DR REDDYS LABORATORIES LTD
Form 6-K
February 17, 2015
Table of Contents

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 6-K

REPORT OF FOREIGN PRIVATE ISSUER

PURSUANT TO RULE 13A-16 OR 15D-16

UNDER THE SECURITIES EXCHANGE ACT OF 1934

For the Quarter Ended December 31, 2014

Commission File Number 1-15182

DR. REDDY S LABORATORIES LIMITED

(Translation of registrant s name into English)

8-2-337, Road No. 3, Banjara Hills

Hyderabad, Telangana 500 034, India

+91-40-49002900

(Address of principal executive office)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.

Form 20-F x Form 40-F ¨

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1): ¨

Note: Regulation S-T Rule 101(b)(1) only permits the submission in paper of a Form 6-K if submitted solely to provide an attached annual report to security holders.

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7): ¨

Note: Regulation S-T Rule 101(b)(7) only permits the submission in paper of a Form 6-K if submitted to furnish a report or other document that the registrant foreign private issuer must furnish and make public under the laws of the jurisdiction in which the registrant is incorporated, domiciled or legally organized (the registrant s home country), or under the rules of the home country exchange on which the registrant s securities are traded, as long as the report or other document is not a press release, is not required to be and has not been distributed to the registrant s security holders, and, if discussing a material event, has already been the subject of a Form 6-K submission or other Commission filing on EDGAR.

Indicate by check mark whether by furnishing the information contained in this Form, the registrant is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes ¨ No x

If Yes is marked, indicate below the file number assigned to registrant in connection with Rule 12g3-2(b): 82-____ .

Table of Contents

QUARTERLY REPORT

Quarter Ended December 31, 2014

Currency of Presentation and Certain Defined Terms

In this Quarterly Report, references to $ or dollars or U.S.$ or U.S. dollars are to the legal currency of the Un States and references to Rs. or rupees or Indian rupees are to the legal currency of India. Our unaudited condensed consolidated interim financial statements are presented in Indian rupees and are prepared in accordance with International Accounting Standard 34, *Interim Financial Reporting* (IAS 34). Convenience translation into U.S. dollars with respect to the unaudited condensed consolidated interim financial statements is also presented. References to a particular fiscal year are to our fiscal year ended March 31 of such year. References to ADS are to our American Depositary Shares. All references to IAS are to the International Accounting Standards, to IASB are to the International Accounting Standards Board, to IFRS are to International Financial Reporting Standards, to SIC are to Standing Interpretations Committee and to IFRIC are to the International Financial Reporting Interpretations Committee.

References to U.S. FDA are to the United States Food and Drug Administration, to NDAs are to New Drug Applications, and to ANDAs are to Abbreviated New Drug Applications.

References to U.S. or United States are to the United States of America, its territories and its possessions. References to India are to the Republic of India. All references to we, us, our, DRL, Dr. Reddy s or the Company Dr. Reddy s Laboratories Limited and its subsidiaries. Dr. Reddy s is a registered trademark of Dr. Reddy s Laboratories Limited in India. Other trademarks or trade names used in this Quarterly Report are trademarks registered in the name of Dr. Reddy s Laboratories Limited or are pending before the respective trademark registries, unless otherwise specified. Market share data is based on information provided by IMS Health Inc. and its affiliates (IMS Health), a provider of market research to the pharmaceutical industry, unless otherwise stated.

Except as otherwise stated in this report, all convenience translations from Indian rupees to U.S. dollars are at the certified foreign exchange rate of U.S.$1.00 = Rs.63.04, as published by Federal Reserve Board of Governors on December 31, 2014. No representation is made that the Indian rupee amounts have been, could have been or could be converted into U.S. dollars at such a rate or any other rate. Any discrepancies in any table between totals and sums of the amounts listed are due to rounding.

Information contained in our website, www.drreddys.com, is not part of this Quarterly Report and no portion of such information is incorporated herein.

Forward-Looking and Cautionary Statement

IN ADDITION TO HISTORICAL INFORMATION, THIS QUARTERLY REPORT CONTAINS CERTAIN FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933, AS AMENDED AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED. THE FORWARD-LOOKING STATEMENTS CONTAINED HEREIN ARE SUBJECT TO CERTAIN RISKS AND UNCERTAINTIES THAT COULD CAUSE ACTUAL RESULTS TO DIFFER MATERIALLY FROM THOSE REFLECTED IN THE FORWARD-LOOKING STATEMENTS. FACTORS THAT MIGHT CAUSE SUCH A DIFFERENCE INCLUDE, BUT ARE NOT LIMITED TO, THOSE DISCUSSED IN THE SECTION ENTITLED OPERATING AND FINANCIAL REVIEW AND ELSEWHERE IN THIS REPORT. READERS ARE CAUTIONED NOT TO PLACE UNDUE RELIANCE ON THESE FORWARD-LOOKING STATEMENTS,

WHICH REFLECT OUR ANALYSIS ONLY AS OF THE DATE HEREOF. IN ADDITION, READERS SHOULD CAREFULLY REVIEW THE INFORMATION IN OUR PERIODIC REPORTS AND OTHER DOCUMENTS FILED WITH AND/OR FURNISHED TO THE SECURITIES AND EXCHANGE COMMISSION (SEC) FROM TIME TO TIME.

Table of Contents

TABLE OF CONTENTS

ITEM 1. FINANCIAL STATEMENTS	4
ITEM 2. OPERATING AND FINANCIAL REVIEW, TREND INFORMATION	35
ITEM 3. LIQUIDITY AND CAPITAL RESOURCES	45
ITEM 4. OTHER MATTERS	47
ITEM 5. EXHIBITS	48
SIGNATURES	49
EXHIBIT 99.1: INDEPENDENT AUDITORS REPORT ON REVIEW OF UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS	

3

Table of Contents

ITEM 1. FINANCIAL STATEMENTS

DR. REDDY S LABORATORIES LIMITED

UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENT OF FINANCIAL POSITION

(in millions, except share and per share data)

Particulars	Note	December 31, 2014	As of December 31, 2014	March 31, 2014
		Convenience translation into U.S.$ (See Note 2.(d))		
ASSETS				
Current assets				
Cash and cash equivalents	4	U.S.$ 100	Rs.6,278	Rs.8,451
Other investments	5	356	22,458	25,083
Trade and other receivables		638	40,224	33,037
Inventories	6	461	29,038	23,992
Derivative financial instruments	8	18	1,133	554
Current tax assets		14	901	1,298
Other current assets		185	11,668	11,332
Total current assets		**U.S.$ 1,772**	**Rs. 111,700**	**Rs. 103,747**
Non-current assets				
Property, plant and equipment	9	U.S.$ 760	Rs.47,887	Rs.44,424
Goodwill	10	56	3,538	3,428
Other intangible assets	11	227	14,282	11,269
Investment in equity accounted investees		16	995	806
Other investments non-current	5	0	11	
Deferred tax assets		82	5,188	6,054
Other non-current assets		13	798	495
Total non-current assets		**U.S.$ 1,153**	**Rs. 72,699**	**Rs. 66,476**
Total assets		**U.S.$ 2,925**	**Rs. 184,399**	**Rs. 170,223**
LIABILITIES AND EQUITY				
Current liabilities				
Trade and other payables		U.S.$ 196	Rs. 12,333	Rs. 10,503
Derivative financial instruments	8	11	678	305
Current tax liabilities		37	2,334	1,192
Short-term borrowings	12	257	16,172	20,607
Long-term borrowings, current portion	12	112	7,053	3,395

Provisions			54		3,385		2,819
Other current liabilities			262		16,526		15,242
Total current liabilities		**U.S.$**	**928**	**Rs.**	**58,481**	**Rs.**	**54,063**
Non-current liabilities							
Long-term borrowings, excluding current portion	12	U.S.$	261	Rs.	16,431	Rs.	20,740
Provisions non-current			1		57		92
Deferred tax liabilities			40		2,495		2,744
Other non-current liabilities			29		1,828		1,783
Total non-current liabilities		**U.S.$**	**330**	**Rs.**	**20,811**	**Rs.**	**25,359**
Total liabilities		**U.S.$**	**1,258**	**Rs.**	**79,292**	**Rs.**	**79,422**

The accompanying notes form an integral part of these unaudited condensed consolidated interim financial statements.

Table of Contents

DR. REDDY S LABORATORIES LIMITED

UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENT OF FINANCIAL POSITION

(in millions, except share and per share data)

Particulars	Note	December 31, 2014 *Convenience translation into U.S.$ (See Note 2.(d))*	As of December 31, 2014	As of March 31, 2014
Equity				
Share capital	15	U.S.$ 14	Rs. 852	Rs. 851
Equity shares held by controlled trust				(5)
Share premium		352	22,161	21,553
Share based payment reserve		15	962	1,008
Retained earnings		1,245	78,454	65,051
Other components of equity		42	2,678	2,343
Total equity		**U.S.$ 1,667**	**Rs. 105,107**	**Rs. 90,801**
Total liabilities and equity		**U.S.$ 2,925**	**Rs. 184,399**	**Rs. 170,223**

The accompanying notes form an integral part of these unaudited condensed consolidated interim financial statements.

Table of Contents

DR. REDDY S LABORATORIES LIMITED

UNAUDITED CONDENSED CONSOLIDATED INTERIM INCOME STATEMENT

(in millions, except share and per share data)

Particulars	Note	Nine months ended December 31, 2014	2014	2013	Three months ended December 31, 2014	2013
		Convenience translation into U.S.$ (See Note 2.(d))				
Revenues		U.S.$ 1,737	Rs. 109,485	Rs. 97,361	Rs. 38,431	Rs. 35,338
Cost of revenues		719	45,303	41,482	16,079	13,947
Gross profit		**1,018**	**64,182**	**55,879**	**22,352**	**21,391**
Selling, general and administrative expenses		516	32,503	28,476	11,151	9,945
Research and development expenses		195	12,304	8,417	4,316	2,979
Other (income)/expense, net	13	(13)	(791)	(1,189)	(341)	(177)
Total operating expenses		**698**	**44,016**	**35,704**	**15,126**	**12,747**
Results from operating activities		**320**	**20,166**	**20,175**	**7,226**	**8,644**
Finance income		43	2,712	1,169	1,264	330
Finance expense		(13)	(797)	(933)	(251)	(315)
Finance (expense)/income, net	14	**30**	**1,915**	**236**	**1,013**	**15**
Share of profit of equity accounted investees, net of tax		2	151	126	47	46
Profit before tax		**353**	**22,232**	**20,537**	**8,286**	**8,705**
Tax expense	18	83	5,242	3,841	2,541	2,521
Profit for the period		**270**	**16,990**	**16,696**	**5,745**	**6,184**
Attributable to:						
Equity holders of the Company		270	16,990	16,699	5,745	6,185
Non-controlling interest				(3)		(1)
Profit for the period		**U.S.$ 270**	**Rs. 16,990**	**Rs. 16,696**	**Rs. 5,745**	**Rs. 6,184**
Earnings per share:						
		U.S.$ 1.58	Rs. 99.77	Rs. 98.21	Rs. 33.72	Rs. 36.36

Basic earnings per share of Rs.5/- each										
Diluted earnings per share of Rs.5/- each	U.S.$	1.58	Rs.	99.42	Rs.	97.85	Rs.	33.61	Rs.	36.25

The accompanying notes form an integral part of these unaudited condensed consolidated interim financial statements.

6

Table of Contents

DR. REDDY S LABORATORIES LIMITED

UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENT OF COMPREHENSIVE INCOME

(in millions, except share and per share data)

Particulars	**Nine months ended December 31, 2014**	**2014**	**2013**	**Three months ended December 31, 2014**	**2013**
	Convenience translation into U.S.$ (See Note 2.(d))				
Profit for the period	**U.S.$ 270**	**Rs. 16,990**	**Rs. 16,696**	**Rs. 5,745**	**Rs. 6,184**
Other comprehensive income/(loss)					
Items that will not be reclassified to profit or loss:					
Items that may be reclassified subsequently to profit or loss:					
Changes in fair value of available for sale financial instruments	U.S.$ 4	Rs. 283	Rs. (33)	Rs. 46	Rs. 33
Foreign currency translation adjustments	1	67	705	(87)	(75)
Effective portion of changes in fair value of cash flow hedges, net	1	58	(2,661)	343	1,209
Tax on items that may be reclassified subsequently to profit or loss	(1)	(73)	343	(79)	(367)
Total items that may be reclassified subsequently to profit or loss	**U.S.$ 5**	**Rs. 335**	**Rs. (1,646)**	**Rs. 223**	**Rs. 800**
Other comprehensive income/(loss) for the period, net of tax	**U.S.$ 5**	**Rs. 335**	**Rs. (1,646)**	**Rs. 223**	**Rs. 800**
Total comprehensive income for the period	**U.S.$ 275**	**Rs. 17,325**	**Rs. 15,050**	**Rs. 5,968**	**Rs. 6,984**
Attributable to:					
Equity holders of the Company	275	17,325	15,049	5,968	6,985
Non-controlling interests			1		(1)
Total comprehensive income for the period	**U.S.$ 275**	**Rs. 17,325**	**Rs. 15,050**	**Rs. 5,968**	**Rs. 6,984**

The accompanying notes form an integral part of these unaudited condensed consolidated interim financial statements.

7

Table of Contents

DR. REDDY S LABORATORIES LIMITED

UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENT OF CHANGES IN EQUITY

(in millions, except share and per share data)

Particulars	Number of shares	Share capital	Share premium	Fair value reserve
Balance as of April 1, 2014	**170,108,868**	**Rs. 851**	**Rs. 21,553**	**Rs. 78**
Issue of equity shares on exercise of options	256,971	1	412	
Share based payment expense				
Profit for the period				
Dividend paid (including corporate dividend tax)				
Sale of equity shares held by controlled trust[1]			196	
Net change in fair value of available for sale financial instruments, net of tax expense of Rs.91				192
Foreign currency translation adjustments, net of tax benefit of Rs.17				
Effective portion of changes in fair value of cash flow hedges, net of tax benefit of Rs.1				
Balance as of December 31, 2014	**170,365,839**	**Rs. 852**	**Rs. 22,161**	**Rs. 270**
Convenience translation into U.S.$ (See Note 2.(d))		**U.S.$ 14**	**U.S.$ 352**	**U.S.$ 4**
Balance as of April 1, 2013	**169,836,475**	**Rs. 849**	**Rs. 21,214**	**Rs. 52**
Issue of equity shares on exercise of options	263,260	1	327	
Share based payment expense				
Profit for the period				
Dividend paid (including corporate dividend tax)				
Transfer to debenture redemption reserve				
Net change in fair value of available for sale financial instruments, net of tax benefit of Rs.10				(23)
Foreign currency translation differences, net of tax expense of Rs.9				
Effective portion of changes in fair value of cash flow hedges, net of tax benefit of Rs.342				
Acquisition of non-controlling interests				

Balance as of December 31, 2013	**170,099,735**	**Rs.**	**850**	**Rs.**	**21,541**	**Rs.**	**29**

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The accompanying notes form an integral part of these unaudited condensed consolidated interim financial statements.

Table of Contents

DR. REDDY S LABORATORIES LIMITED

UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENT OF CHANGES IN EQUITY

(in millions, except share and per share data)

[Continued from above table, first column repeated]

Particulars	Share based payment reserve		Equity shares held by a controlled trust		Foreign currency translation reserve		Hedging reserve	
Balance as of April 1, 2014	**Rs.**	**1,008**	**Rs.**	**(5)**	**Rs.**	**4,477**	**Rs.**	**(1,960)**
Issue of equity shares on exercise of options		(411)						
Share based payment expense		365						
Profit for the period								
Dividend paid (including corporate dividend tax)								
Sale of equity shares held by controlled trust[(1)]				5				
Net change in fair value of available for sale financial instruments, net of tax expense of Rs.91								
Foreign currency translation adjustments, net of tax benefit of Rs.17						84		
Effective portion of changes in fair value of cash flow hedges, net of tax benefit of Rs.1								59
Balance as of December 31, 2014	**Rs.**	**962**	**Rs.**		**Rs.**	**4,561**	**Rs.**	**(1,901)**
Convenience translation into U.S.$ (See Note 2.(d))	**U.S.$**	**15**	**U.S.$**		**U.S.$**	**72**	**U.S.$**	**(30)**
Balance as of April 1, 2013	**Rs.**	**911**	**Rs.**	**(5)**	**Rs.**	**3,928**	**Rs.**	**(390)**
Issue of equity shares on exercise of options		(327)						
Share based payment expense		321						
Profit for the period								
Dividend paid (including corporate dividend tax)								
Transfer to debenture redemption reserve								
Net change in fair value of available for sale financial instruments, net of								

tax benefit of Rs.10								
Foreign currency translation differences, net of tax expense of Rs.9						693		
Effective portion of changes in fair value of cash flow hedges, net of tax benefit of Rs.342								(2,319)
Acquisition of non-controlling interests								
Balance as of December 31, 2013	**Rs.**	**905**	**Rs.**	**(5)**	**Rs.**	**4,621**	**Rs.**	**(2,709)**

[Continued on next page]

The accompanying notes form an integral part of these unaudited condensed consolidated interim financial statements.

Table of Contents

DR. REDDY S LABORATORIES LIMITED

UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENT OF CHANGES IN EQUITY

(in millions, except share and per share data)

[Continued from above table, first column repeated]

Particulars	Retained earnings		Debenture redemption reserve		Non-controlling interests		Actuarial gains/ (losses)		Total	
Balance as of April 1, 2014	**Rs.**	**65,051**	**Rs.**		**Rs.**		**Rs.**	**(252)**	**Rs.**	**90,801**
Issue of equity shares on exercise of options										2
Share based payment expense										365
Profit for the period		16,990								16,990
Dividend paid (including corporate dividend tax)		(3,587)								(3,587)
Sale of equity shares held by controlled trust[1]										201
Net change in fair value of available for sale financial instruments, net of tax expense of Rs.91										192
Foreign currency translation adjustments, net of tax benefit of Rs.17										84
Effective portion of changes in fair value of cash flow hedges, net of tax benefit of Rs.1										59
Balance as of December 31, 2014	**Rs.**	**78,454**	**Rs.**		**Rs.**		**Rs.**	**(252)**	**Rs**	**105,107**
Convenience translation into U.S.$ (See Note 2.(d))	**U.S.$**	**1,245**	**U.S.$**		**U.S.$**		**U.S.$**	**(4)**	**U.S.$**	**1,667**
Balance as of April 1, 2013	**Rs.**	**44,815**	**Rs.**	**1,711**	**Rs.**	**20**	**Rs.**	**(300)**	**Rs.**	**72,805**
Issue of equity shares on exercise of options										1
Share based payment expense										321
Profit for the period		16,699				(3)				16,696
Dividend paid (including corporate dividend tax)		(2,985)								(2,985)
		(638)		638						

Transfer to debenture redemption reserve					
Net change in fair value of available for sale financial instruments, net of tax benefit of Rs.10					(23)
Foreign currency translation differences, net of tax expense of Rs.9			3		696
Effective portion of changes in fair value of cash flow hedges, net of tax benefit of Rs.342					(2,319)
Acquisition of non-controlling interests	(4)		(20)		(24)
Balance as of December 31, 2013	**Rs. 57,887**	**Rs. 2,349**	**Rs. 0**	**Rs. (300)**	**Rs. 85,168**

(1) During the nine months ended December 31, 2014, the Company disposed of all of the shares held by its controlled trust for a total consideration of Rs.201. A gain of Rs.196 arising from this transaction is recorded in share premium.

The accompanying notes form an integral part of these unaudited condensed consolidated interim financial statements.

10

Table of Contents

DR. REDDY S LABORATORIES LIMITED

UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENT OF CASH FLOWS

(in millions, except share and per share data)

Particulars	For the nine months ended December 31, 2014 *Convenience translation into U.S.$ (See Note 2.(d))*	2014	2013
Cash flows from/(used in) operating activities:			
Profit for the period	U.S.$ 270	Rs. 16,990	Rs. 16,696
Adjustments for:			
Income tax expense	83	5,242	3,841
Dividend and profit on sale of investments	(7)	(458)	(87)
Depreciation and amortization	93	5,871	5,140
Impairment loss/(reversal of impairment loss) on intangible asset	8	534	(497)
Inventory write-downs	40	2,492	1,233
Allowance for doubtful trade and other receivables	2	136	225
Loss/(profit) on sale of property, plant and equipment and other intangible assets, net	1	41	(58)
Allowance for sales returns	34	2,154	1,547
Share of profit of equity accounted investees	(2)	(151)	(126)
Exchange (gain)/loss, net	4	259	(1,586)
Interest (income)/expense, net	(1)	(72)	144
Share based payment expense	6	365	321
Changes in operating assets and liabilities:			
Trade and other receivables	(146)	(9,194)	(242)
Inventories	(121)	(7,630)	(3,492)
Trade and other payables	20	1,255	(3,106)
Other assets and other liabilities	(5)	(290)	(4,716)
Cash generated from operations	**U.S.$ 278**	**Rs. 17,544**	**Rs. 15,237**
Income tax paid	(44)	(2,772)	(3,862)
Net cash from operating activities	**U.S.$ 234**	**Rs. 14,772**	**Rs. 11,375**
Cash flows from/(used in) investing activities:			
Expenditure on property, plant and equipment	U.S.$ (109)	Rs. (6,857)	Rs. (7,998)
Proceeds from sale of property, plant and equipment	2	123	68
Expenditure on other intangible assets	(91)	(5,731)	(547)
Proceeds from sale of other intangible assets			29
Purchase of other investments	(418)	(26,350)	(13,812)
Proceeds from sale of other investments	473	29,822	21,912

Cash paid for acquisition of business, net of cash acquired	(4)	(276)	
Interest and dividend received	12	730	391
Net cash from/(used in) investing activities	**U.S.$ (135)**	**Rs. (8,539)**	**Rs. 43**
Cash flows from/(used in) financing activities:			
Proceeds from issuance of equity shares	U.S.$ 0	Rs. 1	Rs. 1
Proceeds from sale of equity shares held by a controlled trust	3	201	
Repayment of short term borrowings, net	(35)	(2,222)	(2,843)
Proceeds from long term borrowings			10,100
Repayment of long term borrowings	(29)	(1,809)	(130)
Cash paid for acquisition of non-controlling interests			(24)
Dividend paid (including corporate dividend tax)	(57)	(3,587)	(2,985)
Interest paid	(13)	(820)	(550)
Net cash from/(used in) financing activities	**U.S.$ (131)**	**Rs. (8,236)**	**Rs. 3,569**
Net increase/(decrease) in cash and cash equivalents	U.S.$ (32)	Rs. (2,003)	Rs. 14,987
Effect of exchange rate changes on cash and cash equivalents	(3)	(170)	1,130
Cash and cash equivalents at the beginning of the period (See Note 4)	134	8,451	5,054
Cash and cash equivalents at the end of the period (See Note 4)	**U.S.$ 100**	**Rs. 6,278**	**Rs. 21,171**

The accompanying notes form an integral part of these unaudited condensed consolidated interim financial statements.

