depreciation and amortization	369	347	22	6%
Research and development	329	291	38	13%
Interest, finance charges and other	168	149	19	13%
Income taxes	24	33	(9)	-27%

The overall 5% increase in cost of sales and services for the six month period 2004, compared to the six month period 2003, was attributable almost entirely to increased activity at PowerSecure and Southern Flow.

The 5% increase in Southern Flow's costs of sales and services in the six month period 2004 reflects the 9% increase in its revenues. Southern Flow's gross profit margin was 25.7% for the six month period 2004, compared to 23.0% during the six month period 2003. The improved gross profit margin reflects generally improved market conditions.

The 9% increase in PowerSecure's costs of sales and services in the six month period 2004 is a combined result of the 15% increase in PowerSecure's revenues, cost efficiencies in project installation and construction, and a higher percentage of professional service revenues, with higher associated profit margins, in the six month period 2004 compared to the six month period 2003. As a result, PowerSecure's gross profit margin increased to 28.5% during the six month period 2004, as compared to 24.7% during the six month period 2003.

The 1% decrease in Metretek Florida's costs of sales and services in the six month period 2004 was a direct result of the 19% decrease in Metretek Florida's revenues. Metretek Florida's gross profit margin decreased to 11.5% for the six month period 2004, compared to 27.8% for the six month period 2003. The primary causes of this decrease in Metretek Florida's gross profit margin were a change in the mix of products sold, represented by a significant decrease in higher margin sales of field devices, data collection and communications solutions products, but offset by an increase in lower margin contract manufacturing sales, and an net decrease in overall sales, that resulted in a lower sales denominator over which to spread our fixed production overhead.

The 4% increase in general and administrative expenses in the six month period 2004, as compared to the six month period 2003, was primarily due to increases in personnel and related overhead costs associated with the development and growth of PowerSecure's business necessitating an expansion of PowerSecure's workforce. In addition, the six month period 2004 general and administrative expenses also increased as the result of smaller increases in personnel

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and related overhead costs at the parent level and at Southern Flow attributable to increases in professional fees, insurance costs, salaries and wages. These general and administrative expense increases were partially offset by a reduction in legal expenses associated with the Company's Class Action lawsuit during the six month period 2004 compared to the six month period 2003.

The 49% increase in selling, marketing and service expenses in the six month period 2004, as compared to the six month period 2003, was due entirely to increased personnel, commission costs, and business development expenses associated with the development and growth of the business of PowerSecure during the six month period 2004.

The 6% increase in depreciation and amortization expenses in the six month period 2004, as compared to the six month period 2003, primarily reflects an increase in depreciable equipment at PowerSecure and Metretek Florida as well as amortization of the premium paid for the Company's additional investment in its unconsolidated affiliate early in 2004.

The 13% increase in research and development expenses in the six month period 2004, as compared to the six month period 2003, primarily reflects additional personnel and associated costs at Metretek Florida that were specifically directed toward further development of our new InvisiConnect suite of M2M products.

The 13% increase in interest, finance charges and other expenses in the six month period 2004, as compared to the six month period 2003, reflects the additional bank finance charges and interest on borrowings related to PowerSecure's line of credit, which commenced in September 2003, as well as additional interest costs related to a PowerSecure project loan and the term loan used to finance our additional equity interest in our unconsolidated affiliate, both of which commenced in the first quarter of 2004.

Income tax expenses include state income taxes in various state jurisdictions in which we have taxable activities. We incur no federal income tax expense because of our consolidated net operating losses. The 27% decrease in income taxes in the six month period 2004, as compared to the six month period 2003, was entirely due to reduced state income tax expense incurred by Southern Flow in Louisiana, Oklahoma, and Mississippi.

