

ELECTRIC CITY CORP  
Form 10-Q  
May 13, 2004

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

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**Form 10-Q**

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

**For the quarterly period ended March 31, 2004**

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

**Commission file number 000-2791**

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**ELECTRIC CITY CORP.**

(Exact name of small business issuer as specified in its charter)

**Delaware** **36-4197337**  
(State or other jurisdiction of incorporation or (I.R.S. Employer Identification No.)  
organization)

**1280 Landmeier Road, Elk Grove Village, Illinois 60007-2410**  
(Address of principal executive offices)

**(847) 437-1666**  
(Issuer's telephone number)

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(Former name, former address and former fiscal year, if changed since last report)

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 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 x No o

Indicate by check mark whether the registrant is an accelerated filer (as defined by Rule 12b-2 of the Exchange Act) Yes x No o

40,922,022 shares of the registrant's common stock, \$.0001 par value per share, were outstanding as of March 31, 2004.

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**ELECTRIC CITY CORP.**  
**FORM 10-Q**  
For The Quarter Ended March 31, 2004

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**ELECTRIC CITY CORP.  
CONDENSED CONSOLIDATED BALANCE SHEET**

	<b>March 31, 2004 (unaudited)</b>	<b>December 31, 2003(1)</b>
	<hr/>	<hr/>
<b>Liabilities and Stockholders Equity</b>		
<b>Current Liabilities</b>		
Current maturities of long-term debt	\$ 1,005,017	\$ 536,809
Accounts payable	1,131,811	1,298,821
Accrued expenses	639,180	541,588
Deferred revenue	389,935	383,308
Customer deposits	500,000	511,167
	<hr/>	<hr/>
<b>Total Current Liabilities</b>	<b>3,665,943</b>	<b>3,271,693</b>
	<hr/>	<hr/>
<b>Deferred Revenue</b>	<b>216,666</b>	<b>229,166</b>
<b>Long-Term Debt</b> , less current maturities, net of unamortized discount of \$125,942 and \$241,775 at March 31, 2004 and December 31, 2003, respectively	<b>178,836</b>	<b>811,836</b>
	<hr/>	<hr/>
<b>Total Liabilities</b>	<b>4,061,445</b>	<b>4,312,695</b>
	<hr/>	<hr/>
<b>Stockholders Equity</b>		
Preferred stock, \$.01 par value; 5,000,000 shares authorized Series A 0 and 2,396,590 shares issued and outstanding as of March 31, 2004 and December 31, 2003, respectively		<b>23,966</b>
Series C 0 and 233,614 issued and outstanding as of March 31, 2004 and December 31, 2003, respectively		<b>2,336</b>
Series D 0 and 157,769 issued and outstanding as of March 31, 2004 and December 31, 2003, respectively		<b>1,578</b>
Series E 217,030 and 0 issued and outstanding as of March 31, 2004 and December 31, 2003, respectively (liquidation value of \$43,406,000 and \$0 at March 31, 2004 and December 31, 2003, respectively)	<b>2,171</b>	
Common stock, \$.0001 par value; 120,000,000 shares authorized, 40,922,022 and 34,342,022 issued as of March 31, 2004 and December 31, 2003, respectively	<b>4,094</b>	<b>3,436</b>
Additional paid-in capital	<b>54,880,419</b>	<b>51,376,137</b>
Accumulated deficit	<b>(49,724,249)</b>	<b>(48,366,521)</b>
	<hr/>	<hr/>

<b>Total Stockholders</b>	<b>Equity</b>	<b>5,162,435</b>	<b>3,040,932</b>
		<u>                    </u>	<u>                    </u>
		<b>\$ 9,223,880</b>	<b>\$ 7,353,627</b>
		<u>                    </u>	<u>                    </u>

*See accompanying notes to condensed consolidated financial statements*

*(1) Derived from audited financial statements in the Company's annual report on Form 10-KSB for the year ended December 31, 2003*

Table of Contents**ELECTRIC CITY CORP.****CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS****(Unaudited)**

<b>Three months ended, March 31</b>	<b>2004</b>	<b>2003</b>
<b>Revenue</b>	<b>\$ 816,242</b>	<b>\$ 1,150,752</b>
<b>Expenses</b>		
Cost of sales	786,009	1,116,504
Selling, general and administrative	1,027,639	1,021,326
	<u>1,813,648</u>	<u>2,137,830</u>
Operating loss	<u>(997,406)</u>	<u>(987,078)</u>
<b>Other Income (Expense)</b>		
Interest income	4,364	1,667
Interest expense	(364,686)	(14,107)
Total other income (expense)	<u>(360,322)</u>	<u>(12,440)</u>
Loss from continuing operations	<u>(1,357,728)</u>	<u>(999,518)</u>
<b>Discontinued Operations</b>		
Loss from discontinued operations	<u>(244,811)</u>	<u>(244,811)</u>
	<u>(244,811)</u>	<u>(244,811)</u>
<b>Net Loss</b>	<u>(1,357,728)</u>	<u>(1,244,329)</u>
<b>Plus Preferred Stock Dividends</b>	<u>(3,164,021)</u>	<u>(833,992)</u>
<b>Net Loss Available to Common Shareholder</b>	<u>\$ (4,521,749)</u>	<u>\$ (2,078,321)</u>
	<b>\$ (0.13)</b>	<b>\$ (0.05)</b>

Basic and diluted loss per common share from continuing operations		
Discontinued operations		(0.01)
<b>Basic and Diluted Net Loss Per Common Share</b>	<b>\$ (0.13)</b>	<b>\$ (0.06)</b>
	<u>                    </u>	<u>                    </u>
<b>Weighted Average Common Shares Outstanding</b>	<b>35,551,362</b>	<b>32,681,886</b>
	<u>                    </u>	<u>                    </u>

*See accompanying notes to condensed consolidated financial statements*



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(Unaudited)**

	<b>Common Shares</b>	<b>Common Stock</b>	<b>Series A Preferred Shares</b>	<b>Series A Preferred Stock</b>	<b>Series C Preferred Shares</b>	<b>Series C Preferred Stock</b>
<b>Balance</b> , December 31, 2003	34,342,022	\$3,436	2,396,590	\$ 23,966	233,614	\$ 2,336
Issuance of common stock (net of offering costs of \$796,363)	5,000,000	500				
Conversion of Series A Preferred Stock	1,450,000	145	(145,000)	(1,450)		
Redemption of preferred stock			(514,375)	(5,144)		
Exchange of preferred stock			(1,737,215)	(17,372)	(233,614)	(2,336)
Cumulative dividends on preferred stock						
Satisfaction of accrued dividends through the issuance of preferred stock						
Conversion of term note	130,000	13				
Net loss for the three months ended March 31, 2004						
<b>Balance</b> , March 31, 2004	<u>40,922,022</u>	<u>\$4,094</u>		<u>\$</u>		<u>\$</u>

[Additional columns below]

[Continued from above table, first column(s) repeated]