DR. REDDY S LABORATORIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(in millions, except share and per share data)

1. Reporting entity

Dr. Reddy s Laboratories Limited (DRL or the parent company), together with its subsidiaries (collectively, the Company), is a leading India-based pharmaceutical company headquartered in Hyderabad, Telangana, India. Through its three businesses - Pharmaceutical Services and Active Ingredients, Global Generics and Proprietary Products the Company offers a portfolio of products and services, including Active Pharmaceutical Ingredients (APIs), Custom Pharmaceutical Services (CPS), generics, biosimilars, differentiated formulations and New Chemical Entities (NCEs). The Company s principal research and development facilities are located in Telangana, India, Cambridge, United Kingdom and Leiden, the Netherlands; its principal manufacturing facilities are located in Telangana, India, Andhra Pradesh, India, Himachal Pradesh, India, Cuernavaca-Cuautla, Mexico, Mirfield, United Kingdom, Louisiana, United States, and Tennessee, United States; and its principal markets are in India, Russia, the United States, the United Kingdom, Venezuela and Germany. The Company s shares trade on the Bombay Stock Exchange and the National Stock Exchange in India and also on the New York Stock Exchange in the United States.

2. Basis of preparation of financial statements

a) Statement of compliance

These unaudited condensed consolidated interim financial statements are prepared in accordance with IAS 34, Interim Financial Reporting as issued by the International Accounting Standards Board. They do not include all of the information required for a complete set of annual financial statements and should be read in conjunction with the audited consolidated financial statements and related notes included in the Company s Annual Report on Form 20-F for the fiscal year ended March 31, 2014. These unaudited condensed consolidated interim financial statements were authorized for issuance by the Company s Board of Directors on February 16, 2015.

b) Significant accounting policies

The accounting policies applied by the Company in these unaudited condensed consolidated interim financial statements are the same as those applied by the Company in its audited consolidated financial statements as at and for the year ended March 31, 2014 contained in the Company s Annual Report on Form 20-F.

c) Functional and presentation currency

These unaudited condensed consolidated interim financial statements are presented in Indian rupees, which is the functional currency of the parent company. All financial information presented in Indian rupees has been rounded to the nearest million.

In respect of all non-Indian subsidiaries that operate as marketing arms of the parent company in their respective countries/regions, the functional currency has been determined to be the functional currency of the parent company (i.e., the Indian rupee). The operations of these entities are largely restricted to importing of finished goods from the parent company in India, sales of these products in the foreign country and remittance of the sale proceeds to the parent company. The cash flows realized from sales of goods are readily available for remittance to the parent

company and cash is remitted to the parent company on a regular basis. The costs incurred by these entities are primarily the cost of goods imported from the parent company. The financing of these subsidiaries is done directly or indirectly by the parent company. In respect of subsidiaries whose operations are self-contained and integrated within their respective countries/regions, the functional currency has been determined to be the local currency of those countries/regions.

d) Convenience translation

The unaudited condensed consolidated interim financial statements have been prepared in Indian rupees. Solely for the convenience of the reader, the unaudited condensed consolidated interim financial statements as of and for the nine months ended December 31, 2014 have been translated into U.S. dollars at the certified foreign exchange rate of U.S.$1.00 = Rs. 63.04, as published by the Federal Reserve Board of Governors on December 31, 2014. No representation is made that the Indian rupee amounts have been, could have been or could be converted into U.S. dollars at such a rate or any other rate. Such convenience translation is not subject to review by the Company s independent auditors.

e) Use of estimates and judgments

The preparation of unaudited condensed consolidated interim financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. In preparing these unaudited condensed consolidated interim financial statements, the significant judgments made by management in applying the Company s accounting policies and the key sources of estimation uncertainty were the same as those that applied to the audited consolidated financial statements as at and for the year ended March 31, 2014.

DR. REDDY S LABORATORIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(in millions, except share and per share data)

2. Basis of preparation of financial statements (continued)

f) Recent accounting pronouncements

Standards issued but not yet effective and not early adopted by the Company

IFRS 9- Financial instruments

In July 2014, the IASB issued the final version of IFRS 9, Financial instruments . IFRS 9 significantly differs from IAS 39, Financial Instruments: Recognition and Measurement , and includes a logical model for classification and measurement, a single, forward-looking expected loss impairment model and a substantially-reformed approach to hedge accounting. IFRS 9 is effective for annual periods beginning on or after January 1, 2018 with early application permitted. The Company is in the process of evaluating the impact of the new standard on its consolidated financial statements.

IFRS 15- Revenue from Contracts with Customers

In May 2014, the IASB issued IFRS 15, Revenue from Contracts with Customers . The core principle of the new standard is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Further, the new standard requires enhanced disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity s contracts with customers. The new revenue recognition standard is applicable for annual periods beginning on or after January 1, 2017 with early application permitted. The Company is in the process of evaluating the impact of the new standard on its consolidated financial statements.

Amendments to IAS 16- Property, plant and equipment and IAS 38- Intangible assets

In May 2014, the IASB issued limited-scope amendments to IAS 16, Property, plant and equipment and IAS 38, Intangible assets , to clarify the use of a revenue-based depreciation or amortization method. With respect to property, plant and equipment, the IASB has clarified that the use of revenue-based methods to calculate the depreciation of an asset is not appropriate because revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits embodied in the asset. With respect to intangible assets, the amended standard incorporates a rebuttable presumption that an amortization method based on the revenue generated by an activity that includes the use of an intangible asset is inappropriate. The amendments are effective for annual periods beginning on or after January 1, 2016 with early application permitted. The Company believes that these amendments will not have any material impact on its consolidated financial statements.

Table of Contents

DR. REDDY S LABORATORIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(in millions, except share and per share data)

3. Segment reporting

The Chief Operating Decision Maker (CODM) evaluates the Company s performance and allocates resources based on an analysis of various performance indicators by operating segments. The CODM reviews revenue and gross profit as the performance indicator for all of the operating segments, and does not review the total assets and liabilities of an operating segment.

The Company s reportable operating segments are as follows:

- Global Generics;
- Pharmaceutical Services and Active Ingredients (PSAI); and
- Proprietary Products.

Global Generics. This segment consists of finished pharmaceutical products ready for consumption by the patient, marketed under a brand name (branded formulations) or as generic finished dosages with therapeutic equivalence to branded formulations (generics). This segment includes the operations of the Company s biologics business.

Pharmaceutical Services and Active Ingredients. This segment includes active pharmaceutical ingredients and intermediates, also known as active pharmaceutical products or bulk drugs, which are the principal ingredients for finished pharmaceutical products. Active pharmaceutical ingredients and intermediates become finished pharmaceutical products when the dosages are fixed in a form ready for human consumption such as a tablet, capsule or liquid using additional inactive ingredients. This segment also includes contract research services and the manufacture and sale of active pharmaceutical ingredients and steroids in accordance with the specific customer requirements.

Proprietary Products. This segment includes the discovery and development of new chemical entities and differentiated formulations for subsequent commercialization. The Company s differentiated formulations portfolio consists of new, synergistic combinations and technologies that improve safety and/or efficacy by modifying pharmacokinetics of existing medicines. This segment also includes the Company s specialty pharmaceuticals business, which conducts sales and marketing operations for in-licensed and co-developed dermatology products.

Others. This includes the operations of the Company s wholly-owned subsidiary, Aurigene Discovery Technologies Limited, a discovery stage biotechnology company developing novel and best-in-class therapies in the fields of oncology and inflammation and which works with established pharmaceutical and biotechnology companies in early-stage collaborations, bringing drug candidates from hit generation through Investigational New Drug (IND)

filing.

The measurement of each segment s revenues, expenses and assets is consistent with the accounting policies that are used in preparation of the Company s consolidated financial statements.

Information about segments:	**For the nine months ended December 31, 2014**				
Segments	**Global Generics**	**PSAI**	**Proprietary Products**	**Others**	**Total**
Segment revenues [1]	**Rs. 89,563**	**Rs. 18,042**	**Rs. 990**	**Rs. 890**	**Rs. 109,485**
Gross profit	**Rs. 59,089**	**Rs. 3,996**	**Rs. 832**	**Rs. 265**	**Rs. 64,182**
Selling, general and administrative expenses					32,503
Research and development expenses					12,304
Other (income)/expense, net					(791)
Results from operating activities					**Rs. 20,166**
Finance (expense)/income, net					1,915
Share of profit of equity accounted investees, net of tax					151
Profit before tax					**Rs. 22,232**
Tax expense					5,242
Profit for the period					**Rs. 16,990**

[1] Segment revenue for the nine months ended December 31, 2014 does not include inter-segment revenues from PSAI to Global Generics, which is accounted for at a cost of Rs.5,600.

14

DR. REDDY S LABORATORIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(in millions, except share and per share data)

3. Segment reporting (continued)

Information about segments:

	For the nine months ended December 31, 2013				
Segments	**Global Generics**	**PSAI**	**Proprietary Products**	**Others**	**Total**
Segment revenues [1]	**Rs. 77,846**	**Rs. 17,333**	**Rs. 1,222**	**Rs. 960**	**Rs. 97,361**
Gross profit	**Rs. 51,093**	**Rs. 3,486**	**Rs. 1,119**	**Rs. 181**	**Rs. 55,879**
Selling, general and administrative expenses					28,476
Research and development expenses					8,417
Other (income)/expense, net					(1,189)
Results from operating activities					**Rs. 20,175**
Finance (expense)/income, net					236
Share of profit of equity accounted investees, net of tax					126
Profit before tax					**Rs. 20,537**
Tax expense					3,841
Profit for the period					**Rs. 16,696**

[1] Segment revenue for the nine months ended December 31, 2013 does not include inter-segment revenues from PSAI to Global Generics, which is accounted for at a cost of Rs.3,925.

Information about segments:

	For the three months ended December 31, 2014		
Segments	**PSAI**	**Others**	**Total**

	Global Generics		Proprietary Products		
Segment revenues [1]	**Rs. 31,692**	**Rs. 6,112**	**Rs. 386**	**Rs. 241**	**Rs. 38,431**
Gross profit	**Rs. 20,881**	**Rs. 1,050**	**Rs. 322**	**Rs. 99**	**Rs. 22,352**
Selling, general and administrative expenses					11,151
Research and development expenses					4,316
Other (income)/expense, net					(341)
Results from operating activities					**Rs. 7,226**
Finance (expense)/income, net					1,013
Share of profit of equity accounted investees, net of tax					47
Profit before tax					**Rs. 8,286**
Tax expense					2,541
Profit for the period					**Rs. 5,745**

[1] Segment revenue for the three months ended December 31, 2014 does not include inter-segment revenues from PSAI to Global Generics, which is accounted for at a cost of Rs.1,882.

Information about segments:

	For the three months ended December 31, 2013				
Segments	**Global Generics**	**PSAI**	**Proprietary Products**	**Others**	**Total**
Segment revenues [1]	**Rs. 29,396**	**Rs. 5,062**	**Rs. 478**	**Rs. 402**	**Rs. 35,338**
Gross profit	**Rs. 20,051**	**Rs. 795**	**Rs. 432**	**Rs. 113**	**Rs. 21,391**
Selling, general and administrative expenses					9,945
Research and development expenses					2,979
Other (income)/expense, net					(177)
Results from operating activities					**Rs. 8,644**
Finance (expense)/income, net					15
Share of profit of equity accounted investees, net of tax					46
Profit before tax					**Rs. 8,705**
Tax expense					2,521
Profit for the period					**Rs. 6,184**

[1] Segment revenue for the three months ended December 31, 2013 does not include inter-segment revenues from PSAI to Global Generics, which is accounted for at a cost of Rs.1,480.

Table of Contents

DR. REDDY S LABORATORIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(in millions, except share and per share data)

3. Segment reporting (continued)

Analysis of revenue by geography:

The following table shows the distribution of the Company s revenues by geography, based on the location of the customers:

Geography	For the nine months ended December 31, 2014	For the nine months ended December 31, 2013	For the three months ended December 31, 2014	For the three months ended December 31, 2013
North America (the United States and Canada)	Rs. 52,144	Rs. 44,756	Rs. 18,705	Rs. 17,698
Russia and other countries of the former Soviet Union	14,425	15,301	4,766	5,296
India	15,746	14,420	5,277	4,858
Europe	12,627	12,002	4,096	3,908
Others	14,543	10,882	5,587	3,578
	Rs. 109,485	**Rs. 97,361**	**Rs. 38,431**	**Rs. 35,338**

Analysis of revenue by geography within Global Generics segment:

The following table shows the distribution of revenues of the Company s Global Generics segment by geography, based on the location of the customer:

Geography	For the nine months ended December 31, 2014	For the nine months ended December 31, 2013	For the three months ended December 31, 2014	For the three months ended December 31, 2013
North America (the United States and Canada)	Rs. 47,568	Rs. 40,338	Rs. 16,819	Rs. 16,223
Russia and other countries of the former Soviet Union	14,425	15,301	4,766	5,296

India	13,126	11,613	4,328	3,913
Europe	4,851	5,196	1,947	1,862
Others	9,593	5,398	3,832	2,102
	Rs. 89,563	**Rs. 77,846**	**Rs. 31,692**	**Rs. 29,396**

Analysis of revenue by geography within PSAI segment:

The following table shows the distribution of revenues of the Company s PSAI segment by geography, based on the location of the customer:

	For the nine months ended December 31,		**For the three months ended December 31,**	
Geography	**2014**	**2013**	**2014**	**2013**
North America (the United States and Canada)	Rs. 3,205	Rs. 2,816	Rs. 1,360	Rs. 780
India	2,619	2,808	948	945
Europe	7,285	6,400	2,055	1,949
Others	4,933	5,309	1,749	1,388
	Rs. 18,042	**Rs. 17,333**	**Rs. 6,112**	**Rs. 5,062**

DR. REDDY S LABORATORIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(in millions, except share and per share data)

4. Cash and cash equivalents

Cash and cash equivalents consist of the following:

	As of	
	December 31, 2014	**March 31, 2014**
Cash balances	Rs. 4	Rs. 3
Balances with banks	3,870	4,580
Term deposits with banks (original maturities up to 3 months)	2,404	3,868
Cash and cash equivalents in the statement of financial position	**6,278**	**8,451**
Bank overdrafts used for cash management purposes		
Cash and cash equivalents in the statement of cash flow	**Rs. 6,278**	**Rs. 8,451**

Cash and cash equivalents included restricted cash of Rs.507 and Rs.343, respectively, as of December 31, 2014 and March 31, 2014, which consisted of:

Rs.59 as of December 31, 2014 and Rs.83 as of March 31, 2014, representing amounts in the Company s unclaimed dividend and debenture interest accounts;

Rs.319 as of December 31, 2014 and Rs.25 as of March 31, 2014, representing cash and cash equivalents of the Company s subsidiary in Venezuela, which are subject to foreign exchange controls;

Rs.114 as of December 31, 2014 and Rs.115 as of March 31, 2014, representing amounts deposited as security for a bond executed for an environmental liability relating to the Company s site in Mirfield, United Kingdom;

Rs.0 as of December 31, 2014 and Rs.96 as of March 31, 2014, representing amounts deposited in an escrow account pursuant to a research and collaboration arrangement entered with Um Pharmauji Sdn. Bhd., Malaysia;

and

Rs.15 as of December 31, 2014 and Rs.24 as of March 31, 2014, representing other restricted cash amounts.

5. Other investments

Other investments consist of investments in units of mutual funds, equity securities and term deposits (i.e., certificates of deposit having an original maturity period exceeding 3 months) with banks. The details of such investments as of December 31, 2014 are as follows:

	Cost	Gain recognized directly in equity	Fair value
Investment in units of mutual funds	Rs. 10,761	Rs. 355	Rs. 11,116
Investment in equity securities	3	34	37
Term deposits with banks	11,316		11,316
	Rs. 22,080	**Rs. 389**	**Rs. 22,469**
Current portion			
Investment in units of mutual funds	Rs. 10,761	Rs. 355	Rs. 11,116
Investment in equity securities	3	34	37
Term deposits with banks	11,305		11,305
	Rs. 22,069	**Rs. 389**	**Rs. 22,458**
Non-current portion			
Term deposits with banks	Rs. 11	Rs.	Rs. 11
	Rs. 11	**Rs.**	**Rs. 11**

As of March 31, 2014, all of such investments were current, the details of which are as follows:

	Cost	Gain recognized directly in equity	Fair value
Investment in units of mutual funds	Rs. 10,676	Rs. 86	Rs. 10,762
Investment in equity securities	3	20	23
Term deposits with banks	14,298		14,298
	Rs. 24,977	**Rs. 106**	**Rs. 25,083**

Table of Contents

DR. REDDY S LABORATORIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(in millions, except share and per share data)

6. Inventories

Inventories consist of the following:

	As of	
	December 31, 2014	**March 31, 2014**
Raw materials	Rs. 7,553	Rs. 6,127
Packing materials, stores and spares	2,044	1,626
Work-in-progress	8,069	6,619
Finished goods	11,372	9,620
	Rs. 29,038	**Rs. 23,992**

The above table includes inventories amounting to Rs.589 and Rs.612 which are carried at fair value less cost to sell, as at December 31, 2014 and March 31, 2014, respectively.

During the three months and nine months ended December 31, 2014, the Company recorded inventory write-downs of Rs.1,185 and Rs.2,492, respectively (as compared to Rs.385 and Rs.1,233 for the three months and nine months ended December 31, 2013, respectively). These adjustments were included in cost of revenues.

Cost of revenues for the three months and nine months ended December 31, 2014 includes raw materials, consumables and changes in finished goods and work in progress recognized in the income statement amounting to Rs.9,616 and Rs.25,910, respectively (as compared to Rs.7,680 and Rs.23,389 for the three months and nine months ended December 31, 2013, respectively). Cost of revenues for the three months and nine months ended December 31, 2014 includes other expenditures recognized in the income statement amounting to Rs.6,462 and Rs.19,392 respectively (as compared to Rs.6,267 and Rs.18,093 for the three months and nine months ended December 31, 2013, respectively).

7. Hedges of foreign currency risks

The Company is exposed to exchange rate risk which arises from its foreign currency revenues and expenses, primarily in U.S. dollars, U.K. pounds sterling, Russian roubles and Euros, and foreign currency debt in U.S. dollars, U.K. pounds sterling, Russian roubles and Euros.

The Company uses forward contracts, future contracts, swaps and option contracts (collectively, derivative contracts) to mitigate its risk of changes in foreign currency exchange rates. The Company also uses non-derivative financial instruments as part of its foreign currency exposure risk mitigation strategy.

Hedges of highly probable forecasted transactions

The Company classifies its derivative contracts that hedge foreign currency risk associated with highly probable forecasted transactions as cash flow hedges and measures them at fair value. The effective portion of such cash flow hedges is recorded in the Company s hedging reserve as a component of equity and re-classified to the income statement as revenue in the period corresponding to the occurrence of the forecasted transactions. The ineffective portion of such cash flow hedges is recorded in the income statement as finance costs immediately.

The Company also designates certain non-derivative financial liabilities, such as foreign currency borrowings from banks, as hedging instruments for the hedge of foreign currency risk associated with highly probable forecasted transactions. Accordingly, the Company applies cash flow hedge accounting to such relationships. Re-measurement gain/loss on such non-derivative financial liabilities is recorded in the Company s hedging reserve as a component of equity and re-classified to the income statement as revenue in the period corresponding to the occurrence of the forecasted transactions.

In respect of the aforesaid hedges of highly probable forecasted transactions, the Company has recorded, as a component of equity, a net gain of Rs.343 and net gain of Rs.58 for the three and nine months ended December 31, 2014, respectively (as compared to a net gain of Rs.1,209 and a net loss of Rs.2,661 for the three and nine months ended December 31, 2013, respectively). The Company also recorded, as part of revenue, a net loss of Rs.66 and a net gain of Rs.62 during the three and nine months ended December 31, 2014, respectively (as compared to a net loss of Rs.345 and Rs.846 during the three and nine months ended December 31, 2013, respectively).

The net carrying amount of the Company s hedging reserve as a component of equity before adjusting for tax impact was a loss of Rs.1,846 and Rs.1,903 as of December 31, 2014 and March 31, 2014, respectively.

DR. REDDY S LABORATORIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(in millions, except share and per share data)

7. Hedges of foreign currency risks (continued)

Hedges of recognized assets and liabilities

Changes in the fair value of derivative contracts that economically hedge monetary assets and liabilities in foreign currencies, and for which no hedge accounting is applied, are recognized in the income statement. The changes in fair value of these derivative contracts, as well as the foreign exchange gains and losses relating to the monetary items, are recognized as part of net finance costs .

In respect of all of its foreign exchange derivative contracts, the Company has recorded, as part of finance costs, a net gain of Rs.238 and Rs.1,000 for the three and nine months ended December 31, 2014, respectively (as compared to a net gain of Rs.870 and a net loss of Rs.1,989 for the three and nine months ended December 31, 2013, respectively).

8. Financial instruments

Non-derivative financial instruments

Non-derivative financial instruments consists of investments in mutual funds, equity and debt securities, trade receivables, certain other assets, cash and cash equivalents, loans and borrowings, trade payables and certain other liabilities.

Derivative financial instruments

The Company uses forward exchange contracts, futures contracts, swaps and option contracts (collectively, derivative contracts) to mitigate its risk of changes in foreign currency exchange rates. The Company uses interest rate swaps (including cross currency interest rate swaps) to mitigate the risk of changes in interest rates.