QUARTERLY FLUCTUATIONS

Our quarterly revenues, expenses, margins, net income and other operating results have fluctuated significantly from quarter-to-quarter, period-to-period and year-to-year in the past and are expected to continue to fluctuate significantly in the future due to a variety of factors, many of which are outside of our control. These factors include, without limitation, the following:

- the size, timing and terms of sales and orders, including customers delaying, deferring or canceling purchase orders, or making smaller purchases than expected;
- our ability to implement our business plans and strategies and the timing of such implementation;
- the timing, pricing and market acceptance of our new products and services such as

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- the pace of development of our new businesses and the growth of their markets;
- changes in our pricing policies and those of our competitors;
- variations in the length of our product and service implementation process;
- changes in the mix of products and services having differing margins;
- changes in the mix of international and domestic revenues;
- the life cycles of our products and services;
- budgeting cycles of utilities and other major customers;
- general economic and political conditions;
- the resolution of pending and any future litigation and claims;
- economic conditions in the energy industry, especially in the natural gas and electricity sectors;
- the effects of governmental regulations and regulatory changes in our markets;
- changes in the prices charged by our suppliers;
- our ability to make and obtain the expected benefits from acquisitions of technology or businesses, and the costs related to such acquisitions;
- changes in our operating expenses; and
- the development and maintenance of business relationships with strategic partners.

Because we have little or no control over most of these factors, our operating results are difficult to predict. Any substantial adverse change in any of these factors could negatively affect our business and results of operations.

Our revenues and other operating results are heavily dependant upon the volume and timing of customer orders and payments and the date of product delivery. The timing of large individual sales is difficult for us to predict. Because our operating expenses are based on anticipated revenues and because a high percentage of these are relatively fixed, a shortfall or delay in recognizing revenue could cause our operating results to vary significantly from quarter-to-quarter and could result in significant operating losses in any particular quarter. If our revenues fall below our expectations in any particular quarter, we may not be able to reduce our expenses rapidly in response to the shortfall, which could result in us suffering significant operating losses in that quarter.

Over PowerSecure's three year operating history, its revenues, costs, gross margins, cash flow, net income and other operating results have varied from quarter-to-quarter, period-to-period and year-to-year, for a number of reasons, including the factors mentioned above, and we expect such fluctuations to continue in the future. PowerSecure's revenues depend in large part upon the timing and the size of projects awarded to PowerSecure, and to a lesser extent the timing of the completion of those projects. In addition, distributed

generation is an emerging

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market and PowerSecure is a new competitor in the market, so there is no established customer base on which to rely or certainty as to future contracts. Another factor that could cause material fluctuations in PowerSecure's quarterly results is the amount of recurring, as opposed to non-recurring, sources of revenue. Through June 30, 2004, the majority of PowerSecure's revenues constituted non-recurring revenues.

Metrotek Florida has historically derived most of its revenues from sales of its products and services to the utility industry. Metrotek Florida has experienced variability of operating results on both an annual and a quarterly basis due primarily to utility purchasing patterns and delays of purchasing decisions as a result of mergers and acquisitions in the utility industry and changes or potential changes to the federal and state regulatory frameworks within which the utility industry operates. The utility industry, both domestic and foreign, is generally characterized by long budgeting, purchasing and regulatory process cycles that can take up to several years to complete. In recent years, Metrotek Florida has diversified its business by entering the contract manufacturing market, but this business heavily depends upon the amount, size and timing of customer orders, and is subject to customers delaying, deferring or canceling purchase orders, or making smaller purchases than expected.

Due to all of these factors and the other risks discussed in this Report and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2003, you should not rely on quarter-to-quarter or year-to-year comparisons of our results of operations as an indication of our future performance. Quarterly or annual comparisons of our operating results are not necessarily meaningful or indicative of future performance.

LIQUIDITY AND CAPITAL RESOURCES

Capital Requirements. We require capital primarily to finance our:

- operations;
- inventory;
- accounts receivable;
- research and development efforts;
- property and equipment acquisitions;
- software development;
- debt service requirements; and
- business and technology acquisitions and other growth transactions.