	<b>Series D Preferred Shares</b>	<b>Series D Preferred Stock</b>	<b>Series E Preferred Shares</b>	<b>Series E Preferred Stock</b>	<b>Additional Paid-in Capital</b>	<b>Accumulated Deficit</b>	<b>Total Stockholders Equity</b>
<b>Balance</b> , December 31, 2003	157,769	\$ 1,578		\$	\$51,376,137	\$(48,366,521)	\$ 3,040,932
Issuance of common stock (net					10,203,137		10,203,637

of offering costs of \$796,363)							
Conversion of Series A Preferred Stock					1,305		
Redemption of preferred stock	(24,087)	(241)			(6,994,621)		(7,000,006)
Exchange of preferred stock	(133,682)	(1,337)	210,451	2,105	18,940		
Cumulative dividends on preferred stock					(657,900)		(657,900)
Satisfaction of accrued dividends through the issuance of preferred stock			6,579	66	657,834		657,900
Conversion of term note					275,587		275,600
Net loss for the three months ended March 31, 2004						(1,357,728)	(1,357,728)
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
<b>Balance, March 31, 2004</b>		\$	217,030	\$2,171	\$54,880,419	\$(49,724,249)	\$ 5,162,435
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>

*See accompanying notes to condensed consolidated financial statements.*

Table of Contents**ELECTRIC CITY CORP.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

<b>Three months ended March 31</b>	<b>2004</b>	<b>2003</b>
<b>Cash Flow from Operating Activities</b>		
Net loss	\$ (1,357,728)	\$(1,244,329)
Adjustments to reconcile net loss to net cash used in operating activities, net of asset disposals		
Depreciation and amortization	14,208	45,015
Provision for bad debt	239	5,726
Warrants issued in exchange for services received		58,500
Amortization of deferred financing costs	231,218	
Amortization of original issue discount	115,834	
Accrued interest converted to common stock	4,737	
Changes in assets and liabilities, net of dispositions		
Accounts receivable	70,624	(87,718)
Inventories	(74,041)	139,996
Other current assets	(52,428)	(51,701)
Accounts payable	(167,010)	204,160
Accrued expenses	97,592	(254,036)
Deferred revenue	(5,873)	(12,498)
Other current liabilities	(11,167)	
Net cash used in operating activities	(1,133,795)	(1,196,885)
<b>Cash Flows Used In Investing Activities</b>		
Purchase of property and equipment	(8,875)	
Net cash provided by (used in) investing activities	(8,875)	
<b>Cash Flows Provided by (Used in) Financing Activities</b>		
Payment on long-term debt	(9,763)	(37,676)
Preferred stock redemption	(7,000,006)	
Proceeds from issuance of common stock	11,000,000	1,000,000
Issuance costs related to stock issuances	(796,363)	(95,690)
Short-swing profit contribution		798
Net cash provided by financing activities	3,193,868	867,432

	<u>                    </u>	<u>                    </u>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>2,051,198</b>	<b>(329,453)</b>
<b>Cash and Cash Equivalents, at beginning of period</b>	<b>2,467,023</b>	<b>1,555,904</b>
	<u>                    </u>	<u>                    </u>
<b>Cash and Cash Equivalents, at end of period</b>	<b>\$ 4,518,221</b>	<b>\$ 1,226,451</b>
	<u>                    </u>	<u>                    </u>
<b>Supplemental Disclosure of Cash Flow Information</b>		
Cash paid during the periods for interest	\$ 12,106	\$ 14,143
Cash paid during the periods for interest discontinued operations		4,577
<b>Supplemental Disclosures of Noncash Investing and Financing Activities</b>		
Conversion of convertible debt to common stock	\$ 270,863	\$
Accrued interest satisfied through the issuance of common stock	17,481	
In February and March of 2004, certain holders of Series A preferred stock converted 145,000 shares of Series A preferred stock into 1,450,000 shares of the Company's common stock.		

*See accompanying notes to condensed consolidated financial statements*

**Table of Contents****Electric City Corp.****Notes to Financial Statements*****Note 1 Basis of Presentation***

The financial information included herein is unaudited; however, such information reflects all adjustments (consisting solely of normal recurring adjustments), which, in the opinion of management, are necessary for a fair statement of results for the interim periods.

The results of operations for the three months ended March 31, 2004 and 2003 are not necessarily indicative of the results to be expected for the full year.

For further information, refer to the audited financial statements and the related footnotes included in the Electric City Corp. Annual Report on Form 10-KSB, for the year ended December 31, 2003.

***Note 2 - Stock-based Compensation***

At March 31, 2004, the Company had a stock-based compensation plan, which is more fully described in Note 16 in the Company's Annual Report on Form 10-KSB as filed on March 31, 2003. The Company applies and intends to continue to apply the recognition and intrinsic value measurement principles of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations in accounting for those plans. No stock-based compensation expense was reflected in the net loss for the three month periods ended March 31, 2004 or March 31, 2003, as all options granted under the plan had an exercise price equal to or greater than the market value of the underlying common stock on the date of the grant. The following table illustrates the effect on the net loss and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation, to stock-based compensation:

	<b>Three Months Ended</b>	
	<b>March 31</b>	
	<b>2004</b>	<b>2003</b>
	<hr/>	<hr/>
Net Loss, as reported	\$(1,358,000)	\$(1,244,000)
Deduct: Stock-based employee compensation expense included in reported net loss		
Add: Total stock-based employee compensation (expense) income determined under fair value based method for awards (1)	(135,000)	(259,000)
	<hr/>	<hr/>
Net Loss, pro-forma	(1,493,000)	(1,503,000)
Preferred stock dividends	(3,164,000)	(834,000)
	<hr/>	<hr/>
Net Loss Available to Common Shareholder	\$(4,657,000)	(2,337,000)

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Net loss per share			
Basic and diluted	as reported	\$ (0.13)	\$ (0.06)
Basic and diluted	pro forma	\$ (0.13)	\$ (0.07)

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<sup>1</sup> All awards refer to awards granted, modified, or settled in fiscal periods beginning after December 15, 1994 that is, awards for which the fair value was required to be measured and disclosed under Statement 123.

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**Table of Contents*****Note 3 - Recent Accounting Pronouncements***

In March, 2004, the FASB issued an exposure document entitled *Share-Based Payment - an amendment of Statements No. 123 and 95 (Proposed Statement of Financial Accounting Standards)*. The proposed Statement would eliminate the ability to account for share-based compensation transactions using APB Opinion No. 25 and generally require instead that such transactions be accounted for using a fair-value-based method. This accounting, if approved, will result in compensation expense charges to our future results of operations. The proposed Statement, if adopted, would be applied to public entities prospectively for fiscal years beginning after December 15, 2004, as if all share-based compensation awards granted, modified, or settled after December 15, 1994, had been accounted for using the fair-value method of accounting. Retrospective application of the proposed Statement is not permitted.

***Note 4 Net Loss Per Share***

The Company computes loss per share under Statement of Financial Accounting Standards (SFAS) No. 128 Earnings Per Share, which requires presentation of two amounts: basic and diluted loss per common share. Basic loss per common share is computed by dividing loss available to common stockholders by the number of weighted average common shares outstanding, and includes all common stock issued. Diluted earnings would include all common stock equivalents. The Company has not included the outstanding options, warrants or shares issuable upon conversion of the preferred stock and convertible debt as common stock equivalents in the computation of diluted loss per share for the three months ended March 31, 2004 and 2003 because the effect would be antidilutive.