Financial instruments by category

The carrying value and fair value of financial instruments by each category as at December 31, 2014 were as follows:

	Note	Loans and receivables	Available for sale	Other financial liabilities	Derivative financial instruments	Total carrying value	Total fair value
Assets:							
Cash and cash equivalents	4	Rs. 6,278	Rs.	Rs.	Rs.	Rs. 6,278	Rs. 6,278
Other investments	5	11,316	11,153			22,469	22,469

Trade and other receivables		40,224				40,224	40,224
Derivative financial instruments					1,133	1,133	1,133
Other assets(1)		2,475				2,475	2,475
Total		**Rs. 60,293**	**Rs. 11,153**	**Rs.**	**Rs. 1,133**	**Rs. 72,579**	**Rs. 72,579**
Liabilities:							
Trade and other payables		Rs.	Rs.	Rs. 12,333	Rs.	Rs. 12,333	Rs. 12,333
Derivative financial instruments					678	678	678
Long-term borrowings	12			23,516		23,516	23,516
Short-term borrowings	12			16,172		16,172	16,172
Other liabilities and provisions(2)				17,708		17,708	17,708
Total		**Rs.**	**Rs.**	**Rs. 69,729**	**Rs. 678**	**Rs. 70,407**	**Rs. 70,407**

19

Table of Contents

DR. REDDY S LABORATORIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(in millions, except share and per share data)

8. Financial instruments (continued)

The carrying value and fair value of financial instruments by each category as at March 31, 2014 were as follows:

	Note	Loans and receivables	Available for sale	Other financial liabilities	Derivative financial instruments	Total carrying value	Total fair value
Assets:							
Cash and cash equivalents	4	Rs. 8,451	Rs.	Rs.	Rs.	Rs. 8,451	Rs. 8,451
Other investments	5	14,298	10,785			25,083	25,083
Trade and other receivables		33,037				33,037	33,037
Derivative financial instruments					554	554	554
Other assets[1]		1,853				1,853	1,853
Total		**Rs. 57,639**	**Rs. 10,785**	**Rs.**	**Rs. 554**	**Rs. 68,978**	**Rs. 68,978**
Liabilities:							
Trade and other payables		Rs.	Rs.	Rs. 10,503	Rs.	Rs. 10,503	Rs. 10,503
Derivative financial instruments					305	305	305
Long-term borrowings	12			24,213		24,213	24,213
Short-term borrowings	12			20,607		20,607	20,607
Other liabilities and provisions[2]				16,463		16,463	16,463
Total		**Rs.**	**Rs.**	**Rs. 71,786**	**Rs. 305**	**Rs. 72,091**	**Rs. 72,091**

(1) Other assets that are not financial assets (such as receivables from statutory authorities, export benefit receivables, prepaid expenses, advances paid and certain other receivables) amounting to Rs.10,892 and Rs.11,273 as of December 31, 2014 and March 31, 2014, respectively, are not included.

(2) Other liabilities that are not financial liabilities (such as statutory dues payable, deferred revenue, advances from customers and certain other accruals) amounting to Rs.6,422 and Rs.4,665 as of December 31, 2014 and March 31, 2014, respectively, are not included.

Fair value hierarchy

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices).

Level 3 - Inputs for the assets or liabilities that are not based on observable market data (unobservable inputs).

The following table presents the fair value hierarchy of assets and liabilities measured at fair value on a recurring basis as of December 31, 2014:

Particulars	Level 1	Level 2	Level 3	Total
Available for sale - Financial asset - Investments in units of mutual funds	Rs. 11,116	Rs.	Rs.	Rs. 11,116
Available for sale - Financial asset - Investment in equity securities	37			37
Derivative financial instruments - gain/(loss) on outstanding foreign exchange forward, option and swap contracts and interest rate swap contracts[1]		455		455

The following table presents the fair value hierarchy of assets and liabilities measured at fair value on a recurring basis as of March 31, 2014:

Particulars	Level 1	Level 2	Level 3	Total
Available for sale - Financial asset - Investments in units of mutual funds	Rs. 10,762	Rs.	Rs.	Rs. 10,762
Available for sale - Financial asset - Investment in equity securities	23			23
Derivative financial instruments - gain/(loss) on outstanding foreign exchange forward, option and swap contracts and interest rate swap contracts[1]		249		249

(1) The Company enters into derivative financial instruments with various counterparties, principally financial institutions and banks. Derivatives valued using valuation techniques with market observable inputs are mainly interest rate swaps, foreign exchange forward option and swap contracts. The most frequently applied valuation techniques include forward pricing, swap models and Black-Scholes-Merton models (for option valuation), using present value calculations.

The models incorporate various inputs, including foreign exchange spot and forward rates, interest rate curves and forward rate curves. As at December 31, 2014 and March 31, 2014, the changes in counterparty credit risk had no material effect on the hedge effectiveness assessment for derivatives designated in hedge relationships and other

financial instruments recognized at fair value.

20

DR. REDDY S LABORATORIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(in millions, except share and per share data)

9. Property, plant and equipment

Acquisitions and disposals

During the nine months ended December 31, 2014, the Company acquired assets at an aggregate cost of Rs.7,835 (as compared to a cost of Rs.8,707 and Rs.11,022 for the nine months ended December 31, 2013 and the year ended March 31, 2014, respectively).

Assets with a net book value of Rs.163 were disposed of during the nine months ended December 31, 2014 (as compared to Rs.39 and Rs.235 for the nine months ended December 31, 2013 and the year ended March 31, 2014, respectively), resulting in a net loss on disposal of Rs.41 during the nine months ended December 31, 2014 (as compared to net gain of Rs.29 and Rs.24 for the nine months ended December 31, 2013 and the year ended March 31, 2014, respectively).

Depreciation expense for the three months and nine months ended December 31, 2014 was Rs.1,462 and Rs.4,189 respectively (as compared to Rs.1,208 and Rs.3,496 for the three months and nine months ended December 31, 2013, respectively).

Capital commitments

As of December 31, 2014 and March 31, 2014, the Company was committed to spend approximately Rs.4,299 and Rs.2,920, respectively, under agreements to purchase property, plant and equipment. This amount is net of capital advances paid in respect of such purchases.

10. Goodwill

Goodwill arising upon business acquisitions is not amortized but tested for impairment at least annually or more frequently if there is any indication that the cash generating unit to which goodwill is allocated is impaired.

The following table presents the changes in goodwill during the nine months ended December 31, 2014 and 2013 and the year ended March 31, 2014:

	Nine months ended December 31, 2014		Nine months ended December 31, 2013		Year ended March 31, 2014	
Opening balance[1]	Rs.	3,428	Rs.	3,193	Rs.	3,193
Goodwill arising on business combination[2]		203				

Effect of translation adjustments		(93)		280		235
Closing balance[1]	**Rs.**	**3,538**	**Rs.**	**3,473**	**Rs.**	**3,428**

(1) This does not include goodwill arising upon investment in associates of Rs.181, which is included in the carrying value of the investment in the equity accounted investees.

(2) Represents excess of consideration paid over the fair value of the net assets acquired from Cherokee Pharma LLC during the nine months ended December 31, 2014. Total purchase consideration was Rs.292 and the fair value of the net assets acquired was Rs.89. The amount of goodwill is primarily attributable to the acquired workforce and expected synergies. The acquisition was not material to the Company and, accordingly, no further disclosures have been made in the consolidated financial statements of the Company.

11. Intangible assets

During the three months and nine months ended December 31, 2014, the Company acquired intangible assets at an aggregate cost of Rs.5,314 and Rs.5,606, respectively (as compared to a cost of Rs.465 and Rs.752 for the three months and nine months ended December 31, 2013, respectively and Rs.743 for the year ended March 31, 2014), including assets acquired through business combinations of Rs.0 and Rs.56 for the three and nine months ended December 31, 2014, respectively (as compared to a cost of Rs.0 for the three and nine months ended December 31, 2013 and Rs.0 for the year ended March 31, 2014).

Intangible assets acquired during the three months and nine months ended December 31, 2014 includes the acquisition from Novartis Consumer Health Inc. of the title and rights to its Habitrol® brand and related U.S. marketing rights. Refer to Note 22 of these unaudited condensed consolidated interim financial statements for further details on this acquisition.

Amortization expenses for the three months and nine months ended December 31, 2014 were Rs.579 and Rs.1,682, respectively (as compared to amortization expenses of Rs.586 and Rs.1,644 for the three months and nine months ended December 31, 2013, respectively).

Table of Contents

DR. REDDY S LABORATORIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(in millions, except share and per share data)

11. Intangible assets (continued)

Impairment losses for the three months ended December 31, 2014

For the three months ended December 31, 2014, the Company recorded impairment losses of Rs.534 in the unaudited condensed consolidated interim income statement, primarily relating to the following:

Customer related intangibles

OctoPlus N.V., a wholly owned subsidiary of the Company, is engaged in the Company s internal drug development projects as well as providing pharmaceutical development services to external customers.

During the three months ended December 31, 2014, the Company decided to significantly increase the utilization of OctoPlus N.V. s technical know-how, its time and effort on internal drug development projects and scale-down its external pharmaceutical development services. Consequent to such decision, the Company reassessed the recoverable amounts of associated customer related intangibles and determined that the carrying amount of such customer related intangibles was higher than their recoverable amount. Accordingly, an amount of Rs.249 was recorded as an impairment loss for the three months ended December 31, 2014 under Selling, general and administrative expenses in the Company s unaudited condensed consolidated interim income statement. The above impairment loss relates to the Company s PSAI segment. As at December 31, 2014, the carrying amount of such customer related intangibles after impairment loss was Rs.0.

Product related intangibles

Based on the performance of and expected cash flows from some of the Company s product related intangibles pertaining to its Global Generics segment, the Company reassessed the recoverable amounts of such product related intangibles and determined that the carrying amount of such product-related intangibles was higher than their recoverable amount. Accordingly, an amount of Rs.201 was recorded as an impairment loss during the three months ended December 31, 2014 under Selling, general and administrative expenses in the Company s unaudited condensed consolidated interim income statement. As at December 31, 2014, the carrying amount of such product related intangibles after impairment loss was Rs.0.

Reversal of impairment losses for the three months ended December 31, 2013

Consequent to the increase in expected cash flows of some of the products forming part of the product related intangibles pertaining to the Company s Global Generics segment, the Company, following the guidance under IAS 36 Impairment of assets , estimated the recoverable amount of such intangible asset and assessed that the impairment loss recorded in an earlier period should be reversed. Accordingly, an amount of Rs.497 was reversed during the three

months ended December 31, 2013. The expected cash flows increased primarily due to various market dynamics, such as reduced competition and favorable pricing position.

The above reversal of impairment losses relate to the Company s Global Generics segment. The pre-tax cash flows have been discounted based on a pre-tax discount rate of 5.68%. As at December 31, 2013, the carrying amount of such product related intangibles after reversal of impairment loss was Rs.1,424.

12. Borrowings

Short term borrowings

The Company had short term borrowings of Rs.16,172 as of December 31, 2014, as compared to Rs.20,607 as of March 31, 2014. The borrowings primarily consist of packing credit loans drawn by the parent company and other unsecured loans drawn by its subsidiaries in Switzerland and Germany.

Short term borrowings consist of the following:

	As of	
	December 31, 2014	**March 31, 2014**
Packing credit borrowings	Rs. 10,733	Rs. 17,630
Other foreign currency borrowings	5,439	2,977
	Rs. 16,172	**Rs. 20,607**

22

Table of Contents

DR. REDDY S LABORATORIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(in millions, except share and per share data)

12. Borrowings (continued)

Short-term borrowings(continued)

An interest rate profile of short term borrowings from banks is given below:

	As at			
	December 31, 2014		March 31, 2014	
	Currency	Interest Rate	Currency	Interest Rate
Packing credit borrowings	USD	LIBOR + 25 to 40 bps	USD	LIBOR + 25 to 85 bps
	EURO	LIBOR + 20 bps	EURO	LIBOR + 20 bps
	RUB	7.75% to 9.80%	RUB	7.20% to 7.75%
			RUB	Mosprime + 60 bps
			INR	9.50% to 10%
Other short term borrowings	EURO	LIBOR + 90 bps	EURO	LIBOR + 90 bps

Long-term borrowings

Long-term borrowings consist of the following:

	As at	
	December 31, 2014	March 31, 2014
Foreign currency borrowing by the Company s Swiss subsidiary	Rs. 12,103	Rs. 13,103
Foreign currency borrowing by the parent company	9,455	8,987
Foreign currency borrowing by the Company s U.K. subsidiary	983	998
Obligations under finance leases	943	1,047
	Rs. 23,484	**Rs. 24,135**

Current portion				
Foreign currency borrowing by the Company s Swiss subsidiary	Rs.	6,934	Rs.	3,295
Obligations under finance leases		119		100
	Rs.	**7,053**	**Rs.**	**3,395**
Non-current portion				
Foreign currency borrowing by the Company s Swiss subsidiary	Rs.	5,169	Rs.	9,808
Foreign currency borrowing by the parent company		9,455		8,987
Foreign currency borrowing by the Company s U.K. subsidiary		983		998
Obligations under finance leases		824		947
	Rs.	**16,431**	**Rs.**	**20,740**

In the above table, the term Swiss subsidiary refers to Dr. Reddy s Laboratories, SA and the term U.K. Subsidiary refers to Dr. Reddy s Laboratories (EU) Limited.

Long-term borrowing of Swiss Subsidiary

During the year ended March 31, 2012, Dr. Reddy s Laboratories, SA (one of the Company s subsidiaries in Switzerland) (the Swiss Subsidiary) borrowed the sum of U.S.$220. The Swiss Subsidiary is required to repay the loan in eight equal quarterly installments commencing at the end of the 39th month and continuing until the end of the 60th month from September 30, 2011. The parent company has guaranteed all obligations of the Swiss Subsidiary under the loan agreement.

As part of this arrangement, the Company incurred an amount of U.S.$3.73 in arrangement fees and other administrative charges. The Company accounted for these costs as transaction costs under IAS 39 and they are being amortized over the term of the loan using the effective interest method.

During the three months ended December 31, 2014, the Swiss subsidiary repaid the first installment of U.S.$27.5 due under the loan agreement.

The loan agreement imposes various financial covenants on both the parent company and the Swiss Subsidiary. As of December 31, 2014, the Company was in compliance with such financial covenants.

DR. REDDY S LABORATORIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(in millions, except share and per share data)

12. Borrowings (continued)

Long-term borrowings(continued)

Long-term borrowing of the parent company

During the year ended March 31, 2014, the Company borrowed the sum of U.S.$150. The term of the loan is for sixty-six months starting from August 12, 2013. The Company is required to repay the loan in five equal quarterly installments commencing at the end of the 54th month and continuing until the end of the 66th month after August 12, 2013.

The loan agreement imposes various financial covenants on the Company. As of December 31, 2014, the Company was in compliance with such financial covenants.

The interest rate profile of long-term loans and borrowings (other than obligations under finance leases) is given below:

	As at			
	December 31, 2014		March 31, 2014	
	Currency	Interest Rate	Currency	Interest Rate
Foreign currency borrowings	USD	LIBOR+100 to 179 bps	USD	LIBOR+100 to 179 bps
	GBP	LIBOR+130 bps	GBP	LIBOR+130 bps

Undrawn lines of credit from bankers

The Company had undrawn lines of credit of Rs.22,346 and Rs.14,596 as of December 31, 2014 and March 31, 2014, respectively, from its banks for working capital requirements. The Company has the right to draw upon these lines of credit based on its requirements.

Non-derivative financial liabilities designated as cash flow hedges

The Company has designated some of its foreign currency borrowings from banks (non-derivative financial liabilities) as hedging instruments for hedge of foreign currency risk associated with highly probable forecasted transactions and, accordingly, applies cash flow hedge accounting for such relationships. Re-measurement gain/loss on such

non-derivative financial liabilities is recorded in the Company s hedging reserve as a component of equity and re-classified to the income statement as revenue in the period corresponding to the occurrence of the forecasted transactions. The carrying value of such non-derivative financial liabilities as of December 31, 2014 and March 31, 2014 was Rs.12,134 and Rs.13,181, respectively.

13. Other (income)/expense, net

	Nine months ended December 31,		Three months ended December 31,	
	2014	**2013**	**2014**	**2013**
Loss/(profit) on sale/disposal of property, plant and equipment and intangibles, net	Rs. 41	Rs. (58)	Rs. 1	Rs. (31)
Sale of spent chemical	(434)	(333)	(139)	(103)
Miscellaneous income[1]	(398)	(798)	(203)	(43)
	Rs. (791)	**Rs. (1,189)**	**Rs. (341)**	**Rs. (177)**

(1) Miscellaneous income, for the nine months ended December 31, 2013, includes Rs.431 from the resolution of litigation associated with the sale of one of the Company s generic products in North America.

14. Finance (expense)/income, net

Finance (expense)/income, net consists of the following:

	Nine months ended December 31,		Three months ended December 31,	
	2014	**2013**	**2014**	**2013**
Interest income	Rs.869	Rs.789	Rs.387	Rs.230
Dividend and profit on sale of other investments	458	87	211	37
Foreign exchange gain, net	1,385	293	666	63
Interest expense	(797)	(933)	(251)	(315)
	Rs. 1,915	**Rs. 236**	**Rs. 1,013**	**Rs. 15**

Table of Contents

DR. REDDY S LABORATORIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(in millions, except share and per share data)

15. Share capital and share premium

During the nine months ended December 31, 2014 and 2013, 256,971 and 263,260 equity shares, respectively, were issued as a result of the exercise of vested options granted to employees pursuant to the Dr. Reddy s Employees Stock Option Plan-2002 and Dr. Reddy s Employees Stock Option Plan-2007. During the nine months ended December 31, 2014, an aggregate of 254,471 options having an exercise price of Rs.5 (based upon the par value of the underlying shares) and 2,500 options having an exercise price of Rs.448 (based upon the grant-date fair market value of the underlying shares) were exercised. During the nine months ended December 31, 2013, each of the options exercised had an exercise price of Rs.5, being equal to the par value of the underlying shares.The amount of grant date fair value previously recognized for these options has been transferred from share based payment reserve to share premium in the unaudited condensed consolidated statement of changes in equity.

16. Employee stock incentive plans

Pursuant to the special resolutions approved by the shareholders in the Annual General Meetings held on September 24, 2001 and on July 27, 2005, respectively, the Company instituted the Dr. Reddy s Employees Stock Option Plan-2002 (the DRL 2002 Plan) and the Dr. Reddy s Employees ADR Stock Option Plan-2007 (the DRL 2007 Plan), each of which allows for grants of stock options to eligible employees.

The terms and conditions of the grants made during the nine months ended December 31, 2014 under the above plans were as follows:

Particulars	Number of instruments	Exercise price	Vesting period	Contractual life
DRL 2002 Plan	230,840	Rs.5.00	1 to 4 years	5 years
DRL 2007 Plan	45,796	Rs.5.00	1 to 4 years	5 years

The above grants were made on July 14, 2014, June 15, 2014 and May 25, 2014.

The terms and conditions of the grants made during the nine months ended December 31, 2013 under the above plans were as follows:

Particulars	Number of instruments	Exercise price	Vesting period	Contractual life
DRL 2002 Plan	258,870	Rs.5.00	1 to 4 years	5 years
DRL 2007 Plan	44,240	Rs.5.00	1 to 4 years	5 years

The above grants were made on May 13, 2013.

The weighted average inputs used in computing the fair value of such grants were as follows:

	Grants made on			
	July 14, 2014	**June 15, 2014**	**May 25, 2014**	**May 13, 2013**
Expected volatility	23.20%	23.15%	22.52%	20.50%
Exercise price	Rs. 5.00	Rs. 5.00	Rs. 5.00	Rs. 5.00
Option life	2.5 Years	2.5 Years	2.5 Years	2.5 Years
Risk-free interest rate	8.55%	8.38%	8.50%	7.43%
Expected dividends	0.67%	0.74%	0.78%	0.72%
Grant date share price	Rs. 2,695.00	Rs. 2,445.15	Rs. 2,308.70	Rs. 2,077.30

In addition to the above, during the nine months ended December 31, 2014, the Company adopted a new program to grant performance linked stock options to certain employees under the DRL 2002 Plan and the DRL 2007 Plan. Under this program, the vesting of stock options is conditional upon achievement of various performance targets over the three year period ending on March 31, 2017. Performance targets are measured each year against pre-defined interim targets and eligible employees are granted stock options upon meeting such targets. The stock options so granted are ultimately vested with the employees who meet subsequent service vesting conditions which range from 1 to 4 years. After vesting, such stock options generally have a maximum contractual term of five years.

The fair value of services received in return for stock options granted to employees is measured by reference to the fair value of stock options granted. The fair value of stock options has been measured using the Black-Scholes-Merton valuation model at the date of the grant.

Table of Contents

DR. REDDY S LABORATORIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(in millions, except share and per share data)

16. Employee stock incentive plans (continued)

Share-based payment expense

For the three months and nine months ended December 31, 2014, the Company recorded employee share based payment expense of Rs.135 and Rs.365, respectively (as compared to Rs.117 and Rs.321 for the three months and nine months ended December 31, 2013, respectively). As of December 31, 2014, there was approximately Rs.691 of total unrecognized compensation cost related to unvested stock options. This cost is expected to be recognized over a weighted-average period of 3.69 years.

17. Employee benefit plans

Gratuity benefits

In accordance with applicable Indian laws, the Company provides for gratuity, a defined benefit plan (the Gratuity Plan) covering certain categories of employees in India. The Gratuity Plan provides a lump sum payment to vested employees at retirement or termination of employment. The amount of payment is based on the respective employee s last drawn salary and the years of employment with the Company. Effective September 1, 1999, the Company established the Dr. Reddy s Laboratories Gratuity Fund (the Gratuity Fund). Liabilities in respect of the Gratuity Plan are determined by an actuarial valuation, based upon which the Company makes contributions to the Gratuity Fund. Trustees administer the contributions made to the Gratuity Fund. Amounts contributed to the Gratuity Fund are primarily invested in Indian government bonds and corporate debt securities. A small portion of the fund is also invested in equity securities of Indian companies.

For the three months and nine months ended December 31, 2014, the net periodic benefit cost was Rs.45 and Rs.134, respectively (as compared to Rs.36 and Rs.107 for the three months and nine months ended December 31, 2013, respectively).

Compensated absences

The Company provides for accumulation of compensated absences by certain categories of its employees. These employees can carry forward a portion of the unutilized compensated absences and utilize it in future periods or receive cash in lieu thereof as per the Company s policy. The Company records a liability for compensated absences in the period in which the employee renders the services that increases this entitlement. The total liability recorded by the Company towards this benefit was Rs.555 and Rs.463 as at December 31, 2014 and March 31, 2014, respectively.

18. Income taxes

Income tax expense is recognized based on the Company s best estimate of the average annual income tax rate for the fiscal year applied to the pre-tax income of the interim period. The average annual income tax rate is determined for each taxing jurisdiction and applied individually to the interim period pre-tax income of each jurisdiction. The difference between the estimated average annual income tax rate and the enacted tax rate is accounted for by a number of factors, including the effect of expenses that are not deductible for tax purposes, income exempted from income taxes, and effects of changes in tax laws and rates.

The Company s consolidated weighted average tax rates for the nine months ended December 31, 2014 and 2013 were 23.6% and 18.7%, respectively. The effective tax rate for the nine months ended December 31, 2013 was lower as compared to the nine months ended December 31, 2014 primarily as a result of a favorable order from the Income Tax Appellate Tribunal, Hyderabad on a previously litigated tax matter.

The Company s consolidated weighted average tax rates for the three months ended December 31, 2014 and 2013 were 30.7% and 29.0% respectively. The effective tax rate for the three months ended December 31, 2014 was higher as compared to the three months ended December 31, 2013 primarily on account of a higher proportion of the Company s profits being taxed in jurisdictions with higher tax rates.