Cash Flow. We have historically financed our operations and growth primarily through a combination of cash on hand, cash generated from operations, borrowings under credit facilities, and proceeds from private and public sales of equity. As of June 30, 2004, we had working capital of \$13,674,000, including \$9,654,000 in cash and cash equivalents, compared to working capital of \$5,964,000 on December 31, 2003, which included \$2,102,000 in cash and cash equivalents.

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Net cash used in operating activities was \$262,000 in the six month period 2004,

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consisting of approximately \$433,000 of cash provided by operations, before changes in assets and liabilities, and approximately \$695,000 of cash used in changes in working capital and other asset and liability accounts. This compares to net cash provided by operating activities of \$1,093,000 in the six month period 2003, consisting of approximately \$574,000 of cash provided by operations, before changes in assets and liabilities, and approximately \$519,000 of cash provided by changes in working capital and other asset and liability accounts.

Net cash used in investing activities was \$2,615,000 in the six month period 2004, as compared to cash used in investing activities of \$151,000 in the six month period 2003. Net cash used in investing activities during the six month period 2004 included the purchase of a \$1,000,000 restricted certificate of deposit in connection with the waiver and amendment of certain loan covenant compliance requirements for Metretek Florida. In addition during the six month period 2004, we purchased additional equity interests in our unconsolidated affiliate for \$956,000 and used \$665,000 to purchase equipment items at each of our operating subsidiaries. The net cash used in investing activities during the six month period 2003 was attributable to the purchase of equipment at PowerSecure and Southern Flow.

Net cash provided by financing activities was \$10,430,000 in the six month period 2004, compared to net cash provided by financing activities of \$130,000 in the six month period 2003. The majority of the net cash provided by financing activities in the six month period 2004 was attributable to \$9,849,000 net proceeds from a Private Placement of our Common Stock in May 2004 as well as \$961,000 proceeds from a bank term loan used to finance the acquisition of the additional equity interests in our unconsolidated affiliate. The net cash provided by financing activities in the six month period 2003 represented net borrowings on our line of credit, partially offset by payments on long-term notes payable and payments on capital lease obligations.

During the remainder of 2004, we plan to continue our research and development efforts to enhance our existing products and services and to develop new products and services. Our research and development expenses totaled \$329,000 during the six month period 2004. We anticipate that our research and development expenses in fiscal 2004 will total approximately \$812,000, virtually all of which will be directed to Metretek Florida's business.

Our capital expenditures during the six month period 2004 were approximately \$665,000, including \$417,000 of capital expenditures for two PowerSecure "company-owned" distributed generation projects, one of which is still under construction at June 30, 2004. We anticipate capital expenditures in fiscal 2004 of approximately \$1,800,000, including \$1.4 million of capital invested in "company-owned" distributed generation projects. The remaining \$400,000 in capital expenditures will benefit all of our key subsidiaries. We also acquired approximately \$486,000 of equipment through capital leases in the six month period 2004, substantially all of which has been used to increase MCM's production capacity. PowerSecure's "company-owned" projects are anticipated to be funded primarily through long-term financing arrangements provided through PowerSecure's major suppliers. However, we cannot provide any assurance that those financing arrangements will be sufficient to allow PowerSecure to meet our objectives for its growth and development without internal funding or will be on favorable terms.

Working Capital Credit Facility. We have a \$3 million credit facility ("Credit Facility") with Wells Fargo Business Credit, Inc. ("Wells Fargo") that matures in September 2006. The Credit Facility restricts our ability to sell or finance our subsidiaries, without Wells Fargo's consent. The Credit Facility, which constitutes our primary credit agreement, is used primarily to fund the operations and growth of our subsidiaries, especially PowerSecure and MCM.

The Credit Facility consists of separate credit agreements between Wells Fargo and each of Southern Flow, Metretek Florida and PowerSecure, as borrowers. At June 30, 2004, we had an aggregate borrowing base of \$3,000,000 under the Credit Facility, of which \$2,064,000 had been borrowed, leaving \$936,000 available to borrow.