The following table sets forth the weighted average shares issuable upon exercise of outstanding options and warrants and conversion of preferred stock and convertible debt that are not included in the basic and diluted loss per share available to common stockholders because to do so would be antidilutive:

	<b>Three Months Ended March 31</b>	
	<b>2004</b>	<b>2003</b>
	<hr/>	<hr/>
Weighted average shares issuable upon exercise of outstanding options	10,417,895	10,223,848
Weighted average shares issuable upon exercise of outstanding warrants	9,994,867	8,664,622
Weighted average shares issuable upon conversion of preferred stock	26,940,366	23,834,970
Weighted average shares issuable upon conversion of convertible debt	348,578	<hr/>
	<hr/>	<hr/>
Total	<b>47,701,706</b>	<b>42,723,440</b>
	<hr/>	<hr/>





**Table of Contents*****Note 5 - Warranty Obligations***

The Company warrants to the purchasers of its EnergySaver line of products that the product will be free of defects in material and workmanship for one year from the date of installation. The Company records the estimated cost that may be incurred under its warranties at the time the product revenue is recognized based upon the relationship between historical and anticipated warranty costs and sales volumes. The Company periodically assesses the adequacy of its recorded warranty liability and adjusts the amounts as necessary. While the Company believes that its estimated liability for product warranties is adequate and that the judgment applied is appropriate, the estimated liability for product warranties could differ materially from actual future warranty costs. Changes in the Company's warranty liability are as follows:

	<b>Three Months Ended</b>	
	<b>March 31</b>	
	<b>2004</b>	<b>2003</b>
Balance, beginning of year	\$ 121,702	\$ 107,127
Warranties issued	8,250	12,250
Settlements	(3,217)	(15,932)
	<u>          </u>	<u>          </u>
Balance, as of March 31	<u>\$ 126,735</u>	<u>\$ 103,445</u>

***Note 6 - Inventories***

Inventories consisted of the following:

	<b>March 31,</b>	<b>December 31,</b>
	<b>2004</b>	<b>2003</b>
Raw materials	\$ 508,313	\$ 496,906
Work in process	5,850	12,817
Finished goods	760,024	690,423
	<u>          </u>	<u>          </u>
	<u>\$ 1,274,187</u>	<u>\$ 1,200,146</u>

**Table of Contents*****Note 7 - Dividends***

Dividends are comprised of the following:

	<b>Three Months Ended March 31</b>	
	<b>2004</b>	<b>2003</b>
Accrual of Dividend on Series A Convertible Preferred	\$ 540,705	\$542,798
Accrual of Dividend on Series C Convertible Preferred	53,206	52,911
Accrual of Dividend on Series D Convertible Preferred	35,932	
Accrual of Dividend on Series E Convertible Preferred	28,057	
Deemed dividend associated with beneficial conversion price on shares issued in satisfaction of convertible preferred dividends	638,163	238,283
Deemed dividend associated with the redemption and exchange of outstanding preferred stock	1,860,458	
Deemed dividend associated with change in the expiration date of warrants to purchase shares of preferred stock	7,500	
	<hr/>	<hr/>
Total	<b>\$3,164,021</b>	<b>\$833,992</b>

**Table of Contents****Note 8 Business Segment Information**

The Company organizes and manages its business in two distinct segments: the Energy Technology segment, and the Building Control and Automation segment. In classifying its operational entities into a particular segment, the Company segregated its businesses with similar economic characteristics, products and services, production processes, customers, and methods of distribution into distinct operating groups.

The Energy Technology segment designs, manufactures and markets energy saving technologies, primarily to commercial and industrial customers. The principal products produced and marketed by this segment are the EnergySaver, the Global Commander and negative power systems under the trade name, Virtual Negawatt Power Plan or VNPP. This segment is headquartered, and most of its operations are located, in Elk Grove Village, Illinois.

The Building Control and Automation segment, which is comprised of our Great Lakes Controlled Energy subsidiary, provides integration of building and environmental control systems for commercial and industrial customers. Great Lakes Controlled Energy is headquartered in, and operates out of its own facility, located in Elk Grove Village, Illinois.

Prior to fiscal year 2003, the Company's reportable segments included the Power Management segment, which designed, manufactured and marketed a wide range of commercial and industrial switching gear and distribution panels. Effective May 31, 2003, the Company divested this segment, accordingly, the net assets and operating results have been separately reported as discontinued operations. Prior year segment information has been restated to reflect corporate costs previously allocated to the Power Management segment, which will continue despite the divestiture of the segment.

The following is the Company's business segment information:

	<b>Three Months Ended</b>	
	<b>March 31</b>	
	<b>2004</b>	<b>2003</b>
	<hr/>	<hr/>
Revenues:		
Energy Technology	\$ 323,000	\$ 485,000
Building Automation Controls	493,000	677,000
Intercompany sales - Energy Technology		(5,000)
Intercompany sales - Building Control and Automation		(6,000)
	<hr/>	<hr/>
Total	816,000	1,151,000
Operating Loss:		
Energy Technology	(513,000)	(521,000)
Building Automation Controls	(148,000)	(129,000)
Corporate Overhead	(377,000)	(337,000)
	<hr/>	<hr/>
Total	(998,000)	(987,000)
Interest Expense, net	(360,000)	(13,000)

	_____	_____
Loss from continuing operations	\$(1,358,000)	\$(1,000,000)
	<u>                    </u>	<u>                    </u>

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	<u>March 31, 2004</u>	<u>December 31, 2003</u>
Total Assets:		
Energy Technology	7,735,000	5,824,000
Building Automation Controls	1,489,000	1,530,000
	<u>                    </u>	<u>                    </u>
Total	<u>\$9,224,000</u>	<u>\$7,354,000</u>

**Note 9 Private Placement and Redemption and Exchange Offer**

On March 19, 2004, the Company entered into a securities purchase agreement with a group of four mutual funds managed by Security Benefit Group, Inc. ( Security Benefit ), whereby the Company issued to such purchasers, in exchange for \$11,000,000 in gross proceeds, a package of securities that included 5,000,000 shares of the Company's common stock and 5 year warrants to purchase 1,750,000 additional shares of common stock at \$2.42 per share (the Common Stock Warrants ). The exercise price under the Common Stock Warrants is subject to adjustment if the Company issues shares of common stock at a price below the lower of the exercise price or the market price at the time.

Also on March 19, 2004, the Company entered into a Redemption and Exchange Agreement with the holders of its outstanding Series A Convertible Preferred Stock, Series C Convertible Preferred Stock and Series D Convertible Preferred Stock (collectively, the Existing Preferred Stock ) under which the Company agreed to redeem 538,462 shares of Existing Preferred Stock at a price of \$13 per share (the Redemption ) and to exchange shares of its newly authorized Series E Convertible Preferred Stock (the Series E Preferred ) for all remaining outstanding shares of Existing Preferred Stock (the Exchange ) on a 1 for 10 basis (one share of Series E Preferred exchanged for 10 shares of Existing Preferred Stock). The Company used \$7 million of the proceeds from the issuance of securities to Security Benefit to accomplish the Redemption, which closed on March 22, 2004.