Income tax expenses were Rs.2,541 and Rs.5,242 for the three and nine months ended December 31, 2014, respectively, as compared to Rs.2,521 and Rs.3,841 for the three and nine months ended December 31, 2013, respectively.

Total tax expense recognized directly in the equity amounted to Rs.79 and Rs.73 for the three and nine months ended December 31, 2014, respectively, as compared to a tax expense of Rs.367 and a tax benefit of Rs.343 for the three and nine months ended December 31, 2013, respectively. Such tax expenses/benefits were primarily due to tax effects on the changes in fair value of available for sale financial instruments and the foreign exchange gain/loss on cash flow hedges. Refer to Note 7 of these unaudited condensed consolidated interim financial statements for further details on cash flow hedges.

DR. REDDY S LABORATORIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(in millions, except share and per share data)

19. Related parties

The Company has entered into transactions with the following related parties:

Green Park Hotel and Resorts Limited for hotel services;

Dr. Reddy s Foundation towards contributions for social development;

Pudami Educational Society towards contributions for social development;

Dr. Reddy s Institute of Life Sciences towards services availed for research and development;

Ecologic Chemicals Limited for purchases and sales of active pharmaceutical ingredients and other assets; and

Stamlo Hotels Private Limited for hotel services.

These are enterprises over which key management personnel have control or significant influence. Key management personnel consists of the Company s Directors and members of the Company s Management Council.

The Company has also entered into cancellable operating lease transactions with key management personnel and their relatives.

Further, the Company contributes to the Dr. Reddy s Laboratories Gratuity Fund, which maintains the plan assets of the Company s Gratuity Plan for the benefit of its employees.

The following is a summary of significant related party transactions:

	Nine months ended December 31,		**Three months ended December 31,**	
	2014	**2013**	**2014**	**2013**
Services availed for research and development	Rs. 73	Rs. 115	Rs. 22	Rs. 49

Contribution towards social development	176	104	65	35
Hotel expenses paid	31	23	11	15
Lease rental paid under cancellable operating leases to key management personnel and their relatives	27	27	8	9
Purchases of raw materials	5	96		9
Purchases of assets from significant interest entities[1]		1,264		
Sales of raw materials		49		
Sales of assets to significant interest entities		14		14

(1) Towards assets acquired from Ecologic Chemicals Limited.

The Company had the following amounts due from related parties:

	As at	
	December 31, 2014	**March 31, 2014**
Key management personnel (towards rent deposits)	8	8

The Company had the following amounts due to related parties:

	As at	
	December 31, 2014	**March 31, 2014**
Due to related parties	Rs.	Rs. 1

The following table describes the components of compensation paid or payable to key management personnel:

	Nine months ended December 31,		Three months ended December 31,	
	2014	**2013**	**2014**	**2013**
Salaries and other benefits	Rs. 235	Rs. 204	Rs. 80	Rs. 67
Contributions to defined contribution plans	12	11	4	4
Commission to directors	240	165	80	55
Share-based payments expense	51	46	17	18
Total	**Rs. 538**	**Rs. 426**	**Rs. 181**	**Rs. 144**

DR. REDDY S LABORATORIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(in millions, except share and per share data)

19. Related parties (continued)

Some of the key management personnel of the Company are also covered under the Company s Gratuity Plan along with the other employees of the Company. Proportionate amounts of gratuity accrued under the Company s Gratuity Plan have not been separately computed or included in the above disclosure.

20. Disclosure of Expense by Nature

The following table shows supplemental information related to certain nature of expense items for the nine months ended December 31, 2014 and 2013, respectively.

	Nine months ended December 31, 2014			
Particulars	**Cost of revenues**	**Selling, general and administrative expenses**	**Research and development expenses**	**Total**
Employee benefits	Rs. 7,166	Rs. 11,553	Rs. 2,954	Rs. 21,673
Depreciation and amortization	3,015	2,179	677	5,871

	Nine months ended December 31, 2013			
Particulars	**Cost of revenues**	**Selling, general and administrative expenses**	**Research and development expenses**	**Total**
Employee benefits	Rs. 6,148	Rs. 10,036	Rs. 1,937	Rs. 18,121
Depreciation and amortization	2,780	2,074	286	5,140

The following table shows supplemental information related to certain nature of expense items for the three months ended December 31, 2014 and 2013, respectively.

	Three months ended December 31, 2014			
Particulars	**Cost of revenues**	**Selling, general and administrative expenses**	**Research and development expenses**	**Total**
Employee benefits	Rs. 2,334	Rs. 3,782	Rs. 1,081	Rs. 7,197
Depreciation and amortization	1,046	732	263	2,041

Three months ended December 31, 2013

Particulars	Cost of revenues	Selling, general and administrative expenses	Research and development expenses	Total
Employee benefits	Rs. 2,081	Rs. 3,657	Rs. 808	Rs. 6,546
Depreciation and amortization	960	736	98	1,794

28

Table of Contents

DR. REDDY S LABORATORIES LIMITED

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(in millions, except share and per share data)

21. Contingencies

The Company is involved in disputes, lawsuits, claims, governmental and/or regulatory inspections, inquiries, investigations and proceedings, including patent and commercial matters that arise from time to time in the ordinary course of business. The more significant matters are discussed below. Most of the claims involve complex issues. Often, these issues are subject to unc"2">**Stock Capital Deficit Stock Equity**

Balance, December 31, 2002
2,152,219 $215 2,171,192 $21,712 211,643 $2,116 $ $ $47,153,327 $(42,884,579) $(8,500) $4,284,291

Issuance of common stock (net of offering costs of $154,790)
121,008 12 1,515,114 1,515,126
Issuance of Series D Convertible Preferred Stock for cash (net of offering costs of $142,672)
150,000 1,500 1,355,828 1,357,328
Issuance of common stock to purchasers of Series D Convertible Preferred Stock
1,504 0 0
Cumulative dividends on Preferred Stock
(2,551,379) (2,551,379)
Satisfaction of accrued dividends through the issuance of preferred stock
225,398 2,254 21,971 220 7,769 78 2,548,827 2,551,379
Warrants issued in connection with convertible debt issuance and line of credit
541,400 541,400
Value of beneficial conversion feature on convertible debt
180,381 180,381
Conversion of term note
1,667 0 53,000 53,000
Exercise of warrants
13,133 1 196,999 197,000
Warrants issued in exchange for services received
393,550 393,550
Short-swing profit contribution
798 798
Retirement of shares held in treasury
(67) (8,500) 8,500
Net loss for the year ended December 31, 2003
(5,481,942) (5,481,942) -
Balance, December 31, 2003
2,289,464 $228 2,396,590 $23,966 233,614 $2,336 157,769 $1,578 $ $51,379,345 $(48,366,521) $ $3,040,932

Issuance of common stock (net of offering costs of $910,393)

333,333 33 10,089,574 10,089,607
Conversion of preferred stock
130,447 13 (145,000) (1,450) (5,067) (51) 1,488
Redemption of preferred stock
(514,375) (5,144) (24,087) (241) (6,994,621) (7,000,006)
Exchange of preferred stock
(1,737,215) (17,372) (233,614) (2,336) (133,682) (1,337) 210,451 2,105 18,940
Cumulative dividends on preferred stock
(1,636,780) (1,636,780)
Satisfaction of accrued dividends through the issuance of preferred stock
16,368 164 1,636,616 1,636,780
Conversion of term note
8,667 1 275,599 275,600
Exercise of warrants (net of offering costs of $24,000)
12,333 1 3,000 30 460,969 461,000
Warrants issued for services received
72,500 72,500
Other
(74)
Net loss for the year ended December 31, 2004
(5,159,362) (5,159,362) -
Balance, December 31, 2004
2,774,170 $276 $ $ $ 224,752 $2,248 $55,303,630 $(53,525,883) $ $1,780,271
Issuance of common stock (net of offering costs of $211,787)
416,667 42 5,413,171 5,413,213
Conversion of preferred stock
14,447 2 (2,167) (22) 20
Shares issued for the acquisition of Maximum Performance Group, Inc.
166,149 17 2,691,590 2,691,607
Cumulative dividends on preferred stock
(1,366,900) (1,366,900)
Satisfaction of accrued dividends through the issuance of preferred stock
13,669 137 1,366,763 1,366,900
Warrants issued in connection with convertible debt issuance
920,000 920,000
Common stock issued for services received
15,032 2 125,482 125,484
Warrants issued for services received
319,800 319,800
Net loss for the year ended December 31, 2005
(6,872,738) (6,872,738) -
Balance, December 31, 2005
3,386,465 $339 $ $ $ 236,254 $2,363 $64,773,556 $(60,398,621) $ $4,377,637

(1) Adjusted for 1 for 15 reverse split of common stock effected June 15, 2006.

See accompanying notes to consolidated financial statements.

Lime Energy Co.
(formerly known as Electric City Corp.)
Statement of Cash Flows

	Year ended December 31, 2005	Year ended December 31, 2004	Year ended December 31, 2003
Cash Flows From Operating Activities			
Net loss	$ (6,872,738)	$ (5,159,362)	$ (5,481,942)
Adjustments to reconcile net loss to net cash used in operating activities, net of assets acquired and disposed of:			
Provision for (recovery on) bad debts	96,872	5,865	(21,511)
Depreciation and amortization	601,869	58,878	110,632
Amortization of deferred financing costs	93,774	382,710	203,616
Amortization of issuance discount	71,639	191,727	102,006
Issuance of shares and warrants in exchange for services received	319,800	72,500	393,550
Accrued interest converted to common stock		4,736	654
Loss on disposal of discontinued operations			764,148
Loss on disposal of fixed assets	11,743		
Goodwill impairment	242,830		
Changes in assets and liabilities, net of dispositions			
Accounts receivable	(484,685)	377,842	(67,222)
Inventories	(102,022)	(334,628)	713,689
Advances to suppliers	148,012		
Other current assets	(81,604)	(143,971)	(87,660)
Accounts payable	(1,299,561)	(14,401)	74,346
Accrued liabilities	2,136	26,101	(328,898)
Deferred revenue	401,050	4,112	283,308
Customer deposits	(105,757)	488,833	511,167
Net cash used in operating activities	(6,956,642)	(4,039,058)	(2,830,117)
Cash Flows From Investing Activities			
Acquisition (including acquisition costs), net of cash acquired	(1,632,972)		
Sale of discontinued operations			929,032
Purchase of property and equipment	(548,874)	(149,603)	(32,304)
Net cash (used in) provided by investing activities	(2,181,846)	(149,603)	896,728
Cash Flows From Financing Activities			

Borrowings (payments) on line of credit	2,000,000		(500,000)
Proceeds from long-term debt	5,000,000		1,010,000
Payments on long-term debt	(541,547)	(39,155)	(427,514)
Preferred stock redemption		(7,000,006)	
Proceeds from issuance of preferred stock		11,000,000	1,500,000
Proceeds from issuance of common stock	5,625,000		1,669,914
Costs related to stock issuances	(211,787)	(910,393)	(297,462)
Cash paid for deferred financing costs	(293,836)		(308,228)
Proceeds from exercise of warrants		461,000	197,000
Short-swing profit contribution			798
Net cash provided by financing activities	11,577,830	3,511,446	2,844,508
Net Increase (Decrease) in Cash and Cash Equivalents	2,439,342	(677,215)	911,119
Cash and Cash Equivalents, at beginning of period	1,789,808	2,467,023	1,555,904
Cash and Cash Equivalents, at end of period	$ 4,229,150	$ 1,789,808	$ 2,467,023

F-6

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Statement of Cash Flows

	Year ended December 31, 2005	Year ended December 31, 2004	Year ended December 31, 2003
Supplemental Disclosures of Cash Flow Information			
Cash paid during the period for interest continuing operations	$ 214,258	$ 82,340	$ 44,000
Cash paid during the period for interest discontinued operations	364	660	9,000
Stock, warrants and options issued in exchange for services received	319,800	72,500	393,550
Accrual satisfied through the issuance of common stock		4,736	654
Inventory transferred to fixed assets (VNPP assets)		762,243	
Satisfaction of accrued dividends on Series A Preferred Stock through the issuance of 5,407 shares of Series E Preferred stock during the year ended December 31, 2004 and 225,398 shares of Series A Preferred stock during the year ended December 31, 2003		540,705	2,253,978
Satisfaction of accrued dividends on Series C Preferred Stock through the issuance of 532 shares of Series E Preferred stock during the year ended December 31, 2004 and 21,971 shares of Series C Preferred stock during the year ended December 31, 2003		53,206	219,712
Satisfaction of accrued dividends on Series D Preferred Stock through the issuance of 359 shares of Series E Preferred stock during the year ended December 31, 2004 and 7,769 shares of Series D Preferred stock during the year ended December 31, 2003		35,932	77,689
Satisfaction of accrued dividends on Series E Preferred Stock through the issuance of 13,669 and 10,070 shares of Series E Preferred stock during the years ended December 31, 2005 and December 31, 2004, respectively	1,366,900	1,006,937	
Conversion of convertible debt to common stock	$	$ 270,864	$ 52,346

See accompanying notes to consolidated financial statements.

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

Note 1 Description of Business

Lime Energy Co. (formerly Electric City Corp.) (the Company), a Delaware corporation, is a developer, manufacturer and integrator of energy savings technologies and building automation systems. The Company is made up of three separate companies, comprising two distinct business segments: Lime Energy Co. and Maximum Performance Group, Inc. comprise the Energy Technology segment and Great Lakes Controlled Energy Corporation comprises the Building Control and Automation segment. Electric City and Great Lakes Controlled Energy operate out of separate facilities, both located in Elk Grove Village, Illinois, a suburb of Chicago. Maximum Performance Group is headquartered in New York City with a sales and engineering office in San Diego, California. In January 2006, the Company made the decision to sell Great Lakes in order to focus exclusively on its Energy Technology products. On April 3, 2006, effective March 31, 2006 it sold its Building Control and Automation business to the former owners. The results of operations for Great Lakes have been presented as a separate component of income before extraordinary items for all periods presented in these financial statements. As a result of the sale, as of March 31, 2006 the Company has only one operating segment.

Note 2 Basis of Presentation

The accompanying consolidated financial statements have been prepared on the going concern basis which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has experienced operating losses and negative cash flow from operations since inception and currently has an accumulated deficit. These factors raise substantial doubt about the Company s ability to continue as a going concern. The Company s ability to continue as a going concern is ultimately dependent on its ability to obtain additional funding and increase sales to a level that will allow it to operate profitably and sustain positive operating cash flows. In January 2006, the Company announced that its Chief Executive Officer had resigned and been replaced by a member of the Board of Directors. The new CEO has begun to implement changes that he hopes will improve the Company s sales and profitability. The Company anticipates that it will raise additional capital before the end of 2006 in order to continue to fund operations while it works to improve profitability and cash flow. The Company has historically funded its operations through the issuance of additional equity and secured debt. However, there is no assurance that the Company will continue to be successful in obtaining additional funding in the future or improving its operating results. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the possible inability of the Company to continue as a going concern.

Note 3 Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of Lime Energy Co. and its wholly owned subsidiary Maximum Performance Group, Inc. All significant intercompany balances and transactions have been eliminated.

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Concentration of Risk

The Company s customers are primarily distributors of its EnergySaver product line, building owners, general contractors and electrical contractors. Two customers accounted for 37% and 11% of the Company s consolidated billings during the year ended December 31, 2005, respectively. During the year ended December 31, 2004 five customers accounted for 39%, 14%, 12%, 11% and 10% of the Company s consolidated revenue, respectively, and three customers accounted for 34%, 24% and 15% of the Company s consolidated revenue, respectively during the year ended December 31, 2003. The customer that accounted for 37% of the Company s consolidated sales in 2005 was not a customer of the Company in 2004. Of the customers accounting for more than 10% of the Company s consolidated sales in 2004, one also accounted for more than 10% of consolidated sales in 2003.

The Company purchases its raw materials from a variety of suppliers and continues to seek out alternate suppliers for critical components so that it can be assured that its manufacturing processes will not be interrupted by the inability of a single supplier to deliver product. During the year ended December 31, 2005, no single supplier accounted for more than 10% of the Company s total purchases. During the year ended December 31, 2004, three suppliers accounted for 25%, 19% and 14% of the Company s total purchases, respectively. During the year ended December 31, 2003, three suppliers accounted for 24%, 17% and 11% of the Company s total purchases, respectively.

The Company maintains cash and cash equivalents in accounts with a financial institution in excess of the amount insured by the Federal Deposit Insurance Corporation. The Company monitors the financial stability of this institution regularly and management does not believe there is significant credit risk associated with deposits in excess of federally insured amounts.

Allowance for Doubtful Accounts

The Company records an allowance for doubtful accounts based on specifically identified amounts that it believes to be uncollectible. If actual collections experience changes, revisions to the allowance may be required. After all attempts to collect a receivable have failed, the receivable is written off against the allowance. Based on the information available to it, the Company believes its allowance for doubtful accounts is adequate. However, actual write-offs might exceed the recorded allowance.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined utilizing the first-in, first-out (FIFO) method.

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

Properties & Equipment

Property and equipment are stated at cost. For financial reporting purposes depreciation is computed over the estimated useful lives of the assets by the straight-line method over the following lives:

Buildings	39 years
Computer equipment	3 years
Office Equipment	3 - 5 years
Furniture	5 - 10 years
Manufacturing equipment	3 - 5 years
Transportation equipment	3 - 5 years
VNPP assets	10 years

Cost in Excess of Assets Acquired

Goodwill represents the purchase price in excess of the fair value of assets acquired in business combinations. Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets , requires the Company to assess goodwill for impairment at least annually in the absence of an indicator of possible impairment and immediately upon an indicator of possible impairment.

	Building Control and Automation	Energy Technology	Total
Balance at January 1, 2004	$ 416,573	$	$ 416,573
Balance at December 31, 2004	416,573		416,573
Acquisition of Maximum Performance Group, Inc.		4,155,660	4,155,660
Impairment charge	(242,831)		(242,831)
Balance at December 31, 2005	$ 173,743	$ 4,155,660	$ 4,329,402

During the fourth quarters of 2004 and 2003, the Company completed its annual assessment of impairment regarding the goodwill recorded for its Building Control and Automation segment. Those assessments, supported by independent appraisals of the fair value of the segment, did not identify any impairment. However, the preliminary 2005 appraisal, made using customary valuation methodologies, including discounted cash flows and fundamental analysis, did reveal a potential impairment. Further supporting this assessment, in February 2006, the Company signed a letter of intent to sell the segment for an amount below the carrying value of the reporting unit. The decline in fair value of the Building Control and Automation segment is primarily the result of the segment failing to meet earnings expectations, due in part to strong competitors in its markets. As a result of this decline in fair value, the Company recorded an impairment loss of $242,831 for the year ended December 31, 2005, which is included in the loss from discontinued operations.

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

It is possible that upon completion of future impairment tests, as the result of changes in facts or circumstances, the Company may have to take additional charges to recognize a further write-down of the value of our acquisitions to their estimated fair values.

Deferred Financing Costs

The Company has capitalized as deferred financing costs $980,063 of expense incurred in arranging its convertible revolving credit facility and convertible term loans. These deferred financing costs are being amortized over the life of the related convertible term loan using the effective interest method. Upon conversion of any portion of a term loan a corresponding portion of the deferred financing costs are recognized as interest expense. The Company included $93,774, $382,710 and $203,616 of amortization of deferred financing costs in interest expense in 2005, 2004 and 2003, respectively.

Impairment of Long-Lived Assets

The Company records impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of those items. Our cash flow estimates are based on historical results adjusted to reflect our best estimate of future market and operating conditions. The net carrying value of assets not recoverable is reduced to fair value. Our estimates of fair value represent our best estimate based on industry trends and reference to market rates and transactions.

Revenue Recognition

The Company recognizes revenue when all four of the following criteria are met: (i) persuasive evidence has been received that an arrangement exists; (ii) delivery of the products and/or services has occurred; (iii) the selling price is fixed or determinable; and (iv) collectibility is reasonably assured. In addition, the Company follows the provisions of the Securities and Exchange Commission s Staff Accounting Bulletin No. 104, Revenue Recognition, which sets forth guidelines in the timing of revenue recognition based upon factors such as passage of title, installation, payments and customer acceptance. Any amounts received prior to satisfying the Company s revenue recognition criteria is recorded as deferred revenue in the accompanying balance sheet.

Revenues on long-term contracts are recorded under the percentage of completion method in conjunction with the cost-to-cost method of measuring the extent of progress toward completion. Any anticipated losses on contracts are charged to operations as soon as they are determinable. Prior to the second quarter of 2005, due to its limited experience estimating the profitability on its long-term contracts at its Building Control and Automation business, the Company deferred all contract related profits (i.e. assumed zero profit) until completion of the contract when the actual profit on the contract was known. Starting in the second quarter of 2005 the Company began recognizing contract related profits based on the projected profits for the contract, consistent with the AICPA s Statement of Position 81-1 (SOP 81-1).

The timing of revenue recognition may differ from contract payment schedules resulting in revenues that have been earned but not yet billed. These amounts are recorded on the balance sheet as Costs and estimated earnings in excess of billings on uncompleted contracts. The Company recorded costs and estimated profits in excess of billings on long-term jobs of $28,462 and $0 at December 31, 2005 and 2004, respectively. Billings on contracts that do not meet the Company s revenue recognition policy requirements for which it has been paid or has a valid account receivable are recorded as deferred revenue. Billings in excess of costs on long-term jobs generated by our Building Control and Automation

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

business of $241,154 and $387,419 are included in deferred revenue at December 31, 2005 and 2004, respectively.

Under certain long-term contracts, customers may withhold payment of approximately 5% to 10% of billings (retainage) until completion of the job. Retainage of $30,966 and $315,922 is included in accounts receivable at December 31, 2005 and 2004. All of the retainage outstanding as of December 31, 2005 is expected to be collected during fiscal 2006.

The Company s MPG subsidiary often bundles contracts to provide monitoring services and web access with the sale of its eMAC hardware. As a result, these sales are considered to be contracts with multiple deliverables which at the time the hardware is delivered and installed includes undelivered services essential to the functionality of the product. Accordingly, the Company defers the revenue for the product and services and the cost of the equipment and installation and recognizes them over the term of the monitoring contract. The monitoring contracts vary in length from 1 month to 5 years. Deferred revenue includes $1,440,172 as of December 31, 2005, related to these contracts.

The Company has entered into agreements in which it has contracted with utilities to establish a Virtual Negawatt Power Plan (VNPP). Under these contracts, the Company installs Energy Saver units at participating host locations (i.e. the utility s customer). The participating host locations receive the benefit of reduced utility costs through the operation of the units. The Company is able to reduce electric demand requirements during periods of peak demand, providing nearly instantaneous control, measurement and verification of load reduction. The utility companies will pay the Company for the availability of this demand reduction and the Company will recognize revenue under these contracts over the period for which the demand reduction is provided. Revenue of $15,781 was recognized from these contracts during the fourth quarter of 2005. No revenue was recognized under such contracts for the years ended December 31, 2004 and 2003. The cost of the energy saver units currently at host locations under such VNPP programs is included in fixed assets and depreciated over the term these units will be used under the existing contracts.