The Credit Facility contains minimum interest charges and unused credit line and termination fees. The obligations of each of the borrowers have been guaranteed by Metretek Technologies, the other borrowers and MCM. These guarantees have been secured by guaranty agreements and security agreements entered into by the guarantors. The security agreements grant to Wells Fargo a first priority security interest in virtually all of the assets of each of the guarantors. The Credit Facility is further secured by a first priority security interest in virtually all of the assets of each borrower. Each credit agreement contains standard affirmative and negative covenants by the borrower, including financial covenants and other standard covenants related to operations, including limitations on future indebtedness and the payment of dividends the sale of assets and other corporate transactions, without Wells Fargo's consent. The Credit Facility between Wells Fargo and Southern Flow was amended in the first quarter 2004 to provide for new financial covenants applicable to certain financial results of Southern Flow during fiscal 2004.

The Credit Facility between Wells Fargo and Metretek Florida was amended during the second quarter 2004 to establish less restrictive financial covenants for the remainder of fiscal 2004. As a condition to the waiver of an existing default and the amendment to the credit agreement, we agreed to purchase a \$1,000,000 certificate of deposit (the "Restricted Cash Investment"), in which Wells Fargo has been granted a security interest. The Restricted Cash Investment is held in the Company's name in a depository account at Wells Fargo Bank, National Association and it matures on December 4, 2004, subject to renewal at the instruction of Wells Fargo. The Restricted Cash Investment is carried at cost, which approximates fair value, and is restricted as to withdrawal or use by the Company, except as may be permitted by Wells Fargo. The Restricted Cash Investment has been classified as a non-current asset in our consolidated balance sheet at June 30, 2004.

Term Loan. During the first quarter 2004, we formed Conquest Acquisition Company LLC, a majority-owned subsidiary, for the purpose of acquiring \$956,000 of additional equity interests in our unconsolidated affiliate, MM1995-2. Financing of the acquired equity interests was provided by a term loan from a commercial bank. The term loan is secured by our interests in MM1995-2, and we provided a guaranty of \$625,000 of the loan. The term loan provides for 60 monthly payments of principal and interest (at a rate of 5.08%) in the amount of approximately \$18,500 per month. We expect that monthly payments on the term loan will be funded through cash distributions from MM1995-2.

Heins Stipulation. On June 11, 2004, the Denver Court granted final approval of the Heins Settlement, which became effective on July 26, 2004. The

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Heins Settlement fully resolves all claims by the Class Action Plaintiff against us and the other Metrotek Defendants in the Heins Class Action. The Heins Settlement includes payment of \$2,375,000 from the proceeds of our directors' and officers' insurance policy. We have paid \$375,000 for use in the Heins Settlement, and we have issued the Heins Settlement Note payable to the Heins Settlement Fund in the amount of \$3.0 million, and commenced payments thereunder on June 30, 2004. The Heins Settlement Note bears interest at the rate of prime plus three percent (prime + 3%), payable in 16 quarterly installments, each of \$187,500 principal plus accrued interest, and is guaranteed by the 1997 Trust and all of our subsidiaries. This litigation and settlement are more fully discussed, and the capitalized terms used in this paragraph are defined, in "Part II, Item 1. Legal Proceedings." The loss resulting from the amounts due on the Heins Settlement, other than interest on the Heins Settlement Note, was recorded in fiscal 2002.

Contractual Obligations and Commercial Commitments. We incur various contractual obligations and commercial commitments in our normal course of business. We lease certain office space, operating facilities and equipment under long-term lease agreements. In addition, we are obligated to make future payments under the Credit Facility and a mortgage loan, and to redeem our Series B Preferred Stock in December 2004. Finally, we are required to make certain payments under the terms a class action litigation settlement, payments of which commenced June 30, 2004. The following table sets forth our contractual obligations and commercial commitments as of June 30, 2004:

	PAYMENTS DUE BY PERIOD (1)			
	TOTAL	REMAINDER OF 2004	YEARS 2005-2006	YEARS 2007-2008
CONTRACTUAL OBLIGATIONS				
Credit Facility (2)	\$ 2,064,000	\$ -	\$ 2,064,000	\$ -
Capital Lease Obligations	509,000	59,000	248,000	197,000
Operating Leases	2,064,000	470,000	1,036,000	558,000
Series B Preferred Stock (3)	6,317,000	6,317,000	-	-
Heins Settlement	2,813,000	375,000	1,500,000	938,000
Term Loan	941,000	97,000	375,000	414,000
Other Long-Term Obligations	491,000	151,000	75,000	258,000
	Total	\$ 7,469,000	\$ 5,298,000	\$ 2,365,000
		\$ 7,469,000	\$ 5,298,000	\$ 2,365,000

(1) Does not include interest that may become due and payable on such obligations in any future period.

(2) Total repayments are based upon borrowings outstanding as of June 30, 2004, not projected borrowings under the Credit Facility.

(3) Based upon accrued and unpaid dividends as of June 30, 2004, although the redemption date is December 9, 2004. The Series B Preferred Stock is convertible, at the option of the holders thereof, into Common Stock at the conversion rate of approximately \$3.06 per share of Common Stock, but the amount set forth in the table does not give effect to any shares of Series B Preferred Stock that may be converted prior to the redemption

date.

Off-Balance Sheet Arrangements. During the six month period 2004, we did not engage in any material off-balance sheet activities nor have any relationships or arrangements with unconsolidated entities established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities nor do we have any commitment or intent to provide additional funding to any such entities.

Liquidity. Based upon our plans and assumptions as of the date of this Report, we currently believe that our capital resources, including our cash and cash equivalents, amounts available under our Credit Facility, along with funds expected to be generated from our operations, will be sufficient to meet our anticipated cash needs during the next 12 months, including our working capital needs, capital requirements and debt service commitments, other than the development of the company-owned business of PowerSecure. However, any projections of future cash needs and cash flows are subject to substantial risks and uncertainties. See "--Cautionary Note Regarding Forward-Looking Statements" below. We cannot provide any assurance that our actual cash requirements will not be greater than we currently expect or that these sources of liquidity will be available when needed.

Unless the holders of our Series B Preferred Stock elect to convert their Preferred Stock to Common Stock, the terms of our Series B Preferred Stock will require us to redeem all shares of our Series B Preferred Stock that remain outstanding on December 9, 2004 at a redemption price equal to the liquidation preference of \$1,000 per share plus accumulated and unpaid dividends. The Series B Preferred Stock is convertible, at the option of the holders thereof, into Common Stock at the conversion rate of approximately \$3.06 per share of Common Stock. While the conversion of shares of Series B Preferred Stock into shares of Common Stock prior to the redemption date will reduce our redemption obligation, we cannot determine at this time how many shares of Series B Preferred Stock will ultimately be converted. As of June 30, 2004, the total redemption obligation was approximately \$6.3 million.

For the following reasons, we may require additional funds, beyond our currently anticipated resources, to support our working capital requirements, our operations or our other cash flow needs:

- While we have reorganized our Metretek Florida business with the goal of making its cash flow positive, the operations of Metretek Florida, or its subsidiary MCM, may require us to fund future operating losses or costs of business expansion.
- We expect that the costs of financing the continuing and anticipated development and growth of PowerSecure, including the equipment, labor and other capital costs of significant turn-key projects that arise from time to time depending on backlog and customer requirements, will, and that similar costs that would be associated with developing any future distributed generation systems for its company-owned business package, would, require us to raise significant additional funds, beyond our current

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capital resources.

- From time to time as part of our business plan, we engage in

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discussions regarding potential acquisitions of businesses and technologies. Our ability to finance any an acquisition in the future will be dependent upon our ability to raise additional capital. As of the date of this report, we have not entered into any binding agreement or understanding committing us to any such acquisition, but we regularly engage in discussions related to such acquisitions.