Under the Redemption and Exchange transaction, the Company redeemed 538,462 shares of its outstanding Existing Preferred Stock which were convertible into 5,384,620 shares of common stock, at a price equivalent to \$1.30 per common share, and exchanged 210,451 shares of the new Series E Preferred) for the remaining 2,104,509 outstanding shares of the Existing Preferred Stock. All of the Existing Preferred Stock has been cancelled. The Series E Preferred has substantially the same rights as the shares of Existing Preferred Stock that it replaced, including:

special approval rights in respect of certain actions by the Company, including any issuance of shares of capital stock by the Company that would have the right to receive dividends or the right to participate in any distribution upon liquidation which was senior to or equal to the rights of the Series E Preferred (other than issuances to pay dividends on the preferred and under certain other limited exceptions such as conversion of outstanding convertible securities) and any acquisition, sale, merger, joint venture, consolidation or reorganization involving the Company or any of its subsidiaries;

a conversion price equivalent to \$1.00 per share;

the right to elect up to four directors;

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

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

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anti-dilution protection that would adjust the conversion price in the event we issue equity at a price which is less than the conversion price .

The Exchange was effected on a 1 for 10 basis: whereas each share of the Existing Preferred Stock was convertible into 10 shares of Common Stock and had a liquidation preference of \$20 per share, each share of the Series E Preferred is convertible into 100 shares of Common Stock and has a liquidation preference of \$200 per share. As part of the Exchange, all outstanding warrants to purchase shares of Series D Convertible Preferred Stock were exchanged for similar warrants to purchase shares of Series E Preferred, but the expiration date was extended from June 30, 2004 to October 31, 2004. Such Series E warrants issued are exercisable for an aggregate of 3,750 shares of Series E Preferred at a price of \$100 per share. They replaced warrants exercisable for 37,500 shares of Series D Preferred at an exercise price of \$10 per share.

In addition the Existing Preferred Stock carried a dividend rate of 10% payable at the Company's election in cash or in additional shares of preferred stock during the first three years following issuance. After the third anniversary of issuance we were required to pay all dividends in cash and the dividend rate increased by ½% every six months until it reached 15%, where it would remain until the shares were converted or redeemed. The Series E Preferred carries a 6% dividend that is payable at the Company's election in cash or additional shares of Series E Preferred for as long as the shares remain outstanding.

The following table summarizes the change in outstanding shares that resulted from this series of transactions:

	<b>Number of Shares (1)</b>		
	<b>Prior to Transactions</b>	<b>After the Transactions</b>	<b>Change</b>
Preferred A	22,515,890	0	(22,515,890)
Preferred C	2,336,130	0	(2,336,130)
Preferred D	1,577,690	0	(1,577,690)
Preferred E	0	21,046,900	21,046,900
	<hr/>	<hr/>	<hr/>
Total preferred	26,429,710	21,046,900	(5,382,810)
Common stock	35,922,022	40,922,022	5,000,000
	<hr/>	<hr/>	<hr/>
Total shares outstanding	62,351,732	61,968,922	(382,810)
Total shares issuable under outstanding options and warrants	19,992,048	21,742,048	1,750,000
	<hr/>	<hr/>	<hr/>
Total shares issued or issuable	82,343,780	83,710,970	1,367,190
	<hr/>	<hr/>	<hr/>

(1) All shares presented on an as converted basis

The dilutive effect of the payment-in-kind dividend on the preferred stock will be reduced significantly as a result of the Redemption because of the lower dividend rate on the Series E Preferred stock. Based on the terms and number of shares of the Existing Preferred outstanding prior to the Redemption and Exchange, if the Company continued to pay preferred dividends by issuing additional preferred shares, the Company would have issued shares of preferred stock convertible into 10,306,790 shares of common



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stock over the next three years, whereas it only expects to issue shares of Series E preferred convertible into 4,473,919 shares of common stock over the same period, a reduction of 5,832,871 shares or 56.6%.

As part of the Redemption and Exchange, the preferred stockholders agreed to amend and restate their existing stock trading agreements, effectively replacing them with a new three year agreement containing volume and price limitations which become effective on September 8, 2004 after the original expiration date of September 7, 2004. The Investor Rights Agreement and the Stockholders Agreement among the Company, the preferred stockholders and certain other parties were also amended and restated as part of the Redemption and Exchange, principally to reflect the changes in the outstanding preferred stock resulting from the transactions.

For accounting purposes the Redemption and Exchange transaction was viewed as a redemption for cash and shares of Series E preferred stock. As a result of the transaction the Company incurred a non-cash deemed dividend of \$1,860,458. This non-cash deemed dividend was determined by comparing the fair value of the consideration given (the cash and the market value of the Series E Preferred) to the carrying value of the Existing Preferred Stock. The fair value of the consideration given exceeded the carrying value of the Existing Preferred primarily due to the fact that the market price of the Company's common stock was higher on the day the Redemption and Exchange transaction closed than it was when the Existing Preferred Stock was originally issued. The deemed dividend was recorded as offsetting charges and credits to additional paid-in capital, without any effect on total stockholders' equity.

Morgan Keegan & Company, Inc. acted as placement agent for the Company with respect to the transaction and was paid a placement agent fee of \$660,000. The Stockpage.com was also paid a finder's fee of \$55,000 related to the transaction. Other issuance costs related to the transaction totaled \$81,363.

***Note 10 Equity Issuances***

On January 2, 2004, Laurus Master Funds converted \$63,600 of principal on the Company's Convertible Term Note into 30,000 shares of common stock.

On January 28, 2004, Laurus Master Funds converted \$207,263 of principal and \$4,737 of accrued interest on the Company's Convertible Term Note into 100,000 shares of common stock.

On February 10, 2004, a holder of the Company's Series A Convertible Preferred Stock converted 45,000 shares of Series A Convertible Preferred Stock into 450,000 shares of common stock.

On March 19, 2004, two holders of the Company's Series A Convertible Preferred Stock converted 100,000 shares of Series A Convertible Preferred Stock into 1,000,000 shares of common stock.

On March 19, 2004, the Company entered into a securities purchase agreement with a group of four mutual funds managed by Security Benefit Group, Inc., as described in Note 9 above.

On March 19, 2004, the Company entered into a Redemption and Exchange Agreement with the holders of its outstanding Series A Convertible Preferred Stock, Series C Convertible Preferred Stock and Series D Convertible Preferred Stock as described in Note 9 above.

On April 7, 2004, the Board of Directors declared dividends payable on our Series E Convertible Preferred Stock for the calendar quarter ending March 31, 2004 to shareholders of record of our Series E Convertible Preferred Stock as of March 31, 2004. The dividends were paid with 6,579 additional shares of Series E Convertible Preferred Stock. Each share of Series E Convertible Preferred Stock is convertible into 100 shares of our common stock. The Company recorded a non-cash deemed dividend of



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\$638,163 related to the issuance of these dividend shares due to the fact that the conversion price on the dividend shares was lower than the market price of the Company's common stock on the date of issue.