Shipping and Handling Costs

The Company classifies freight costs billed to customers as revenue. Costs related to freight are classified as cost of sales.

Research and Development Costs

Research and development costs are charged to operations when incurred and are included in selling, general and administrative expenses. Total research and development costs charged to operations were approximately $400,000, $150,000 and $70,000 for the periods ended December 31, 2005, 2004 and 2003, respectively.

Advertising, Marketing and Promotional Costs

Expenditures on advertising, marketing and promotions are charged to operations in the period incurred and totaled $6,000, $1,000, and $17,000 for the periods ended December 31, 2005, 2004 and 2003, respectively.

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred income taxes are recognized for the tax consequences in future years of the differences between the tax basis of assets and liabilities and their financial reporting amounts at each period end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable earnings. Valuation allowances are established when necessary to reduce deferred tax assets to the amount more likely than not to be realized.

Net Loss Per Share

The Company computes loss per share under Statement of Financial Accounting Standards No. 128, Earnings Per Share. The statement requires presentation of two amounts; basic and diluted loss per share. Basic loss per share is computed by dividing the loss available to common stockholders by the weighted average common shares outstanding. Dilutive earnings per share would include all common stock equivalents unless anti-dilutive. The Company has not included the outstanding options, warrants, convertible preferred stock or convertible debt as common stock equivalents 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 is not included in the basic and diluted net loss per share available to common stockholders:

December 31,	**2005**	**2004**	**2003**
Weighted average shares issuable upon exercise of outstanding options	**781,358**	712,703	686,090
Weighted average shares issuable upon exercise of outstanding warrants	**910,678**	733,594	614,076
Weighted average shares issuable upon conversion of preferred stock	**1,519,209**	1,536,383	1,702,174
Weighted average shares issuable upon conversion of convertible debt	**157,225**	23,845	9,487
Total	**3,368,470**	3,006,525	3,011,827

Financial Instruments

The carrying amounts reported in the consolidated balance sheets for cash, accounts receivable, accounts payable and accrued expenses approximate fair value because of the short-term nature of these amounts. The Company s long-term debt approximates fair value based on instruments with similar terms.

Stock-based Compensation

At December 31, 2005, the Company had a stock-based compensation plan, which is described in Note 19. The Company applied 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 such plan. No stock-based compensation expense was reflected in the 2005, 2004 or 2003 net loss as all options granted during those years had an exercise price equal to or greater than the market value of the underlying common stock on the date of the grant.

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

For purposes of the following pro forma disclosures as required by Statement of Financial Accounting Standards (SFAS) No. 123, the fair value of each option granted after December 15, 1994 has been estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for the grants:

December 31,	**2005**	**2004**	**2003**
Risk-free interest rate	**4.91%**	**4.95%**	**5.02%**
Expected volatility	**98.4%**	**99.0%**	**99.5%**
Expected life (years)	**8.5**	**8.5**	**8.5**
Expected dividend yield	**0%**	**0%**	**0%**

The weighted-average fair value of options granted was $98.85 in 2005, $99.45 in 2004 and $100.80 in 2003. For purposes of pro forma disclosures, the estimated fair value of the options is amortized over the options vesting period.

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:

Year ended December 31,	**2005**	**2004**	**2003**
Net Loss, as reported	**$ (6,873,000)**	**$ (5,159,000)**	**$ (5,482,000)**
Deduct: Stock-based employee compensation expense included in reported net loss			**-**
Add: Total stock-based employee compensation expense determined under fair value based method for awards [1]	**(774,000)**	**(898,000)**	**(889,000)**
Pro forma net loss	**$ (7,647,000)**	**$ (6,057,000)**	**$ (6,371,000)**
Net loss per share			
Basic and diluted as reported	**$ (2.73)**	**$ (3.68)**	**$ (4.58)**
Basic and diluted pro forma	**$ (2.98)**	**$ (4.02)**	**$ (4.97)**

[1] 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.

The Company adopted FAS 123 (R), during the first quarter of 2006, recording $144,610 and $102,259 in expense associated with options issued to employees in its Condensed Consolidated Statements of Operations during the first and second quarters of 2006, respectively.

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

Warranty Obligations

The Company warrants to the purchasers of its products that the product will be free of defects in material and workmanship for one year from the date of installation. In addition, some customers have purchased extended warranties for the Company s products that extend the base warranty for up to ten years. 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. See Note 9 for additional information about the Company s warranty liability.

Insurance Reserves

In October 2005, the Company implemented a partially self-funded health insurance program for its employees. Under the program the Company is responsible for the first $35,000 of each individual claim, but its exposure is limited on a monthly and cumulative basis through insurance provided by a third party insurance company. The Company accrues on a monthly basis an amount sufficient to cover its maximum exposure under the program. As of December 31, 2005 it had an accrued liability of $57,231 to cover future claims under the program. At the end of the plan year it will assess the adequacy of the reserve based on its claims history and adjust the reserve as necessary.

Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment . This statement revises FASB Statement No. 123, Accounting for Stock-Based Compensation and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS No. 123(R) focuses primarily on the accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS No. 123(R) requires companies to recognize in the statement of operations the cost of employee services received in exchange for awards of equity instruments based on the grant-date fair value of those awards (with limited exceptions). This Statement is effective as of the first reporting period that begins after June 15, 2005. The Company adopted SFAS 123(R) during the first quarter of fiscal 2006, the effect of which is recorded to its statement of operations. In March 2005, the SEC staff issued Staff Accounting Bulletin No. 107 (SAB 107) to give guidance on the implementation of SFAS 123R. The Company has taken SAB 107 into consideration during implementation of SFAS 123R.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections A Replacement of APB Opinion No. 20 and FASB Statement No. 3 (SFAS No. 154). SFAS No. 154 requires the retrospective application to prior periods financial statements of changes in accounting principle, unless it is impractical to determine either the period-specific effects or cumulative effect of the accounting change. SFAS No. 154 also requires that a change in depreciation, amortization, or depletion method for long-lived non-financial assets be accounted for as a change in accounting estimate affected by a change in accounting principle. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

Note 4 Acquisition of Maximum Performance Group, Inc.

On May 3, 2005, pursuant to an Agreement and Plan of Merger (the Merger Agreement) dated as of April 28, 2005, by and among Lime Energy Co., MPG Acquisition Corporation, a wholly-owned subsidiary of Electric City (Merger Subsidiary), and Maximum Performance Group, Inc. (MPG), Electric City acquired MPG through the merger of MPG with and into Merger Subsidiary, with Merger Subsidiary continuing as the surviving corporation under the name Maximum Performance Group, Inc.

The merger consideration, after post closing adjustments, consisted of $1,632,972 in cash (net of transaction costs of $137,386 and cash acquired of $136,492), 166,149 shares of Electric City common stock and approximately 166,149 additional shares which have been placed in escrow. Total consideration was $4,616,880, which consisted of $1,632,079 in cash, stock valued at $2,691,607 (based on the average closing price the Company s stock for the five days before and after the announcement of the transaction of $16.20 per share), $137,386 in transaction costs plus commissions paid to Delano Securities in the form of 8,366 shares of common stock valued at $15.00 per share (the closing price of the Company s stock on the effective date of the transaction). The cash portion of the consideration was funded with proceeds from a private placement of the Company s common stock. (See note 17(r) for additional information on the private placement). If MPG s revenues during the two years following the merger exceed an aggregate of $5,500,000 on a cumulative basis, the escrow shares will be released to the former stockholders of MPG at the rate of 13.47 shares for every $1,000 of revenue in excess of such amount. These shares will be valued at the market price at the time they are released from escrow and will result in an increase in the goodwill associated with the transaction. The escrow shares are also available to satisfy any indemnification claims which the Company may have under the Merger Agreement, thus would reduce the shares available for the selling stockholders of MPG. As a part of the transaction, the former stockholders of MPG entered into a stock trading agreement with the Company which restricts their ability to sell shares of the Company s common stock under certain circumstances. As a result of the merger, Merger Subsidiary (which changed its name to Maximum Performance Group, Inc. pursuant to the merger) became responsible for the liabilities of MPG, including approximately $232,000 in payments owed to shareholders and affiliates and approximately $40,000 of bank debt and capitalized lease obligations.

MPG is a technology based provider of energy and asset management products and services. MPG currently manufactures and markets its eMAC line of controllers for HVAC and lighting applications. The eMAC line of controllers provide intelligent control and continuous monitoring of HVAC and lighting equipment via wireless technology to reduce energy usage and improve system reliability. MPG, which had 2004 revenues of approximately $2.3 million, has offices in New York, New York and San Diego, California.

Electric City acquired MPG to expand its product line of proprietary energy conservation technologies and because it believed that the customer bases, technologies and personnel of the two companies complemented each other well and could lead to an expansion of the combined entity s market presence.

In connection with the acquisition of MPG, the Company appointed Leonard Pisano as Electric City s Chief Operating Officer, and Maximum Performance Group, Inc. entered into an employment agreement with Mr. Pisano under which he will be employed for three years as its President.

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

The assets acquired and liabilities assumed in the acquisition are as follows:

Accounts receivable	$ 292,102
Inventory	326,122
Advances to suppliers	472,689
Other current assets	63,611
Net property and equipment	121,608
Identifiable intangible assets	2,432,600
Goodwill	4,155,659
Total assets acquired	7,864,391
Accounts payable	928,509
Accrued expenses	658,940
Deferred revenue	1,011,616
Other current liabilities	525,676
Notes payable	289,587
Total liabilities acquired	3,414,328
Net assets acquired	4,450,063
Less valuation of shares issued for acquisition	(2,691,607)
Acquisition costs paid through the issuance of common stock	(125,484)
Total cash paid, including acquisition costs, net of cash acquired	$ 1,632,972

Utilizing an independent third party valuation firm, the Company has assessed the fair values of assets and liabilities of MPG and allocated the purchase price accordingly. For purposes of the allocation, it has allocated $2,432,600 of the MPG purchase price to identifiable intangible assets with definitive lives such as customer relationships, customer contracts and the eMac technology and software. This amount has been capitalized and is being amortized over the estimated useful life of the related identifiable intangible assets. The amounts capitalized and the estimated useful life of the identifiable intangible assets are as follows:

Asset Class	**Estimated Value**	**Estimated Useful Life**
eMac technology and software	$ 1,979,900	4.0
Customer relationships	267,800	9.7
Customer contracts	184,900	1.0

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

The acquisition was recorded using the purchase method of accounting. Accordingly, the results of the MPG s operations have been included in the consolidated statement of operations since May 1, 2005. Unaudited pro forma results of operations for the years ended December 31, 2005 and 2004 for the Company and MPG, assuming the acquisition took place on January 1, 2004, are as follows:

Year ended December 31,	**2005**	**2004**
Revenue:		
As Reported	**$ 4,854,772**	**$ 2,412,635**
Pro-forma	**5,111,454**	**4,724,950**
Net Loss:		
As Reported	**$ (6,872,738)**	**$ (5,159,362)**
Pro-forma	**(8,560,744)**	**(8,278,842)**
Basic and Diluted Loss per Share:		
As Reported	**$ (2.73)**	**$ (3.68)**
Pro-forma	**(3.26)**	**(4.86)**

Note 5 Discontinued Operations

The Company adopted Statement of Financial Accounting Standards No. 144 (SFAS 144) at the beginning of 2002. Among other things, SFAS 144 requires that the results of operations and related disposal costs as well as the gain or loss on the disposal of a business unit be presented on the statement of operations as a separate component of income before extraordinary items for all periods presented.

On June 3, 2003, the Company entered into an asset purchase agreement with Hoppensteadt Acquisition Corp., whereby Hoppensteadt acquired all of the assets, except for certain receivables and cash, and assumed all of the liabilities, except for bank debt, of the Company s Power Management segment as of May 31, 2003, in exchange for $929,032 in cash. Hoppensteadt Acquisition Corp. is owned by a group of investors that includes former managers of the Company s Power Management segment.

On April 3, 2006, the Company completed a Stock Purchase Agreement with Eugene Borucki and Denis Enberg (the Purchasers) in which it agreed to sell, effective as of March 31, 2006, all of the outstanding capital stock of Great Lakes Controlled Energy Corporation to the Purchasers for 14,194 shares of Electric City common stock (the Transaction). The Stock Purchase Agreement provided that in the event that Great Lakes Adjusted Net Book Value (defined below), was less than $20,000, Electric City would make a cash payment to the Purchasers equal to the difference between the Adjusted Net Book Value and $20,000, and in the event that Great Lakes Adjusted Net Book Value exceeded $20,000 then the Purchasers would make a cash payment to Electric City equal to the amount by which the Adjusted Net Book Value exceeded $20,000. Adjusted Net Book Value was defined as net assets (excluding goodwill) less net liabilities (excluding inter-company debt), as such items were shown on the final closing date balance sheet. During May 2006, the Company and the Purchasers completed the calculation of the Adjusted Net Book Value and determined that the Company owed the Purchasers $3,139.

F-18

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

The assets and liabilities of the discontinued operations that are included in the Company s consolidated assets and liabilities are as follows:

	December 31, 2005	December 31, 2004
Accounts receivable	$ 439,456	$ 839,560
Other current assets	45,287	20,495
Total current assets	484,743	860,055
Net property plant and equipment	16,028	7,678
Total assets	500,771	$ 867,733
Accounts payable	$ 73,825	$ 498,416
Accrued expenses	81,167	67,606
Current portion of long term debt	2,160	3,451
Deferred revenue	241,154	387,419
Customer deposits	50,000	
Total current liabilities	448,306	956,892
Long-term debt		2,160
Total liabilities	$ 448,306	$ 959,052

The revenue and loss related to discontinued operations were as follows:

Year ended December 31	**2005**	**2004**	**2003**
Revenue	**$ 1,161,343**	**$ 1,679,005**	**$ 4,835,637**
Net Loss	**(251,962)**	**(170,338)**	**(776,710)**

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

Note 6 Inventories

Inventories consisted of the following:

December 31,	**2005**	**2004**
Raw materials	**$ 919,832**	**$ 528,718**
Finished goods	**537,957**	**500,927**
	$ 1,457,789	**$ 1,029,645**

Note 7 Property and Equipment

Property and equipment consist of the following:

December 31,	**2005**	**2004**
Land	**$ 205,000**	**$ 205,000**
Building	**984,396**	**984,396**
Furniture	**75,005**	**60,365**
Manufacturing equipment	**47,169**	**40,725**
Office equipment	**288,271**	**202,520**
Transportation equipment	**95,516**	**37,676**
VNPP assets	**1,376,005**	**897,756**
	3,071,362	**2,428,438**
Less accumulated depreciation	**557,166**	**442,877**
	$ 2,514,196	**$ 1,985,561**

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

Note 8 Accrued Expenses

Accrued expenses are comprised of the following:

December 31,	**2005**	**2004**
Commissions	**$ 124,736**	**$ 26,145**
Compensation	**133,463**	**55,979**
Contract labor	**293,456**	
Insurance	**73,432**	
Interest	**71,216**	**6,925**
Lease expense	**55,191**	
Legal	**14,456**	**65,000**
Professional fees	**26,328**	**169,427**
Real estate taxes	**73,135**	**79,496**
Royalties	**12,900**	**6,900**
Sales tax payable	**43,439**	**1,350**
Warranty reserve	**228,331**	**151,008**
Other	**78,682**	**5,459**
	$ 1,228,765	**$ 567,689**

Note 9 Warranty Liability

Changes in the Company s warranty liability are as follows:

December 31,	**2005**	**2004**
Balance, beginning of year	**$ 151,008**	**$ 121,702**
Warranties issued	**116,298**	**36,750**
Settlements	**(38,975)**	**(7,444)**
Balance, end of year	**$ 228,331**	**$ 151,008**

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

Note 10 Line of Credit

On September 11, 2003 the Company closed on a credit facility with Laurus Master Fund, Ltd. (Laurus). The facility included a $1,000,000 convertible term loan and a $2,000,000 convertible revolving line of credit. The credit line replaced an expiring credit line the Company had with American Chartered Bank. The Laurus revolving credit facility provides for borrowings of up to the lesser of (i) $2 million or (ii) 90% of the Company s eligible accounts receivable. The revolving credit facility had an initial term of two years, but on August 31, 2004 the maturity date on the facility was extended to September 1, 2006. The revolving credit facility accrues interest on outstanding balances at the rate of prime (7.25% as of December 31, 2005) plus 1.75%. Laurus has the option to convert all or a portion of the advances under any secured convertible revolving note into shares of the Company s common stock at any time, subject to certain limitations, at a fixed conversion price (originally $24.60 per share, but amended (see below) to $15.75 per share). As amounts are drawn on this line-of-credit, to the extent the current market price exceeds the fixed conversion price, additional interest expense will be recognized as a result of this beneficial conversion feature. The revolving credit facility is secured by a blanket lien on all of the Company s assets, except for its real estate.

On February 28, 2005, the Company and Laurus entered into an amendment to the revolving credit facility which among other things permitted the Company to borrow an amount in excess of the amount supported by the borrowing base (an Overadvance), up to the $2 million limit of the facility, and reduced the fixed conversion price on the revolving credit line to $15.75 per share. The Company borrowed the full $2 million on February 28, 2005. The Company was permitted to remain in the Overadvance position until January 1, 2006 (the Overadvance Period). The amended revolving loan agreement provided that the Overadvance Period would be extended on a month to month basis if the average closing price of the Company s stock for the five last trading days of the prior month was greater than or equal to $17.40 (110% of the new fixed conversion price of $15.75). The Overadvance Period was not extended on January 1, 2006, and on January 12, 2006, the Company reduced the outstanding balance on the revolver to $1,128,248 through the payment of $871,752 in cash. The Company may reborrow the amount repaid if it has sufficient borrowing base to support the borrowings. As of February 28, 2006, our borrowing base would support borrowings of approximately $1,276,000. If at any time after the date the shares underlying the revolving credit facility are registered and the average closing price of the Company s Common Stock for an eleven day period exceeds $18.15 per share (115% of the fixed conversion price), Laurus will be required to convert to common stock the lesser of the outstanding balance of revolving credit line or 25% of the average aggregate dollar weighted trading volume of the Company s Common Stock for the eleven days prior to the conversion (a Mandatory Conversion). Only one Mandatory Conversion can be effected in any 22 day period. All stock conversion prices and exercise prices are subject to adjustment for stock splits, stock dividends or similar events.

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

Note 11 Convertible Term Loans

On September 11, 2003, the Company entered into a $1,000,000 convertible Term Loan with Laurus. The Term Loan had an initial term of two years and was scheduled to amortize at the rate of $50,000 per month beginning February 1, 2004, if not offset by the conversion of all or a portion of the loan prior to the due date of the amortization payment. On August 31, 2004, the maturity date for the Term Loan was extended to September 1, 2006, the amortization schedule was modified to defer the first principal payment to February 1, 2005 and reduce the monthly payments to $35,000 per month, with a final payment of $11,790 due on September 1, 2006 (if not offset by the conversion of all or a portion of the loan prior to the due date of the amortization payment) and the conversion price was reduced from $31.80 to $24.60 per share. The Term Loan, which had an outstanding balance of $291,790 as of December 31, 2005, accrues interest at the greater of prime (7.25% as of December 31, 2005) plus 1.75%, or 6%, and is payable monthly in arrears. The Company has the option of paying scheduled interest and principal, or prepaying all or a portion of the Term Loan with shares of its common stock at the fixed conversion price of $24.60 per share, provided that the closing price of the common stock is greater than $28.35 per share for the 11 trading days immediately preceding the payment date and that the shares are registered with the Securities and Exchange Commission. Laurus also has the option to convert all or a portion of the Term Loan into shares of the Company s common stock at any time, subject to certain limitations, at a fixed conversion price of $24.60 per share. The Term Loan is secured by a blanket lien on all of the Company s assets, except for its real estate.

In conjunction with the Term Loan, Laurus received a five year warrant to purchase up to 9,333 shares of the Company s common stock at prices ranging from $36.60 per share to $46.05 per share. The warrants were valued at $163,400 using a modified Black-Scholes option pricing model. The value of these warrants was recorded as a discount to the Term Loan and are being amortized over the term of the loan using the effective interest method.

Laurus was paid a fee of $150,000 and received an additional five year warrant to purchase up to 18,667 shares of the Company s common stock at prices ranging from $38.10 per share to $47.70 per share in connection with the term loan and revolving credit facility. This warrant was valued at $320,000 using a modified Black-Scholes option pricing model. In addition, the Company issued a one-year warrant to purchase 3,333 shares of common stock at $15.00 per share to Wall & Broad Equities as part of its commission for this transaction. These warrants were valued at $58,000 using a modified Black-Scholes option pricing model. The value of the warrants along with $158,228 in other fees and expenses related to the transaction have been recorded as capitalized costs of financing and are being amortized using the effective interest method over the term of the Term Loan.

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

In recording the transaction, the Company allocated the value of the proceeds to the Term Loan and warrants based on their relative fair values. In doing so, it determined that the Term Loan contained a beneficial conversion feature since the fair market value of the common stock issuable upon conversion of the Term Loan exceeded the value of $836,600 allocated to the Term Loan on the date of issuance. The Term Loan was initially convertible into 31,447 shares of common stock, which at the then current market price of $30.75 per share was worth $966,981. The difference between the market value of the shares issuable upon conversion and the value allocated to the Term Loan of $180,381 is considered to be the value of the beneficial conversion feature. The value of the beneficial conversion feature has also been recorded as a discount to the term note and is being amortized over the term of the loan using the effective interest method.

On November 26, 2003, Laurus converted $52,346 of principal and $654 of accrued interest into 1,667 shares of the Company s common stock, and during January 2004 Laurus converted $270,864 of principal and $4,736 of accrued interest into 8,667 of the Company s common stock.