- We continually evaluate our opportunity to raise additional funds in order to improve our financial position as well as our cash flow requirements, and we may seek additional capital in order to take advantage of such an opportunity or to meet changing cash flow requirements.
- An adverse resolution to claims that may arise from time to time against us could significantly increase our cash requirements beyond our available capital resources.
- Unanticipated events, over which we have no control, could increase our operating costs or decrease our ability to generate revenues from product and service sales beyond our current expectations.

We may seek to raise any needed or desired additional capital from the proceeds of public or private equity or debt offerings at the Metretek Technologies level or at the subsidiary level or both, from asset or business sales, from traditional credit financings or from other financing sources. However, our ability to obtain additional capital when needed or desired will depend on many factors, including general economic and market conditions, our operating performance and investor sentiment, and thus cannot be assured. In addition, depending on how it is structured, a financing could require the consent of our current lender, of the holders of our Series B Preferred Stock or of the investors in the Private Placement. Even if we are able to raise additional capital, the terms of any financings could be adverse to the interests of our stockholders. For example, the terms of a debt financing could restrict our ability to operate our business or to expand our operations, while the terms of an equity financing, involving the issuance of capital stock or of securities convertible into capital stock, could dilute the percentage ownership interests of our stockholders, and the new capital stock or other new securities could have rights, preferences or privileges senior to those of our current stockholders. We cannot assure you that sufficient additional funds will be available to us when needed or desired or that, if available, such funds can be obtained on terms favorable to us and our stockholders and acceptable to those parties who must consent to the financing. Our inability to obtain sufficient additional capital on a timely basis on favorable terms when needed or desired could have a material adverse effect on our business, financial condition and results of operations.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of and made under the safe harbor provisions of Section 27A of the Securities Act of

1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). From time to time in the future, we may make additional forward-looking statements in presentations, at conferences, in press releases, in other reports and filings and otherwise. Forward-looking statements are all statements other than statements of historical facts, including statements that refer to plans, intentions, objectives, goals, strategies, hopes, beliefs, projections, expectations or other characterizations of future

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events or performance, and assumptions underlying the foregoing. The words "may", "could", "should", "would", "will", "project", "intend", "continue", "believe", "anticipate", "estimate", "forecast", "expect", "plan", "potential", "opportunity" and "scheduled", variations of such words, and other similar expressions are often, but not always, used to identify forward-looking statements. Examples of forward-looking statements include statements regarding, among other matters, our plans, intentions, objectives, goals, strategies, beliefs, projections and expectations about the following:

- our prospects, including our future revenues, expenses, net income, margins, profitability, cash flow, liquidity, financial condition and results of operations;
- our products and services, market position, market share, growth and strategic relationships;
- our business plans, strategies, goals and objectives;
- market demand for and customer benefits attributable to our products and services;
- industry trends and customer preferences;
- the nature and intensity of our competition, and our ability to successfully compete in our market;
- the sufficiency of funds, from operations, available borrowings and other capital resources, to meet our future working capital, capital expenditure, debt service and business growth needs;
- pending or potential business acquisitions, combinations, sales, alliances, relationships and other similar business transactions;
- our ability to successfully develop and operate our new businesses;
- the effects on our financial condition, results of operations and cash flows of the resolution of pending or threatened litigation; and
- future economic, business, market and regulatory conditions.

Any forward-looking statements we make are based on our current plans, intentions, objectives, goals, strategies, hopes, beliefs, projections and expectations, as well as assumptions made by and information currently available to management. You are cautioned not to place undue reliance on any forward-looking statements, any or all of which could turn out to be wrong. Forward-looking statements are not guarantees of future performance or events, but are subject to and qualified by substantial risks, uncertainties and other factors, which are difficult to predict and are often beyond our control. Forward-looking statements will be affected by assumptions we might make that do not materialize or that prove to be incorrect and by known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from those expressed, anticipated or implied by such forward-looking statements. These risks, uncertainties and other factors include, but are not limited to, the following:

- our history of losses and no assurance of future profitability;

- our ability to maintain a sufficient amount of capital and liquidity to meet our operating and capital requirement and growth needs;