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

You should read the following discussion regarding the Company along with the Company's financial statements and related notes included in this quarterly report. This quarterly report, including the following discussion, contains forward-looking statements that are subject to risks, uncertainties and assumptions. The Company's actual results, performance and achievements in 2003 and beyond may differ materially from those expressed in, or implied by, these forward-looking statements. See Cautionary Note Regarding Forward-Looking Statements.

### **Overview**

We are a developer, manufacturer and integrator of energy savings technologies, and building automation systems as well as an independent developer of scalable, negative power systems. We currently market the EnergySaver, and the GlobalCommander energy conservation technologies, as well as our independent development of scalable, negative power systems under the trade name, Virtual Negawatt Power Plan or VNPP. Electric City is based in Elk Grove Village, Illinois and is traded on The American Stock Exchange under the symbol ELC. Our premier energy saving product is the EnergySaver system, which reduces energy consumed by lighting, typically by 20% to 30%, with minimal reduction in lighting levels. This technology has applications in commercial buildings, factories and office structures, as well as street lighting and parking lot lighting. Combining the technologies of the EnergySaver and GlobalCommander led to the development of our Virtual Negawatt Power Plan concept, which is essentially a negative power system which we intend to market primarily to utilities as a demand response system. It is envisioned that the demand reduction could be specifically placed across a utility grid targeting potential hot spots such as particular feeders or substations. We believe that the Electric City VNPP will be the first demand response system to provide this level of control to a utility without requiring active customer participation and without impacting a customer's operations or ability to do business. The VNPP can be developed in conjunction with a utility provider, a utility's independent power subsidiary or with other sister companies within a utility family. In some markets, the VNPP can be developed completely at risk just as the industry has seen the development of independent power plants or with a long-term negative power purchase agreement with a utility. We recently entered into an agreement with Commonwealth Edison (ComEd) to develop the first 50-megawatt VNPP system, to be located in northern Illinois. We anticipate that approximately 1,500 EnergySavers will be required to deliver the 50 megawatts of curtailment envisioned under this contract. We have begun to install EnergySavers under this program and expect to complete the installation of units over the next 18 to 24 months. In addition to our EnergySaver system, we design, install and monitor building control and environmental systems through our subsidiary Great Lakes Controlled Energy Corporation (Great Lakes).

### **Results of Operations**

Our revenues reflect the sale of our products, net of allowances for returns and other adjustments. Revenues of Electric City and its subsidiary are generated from the sale of products and services, the vast majority of which are sold in the U.S.

Our cost of goods sold consists primarily of materials and labor. Also included in our cost of goods sold are freight, charges from third parties for installation of our products, costs of operating our manufacturing facility, charges for potential future warranty claims, and royalty costs related to



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EnergySaver sales. Cost of goods sold also includes the wages and expenses of our engineering group at Great Lakes.

Sales and gross profits depend, in part, on the volume and mix of products sold during any given period. Generally, products that we manufacture have a higher gross profit margin than products that we purchase and resell.

A portion of our operating expense is relatively fixed, such as the cost of our facilities. Accordingly, an increase in the volume of sales will generally result in an increase to our gross margins since these fixed expenses do not increase proportionately with sales. We have not consistently utilized the manufacturing capacity of our facility and, therefore, believe that the fixed nature of some of our expenses would contribute to an increase in our gross margin in future periods if sales volumes increase. In particular we believe that our facility in Elk Grove Village can support a sales level of EnergySaver products of approximately \$15 million to \$20 million per year without a significant further investment in fixed assets.

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

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

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

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

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

costs related with marketing and advertising our products;

costs of outside professionals such as lawyers, accountants, and investor relations professionals;

research and development expenses;

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

Interest expense for continuing operations includes the costs and expenses associated with working capital indebtedness, the mortgage on our headquarters building, a convertible term loan, and various auto loans, all as reflected on our current and prior financial statements. Also included in interest expense is amortization of the debt discount which includes the fair value of the warrants issued to Laurus Master Funds, as well as the value of beneficial conversion feature attributed to the Convertible Term Loan. Also reported as interest expense is the amortization of deferred financing costs related to the credit facility with Laurus Master Funds.

**Three Months Ended March 31, 2004 Compared to Three Months Ended March 31, 2003.**

Our total revenue for the three-month period ended March 31, 2004 declined \$334,510 or 29.1% to \$816,242 as compared to \$1,150,752 for the quarter ended March 31, 2003. Revenue related to EnergySaver sales declined approximately \$141,000, or 32%, to approximately \$300,000 for the three months ended March 31, 2004 as compared to approximately \$441,000 for the same period in 2003. EnergySavers unit sales decreased 28% to 33 units during the first quarter of 2004 from 46 units sold during the first quarter of 2003. We believe the decline in EnergySaver revenue is primarily the result of to management s decision to shift resources to focus on the Company s new utility initiative, and in particular the ComEd VNPP. This shift created a lag in revenue due to the startup of our ComEd VNPP. The ComEd VNPP agreement was finalized during the third quarter of 2003 and as a result the Company s in

house sales resources have been actively seeking customers to participate in the newly created program. We began shipment of EnergySavers as part of the ComEd program late in 2003 with continued shipments during the first quarter of 2004, but we have not recognized revenue on any of these shipments.

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We are currently negotiating to transfer the ComEd contract to a limited liability company (the LLC) being created by a Chicago based investment bank. The LLC will in turn purchase all the equipment installed under the ComEd program from us and effectively rent the curtailment capacity to ComEd. Under this arrangement ComEd secures a long-term source of curtailment, which among other things reduces its requirements for peak generating capacity and provides a hedge against rising fuel costs, the LLC holds a long-term contract for curtailment capacity payments from Commonwealth Edison and we receive payment for the equipment at the time of customer acceptance, thereby reducing our working capital requirements. We are currently in the process of negotiating and structuring this transaction and as a result have not yet received a firm commitment from the investment bank. We are also reviewing revenue recognition methodologies related to this transaction to determine if we will be able to recognize revenue at the time we transfer equipment to the LLC, or if we will be required to recognize revenue as service revenue over a longer period. We have targeted the second quarter of 2004 for the closing date of this transaction, at which time if we close we will transfer the first batch of installed units to the LLC and receive payment on the installed units. After the first transfer to the LLC, we anticipate transferring newly installed equipment and receiving payment on a regular basis. The ComEd agreement is expected to result in sales of approximately 1,500 units over the next 18 to 24 months. EnergySaver shipments are expected to increase significantly, beginning in the second quarter 2004, primarily as a result of the ComEd program in combination with continuing and new sales to large scalable commercial customers including among others, the Chicago Public Schools, and Xcel Energy.

Revenue from the sale of building automation products and services decreased approximately \$178,000, or 27% to \$493,000 during the three month period ended March 31, 2004, from approximately \$671,000 recorded in the same period of 2003. Revenue in this segment is recognized as work is completed and material is delivered to the job site, thus will vary based on the level of activity during a particular period. This segment completed two of the five long-term projects it was working on during the fourth quarter of 2003 and anticipates starting a new project during the second quarter of 2004. We expect the revenue for this segment to remain largely unchanged in future periods from the level realized in the most recent quarterly reporting period.