On November 22, 2005, Electric City and Laurus entered into a securities purchase agreement providing for a new four year, $5 million convertible term loan to fund the expansion of the Company s VNPP projects and Shared Savings program, as well as for general corporate purposes (the New Term Loan). The Company received unrestricted access to the proceeds from the New Term Loan on November 25, 2005. The New Term Loan bears interest at the higher of prime (7.25% as of December 31, 2005) plus 2% or 6.75% and requires monthly amortization of $43,860 if paid in additional shares of Common Stock or $44,736 if paid in cash, commencing on June 1, 2006. Any principal balance that has not been repaid or converted to Common Stock will be due at maturity on November 1, 2009. The New Term Loan is convertible into Common Stock at the holder s option at anytime at $17.40 per share (the Fixed Conversion Price) and the Company can require conversion if the market price of its stock averages at least $34.80 (200% of the Fixed Conversion Price) for the last ten days of any month. In addition, if the shares issuable upon conversion are registered and the market price of the Common Stock is $15.00 or greater, the Company can elect to pay monthly interest and principal with shares of stock valued at 85% of the weighted average closing price of the Common Stock for the prior 20 trading days. If the market price of the Common Stock exceeds $19.95 per share (115% of the Fixed Conversion Price) then Laurus shall be required to convert the monthly principal and interest to Common Stock at $17.40, subject to certain conditions. The New Term Loan has a financial covenant that requires, if the market price of the Company s Common Stock is less than $18.30 (105% of the Fixed Conversion Price), that the Company maintains an EBITDA to Debt Expense ratio of not less than 1.1 to 1.0 as of the last day of each fiscal quarter beginning with the fiscal quarter ending September 30, 2006. The Convertible Term Loan and the other obligations to Laurus are secured by all the Company s and its Subsidiary s assets, except for real estate. All stock conversion prices and exercise prices are subject to adjustment for stock splits, stock dividends or similar events.

In connection with the Term Loan, Laurus was paid fees totaling $225,000 and received a seven year warrant to purchase 133,333 shares of the Company s Common Stock at $17.40 per share. The fees, along with an additional $68,835 in transaction expenses were capitalized and will be amortized over the life of the Term Loan utilizing the effective interest method. The warrants were valued at $920,000 using a modified Black-Sholes option pricing model. The value of the warrants was recorded as a discount to the Term Loan and will also be amortized over the life the the Term Loan utilizing the effective interest method.

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

As part of the New Term Loan the Company agreed to split any cash flow generated by the Company s VNPP and Shared Savings projects (the Projects), after the payment of related debt, to the extent any portion of the New Term Loan is used to fund such Projects. The Project Cash Flow has been defined as the revenue generated by the Projects, less the operating costs, maintenance costs and debt service costs (principal, interest and fees) directly related to such Projects. As long as any portion of the New Term Loan is outstanding, the Company has agreed to pay to Laurus on a quarterly basis Performance Interest in an amount equal to two-thirds (2/3rds) of the Project Cash Flow generated by all Projects, not to exceed the Target Return for the quarter. The Target Return is defined to be 5% of the average daily outstanding project related debt during the quarter, less interest (excluding Performance Interest and Bonus Interest) and fees for such quarter. In addition, the Company has agreed to pay Laurus on a quarterly basis, as long as any portion of the New Term Loan is outstanding, Bonus Interest equal to one-third (1/3rd) of any Project Cash Flow in excess of the Performance Interest. After the New Term Loan has been repaid in full, the Company is required to continue to pay Laurus a portion of the Project Cash Flow as follows:

Period Following Repayment of the New Term Loan	Percentage of Project Cash Flow Paid to Laurus
Year 1	50%
Year 2	40%
Year 3	30%
Year 4	20%
Year 5	10%
Year 6+	0%

Note 12 Notes Payable

As part of the acquisition of Maximum Performance Group, Inc., the Company assumed a $150,000 demand note payable to Cinergy Ventures, LLC. The note accrues interest at the rate of prime (7.25% as of December 31, 2005) plus 3%. As of December 31, 2005 the Company had accrued interest payable of $10,533 related to the Note.

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

Note 13 Long Term Debt

The Company s long term debt consists of the following:

December 31,	**2005**	**2004**
Mortgage note to American Chartered Bank, prime (7.25%) plus 1/2%, payable in monthly installments of $3,000, plus interest until January 2007. A final payment of $523,000 is due in February 2007. This note is collateralized by the building and land.	**$ 562,000**	**$ 598,000**
Convertible term note to Laurus Master Fund (less debt discount of $7,768 and $50,048, as of December 31, 2005 and 2004, respectively), interest rate equal to the greater of the prime rate (7.25%) plus 1.75%, or 6.00%, payable in monthly installments of $35,000 plus interest through August 2006 with a final payment of $11,790 due on September 1, 2006 if not converted to common stock prior to the payment due date. The note is collateralized by a general lien on all of the Company s assets, other than its real estate. (see Note 12)	**284,022**	**626,742**
Convertible term note to Laurus Master Fund (less debt discount of $890,641 as of December 31, 2005) interest rate equal to the greater of the prime rate (7.25%) plus 2.00%, or 6.75%, payable monthly. In addition, the Company is required to pay contingent interest as disclosed in Note 12. Beginning June 1, 2006 the Company must begin making monthly principal payments of $43,860 with a final payment of $3,201,754 due on November 1, 2009 if not converted to common stock prior to the payment due date. The note is collateralized by a general lien on all of the Company s assets, other than its real estate. (see Note 12)	**4,109,359**	
Various other notes	**24,651**	**5,611**
Total debt	**4,980,032**	**1,230,353**
Less current portion	**651,313**	**424,451**
Total long-term debt	**$ 4,328,719**	**$ 805,902**

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

The aggregate amounts of long-term debt maturing in each of the next five years as of December 31, 2005, are as follows:

2006	$ 659,081
2007	1,052,694
2008	526,316
2009	3,640,350
2010	
	$5,878,441

Note 14 Lease Commitments

The Company leases offices in New York and California on which it paid a total of $40,288 during the year ended December 31, 2005.

Future minimum rentals to be paid by the Company as of December 31, 2005 are as follows:

Year ending December 31,	**Total**
2006	$ 78,753
2007	66,423
2008	68,083
2009	69,785
2010	53,314
Total	$ 336,358

Note 15 Income Taxes

The composition of income tax expense (benefit) is as follows:

Year ended December 31	**2005**	**2004**	**2003**
Deferred			
Federal	$ (2,272,000)	$ (2,025,000)	$ (1,558,000)
State	(401,000)	(358,000)	(275,000)
Change in valuation allowance	2,673,000	2,383,000	1,833,000
Benefit for income taxes	$	$	$

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

Significant components of the Company s deferred tax asset are as follows:

December 31	**2005**	**2004**
Deferred tax asset consisting principally of net operating losses	**$ 21,689,000**	**$ 19,016,000**
Less valuation allowance	**(21,689,000)**	**(19,016,000)**
Total net deferred tax asset	**$**	**$**

The Company has recorded a valuation allowance equaling the deferred tax asset due to the uncertainty of its realization in the future. At December 31, 2005, the Company has U.S. federal net operating loss carryforwards available to offset future taxable income of approximately $55,000,000, which expire in the years 2018 through 2025.

The reconciliation of income tax expense (benefit) to the amount computed by applying the federal statutory rate is as follows:

Year ended December 31,	**2005**	**2004**	**2003**
Income tax (benefit) at federal statutory rate	**$ (2,337,000)**	**$ (1,754,000)**	**$ (1,864,000)**
State taxes (net of federal tax benefit)	**(336,000)**	**(258,000)**	**(275,000)**
Other nondeductible expenses		**34,000**	**144,000**
Other		**(404,000)**	**162,000**
Increase in valuation allowance	**2,673,000**	**2,382,000**	**1,833,000**
Income tax expense (benefit)	**$**	**$**	**$**

Note 16 Commitments and Contingencies

a) Pursuant to the Consolidated Agreement dated January 8, 2001, among the Company, Giorgio Reverberi (Reverberi), the owner of the patent relating to certain technologies used in the EnergySaver, and Joseph Marino, former Chairman and CEO of Electric City (who assigned the rights to the Company), the Company agreed to pay Reverberi a royalty of $200 for each EnergySaver unit made by or for the Company and sold by the Company. Mr. Marino is also paid a royalty of $100 for each unit sold by the Company. The term of the license granted to the Company expires when the last of Reverberi s patents expires, which the Company expect to be in November, 2017. The license may be terminated by Reverberi if the Company materially breaches its terms and fails to cure the breach within 180 days after Reverberi gives the Company written notice of the breach. Approximately $60,000, $34,000, and $65,000 of expense was incurred under the agreement

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

for the years ended December 31, 2005, 2004 and 2003, respectively. The Company has accrued $12,900 and $6,900 in royalties payable at December 31, 2005 and 2004, respectively.

b) The Company entered into employment agreements with certain officers and employees expiring 2008. Total future commitments under these agreements are as follows:

Year ending December 31,	
2006	**$225,000**
2007	**225,000**
2008	**75,000**
Total	**$525,000**

c) The Company is involved in certain litigation in the normal course of its business. Management intends to vigorously defend these cases. In the opinion of management, the litigation now pending will not have a material adverse affect on the consolidated financial statements of the Company.

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

Note 17 Equity Transactions

2003 Transactions

a) In a series of transactions during February and April 2003, the Company sold 121,008 shares of its common stock for $13.80 per share and issued five year warrants to purchase 33,398 shares of common stock at $13.80 per share resulting in gross proceeds of $1,669,916. The Company incurred offering costs of $154,790 related to these transactions.

b) On June 27, 2003, the Company entered into a securities purchase agreement with a group of investors that included Cinergy Ventures II, LLC, Mr. Richard Kiphart, SF Capital Partners, Ltd., John Thomas Hurvis Revocable Trust and Mr. David Asplund whereby the Company issued, in exchange for $1,500,000 in gross proceeds, a package of securities that included 150,000 shares of its Series D Convertible Preferred Stock (the Series D Preferred), 1,504 shares of its Common Stock, one year warrants to purchase 37,500 additional shares of its Series D Preferred and four year warrants to purchase 14,063 additional shares of its Common Stock.

Proceeds from the transaction were allocated to the Series D Convertible Preferred Stock, the common stock and the warrants issued as part of the Transaction based on their relative fair values. The Series D Convertible Preferred Stock contained a beneficial conversion feature as a result of its initial conversion price, which was lower than the market value of the Company s common stock on the date of issue. The value of this beneficial conversion feature was determined based on the value allocated to the Series D Convertible Preferred Stock, along with the discount to the market value of the common stock on the date of issuance. The value of the beneficial conversion feature was deemed to be equivalent to a non-cash preferred stock dividend. The Company recorded the deemed dividend on the date of issuance by offsetting charges and credits to additional paid-in capital in the amount of $386,984, without any effect on total stockholders equity. The deemed dividend increased the loss applicable to common shareholders in the calculation of the basic and diluted net loss per common share for the year ended December 31, 2003.

Delano Group Securities, LLC acted as placement agent for the Company with respect to the transaction and was paid a placement agent fee of $120,000. Delano Group Securities, LLC is controlled by Mr. David Asplund, one of the investors in the transaction and one of the Company s directors, and effective January 23, 2006 the Company s Chief Executive Officer.

c) During September 2003, the Company entered into a financing arrangement with Laurus Master Fund, Ltd. (Laurus) to provide the Company with a $1 million convertible secured term loan and a $2 million convertible revolving line of credit. As part of this transaction the Company issued warrants to Laurus to purchase 28,000 shares of its common stock. The warrants have exercise prices ranging from $36.60 per share to $47.70 per share and have terms of five years. The warrants were valued at $483,400 using a modified Black-Sholes option pricing model utilizing the following assumptions: risk free rate of 0.951%, expected volatility of 78.0%, expected dividend of $0 and expected life of 5 years. Of the total value, $163,400 was recorded as a discount to the term loan and $320,000 was recorded as deferred financing costs, both of which are being amortized over the term of the underlying debt.

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

d) On July 23, 2003, the Board of Directors approved the retirement of 67 shares of common stock held as treasury stock, which are now deemed authorized but unissued shares.

e) During the year ended December 31, 2003, the Company satisfied the accrued dividend on its preferred stock of $2,551,379 though the issuance of 225,398 shares of its Series A Preferred stock, 21,971 shares of its Series C Preferred stock and 7,769 shares of its Series D Preferred stock. Since these shares of preferred stock were convertible into common stock at a price below the market price on the dates of issuance, the Company was required to recognize deemed dividends of $1,627,985 on the shares issued in satisfaction of the Series A Preferred dividend, $158,691 on the shares issued in satisfaction of the Series C Preferred dividend and $92,878 on the shares issued in satisfaction of the Series D Preferred dividend. These deemed dividends were calculated as the difference between (1) the market value of the common shares into which the preferred shares were convertible on the dates of issuance and (2) the accrued dividend obligation on the outstanding preferred stock.

f) During fiscal 2003, the Company issued warrants to purchase 43,133 shares of its Common Stock to consultants as compensation for services received. As the fair market value of these services was not readily determinable, these services were valued based on the fair market value of the warrants at the time of issuance, which ranged from $4.35 to $21.30 per warrant. The warrants were valued at $393,550 using a modified Black-Sholes option pricing model utilizing the following assumptions: risk-free rates of 0.901% to 1.712%, expected volatility of 73% to 90%, expected dividend of $0 and expected lives of 0.4 to 3 years. The Company recognized total expense of $393,550 relating to the issuance of these warrants during 2003.

g) During fiscal 2003, the Company received proceeds of $197,000 in connection with the exercise of 13,133 warrants, resulting in the issuance of 13,133 shares of the Company s Common Stock.

h) During fiscal 2003, Laurus Master Fund Ltd. converted $52,346 of principal and $654 of accrued interest on the Company s Convertible Term Note into 1,667 shares of our common stock.

2004 Transactions

i) During fiscal 2004, holders of our Series A Convertible Preferred Stock converted 145,000 shares of Series A into 96,667 shares of common stock.

j) Also during 2004, holders of the Company s Series E convertible Preferred Stock converted 5,067 shares of Series E Convertible Preferred Stock into 33,780 shares of Common Stock.

k) 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. whereby it issued to such purchasers, in exchange for $11,000,000 in gross proceeds, a package of securities that included 333,333 shares of its common stock and 5 year warrants to purchase 116,667 additional shares of common stock at $36.30 per share.

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

On March 22, 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 Old Preferred Stock) under which it redeemed 538,462 shares of the outstanding Old Preferred Stock which were convertible into 358,975 shares of common stock, at a redemption price equivalent to $19.50 per common share, and exchanged 210,451 shares of its newly authorized Series E Convertible Preferred Stock (the Series E Preferred) for the remaining 2,104,509 outstanding shares of the Old Preferred Stock (the Exchange) on a 1 for 10 basis (one share of Series E Preferred exchanged for 10 shares of Old Preferred Stock). All of the Old 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 (and subsequently extended to December 31, 2004). Such Series E warrants issued were 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.

Except as respects dividends, the Series E Preferred has substantially the same rights as the shares of Old Preferred Stock that it replaced, including:

- special approval rights with respect to 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 of $15.00 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

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

The Series E Preferred accrues dividends at a rate of 6% (versus 10% for the Old Preferred) per annum, which at the Company s option may be paid by issuing more shares of Series E Preferred.

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

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 which increased the loss available to shareholders and the reported loss per common share. 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 Old Preferred Stock. The fair value of the consideration given exceeded the carrying value of the Old 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 Old 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 $195,393.

l) During fiscal 2004, the Company received proceeds of $485,000 in connection with the exercise of 12,333 common stock warrants and 3,000 Series E Convertible Preferred warrants.

m) During fiscal 2004, the Company issued warrants to purchase 8,000 shares of its common stock at prices between $15.00 and $23.25 per share to consultants for services received. The warrants were valued at $42,600 using a modified Black-Sholes option pricing model utilizing the following assumptions: risk free rate of 1.607% to 2.772%, expected volatility of 42.5 to 53.6%, expected dividend of $0 and expected life of 2 to 3 years. The value of the warrants was charged to operations during the period.

n) During fiscal 2004, Laurus Master Fund Ltd. converted $270,864 of principal and $4,736 of accrued interest on the Company s Convertible Term Note into 8,667 shares of our common stock.

o) During fiscal 2004, the Company satisfied the accrued dividend on its preferred stock of $1,636,780 though the issuance of 16,368 shares of its Series E Preferred stock. Since these shares of preferred stock are convertible into common stock at a price below the market price on the dates of issuance, the Company was required to recognize deemed dividends of $1,127,021 during the period. These deemed dividends were calculated as the difference between (1) the market value of the common shares into which the preferred shares were convertible on the dates of issuance and (2) the accrued dividend obligation on the outstanding preferred stock.

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

2005 Transactions

p) During 2005, two holders of the Company s Series E Convertible Preferred Stock converted 2,167 shares of Series E Convertible Preferred Stock into 14,447 shares of common stock.

q) During 2005, the Company issued the following warrants:

Delano Group Securities, LLC received a five year warrant to purchase 2,000 shares at $15.45 per share, pursuant to an agreement to provide investment banking services. Delano Group Securities, LLC, is a company owned by Mr. David Asplund, one of the Company s directors and effective January 23, 2006 the Company s CEO. The warrant was valued at $13,200 using a modified Black-Sholes option pricing model utilizing the following assumptions: risk free rate of 2.53%, expected volatility of 45.3%, expected dividend of $0 and expected life of 5 years. The value of the warrant was charged to operations during the period.

M&A Railroad and Electric Supply, LLC received a three year warrant to purchase 6,667 options at $16.95 per share to as part of a legal settlement. This warrant was valued at $35,000 using a modified Black-Sholes option pricing model utilizing the following assumptions: risk free rate of 2.767%, expected volatility of 45.0%, expected dividend of $0 and expected life of 3 years. Of the total warrant value $33,000 was charged to operations during the forth quarter of 2004 and $2,000 was charged to operations during the first quarter of 2005.

Laurus Master Fund, Ltd. received a warrant to purchase 26,667 shares of the Company s common stock in exchange for its consent to the Company entering into the PIPE Transaction described under r) below and acquiring MPG, as well as waiving its right to adjust the conversion price on its convertible term note and convertible revolving note. The warrant has an exercise price of $15.00 per share and a term of five years. The warrant was valued at $160,000 using a modified Black-Sholes option pricing model utilizing the following assumptions: risk free rate of 2.941%, expected volatility of 43.7%, expected dividend of $0 and expected life of 5 years. The value of the warrant was charged to interest expense during 2005.

Various consultants received warrants to purchase 27,333 shares of the Company s common stock with exercise prices between $15.00 and $15.45 per share and terms of three to ten years. The warrants were valued collectively at $144,600 using a modified Black-Sholes option pricing model utilizing the following assumptions (depending on the warrant being valued): risk free rate of 2.366% to 3.029%, expected volatility of 40.7% to 46.5%, an expected dividend of $0 and an expected life of 3 to 10 years. The values of the warrants were charged to operations during the 2005.

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

r) On April 28, 2005 the Company issued to five (5) institutional investors, for an aggregate gross purchase price of $5,625,000, 416,667 shares of the Company s common stock and 42 month warrants to purchase 208,333 additional shares of common stock at $15.75 per share (collectively the PIPE Transaction or the PIPE). Warrants to purchase 140,000 shares of common stock were immediately exercisable and the remaining warrants became exercisable six months after closing on October 28, 2005. Net proceeds from the transaction were approximately $5,413,000, of which approximately $1,644,000 was used to fund the acquisition of Maximum Performance Group, Inc., as discussed in Note 4.

Due to the sale price of the securities issued as part of this PIPE Transaction, the Company was required to adjust the exercise price on warrants to purchase 336,989 shares of its common stock held by two investors who had participated in previous equity offerings. The exercise prices on these warrants were reduced from $36.30 and $15.00, respectively, to $13.50. The Company compared the value of the warrants with the old exercise price to the value of the warrants with the reduced exercise price, as determined through the use of a modified Black-Sholes option pricing model, and determined that the reduction in the exercise price had increased the value of the warrants by $484,445. Since these warrants were issued as part of a security offering the increase in value is considered to be a deemed dividend to the security holders. The Company recorded the deemed dividend by offsetting charges and credits to additional paid-in capital, without any effect on total stockholders equity. The deemed dividend increased the loss applicable to common shareholders in the calculation of the basic and diluted net loss per common share for the year ended December 31, 2005.

Delano Group Securities LLC and Mr. David Valentine acted as advisors on the PIPE Transaction. The Company paid Delano Group Securities LLC $16,250 and 3,333 shares of common stock and Mr. Valentine 3,333 shares of common stock for their services. Mr. Asplund and Mr. Valentine both serve as directors of Electric City and effective January 23, 2006, Mr. Asplund became the Company s CEO.

s) As discussed in Note 4, the Company issued 166,149 shares of common stock in connection with the acquisition of Maximum Performance Group, Inc. (MPG). In addition, 166,149 shares of common stock are being held in escrow and will be issued in the event MPG meets specific performance criteria during the two year period following the acquisition.

Delano Group Securities LLC acted as an advisor on the acquisition of MPG and was paid $82,176 and 8,366 shares of common stock for its services. These shares were valued at $15.00 per share, which was the closing market price of the Company s common stock on April 28th. In addition, the Company will issue up to 8,366 additional shares of common stock to Delano as the MPG shares held in escrow are released. Delano Group Securities LLC is owned by Mr. David Asplund, one of Electric City s directors and effective January 23, 2006, the Company s CEO.

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

t) As discussed in Note 11, in November 2005 the Company entered into a securities purchase agreement with Laurus Master Fund, Ltd. (Laurus) whereby it issued to Laurus a $5 million secured convertible term note and a warrant to purchase 133,333 shares of its common stock at $17.40 per share anytime prior to November 22, 2012. The warrants were valued at $920,000 using a modified Black-Sholes option pricing model utilizing the following assumptions: risk free rate of 4.034%, expected volatility of 67.4%, expected dividend of $0 and expected life of 7 years. The value of the warrants was recorded as a discount to the term loan and will be amortized over the term of the underlying debt utilizing the effective interest method.

u) During the year ended December 31, 2005, the Company s Board of Directors declared dividends payable on the Company s Series E Convertible Preferred Stock of $1,366,900. The dividends were paid with 13,699 additional shares of Series E Convertible Preferred Stock. Each share of Series E Convertible Preferred Stock is convertible into 6.67 shares of the Company s common stock.

v) The Company had outstanding warrants to purchase 1,078,866 and 730,324 shares of its common stock as of December 31, 2005 and 2004, respectively, at an exercise price of between $13.50 per share and $98.40 per share. These warrants can be exercised at any time prior to their expiration dates which range between April 2004 and May 2015. The following table summarizes information about warrants outstanding as of December 31, 2005:

	Warrants Outstanding		
Exercise Price	**Number Outstanding at December 31, 2005**	**Weighted Average Remaining Contractual Life**	**Weighted Average Exercise Price**
$13.50 - $15.00	**676,200**	**2.7 years**	**$ 14.25**
$15.01 - $30.00	**365,000**	**3.9 years**	**16.65**
$30.01 $45.00	**27,333**	**2.7 years**	**38.40**
$45.01 $98.40	**10,333**	**2.8 years**	**48.75**
	1,078,866	**3.1 years**	**$ 16.05**

F-36

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

Note 18 Dividends

The dividend expense recognized during 2005, 2004 and 2003 is comprised of the following:

Year ended December 31,	**2005**	**2004**	**2003**
Accrual of dividend on Series A Convertible Preferred	**$**	**$ 540,705**	**$ 2,253,978**
Accrual of Series C Preferred dividend		**53,206**	**219,712**
Accrual of Series D Preferred dividend		**35,932**	**77,689**
Accrual of Series E Preferred dividend	**1,366,900**	**1,006,937**	
Deemed dividend associated with beneficial conversion price on shares issuable in satisfaction preferred dividends		**1,127,021**	**1,879,554**
Deemed dividend associated with beneficial conversion feature of Series D Preferred stock			**386,984**
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		**15,000**	
Deemed dividend associated with change in the exercise price of warrants to purchase shares of common stock	**484,445**		
Total	**$ 1,851,345**	**$ 4,639,259**	**$ 4,817,917**

F-37

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

Note 19 Stock Options

On August 30, 2001, the Company s shareholders approved the adoption of the 2001 Stock Incentive Plan (the Plan), which provides that up to 53,333 shares of the Company s common stock may be delivered under the Plan to certain employees of the Company or any of its subsidiaries and to consultants and directors who are not employees. In addition, the Plan provides for an additional number of shares of the Company s common stock to be reserved for issuance under the plan on January 1st of each succeeding year, beginning January 1, 2002, in an amount equal to the lesser of (i) 5% of the number of outstanding shares of Common Stock, or (ii) 33,333 shares. The awards to be granted under the Plan may be incentive stock options or non-qualified stock options. The exercise price for any incentive stock option (ISO) may not be less than 100% of the fair market value of the stock on the date the option is granted, except that with respect to a participant who owns more than 10% of the common stock the exercise price must be not less than 110% of fair market value. The exercise price of any non-qualified option shall be in the sole discretion of the Compensation Committee or the Board. To qualify as an ISO the aggregate fair market value of the shares (determined on the grant date) granted to any participant may not exceed $100,000 in the first year that they can be exercised. There is no comparable limitation with respect to non-qualified stock options. The term of all options granted under the Plan will be determined by the Compensation Committee or the Board in their sole discretion, provided, however, that the term of each ISO shall not exceed 10 years from the date of grant thereof.