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- our ability to successfully and timely develop, market and operate PowerSecure's systems, including its products, services, and technologies;
- the effects of pending and future litigation;
- our limited operating history in our PowerSecure business;
- the effects of changes in utility tariffs in the regions in which PowerSecure sells its distributed generation systems;
- our ability to develop, on a profitable basis, Metretek Florida's InvisiConnect and contract manufacturing businesses;
- the complexity, uncertainty and time constraints associated with the development and market acceptance of new product and service designs and technologies;
- the effects of intense competition in our markets, including the introduction of competitors' products, services and technologies and our timely and successful response thereto, and our ability to successfully compete in those markets;
- utility purchasing patterns and delays and potential changes to the federal and state regulatory frameworks within which the utility industry operates;
- fluctuations in our operating results, and the long and variable sales cycles of many of our products and services;
- restrictions imposed on us and our ability to raise additional capital by the terms of our Series B Preferred Stock, our Credit Facility, and the Private Placement;
- the negative effect that dividends on our Series B Preferred Stock have on our results of operations;
- the effect of rapid technologic changes on our ability to maintain competitive products, services and technologies;
- our ability to attract, retain and motivate key management, technical and other critical personnel;
- our ability to secure and maintain key contracts, business relationships and alliances;
- our ability to make successful acquisitions and in the future to successfully integrate and utilize any acquired product lines, key employees and businesses;
- changes in the energy industry in general, and technological and market changes in the natural gas and electricity industries in particular;
- the impact and timing of the deregulation of the natural gas and electricity markets;
- our ability to manage the anticipated growth of PowerSecure;
- our ability to obtain adequate supplies of key components and materials for our products on a timely and cost-effective basis;

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- the capital resources, technological requirements, and internal business plans of the natural gas and electricity utilities industry;
- general economic and business conditions, including downturns in market conditions;
- effects of changes in product mix on our expected gross margins and net income;
- risks inherent in international operations;
- risks associated with our management of private energy programs;
- the receipt, timing and size of future customer orders;
- unexpected events affecting our ability to obtain funds from operations, debt or equity

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to finance operations, pay interest and other obligations, and fund needed capital expenditures and other investments;

- our ability to protect our technology, including our proprietary information and our intellectual property rights;
- the effects of recent terrorist activities and military actions;
- the impact of current and future laws and government regulations affecting the energy industry in general and the natural gas and electricity industries in particular;
- the effect of changes in laws, regulations and financial accounting standards; and
- other risks, uncertainties and other factors that are discussed in this Report or that are discussed from time to time in our other reports and documents we file with or furnish to the SEC and the exhibits to such filings, including but not limited to our Annual Report on Form 10-K for the fiscal year ended December 31, 2003.

Any forward-looking statements contained in this Report speak only as of the date of this Report, and any other forward-looking statements we make from time to time in the future speaks only as of the date it is made. We do not intend, and we undertake no duty or obligation, to update or revise any forward-looking statement for any reason, whether as a result of changes in our expectations or the underlying assumptions, the receipt of new information, occurrence of future or unanticipated events, circumstances or conditions or otherwise.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to certain financial instrument market risks, primarily due to changes in interest rates, which may adversely affect our financial condition, results of operations and cash flow. Our exposure to market risk for changes in interest rates relates primarily to (i) income from our investments in short-term interest-bearing marketable securities, the income from which is dependent upon the interest rate of the securities held, and (ii) interest expenses attributable to its long-term debt, including our Credit Facility, which is based on floating interest rates as described in "Item 2. Management's

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Discussion and Analysis and Results of Operations" above. Since substantially all of our revenues, expenses and capital spending are transacted in U.S. dollars, we are not exposed to significant foreign exchange risk. We do not believe that our exposure to commodity price changes is material. We do not use derivative financial instruments to manage exposure to interest rate changes, or for trading or other speculative purposes.