Other revenue decreased by approximately \$16,000 or 41% to \$23,000 during the three-month period ended March 31, 2004 as compared to the \$39,000 recorded during the same period in 2003. Other revenue includes revenue from the installation of EnergySavers, freight, and the pro-rata recognition of a one time payment received for the right to certain EnergySaver distributorships.

Cost of sales for the three-month period ended March 31, 2004 declined \$330,495, or 29.6% to \$786,009 from \$1,116,504 for the three-month period ended March 31, 2003. Gross profit for the first quarter of 2004 declined \$4,015 or 11.7% to \$30,233 from \$34,248 in the first quarter of 2003, but the gross margin earned on sales increased to 3.7% during 2004 from 3.0% in 2003. The decline in gross profit is primarily due to the decline in revenue. In addition, the Building Automation and Controls segment defers recognition of all job related profits until the completion of the associated project and did not complete any long-term projects during the first quarter of 2004. This segment anticipates completing one of its long-term projects during the second quarter of 2004, at which time it will recognize any profit associated with the project. Profits in the EnergySaver business are in part influenced by sales volume due to the fixed nature of our manufacturing overhead. As sales begin to increase due to the ComEd project, this fixed overhead will be spread over more sales, which should contribute to an improvement in the gross margin in this business segment.

SG&A for the three-month period ended March 31, 2004 increased \$6,313, or 0.6% to \$1,027,639, from \$1,021,326 for the three-month period ended March 31, 2003. A \$134,000 reduction in salary expense was more than offset by increases in legal and insurance costs. We expect our SG&A expense to increase slightly over the balance of the year as we add additional headcount to ensure proper execution of the contracts we recently won.





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Other expense for the three-month period ending March 31, 2004 increased \$347,882, to \$360,322 from \$12,440 for the three-month period ended March 31, 2003. Interest expense for the three-month period ended March 31, 2004 includes amortization of the deferred issuance costs and debt discount related to the Laurus convertible term loan totaling \$347,052. Interest income of \$4,364 for the first quarter of 2004 was \$2,697 higher than that recorded in the first quarter of 2003 due to higher invested cash balances.

Our dividend expense for the first quarter of 2004 increased \$2,330,029 to \$3,164,021 from \$833,992 for the same period in 2003. We accrued dividends of \$657,900 and \$595,709 on our Convertible Preferred Stock during the three-month periods ended March 31, 2004 and 2003 respectively. The increase in the dividend accrual was due primarily to an increase in the total shares outstanding as a result of the issuance of shares of the Series D Convertible Preferred in June 2003 and the issuance of shares of preferred stock in satisfaction of accrued dividends. The dividends accrued during the first quarters of 2004 and 2003 were satisfied through the issuance of 6,579 and 59,571 additional shares of our preferred stock, respectively. We were required to recognize non-cash deemed dividends of \$638,163 and \$238,283 on March 31, 2004 and 2003, respectively due to the fact that the conversion price on these shares was lower than the market price of our common stock on the date of issue. The increase in this deemed dividend is primarily the result of the increased difference in the market price of our common stock relative to the conversion price of the dividend shares. The closing market price of our stock on March 31, 2004 was \$1.97 as compared to \$1.40 on March 31, 2003. In addition, despite the fact that the redemption and exchange transaction was favorable for the Company and its common stockholders (see note 9 to the financial statements), we were required to record a non-cash deemed dividend on the transaction of \$1,860,458. For accounting purposes the transaction, which closed in March 2004, was viewed as a redemption for cash and shares of Series E Preferred stock. The non-cash deemed dividend was determined by comparing the fair value of the consideration given (the cash and the market value of the Series E Preferred) to the carrying value of the preferred stock that was redeemed. The fair value of the consideration given exceeded the carrying value of the existing preferred primarily due to the fact that the market price of our common stock was higher on the day the redemption and exchange transaction closed than it was when the existing preferred stock was originally issued. During the first quarter of 2004 we also incurred a \$7,500 deemed dividend when we agreed to extend the expiration date on warrants to purchase shares of our Series E Convertible Preferred stock from June 30, 2004 to October 31, 2004. We agreed to extend these warrants to permit holders who participated in the redemption and exchange to exercise their warrants without violating the short swing trading rules of section 16(b) of the Securities Act of 1934.

As is more fully described in Note 9 to our financial statements, we completed a redemption and exchange offering on March 22, 2004 in which we redeemed 538,462 shares of our outstanding Series A, Series C and Series D Convertible Preferred Stock (the Existing Preferred), and exchanged the remaining 2,104,509 shares of Existing Preferred into 210,451 shares of a new Series E Convertible Preferred Stock at the rate of 10 shares of Series E Convertible Preferred Stock for each share of Existing Preferred. The Existing Preferred Stock carried a dividend rate of 10% payable at the Company's election in cash or in additional shares of preferred stock during the first three years following issuance. After the third anniversary of issuance we were required to pay all dividends in cash and the dividend rate increased by 1/2% every six months until it reached 15%, where it would remain until the shares were converted or redeemed. The Series E Preferred carries a 6% dividend that is payable at the Company's election in cash or additional shares of Series E Preferred for as long as the shares remain outstanding. The reduction in the number of outstanding shares of preferred stock, in combination with the reduction in the dividend rate, will significantly reduce the dilutive effect of the payment-in-kind dividend on the preferred stock in future periods.

**Liquidity and Capital Resources**

As of March 31, 2004, we had cash and cash equivalents of \$4,518,221 compared to \$2,467,023 on December 31, 2003. Our debt obligations as of March 31, 2004 consisted of a convertible secured term



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note of \$676,790, a mortgage of \$625,000 on our facility in Elk Grove Village Illinois, and a vehicle loan of approximately \$8,000.

Our principal cash requirements are for operating expenses, including employee costs, the costs related to research and development, advertising costs, the cost of outside services including those providing accounting, legal, engineering and consulting services, and the funding of inventory and accounts receivable, and capital expenditures. We have financed our operations since inception through the private placement of our common stock, preferred stock and various secured and unsecured loans.

Net cash increased \$2,051,198 during the first three months of 2004 as compared to decreasing \$329,453 during the same period in 2003. Cash consumed by operating activities declined 5.3% to \$1,133,795 during the first three months of 2004 as compared to \$1,196,885 during the same period in 2003. Cash used to fund the net loss before changes in working capital, declined \$143,596 or 12.7%, to \$991,492 during the first three months of 2004 from \$1,135,088 during the same period in 2003. This improvement was primarily the result of the elimination of discontinued operations.