In addition to the ISOs and non-qualified options, the Plan permits the Compensation Committee, consistent with the purposes of the Plan, to grant stock appreciation rights and/or shares of Common Stock to non-employee directors and such employees (including officers and directors who are employees) of, or consultants to, the Company or any of its Subsidiaries, as the Committee may determine, in its sole discretion Under applicable tax laws, however, ISO s may only be granted to employees.

The Plan is administered by the Board, which is authorized to interpret the Plan, to prescribe, amend and rescind rules and regulations relating to the Plan and to determine the individuals to whom, and the time, terms and conditions under which, options and awards are to be granted. The Board may also amend, suspend or terminate the Plan in any respect at any time. However, no amendment may (i) adversely affect the rights of a participant under an award theretofore granted without the consent of such participant, (ii) increase the number of shares reserved for option under the Plan, (iii) modify the requirements for participation in the Plan, or (iv) modify the Plan in any way that would require stockholder approval under the rules and regulations under the Exchange Act or the rules of any stock exchange or market on which the Common Stock is listed (unless such stockholder approval is obtained).

As of December 31, 2005, there were approximately 45 employees of the Company eligible to participate in the Plan, and 186,666 shares of Common Stock reserved under the Plan.

Effective April 1, 2000, the Company adopted a stock option plan for all independent directors, which is separate and distinct from the 2001 Stock Incentive Plan described above. The director s stock option plan provides that eligible directors receive an initial option grant to purchase 5,000 shares upon being appointed to our Board of Directors and additional grants to purchase 1,667 shares on each anniversary of their appointment to the Board. These options have exercise prices equal to the greater of the closing price of our common stock on the grant date, or $15.00, terms of ten years and vest in three equal amounts, beginning on the grant date and on each of the next two anniversaries of the initial grant

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

During 2003, certain directors, officers and key employees of the Company were granted options to acquire 91,333 shares of common stock at exercise prices ranging from $12.60 to $37.65 per share. These options vest over periods through January 2005.

During 2004, certain directors, officers and key employees of the Company were granted options to acquire 67,767 shares of common stock at exercise prices ranging from $17.25 to $35.40 per share. These options vest over periods through January 2006.

During 2005, certain directors, officers and key employees of the Company were granted options to acquire 69,833 shares of common stock at exercise prices ranging from $15.00 to $18.60 per share. These options vest over periods through October 2007.

The following table summarizes the options granted, exercised and outstanding as of December 31, 2005:

	Shares	Exercise Price Per Share	Weighted Average Exercise Price
Outstanding at December 31, 2002	**612,923**	**$ 15.00-$194.85**	**$ 56.70**
Granted	**91,333**	**$ 12.60-$37.65**	**$ 14.85**
Forfeited	**(22,777)**	**$ 15.00-$120.00**	**$ 43.20**
Outstanding at December 31, 2003	**681,479**	**$ 12.60-$194.85**	**$ 51.75**
Granted	**67,767**	**$ 17.25-$35.40**	**$ 25.50**
Forfeited	**(8,111)**	**$ 18.75-$105.00**	**$ 79.80**
Outstanding at December 31, 2004	**741,135**	**$ 12.60-$194.85**	**$ 49.05**
Granted	**69,833**	**$ 15.00-$18.60**	**$ 15.60**
Forfeited	**(10,967)**	**$ 15.00-$120.00**	**$ 23.40**
Outstanding at December 31, 2005	**800,001**	**$ 12.60-$194.85**	**$ 46.50**
Options exercisable at December 31, 2005	**723,518**	**$ 12.60-$194.85**	**$ 48.30**
Options exercisable at December 31, 2004	**651,896**	**$ 12.60-$194.85**	**$ 51.00**
Options exercisable at December 31, 2003	**590,013**	**$ 12.60-$194.85**	**$ 53.10**

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

The weighted-average, grant-date fair value of stock options granted to employees during the year, and the weighted-average significant assumptions used to determine those fair values, using a modified Black-Scholes option pricing model for stock options under Statement of Financial Accounting Standards No. 123, are as follows:

Year ended December 31,	**2005**	**2004**	**2003**
Weighted average fair value per options granted	**$ 10.20**	**$ 17.40**	**$ 8.55**
Significant assumptions (weighted average):			
Risk-free interest rate at grant date	**2.27%**	**1.04%**	**1.13%**
Expected stock price volatility	**65%**	**72%**	**73%**
Expected dividend payout			
Expected option life (years)	**9.1**	**9.1**	**8.8**

The following table summarizes information about stock options outstanding at December 31, 2005:

	Options Outstanding			**Options Exercisable**	
Exercise Price	**Number Outstanding at December 31, 2005**	**Weighted Average Remaining Contractual Life**	**Weighted Average Exercise Price**	**Number Exercisable at December 31, 2005**	**Weighted Average Exercise Price**
$12.60 - $30.00	**508,692**	**4.9 years**	**$ 17.55**	**446,098**	**$ 17.55**
$30.01 - $60.00	**33,889**	**7.3 years**	**37.50**	**29,222**	**38.25**
$60.01 - $90.00	**11,667**	**4.3 years**	**67.95**	**11,667**	**67.95**
$90.01 - $120.00	**242,265**	**4.3 years**	**106.35**	**233,044**	**106.35**
$120.01 - $150.00	**3,467**	**4.1 years**	**135.00**	**3,467**	**135.00**
$150.01 - $195.00	**20**	**5.2 years**	**194.85**	**20**	**194.85**
	800,001	**4.8 years**	**$ 46.50**	**723,518**	**$ 48.30**

Note 20 Related Parties

On January 5, 2000, the Company entered into a distributor agreement with Electric City of Southern California L.L.C., of which Joseph Marino is a member, which provides for an initial term of 10 years. Mr. Marino is one of the Company s founders and its former Chairman and CEO. The agreement grants to Electric City of Southern California a distribution territory which extends from Monterey to Fresno to the northern edge of Death Valley, south to the southern border of California. This agreement provides for terms which members of the Company s board believe are substantially similar to those of other distributor agreements and as favorable to the Company as if negotiated with an unaffiliated third party.

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

Note 21 Business Segment Information

Prior to the sale of Great Lakes, the Company organized and managed 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, the eMAC line of HVAC and lighting controllers, and negative power systems under the trade name Virtual Negawatt Power Plan or VNPP . Operations of Lime Energy Co. and Maximum Performance Group, Inc. are included in the Energy Technology segment. Electric City is headquartered, and most of its operations are located, in Elk Grove Village, Illinois. Maximum Performance Group is headquartered in New York, New York, and has an office in San Diego, California where most of its technical and engineering operations are located.

The Building Control and Automation segment, which is comprised of the 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 leased facility, located in Elk Grove Village, Illinois. Effective March 31, 2006 the Company sold this segment, accordingly, the operating results have reported as discontinued operations.

Prior to May 31 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 operating results have been reported as discontinued operations.

Table of Contents

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

An analysis and reconciliation of the Company s business segment information to the respective information in the consolidated financial statements is as follows:

Year ended December 31,	2005	2004	2003
Revenues:			
Energy Technology	$ 3,693,429	$ 733,630	$ 2,280,532
Operating Loss:			
Energy Technology	(4,578,753)	(2,386,678)	(1,975,441)
Corporate	(1,497,770)	(1,976,297)	(1,610,702)
Total	(6,076,523)	(4,362,975)	(3,586,143)
Interest Expense, net	(544,253)	(626,049)	(354,941)
Loss from continuing operations	(6,620,776)	(4,989,024)	(3,941,084)
Loss from discontinued operations	(251,962)	(170,338)	(1,540,858)
Net Loss	(6,872,738)	(5,159,362)	(5,481,942)
Depreciation and Amortization:			
Energy Technology	592,271	50,257	47,425
Building Control and Automation	9,598	8,621	10,103
Power Management			53,104
Total	601,869	58,878	110,632
Capital Additions:			
Energy Technology	530,925	149,603	19,474
Building Control and Automation	17,949		12,830
Power Management			
Total	548,874	149,603	32,304
Total Assets:			
Energy Technology	16,424,460	5,167,814	5,824,080
Building Control and Automation	674,514	1,311,506	1,529,547
Power Management			

Total	**$ 17,098,974**	**$ 6,479,320**	**$ 7,353,627**

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

Note 22 Selected Quarterly Financial Data (unaudited)

The following represents the Company s unaudited quarterly results for fiscal 2005 and fiscal 2004. These quarterly results were prepared in accordance with U.S. generally accepted accounting principles and reflect all adjustments (consisting solely of normal recurring adjustments) which, in the opinion of management, are necessary for a fair statement of the results.

	Fiscal 2005 Quarters Ended				
	March 31	**June 30**	**September 30**	**December 31**	**Total**
Revenue	**$ 250,713**	**$ 1,550,089**	**$ 1,123,360**	**$ 769,267**	**$ 3,693,429**
Gross profit (loss)	**145,742**	**104,689**	**(74,580)**	**(174,276)**	**1,575**
Loss from continuing operations	**(912,957)**	**(1,712,523)**	**(1,966,007)**	**(2,029,289)**	**(6,620,776)**
Income (loss) from discontinued operations	**237,700**	**(112,111)**	**(48,088)**	**(329,463)**	**(251,962)**
Net loss	**(675,257)**	**(1,824,634)**	**(2,014,095)**	**(2,358,752)**	**(6,872,738)**
Preferred dividends	**(334,800)**	**(339,000)**	**(344,000)**	**(833,545)**	**(1,851,345)**
Net loss available to common shareholders	**(1,010,057)**	**(2,163,634)**	**(2,358,095)**	**(3,192,297)**	**(8,724,083)**
Basic and diluted loss per common share from continuing operations	**(0.45)**	**(0.64)**	**(0.69)**	**(0.84)**	**(2.65)**
Discontinued operations	**0.09**	**(0.04)**	**(0.01)**	**(0.10)**	**(0.08)**
Basic and Diluted Loss Per Common Share	**(0.36)**	**(0.68)**	**(0.70)**	**(0.94)**	**(2.73)**
Weighted Average Common Shares Outstanding	**2,784,438**	**3,195,194**	**3,387,567**	**3,386,677**	**3,190,664**

	Fiscal 2004 Quarters Ended				
	March 31	**June 30**	**September 30**	**December 31**	**Total**
Revenue	**$ 322,922**	**$ 172,809**	**$ 97,141**	**$ 140,758**	**$ 733,630**
Gross profit (loss)	**23,624**	**(19,465)**	**(59,096)**	**(73,799)**	**(128,736)**
Loss from continuing operations	**(1,265,127)**	**(1,034,184)**	**(1,198,524)**	**(1,491,189)**	**(4,989,024)**
Income (loss) from discontinued operations	**(92,601)**	**(110,964)**	**(98,915)**	**132,142**	**(170,338)**
Net loss	**(1,357,728)**	**(1,145,148)**	**(1,297,439)**	**(1,359,047)**	**(5,159,362)**
Preferred dividends	**(3,164,021)**	**(622,884)**	**(445,634)**	**(406,720)**	**(4,639,259)**
Net loss available to common shareholders	**(4,521,749)**	**(1,768,032)**	**(1,743,073)**	**(1,765,767)**	**(9,798,621)**
Basic and diluted loss per common share from continuing operations	**(1.87)**	**(0.61)**	**(0.59)**	**(0.69)**	**(3.62)**
Discontinued operations	**(0.04)**	**(0.04)**	**(0.04)**	**0.05**	**(0.06)**
Basic and Diluted Loss Per Common Share	**(1.91)**	**(0.65)**	**(0.63)**	**(0.64)**	**(3.68)**

Weighted Average Common Shares Outstanding	**2,370,091**	**2,729,227**	**2,764,469**	**2,774,184**	**2,660,093**

Lime Energy Co.
(formerly known as Electric City Corp.)
Notes to Consolidated Financial Statements

Note 23 Subsequent Events

On April 3, 2006, the Company completed a Stock Purchase Agreement with Eugene Borucki and Denis Enberg in which it agreed to sell, effective as of March 31, 2006, all of the outstanding capital stock of Great Lakes Controlled Energy Corporation to the Purchasers for 14,194 shares of Electric City common stock.

On January 23, 2007, the Company effected a 1 for 15 reverse split of its common stock. As a result of the reverse split the number of outstanding shares of its common stock was reduced from 53,789,349 to 3,585,957 shares and the number of common shares into which the Series E preferred stock could be converted was reduced from 23,261,300 shares to 1,550,753 shares. All share quantities and prices presented in these statements have been adjusted to reflect this reverse split.

Table of Contents

LIME ENERGY CO.
(formerly known as Electric City Corp.)
Schedule II Valuation and Qualifying Accounts

	Balance at beginning of period	Additions/ (recoveries) charged to costs and expenses	Deductions Amounts written-off	Other adjustments	Balance at end of period
Allowance for doubtful accounts:					
Year ended December 31, 2003	$410,000	$(22,000)	$ (2,000)	$(60,000)	$326,000
Year ended December 31, 2004	326,000	6,000	(133,000)		199,000
Year ended December 31, 2005	$199,000	$ 97,000	$ (13,000)	$ 42,000	$325,000

Other adjustment of $(60,000) in 2003 resulted from the sale of Switchboard Apparatus, Inc.
Other adjustment of $42,000 in 2005 resulted from the acquisition of Maximum Performance Group, Inc.

Table of Contents

LIME ENERGY CO.
CONDENSED CONSOLIDATED BALANCE SHEET

	September 30, 2006 (unaudited)	December 31, 2005 *(1)*
Assets		
Current Assets		
Cash and cash equivalents	$ 6,825,874	$ 4,229,150
Accounts receivable, net	2,385,472	1,747,019
Inventories	1,304,832	1,457,789
Advances to suppliers	147,405	324,677
Costs and estimated earnings in excess of billings on uncompleted contracts		28,462
Prepaid expenses and other	329,609	207,480
Total Current Assets	10,993,192	7,994,577
Net Property and Equipment	1,638,833	2,514,196
Long Term Receivables	17,713	
Deferred Financing Costs, net		299,964
Intangibles, net	5,605,691	1,960,835
Cost in Excess of Assets Acquired	9,293,292	4,329,402
	$ 27,548,721	$ 17,098,974

F-46

Table of Contents

LIME ENERGY CO.
CONDENSED CONSOLIDATED BALANCE SHEET

	September 30, 2006 (unaudited)	December 31, 2005 (1)
Liabilities and Stockholders Equity		
Current Liabilities		
Line of credit	$	$ 2,000,000
Accounts payable	1,799,259	913,369
Current maturities of long-term debt	547,850	651,313
Accrued expenses	763,295	1,228,765
Notes payable	150,000	150,000
Deferred revenue	1,780,738	984,728
Customer deposits	1,136,552	1,419,919
Total Current Liabilities	6,177,694	7,348,094
Deferred Revenue	201,160	1,044,524
Long-Term Debt, less current maturities, net of unamortized discount of $0 and $898,409 at September 30, 2006 and December 31, 2005, respectively	33,001	4,328,719
Total Liabilities	6,411,855	12,721,337
Stockholders Equity		
Preferred stock, $.01 par value; 5,000,000 shares authorized Series E 0 and 236,254 issued and outstanding as of September 30, 2006 and December 31, 2005, respectively (liquidation value of $0 and $47,250,800 at September 30, 2006 and December 31, 2005, respectively)		2,363
Common stock, $.0001 par value; 200,000,000 shares authorized, 49,786,611 and 3,386,465 issued as of September 30, 2006 and December 31, 2005, respectively	4,979	339
Additional paid-in capital	92,264,441	64,773,556
Accumulated deficit	(71,132,554)	(60,398,621)
Total Stockholders Equity	21,136,866	4,377,637
	$ 27,548,721	$ 17,098,974

See accompanying notes to condensed consolidated financial statements

(1) Derived from audited financial statements in the Company s annual report on Form 10-K for the year ended December 31, 2005

Table of Contents

LIME ENERGY CO.
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(Unaudited)

Three months ended September 30,	2006	2005
Revenues	$ 2,130,158	$ 1,123,360
Cost of sales	1,592,613	1,197,940
Gross profit (loss)	537,545	(74,580)
Selling, general and administrative	3,974,564	1,813,975
Impairment loss	760,488	
Operating loss	(4,197,507)	(1,888,555)
Other Income (Expense)		
Interest income	96,877	16,879
Interest expense	(16,880)	(94,331)
Total other income (expense)	79,997	(77,452)
Loss from continuing operations	(4,117,510)	(1,966,007)
Discontinued Operations		
Loss from discontinued operations		(48,088)
Net Loss	(4,117,510)	(2,014,095)
Plus Preferred Stock Dividends		(344,000)
Net Loss Available to Common Shareholders	$ (4,117,510)	$ (2,358,095)
Basic and diluted loss per common share from:		
Continuing operations	$ (0.08)	$ (0.69)
Discontinued operations		(0.01)
Basic and Diluted Net Loss Per Common Share	$ (0.08)	$ (0.70)

Weighted Average Common Shares Outstanding	**49,308,350**	**3,387,567**

See accompanying notes to condensed consolidated financial statements

F-48

Table of Contents

LIME ENERGY CO.
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(Unaudited)

Nine months ended September 30,	2006	2005
Revenues	$ 4,611,321	$ 2,924,162
Cost of sales	3,474,496	2,748,311
Gross profit	1,136,825	175,851
Selling, general and administrative	7,957,736	4,383,158
Impairment Loss	760,488	
Operating loss	(7,581,399)	(4,207,307)
Other Income (Expense)		
Interest income	125,646	42,167
Interest expense	(3,256,755)	(426,347)
Total other expense	(3,131,109)	(384,180)
Loss from continuing operations	(10,712,508)	(4,591,487)
Discontinued Operations		
(Loss) income from discontinued operations	(21,425)	77,501
Net Loss	(10,733,933)	(4,513,986)
Plus Preferred Stock Dividends	(24,347,725)	(1,017,800)
Net Loss Available to Common Shareholders	$ (35,081,658)	$ (5,531,786)
Basic and diluted (loss) income per common share from:		
Continuing operations	$ (1.83)	$ (1.79)
Discontinued operations	(0.00)	0.02
Basic and Diluted Net Loss Per Common Share	$ (1.83)	$ (1.77)

Weighted Average Common Shares Outstanding	**19,198,805**	**3,124,609**

See accompanying notes to condensed consolidated financial statements

Table of Contents

LIME ENERGY CO.
STATEMENT OF CONDENSED CONSOLIDATED STOCKHOLDERS EQUITY
(Unaudited)

	Common Shares *(1)*	Common Stock *(1)*	Series E Preferred Shares	Series E Preferred Stock	Additional Paid-in Capital	Accumulated Deficit	Total Stockholders Equity
Balance, December 31, 2005	**3,386,465**	**$ 339**	**236,254**	**$ 2,363**	**$ 64,773,556**	**$ (60,398,621)**	**$ 4,377,637**
Conversion of Series E Preferred Stock	21,695,879	2,170	(243,234)	(2,433)	263		
Issuance of common stock (less issuance costs of $101,162)	17,875,000	1,787			17,772,051		17,773,838
Shares received for sale of Great Lakes Controlled Energy Corporation	(14,194)	(1)			(193,742)		(193,743)
Acquisition of Kapadia Consulting, Inc.	500,000	50			479,950		480,000
Acquisition of Parke P.A.N.D.A Corporation	5,000,000	500			4,999,500		5,000,000
Cumulative dividends on preferred stock					(698,000)		(698,000)
Satisfaction of accrued dividends through the issuance of preferred stock			6,980	70	697,930		698,000
Conversion of revolver	950,865	95			951,882		951,977

Beneficial value of adjustment in conversion price of revolver				950,865		950,865
Term loan liquidated damages satisfied through the issuance of common stock	161,096	16		185,244		185,260
Termination of post repayment interest obligation	231,500	23		266,202		266,225
Warrants issued for services received				25,200		25,200
Share based compensation				2,053,540		2,053,540
Net loss for the nine months ended September 30, 2006					(10,733,933)	(10,733,933)
Balance, September 30, 2006	**49,786,611**	**$ 4,979**	**$**	**$ 92,264,441**	**$ (71,132,554)**	**$ 21,136,866**

See accompanying notes to condensed consolidated financial statements.