ITEM 4. CONTROLS AND PROCEDURES

Our Chief Executive Officer and our Chief Financial Officer evaluated our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Act of 1934, as amended (the "Exchange Act")) as of March 31, 2004, the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

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When designing and evaluating controls and procedures, we make assumptions about the likelihood of future events. At the same time, we make judgments about the cost-benefit relationship of possible controls and procedures. We cannot assure that this design will succeed in achieving its stated goals under all potential future conditions. Similarly, we cannot assure that our evaluation of controls will detect all control issues or instances of fraud, if any.

During the quarter ended June 30, 2004, no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) occurred that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we are involved in disputes and legal proceedings. For a description of these legal proceedings, see Note 3 to our consolidated financial statements, "Commitments and Contingencies," which is contained in Part I of this Report and incorporated herein by this reference.

ITEM 2. CHANGES IN SECURITIES, USE OF PROCEEDS AND ISSUER PURCHASES OF EQUITY SECURITIES

On May 6, 2004, we completed a Private Placement to institutional and accredited investors of 3,510,548 shares of our Common Stock and warrants to purchase 702,109 shares of our Common Stock, raising gross proceeds of \$10,883,000. The price paid in the Private Placement was \$3.10 per unit, each unit consisting of one share of Common Stock and a warrant to purchase 0.2 shares of Common Stock. Roth Capital Partners, LLC acted as placement agent in the Private Placement.

We received net cash proceeds of \$9,849,000 from the Private Placement, after deducting transaction expenses including the placement agent's fee. The

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net proceeds from the Private Placement are intended to be used principally to meet our mandatory redemption obligations related to our Series B Preferred Stock, which matures on December 9, 2004, and for other business commitments and initiatives.

The warrants issued in the Private Placement have an exercise price of \$3.41 per share of common stock and expire in May 2009. The warrants are callable by us commencing one year after issuance if the trading price of our Common Stock is at least two times the warrant exercise price for 30 consecutive trading days and certain other conditions are satisfied. In addition to the warrants issued to the investors, we issued warrants to purchase up to 351,055 shares of Common Stock to the placement agent, which warrants are on the same basic terms as the warrants issued to the investors. We filed a registration statement with the Securities and Exchange Commission (the "SEC"), which registration statement has been declared effective by the SEC, covering resales from time to time of shares of Common Stock issued in the Private Placement or upon the exercise of the warrants.

In addition, as a condition precedent to the closing of the Private Placement, certain holders of our outstanding shares of Series B Preferred Stock converted a total of 2,500 shares of Series B Preferred Stock, including accrued and unpaid dividends thereon. The purpose of this conversion was to reduce our potential preferred stock mandatory redemption liability at the Mandatory Redemption Date from approximately \$10.3 million to approximately \$6.6 million, a reduction of \$3.7 million. Upon conversion, the converting Preferred Stockholders received

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1,209,133 shares of Common Stock (inclusive of 55,871 Additional Shares intended to compensate the converting Preferred Stockholders for dividends that they would otherwise receive on the converted preferred shares between the Private Placement closing date and the Mandatory Redemption Date) and new warrants to purchase 1,209,133 shares of Common Stock. The new warrants may be exercised at a strike price of \$3.0571 per share of Common Stock and expire on June 9, 2005. The strike price of the new warrants is the same price as the conversion price of the Series B Preferred Stock. The Company included both the Additional Shares and the shares of Common Stock issuable upon exercise of the new warrants in the registration statement filed with the SEC in connection with the Private Placement.

The sales and issuances of common stock and warrants to purchase common stock in the foregoing private placement was made by us in reliance upon the exemptions from registration provided under Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act"), and Rule 506 of Regulation D under the Securities Act. The offers and sales were made to accredited investors as defined in Rule 501(a) under the Securities Act, no general solicitation was made by us or any person acting on our behalf; the securities sold were subject to transfer restrictions, and the certificates for those securities contained an appropriate legend stating that they had not been registered under the Securities Act and may not be offered or sold absent registration or pursuant to an exemption therefrom.

Pursuant to the authorization of the Company's Board of Directors, and in order to prevent the Private Placement and the conversion of the shares of Series B Preferred Stock or the acq