Changes in working capital consumed \$142,303 during the first three months of 2004 and \$61,797 during the same period of 2003. Declines in accounts receivable generated \$70,624 during the first three months of 2003, while increases in inventory and other current assets consumed \$74,041 and \$52,428, respectively during the same period. The decline in accounts receivable resulted from receipt of amounts held as retention until completion of larger Building Automation and Controls projects as well as improved collections and the slowdown in sales during the quarter. The increases in inventory and other current assets were both related to the ramp-up in the ComEd program. Included in inventory are EnergySaver units installed at customer host locations for the ComEd program for which we have not yet recognized revenue. Other current assets include installation and shipping costs related to these EnergySaver units. Declines in accounts payable and deferred revenue and other current liabilities consumed cash of \$167,010, \$5,873 and \$11,167, respectively during the three-month period ended March 31, 2004. The decline in accounts payable is primarily the result of payments by Great Lakes to subcontractors who worked on projects that were completed in the fourth quarter of 2003. The decline in accounts payable was partially offset by an increase in accrued expenses during the quarter, which was related to the accrual of amounts due contractors for work completed on Building Automation and Controls projects during the three-month period ended March 31, 2004. An increase in accounts receivable and other assets of \$139,419 during the first quarter of 2003 was offset by a decline in inventory of \$139,996. The increase in accounts receivable was mostly due to the increase in sales in the Building Automation and Controls segment while the decline in inventory came primarily from the Energy Technology segment where we intentionally worked to reduce inventories. The net effect of changes in accounts payable and accrued expenses during the first quarter of 2003 was a \$49,876 use of cash primarily due to the payment by Switchboard Apparatus of a large vendor invoice with extended terms for materials related to a government contract which it was working on.

Investing activities consumed cash of \$8,875 during the three-month period ending March 31, 2004, the result of purchases of property and equipment.

Financing activities generated cash of \$3,193,868 and \$867,432 during the three-month periods ended March 31, 2004 and 2003 respectively. During 2004, we raised \$11,000,000 through the issuance of a package of securities that included shares of our common stock and 5 year warrants to purchase additional shares of common stock. We used \$7,000,006 of the net proceeds from this issuance to effectuate a redemption and exchange offer for our Series A, Series C and Series D Convertible Preferred Stock. We incurred expenses related to these transactions of \$796,363. During the quarter we also made scheduled principal payments on our mortgage and auto loan of \$9,763. During the first quarter of 2003, we issued a package of securities that included shares of our common stock and common stock warrants for gross proceeds of \$1,000,000. We incurred issuance costs of \$95,690 associated with this private placement. During the quarter we also made scheduled principal payments of \$37,676 on our long term debt and



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received a payment from a shareholder of \$798, which represented the short-swing profit inadvertently earned when he purchased shares of our stock within six months of selling shares, which is a violation of section 16(b) of the Securities Act of 1934.

Our mortgage with American Chartered Bank matures on February 1, 2005, at which time we will owe a balloon payment of \$595,000, unless we refinance or extend the mortgage prior to the maturity. It is our intent to attempt to refinance the mortgage with American Chartered Bank or another lender prior to the end of 2004.

We currently have a \$2 million convertible revolving credit facility with Laurus Master Fund, Ltd. ( Laurus ). The revolving credit facility provides for borrowings of up to the lesser of (i) \$2 million or (ii) 90% of our eligible accounts receivable. We have not borrowed under the facility, thus it remains fully available to the extent of our eligible receivables. As of March 31, 2004 eligible receivables would support borrowings of approximately \$500,000 under the facility. The revolving credit facility expires on September 11, 2005 and accrues interest at the rate of prime (currently 4.00%) plus 1.75%. We have the option of paying interest and principal, or prepaying all or a portion of the advances under each Secured Convertible Revolving Note, with shares of our common stock at the fixed conversion price of \$2.12 per share, provided that the closing price of our common stock is greater than \$2.43 per share for the 11 trading days immediately proceeding the payment date and that the shares are registered with Securities and Exchange Commission. We have filed a registration statement with respect to these shares. In addition, Laurus has the option to convert all or a portion of the advances under any Secured Convertible Revolving Note into shares of our common stock at any time, subject to certain limitations, at a fixed conversion price of \$2.12 per share. The revolving credit facility is secured by a blanket lien on all of our assets, except for our real estate.

Our ability to continue the development, manufacturing and the expansion of sales of our products, including the EnergySaver, the GlobalCommander, VNPP and building automation products, will require the continued commitment of significant funds. The actual timing and amount of our future funding requirements will depend on many factors, including the amount and timing of future revenues, our ability to collect our receivables in a timely manner, the level and amount of our product marketing and sales efforts, the magnitude of research and development, and our ability to improve margins.

In an attempt to move the Company to a position where it can start to generate positive cash flow our management has set the following key objectives for cash flow improvement in 2004:

Successfully execute on the ComEd contract. We believe that this is important from several different perspectives. First we anticipate that it will have an immediate positive impact on our cash flow. Secondly, we believe it will establish Electric City as a leader in negative power development, thereby supporting VNPP opportunities with other utilities. And finally we believe it will lead to increased commercial sales of the EnergySaver as customers who participate in the ComEd VNPP with operations outside the ComEd territory gain exposure to the technology. This project is under contract, therefore we are focusing a great deal of our resources on this project and will be hiring additional personnel as part of our efforts to keep this project on schedule.

Increase the profitability of EnergySaver sales. Increasing the margins earned on EnergySaver sales will also have an immediate and positive impact on our cash flow. We have seen improvements in EnergySaver margins over the past two years, but believe that the product has the potential for significantly higher margins. We believe that increased volumes that will result from the ComEd program will lead to higher margins as a result of increased capacity utilization. In addition, a price increase that we implemented effective January 1, 2004 should also lead to improved profitability of the EnergySaver.

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Build on the recent project successes at Great Lakes Controlled Energy to make the Building Controls and Automation business become profitable. Great Lakes has recently been awarded new business and is currently working on existing projects that we believe will result in this segment turning profitable during 2004. This segment must execute effectively in order to realize the profitability potential of these projects.

Continue to aggressively manage our costs in order to conserve cash. While we made significant progress in reducing our costs during the last two years, we must continue to effectively manage all of our costs so that they do not negate the anticipated improvement in profitability in our Energy Technology and Building Automation and Control segments.

Be prepared to raise additional capital in limited amounts if necessary to continue to fund operations until the business turns cash flow positive. Our ability to raise additional capital in the future will depend a great deal on our ability to make progress toward the goals outline above.

We believe that if we are successful in achieving these priorities we should have sufficient liquidity to allow us to operate until our operations turn cash flow positive, hopefully sometime during 2004. Our projections contain certain key assumptions which may or may not occur. If any of the key assumptions contained in our projections are proven wrong, we may begin to experience a liquidity shortage sometime within the next 12 to 18 months which could force us to scale back our growth plans, or, in the worst case, cease operations.

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

**Cautionary Note Regarding Forward-Looking Statements**

This discussion includes forward-looking statements that reflect the Company's current expectations about its future results, performance, prospects and opportunities. The Company has tried to identify these forward-looking statements by using words such as may, will, expects, anticipates, believes, intends, estimates or similar expressions. forward-looking statements are based on information currently available to the Company and are subject to a number of risks, uncertainties and other factors that could cause the Company's actual results, performance, prospects or opportunities in the remainder of 2004 and beyond to differ materially from those expressed in, or implied by, these forward-looking statements. These risks, uncertainties and other factors include, without limitation, the Company's limited operating history, the Company's history of operating losses, customers' acceptance of our products, the Company's use of licensed technologies, risk of increased competition, risk that the Virtual Negawatt Power Plan concept does not succeed, the Company's commercial scale development of products and technologies to satisfy customers demands and requirements, the possible need for additional financing and the terms and conditions of any financing that is consummated, the limited trading market for the Company's securities, the possible volatility of the Company's stock price, the concentration of ownership, and the potential fluctuation in the Company's operating results. For further information about these and other risks, uncertainties and factors, please review the disclosures included under the caption "Risk Factors" in Electric City's filings with the Securities and Exchange Commission. Except as required by Federal securities laws, Electric City undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, changed circumstances or any other reason, after the date of this document.

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**ITEM 3. Quantitative and Qualitative Disclosures About Market Risk**

The only significant exposure we have to market risk at this time is the risk of changes in market interest rates. The interest rates on our debt facilities are variable and change with changes in the prime rate. The interest rate on our convertible term loan is equal to the prime rate (currently 4.0%) plus 1.75% or 6%, whichever is greater. The interest rate on our mortgage is equal to the prime rate plus 1/2%. If the prime rate were to increase 1 percentage point, the annual interest cost on the term loan and mortgage would increase by approximately \$11,000.

**ITEM 4. Controls and Procedures**

a. Evaluation of disclosure controls and procedures.

Our chief executive officer and chief financial officer, after evaluating the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)) as of the end of the period covered by the report, have concluded that our disclosure controls and procedures were effective as of the end of the period covered by the report.

b. Changes in internal controls.

There were no significant changes in our internal controls or in other factors that could significantly affect the Company's internal controls during the period covered by the report.

c. Disclosure controls and procedures.

Disclosure controls and procedures are our controls and other procedures that are designed 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. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

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**PART II. OTHER INFORMATION**

**ITEM 2. Changes In Securities**

- (1) On January 2, 2004, Laurus Master Funds converted \$63,600 of principal on the Company's Convertible Term Note into 30,000 shares of our common stock.
- (2) On January 28, 2004, Laurus Master Funds converted \$207,264 of principal and \$4,736 of accrued interest on the Company's Convertible Term Note into 100,000 shares of our common stock.
- (3) On February 10, 2004, Leaf Mountain Company converted 45,000 shares of Series A Convertible Preferred Stock into 450,000 shares of common stock.
- (4) On March 19, 2004, Morgan Stanley Dean Witter Equity Funding, Inc. converted 95,000 shares of Series A Convertible Preferred Stock into 950,000 shares of common stock.
- (5) On March 19, 2004, Originators Investment Plan L.P. converted 5,000 shares of Series A Convertible Preferred Stock into 50,000 shares of common stock.
- (6) On March 19, 2004, we entered into a securities purchase agreement with a group of four mutual funds managed by Security Benefit Group, Inc., whereby we issued to such purchasers, in exchange for \$11,000,000 in gross proceeds, a package of securities that included 5,000,000 shares of the Company's common stock and 5 year warrants to purchase 1,750,000 additional shares of common stock at \$2.42 per share.

On March 19, 2004, we entered into a Redemption and Exchange Agreement with the holders of its outstanding Series A Convertible Preferred Stock, Series C Convertible Preferred Stock and Series D Convertible Preferred Stock (collectively, the Existing Preferred Stock) under which we redeemed 538,462 shares of our outstanding Existing Preferred Stock which were convertible into 5,384,620 shares of common stock, at a price equivalent to \$1.30 per common share, and exchanged 210,451 shares of our newly authorized Series E Convertible Preferred Stock (the Series E Preferred) for the remaining 2,104,509 outstanding shares of the Existing Preferred Stock (the Exchange) on a 1 for 10 basis (one share of Series E Preferred exchanged for 10 shares of Existing Preferred Stock). All of the Existing Preferred Stock has been cancelled. As part of the Exchange, all outstanding warrants to purchase shares of Series D Convertible Preferred Stock were exchanged for similar warrants to purchase shares of Series E Preferred and the expiration date was changed from June 30, 2004 to October 31, 2004. Such Series E warrants issued are exercisable for an aggregate of 3,750 shares of Series E Preferred at a price of \$100 per share. They replaced warrants exercisable for 37,500 shares of Series D Preferred at an exercise price of \$10 per share.

- (7) On April 7, 2004, the Board of Directors declared dividends payable on our Series E Convertible Preferred Stock for the calendar quarter ending March 31, 2004 to shareholders of record of our Series E Convertible Preferred Stock as of March 31, 2004. The dividends were paid with 6,579 additional shares of Series E Convertible Preferred Stock. Each share of Series E Convertible Preferred Stock is convertible into 100 shares of our common stock.

No underwriters were involved in any of the transactions described above. All of the securities issued in the foregoing transactions were issued by us in reliance upon the exemption from registration available under Section 4(2) of the Securities Act, including Regulation D promulgated thereunder, in that the transactions involved the issuance and sale of our securities to financially sophisticated individuals or





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entities that were aware of our activities and business and financial condition and took the securities for investment purposes and understood the ramifications of their actions. The purchasers also represented that they were accredited investors as defined in Regulation D and/or were acquiring such securities for investment for their own account and not for distribution. Other than the shares issued to the Laurus Master Fund pursuant to conversion of portions of the Convertible Term Note referred to in (1) and (2) above, which have been registered under the Securities Act of 1933, as amended, all certificates representing the common stock so issued have a legend imprinted on them stating that the shares have not been registered under the Securities Act and cannot be transferred until properly registered under the Securities Act or an exemption applies.

**ITEM 4. Submission of Matters to a Vote of Security Holders.**

The issuance of shares of common stock and warrants to a group of four mutual funds managed by Security Benefits Group, Inc. and the Redemption and Exchange transaction described in note (6) to Item 2 Changes In Securities above, both required the consent of the holders of our Existing Preferred Stock, which was obtained in connection with both transactions.

**ITEM 6. Exhibits And Reports On Form 8-K.**

(a) Exhibits

- 4.63 Amended and Restated Directors Stock Option Plan
- 31.1 Certificate of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a-15(e) and 15d-15(e) as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certificate of Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-15(e) and 15d-15(e) as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of the Chief Executive Officer of the Corporation Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of the Chief Financial Officer of the Corporation Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) On March 23, 2004, the Company filed a report on Form 8-K announcing that it had entered into a purchase agreement with a group of four mutual funds managed by Security Benefit Group, Inc. through which it raised \$11,000,000, using \$7,000,006 of the proceeds to effectuate an redemption and exchange in which it redeemed a portion of its outstanding Series A, Series C and Series D Convertible Preferred Stock (the Existing Preferred) and exchange the remaining Existing Preferred to shares of newly issued Series E Convertible Preferred Stock.

(c) On May 5, 2004, the Company filed a report on Form 8-K announcing that it had begun to mail its annual meeting material and releasing a copy of its letter to shareholders.

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**SIGNATURES**

In accordance with the requirements of the Securities and Exchange Act of 1934, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ELECTRIC CITY CORP.:

Dated: May 13, 2004

By: /s/ John Mitola  
John Mitola  
*Chief Executive Officer (principal  
executive officer)*

Dated: May 13, 2004

By: /s/ Jeffrey Mistarz  
Jeffrey Mistarz  
*Chief Financial Officer (principal  
financial and accounting officer)*

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