(1) Adjusted for 1 for 15 reverse split of common stock effected on June 15, 2006

F-50

LIME ENERGY CO.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

Nine months ended September 30	2006	2005
Cash Flow from Operating Activities		
Net loss	$ (10,733,933)	$ (4,513,986)
Adjustments to reconcile net loss to net cash used in operating activities, net of acquisitions and dispositions		
Depreciation and amortization	866,896	373,147
Warrants issued in exchange for services received	25,200	319,800
Liquidated damages satisfied through issuance of common stock	185,260	
Amortization of deferred financing costs	299,964	70,014
Amortization of original issue discount	898,409	35,075
Termination of post repayment interest and interest converted to common stock	274,747	
Beneficial value of revolver adjustment in conversion price	950,865	
Share based compensation	2,053,540	
Loss on disposal of fixed assets	93,563	11,743
Impairment loss	760,488	
Changes in assets and liabilities, net of acquisitions and dispositions		
Accounts receivable	278,241	348,258
Inventories	285,746	(217,339)
Advances to suppliers	177,272	23,640
Other current assets	(96,103)	(90,961)
Accounts payable	95,204	(1,190,517)
Accrued expenses	(520,334)	(148,411)
Deferred revenue	54,469	(93,404)
Other current liabilities	(284,687)	(44,992)
Net cash used in operating activities	(4,335,193)	(5,117,933)
Cash Flows Used In Investing Activities		
Acquisitions (including acquisition costs), net of cash acquired	(3,930,120)	(1,644,419)
Sale of discontinued operations	(83,586)	
Purchase of property and equipment	(29,565)	(470,342)
Net cash used in investing activities	(4,043,271)	(2,114,761)
Cash Flows Provided by Financing Activities		
(Payments) borrowings on lines of credit	(1,456,545)	2,000,000
Payment on long-term debt	(5,342,105)	(390,959)

Proceeds from issuance of common stock	**17,875,000**	**5,625,000**
Issuance costs related to stock issuances	**(101,162)**	**(216,787)**
Net cash provided by financing activities	**10,975,188**	**7,017,254**
Net Increase (Decrease) in Cash and Cash Equivalents	**2,596,724**	**(215,440)**
Cash and Cash Equivalents, at beginning of period	**4,229,150**	**1,789,808**
Cash and Cash Equivalents, at end of period	**$ 6,825,874**	**$ 1,574,368**
Supplemental Disclosure of Cash Flow Information		
Cash paid during the periods for interest continuing operations	**$ 382,541**	**$ 140,346**
Cash paid during the periods for interest discontinued operations	**42**	**302**
Value of warrants issued in exchange for services received	**25,200**	**319,800**

Table of Contents

Supplemental Disclosures of Noncash Investing and Financing Activities:

Holders of Series E preferred stock converted 243,234 shares of Series E preferred stock into 21,695,879 shares of the Company s common stock during the nine months ended September 30, 2006.

Laurus Master Fund, Ltd. elected to convert $943,455 outstanding on the Company s line of credit plus $7,410 in accrued interest into 950,865 shares of the Company s common stock in June 2006.

On June 30, 2006, the Company purchased Parke P.A.N.D.A. Corporation for $2,852,970 in cash (net of cash acquired of $1,710 and including transaction costs of $134,680), and 5,000,000 shares of Lime Energy common stock. The related assets and liabilities at the date of acquisition were as follows:

Cash	$ 1,710
Accounts receivable	710,465
Inventory	142,789
Other current assets	7,088
Property and equipment	79,917
Identifiable intangible assets	3,250,000
Cost in excess of assets acquired	4,536,949
Total assets acquired	8,728,918
Line of credit	(400,000)
Accounts payable	(338,536)
Accrued expenses	(89,571)
Notes payable	(45,763)
Other current liabilities	(368)
Total liabilities assumed	(874,238)
Net assets acquired	7,854,680
Less valuation of shares issued for acquisition	(5,000,000)
Acquisition costs	(134,680)
Total cash paid	$ 2,720,000

On September 26, 2006, effective September 30, 2006 the Company purchased Kapaida Consulting, Inc. for $1,077,150 in cash (net of cash acquired of $47,329 and including transaction costs of $18,415), and 500,000 shares of Lime Energy common stock. The related assets and liabilities at the date of acquisition were as follows:

Cash	$ 47,329
Accounts receivable	501,115
Other current assets	4,403
Long term receivables	17,713
Property and equipment	16,430
Identifiable intangible assets	1,131,000
Cost in excess of assets acquired	600,683
Total assets acquired	2,318,673
Accounts payable	(657,079)

Accrued expenses	**(41,470)**
Deferred revenue	**(14,693)**
Other current liabilities	**(952)**
Total liabilities assumed	**(714,194)**
Net assets acquired	**1,604,479**
Less valuation of shares issued for acquisition	**(480,000)**
Acquisition costs	**(18,415)**
Total cash paid	**$ 1,106,064**

See accompanying notes to condensed consolidated financial statements

F-52

Table of Contents

Lime Energy Co.
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 accompanying consolidated financial statements have been prepared on the going concern basis which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has experienced operating losses and negative cash flow from operations since inception and currently has an accumulated deficit. These factors raise substantial doubt about the Company s ability to continue as a going concern. The Company s ability to continue as a going concern is ultimately dependent on its ability to increase sales to a level that will allow it to operate profitably and sustain positive operating cash flows. Management has recently raised additional funds and is continuing to work to improve profitability through efforts to expand its business in both current and new markets. However, there is no assurance that the Company will be successful in improving its operating results. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the possible inability of the Company to continue as a going concern.

The results of operations for the three and nine months ended September 30, 2006 and 2005 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 Lime Energy Co. (formerly known as Electric City Corp.) Annual Report on Form 10-K for the year ended December 31, 2005.

Note 2 Stock-based Compensation

Effective January 1, 2006, the Company adopted SFAS 123(R). This pronouncement requires companies to measure the cost of employee service received in exchange for a shared based award (typically stock options) based on the fair value of the award. The Company has elected to use the modified prospective transition method for stock options granted prior to January 1, 2006, but for which the vesting period is not complete. Under this transition method the Company accounts for such awards on a prospective basis, with expense being recognized in its statement of operations beginning in the first quarter of 2006 and continuing over the remaining requisite service period based on the grant date fair value estimated in accordance with Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS 123). Prior to 2006 the Company accounted for employee stock options using the method of accounting prescribed by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and the associated interpretations using the intrinsic method. Generally, no expense was recognized related to its stock options under this method because the stock options exercise price were set at the stock s fair market value on the date the options were granted.

Table of Contents

The following table illustrates the effect on the net loss and the net loss per share as if the Company had recognized compensation expense for stock options in accordance with the fair value based recognition provisions of SFAS 123 for periods prior to the adoption of SFAS 123(R):

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Net Loss, as reported	$ (2,014,000)	$ (4,514,000)
Deduct: Stock-based employee compensation expense included in reported net loss		
Add: Total stock-based employee compensation expense determined under fair value based method for awards	(160,000)	(664,000)
Net Loss, pro-forma	(2,174,000)	(5,178,000)
Preferred stock dividends	(344,000)	(1,018,000)
Net Loss Available to Common Shareholders	$ (2,518,000)	$ (6,196,000)
Net loss per share:		
Basic and diluted as reported	$ (0.70)	$ (1.77)
Basic and diluted pro forma	$ (0.74)	$ (1.98)

The weighted-average, grant-date fair value of stock options granted to employees and the weighted-average significant assumptions used to determine those fair values, using a modified Black-Scholes option pricing model for stock options under Statement of Financial Accounting Standards No. 123, are as follows:

	Three Months Ended September 30		Nine months Ended September 30	
	2006	2005	2006	2005
Weighted average fair value per option granted	$0.77	*(1)*	$1.02	$0.69
Significant assumptions (weighted average):				
Risk-free rate	5.06%		5.03%	2.82%
Dividend yield	0.00%		0.00%	0.00%
Expected volatility	92.1%		91.3%	64.6%
Expected life (years)	5.7		5.6	5.5

(1) No options were awarded during the three month period ended

September 30,
2005

The risk-free interest rate is based on the U.S. Treasury Bill rates at the time of grant. The dividend reflects the fact that the Company has never paid a dividend on its common stock and does not expect to in the foreseeable future. The Company estimated the volatility of its common stock at the date of grant based on the historical volatility of its stock. The expected term of the options is based on historical exercise patterns, which the Company believes were representative of future behavior.

Table of Contents

The Company recognized $1,806,671 and $2,053,540 of share based compensation expense related to stock options during the three month and nine month periods ended September 30, 2006, respectively. The Company recognizes compensation expense for stock options on a straight-line basis over the requisite service period, which is generally equal to the vesting period of the option. In calculating the compensation expense the Company has assumed a 15% forfeiture rate based on historical information. The subject stock options expire ten years after the date of grant.
Option activity under the Company s stock option plans as of September 30, 2006 and changes during the three months then ended are presented below:

Three months ended September 30, 2006	Shares	Exercise Price Per Share	Weighted Average Exercise Price
Outstanding at June 30, 2006	1,085,516	$ 1.10-$194.85	$ 39.40
Granted	9,503,333	$1.00-$ 1.05	$ 1.02
Forfeited	(39,468)	$1.02-$ 30.75	$ 8.03
Outstanding at September 30, 2006	10,549,381	$ 1.00-$194.85	$ 5.49
Options exercisable at September 30, 2006	897,605	$ 1.00-$194.85	$ 37.09

Option activity under the Company s stock option plans as of September 30, 2006 and changes during the nine months then ended are presented below:

Nine months ended September 30, 2006	Shares	Exercise Price Per Share	Weighted Average Exercise Price
Outstanding at December 31, 2005	801,652	$ 12.60-$194.85	$ 46.47
Granted	9,876,668	$ 1.00-$ 15.00	$ 1.55
Forfeited	(128,939)	$ 1.02-$105.00	$ 6.36
Outstanding at September 30, 2006	10,549,381	$ 1.00-$194.85	$ 5.49

Table of Contents

The following table summarizes information about stock options outstanding at September 30, 2006:

	Options Outstanding ***(1)***			**Options Exercisable** ***(1)***	
Exercise Price *(1)*	**Number Outstanding at September 30, 2006**	**Weighted Average Remaining Contractual Life**	**Weighted Average Exercise Price ($)**	**Number Exercisable at September 30, 2006**	**Weighted Average Exercise Price ($)**
TBD *(2)*	**3,000,000**	**9.8 years**	***(2)***		***(2)***
$1.00 - $2.00	**6,725,000**	**9.8 years**	**1.02**	**208,888**	**1.03**
$2.01 - $10.00	**100,000**	**9.3 years**	**9.30**		
$10.01 - $20.00	**385,424**	**4.0 years**	**16.19**	**350,427**	**16.31**
$20.01 - $30.00	**74,998**	**3.9 years**	**25.58**	**78,332**	**25.77**
$30.01 - $50.00	**28,220**	**6.7 years**	**33.99**	**24,219**	**34.63**
$50.01 - $194.85	**235,739**	**3.4 years**	**103.95**	**235,739**	**103.95**
	10,549,381	**9.4 years**	**5.49**	**897,605**	**37.09**

(1) *All quantities and exercise prices have been adjusted for a 1 for 15 reverse stock split effected on June 15, 2006.*

(2) *The exercise price on these options will be set on a future date. The exercise price on 1,500,000 shares will equal the average closing price of the Company s stock for the 30 trading days prior to January 22, 2007, and the*

exercise price on the remaining 1,500,000 shares will equal the average closing price of the Company s stock for the 30 trading days prior to January 22, 2008.

The aggregate intrinsic value of the outstanding options (the difference between the closing stock price on the last trading day of the third quarter of 2006 of $1.25 per share and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on September 30, 2006 was $1,543,867. This amount will change based on changes in the fair market value of the Company s common stock.

As of September 30, 2006, $4,720,500 of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of 1.25 years.

Note 3 Revenue Recognition

The Company recognizes revenue when all four of the following criteria are met: (i) persuasive evidence has been received that an arrangement exists; (ii) delivery of the products and/or services has occurred; (iii) the selling price is fixed or determinable; and (iv) collectibility is reasonably assured. In addition, the Company follows the provisions of the Securities and Exchange Commission s Staff Accounting Bulletin No. 104, Revenue Recognition, which sets forth guidelines in the timing of revenue recognition based upon factors such as passage of title, installation, payments and customer acceptance. Any amounts received prior to satisfying the Company s revenue recognition criteria is recorded as deferred revenue in the accompanying balance sheet.

Revenues on long-term contracts are recorded under the percentage of completion, cost-to-cost method of accounting. Any anticipated losses on contracts are charged to operations as soon as they are determinable.

Table of Contents

The timing of revenue recognition may differ from contract payment schedules resulting in revenues that have been earned but not yet billed. These amounts are recorded on the balance sheet as Costs and estimated earnings in excess of billings on uncompleted contracts. Billings on contracts that do not meet the Company s revenue recognition policy requirements for which it has been paid or has a valid account receivable are recorded as deferred revenue.

The Company s MPG subsidiary often bundles contracts to provide monitoring services and web access with the sale of its eMAC hardware. As a result, these sales are considered to be contracts with multiple deliverables which at the time the hardware is delivered and installed includes undelivered services essential to the functionality of the product. Accordingly, the Company defers the revenue for the product and services and the cost of the equipment and installation and recognizes them over the term of the monitoring contract. The monitoring contracts vary in length from 1 month to 5 years.

Note 4 Discontinued Operations

On April 3, 2006, the Company completed a Stock Purchase Agreement with Eugene Borucki and Denis Enberg (the Purchasers) in which it sold, effective as of March 31, 2006, all of the outstanding capital stock of Great Lakes Controlled Energy Corporation to the Purchasers for 14,194 shares of Lime Energy common stock (adjusted for the reverse split effected June 15, 2006). The shares of Lime Energy common stock received from the Purchasers were retired and became authorized but un-issued shares. For accounting purposes, the Company valued these shares at $13.65 each, which is the average closing market price of the common stock prior to entering into the letter of intent to sell Great Lakes. The Company did not incur a gain or loss on the sale of Great Lakes, however it did incur an impairment charge of $242,830 for the year ended December 31, 2005 when it reduced the carrying value of the goodwill associated with Great Lakes in anticipation of the sale.

The assets and liabilities of the discontinued operations that are included in the Company s consolidated assets and liabilities are as follows:

		September 30, 2006		December 31, 2005
Accounts receivable	$		$	439,456
Other current assets				45,287
Total current assets				484,743
Net property plant and equipment				16,028
Total assets			$	500,771
Accounts payable	$		$	73,825
Accrued expenses				81,167
Current portion of long term debt				2,160
Deferred revenue				241,154
Customer deposits				50,000
Total current liabilities				448,306
Total liabilities	$		$	448,306

Table of Contents

The revenue and loss related to discontinued operations were as follows:

	Three Months Ended September 30		Nine months Ended September 30	
	2006	2005	2006	2005
Revenue	$	$189,224	$485,787	$921,189
Net (loss) income		(48,088)	(21,425)	77,501

Note 5 Acquisition of Parke P.A.N.D.A. Corporation

On June 30, 2006, Lime Energy entered into an agreement by and among the Company, Parke Acquisition, LLC, a wholly-owned subsidiary of Lime Energy (Merger Subsidiary), Parke P.A.N.D.A. Corporation (Parke), Daniel W. Parke (a director of Lime Energy) and Daniel W. Parke and Michelle A. Parke as Trustees under The Parke Family Trust, in which it acquired Parke pursuant to the merger of Parke with and into Merger Subsidiary, with Merger Subsidiary continuing as the surviving corporation under the name Parke Industries, LLC.

The merger consideration consisted of $2,720,000 in cash and shares of common stock having the value of $5 million (valuing each share at the $1.00 price used in the private placement of common stock described under c) of Note 18 below) or 5,000,000 shares of Lime Energy common stock, all of which was paid to The Parke Family Trust, the sole stockholder of Parke, which is beneficially owned by Daniel Parke and his spouse, Michelle A. Parke, who are also the trustees of such Trust. As a result of the merger, Merger Subsidiary became responsible for the liabilities of Parke, including $400,000 due on its line of credit and approximately $46,000 in various vehicle loans. The acquisition has been recorded using the purchase method of accounting.

Parke is an energy services provider specializing in the design, engineering and installation of energy efficient lighting upgrades for commercial and industrial users. Parke has 30 employees and is headquartered in Glendora, California with offices in Danville and Carmel, California.

Dan Parke, the president and founder of Parke continues to serve as the President of Parke and as of June 30, 2006 also assumed the position of President and Chief Operating Officer of Lime Energy. Mr. Parke also continues to serve as a director of Lime Energy.

The assets acquired and liabilities assumed in the acquisition, based on a preliminary allocation are as follows:

Cash	$ 1,710
Accounts receivable	710,465
Inventory	142,789
Other current assets	7,088
Net property and equipment	79,917
Identifiable intangible assets	3,250,000
Goodwill	4,536,949
Line of credit	400,000
Accounts payable	338,536
Accrued expenses	89,571
Notes payable	45,763
Other current liabilities	368

Utilizing an independent third party valuation firm, the Company has assessed the fair values of assets and liabilities of Parke and allocated the purchase price accordingly. For purposes of the allocation, it has allocated $620,000 of the Parke purchase price to identifiable intangible assets with definitive lives such as customer contracts, sales pipeline and the non-compete agreement with Dan Parke. This amount has been capitalized and will be amortized over the estimated useful life of the related identifiable intangible assets. It also allocated $2,630,000 to the Parke trade name, which will not be amortized. Amortization of intangibles such as these are generally not deductible for tax purposes. The amounts capitalized and the estimated useful life of the identifiable intangible assets are as follows:

Asset Class	Estimated Value	Estimated Useful Life
Non-compete agreement	$ 362,000	2 Years
Customer contracts	206,000	1 month
Sales pipeline	52,000	5 months
Trade name	2,630,000	Indefinite

Goodwill at the date of acquisition of Parke is based on a preliminary internal valuation study. Therefore reported amounts may change based on finalization, which is expected to occur during the fourth quarter of 2006. This goodwill is not deductible for income tax purposes.

The acquisition was recorded using the purchase method of accounting, accordingly, the results of Parke s operations have been included in the Company s consolidated statement of operations since June 30, 2006. Unaudited pro forma results of operations for the nine months ended September 30, 2006 for the Company and Parke, assuming the acquisition took place on January 1, 2005, are as follows:

	Nine months Ended September 30, 2006	Nine months Ended September 30, 2005
Revenue:		
As Reported	$ 4,611,321	$ 2,924,162
Proforma	6,495,151	5,908,891
Net Loss From Continuing Operations:		
As Reported	(10,733,933)	(4,513,986)
Pro-forma	(10,364,347)	(4,217,213)
Basic and Diluted Loss per Share From Continuing Operations:		
As Reported	(1.83)	(1.77)
Pro-forma	(1.43)	(0.64)

Note 6 Acquisition of Kapadia Consulting, Inc.

On September 26, 2006, the Company entered into an Agreement and Plan of Merger with Kapadia Acquisition, Inc. (Acquisition), a wholly-owned subsidiary of the Company, Kapadia Consulting, Inc. (Kapadia) and Pradeep Kapadia. The parties closed the transactions under the Merger Agreement the same day and filed the Certificate of Merger on September 27, 2006 merging Kapadia with and into Acquisition, with Acquisition continuing as the surviving corporation under the name Kapadia Energy Services, Inc.

Table of Contents

The merger consideration consisted of $1,106,064 in cash and 500,000 shares of Lime Energy common stock. For accounting purposes the common stock was valued at $0.96 per share, the average closing price of the stock for the 20 trading days immediately prior to the closing. The acquisition was recorded using the purchase method of accounting. Kapadia is an engineering firm that specializes in energy management consulting and energy efficient lighting upgrades for commercial and industrial users. Kapadia has seven employees, is headquartered in Peekskill, New York and has an office in Ventura, California.

The acquisition was accounted for by the purchase method and the results of Kapadia have been included in the consolidated statement of operations since September 27, 2006. The pro forma operating results as if the Company had completed the acquisition as of the beginning of the periods presented are not significant to the Company s financial statements and are not presented.

The assets acquired and liabilities assumed in the acquisition are base on a preliminary allocation as follows:

Accounts receivable	$ 501,115
Other current assets	4,403
Long term receivables	17,713
Property and equipment	16,430
Identifiable intangible assets	1,131,000
Goodwill	600,683
Accounts payable	657,079
Accrued expenses	41,470
Deferred revenue	14,693
Other current liabilities	952

Utilizing an independent third party valuation firm, the Company has assessed the fair values of assets and liabilities of Kapadia and allocated the purchase price accordingly. For purposes of the allocation, it has allocated $1,131,000 of the Kapadia purchase price to identifiable intangible assets with definitive lives such as sales backlog, sales pipeline, the non-compete agreement with Pradeep Kapadia and Kapadia s customer list. This amount has been capitalized and will be amortized over the estimated useful life of the related identifiable intangible assets. Amortization of intangibles such as these are generally not deductible for tax purposes. The amounts capitalized and the estimated useful life of the identifiable intangible assets are as follows:

Asset Class	Estimated Value	Estimated Useful Life
Sales backlog	$175,000	3 Months
Sales pipeline	693,000	12 Months
Non-compete agreement	90,000	2 Years
Customer list	173,000	10 Years

Goodwill at the date of acquisition of Kapadia is based on a preliminary internal valuation study. Therefore reported amounts may change based on finalization, which is expected to occur during the fourth quarter of 2006. This goodwill is not deductible for income tax purposes.

F - 60

Table of Contents

Note 7 Cost in Excess of Assets Acquired

Changes in goodwill during 2006 are as follows:

	Building Control and Automation	Energy Technology	Energy Services	Total
Balance at December 31, 2005	$ 173,742	$ 4,155,660	$	$ 4,329,402
Sale of Great Lakes Controlled Energy Corporation	(173,742)			(173,742)
Acquisition of Parke P.A.N.D.A. Corporation			4,536,949	4,536,949
Acquisition of Kapadia Consulting, Inc.			600,683	600,683
Balance at September 30, 2006	$	$ 4,155,660	$ 5,137,632	$ 9,293,292

Goodwill represents the purchase price in excess of the fair value of assets acquired in business combinations. Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets , requires the Company to assess goodwill for impairment at least annually in the absence of an indicator of possible impairment and immediately upon an indicator of possible impairment.

Note 8 Asset Impairment

In accordance with SFAS 144 Accounting for the Impairment or Disposal of Long-Lived Assets, the Company has reviewed the expected undiscounted future cash flows from the Company s northern Illinois VNPP (Virtual Negawatt Power Plan) asset (the ComEd VNPP) and determined that the asset is impaired. Assets utilized under the VNPP program are currently classified as property and equipment.

In September 2003 the Company entered into a contract with Commonwealth Edison Company (ComEd), a Chicago based utility, to provide up to 50 megawatts of curtailment capacity in northern Illinois through December 2015. Under the contract the Company is paid on a quarterly basis for providing the ability to reduce electricity demand as required by ComEd. To provide this curtailment capacity the Company has installed 124 of its EnergySaver lighting controllers in 76 commercial and industrial sites (Customer Hosts) at a cost of $1,267,360. This cost has been capitalized and is being depreciated over the term of the contract as the capacity is made available. As of September 30, 2006, the carrying value of the asset, net of depreciation, was $1,195,276.

As a result of the high capital requirements of this program and changes in the Company s business plan the Company has decided to terminate further investment in the program and has begun negotiations with ComEd to convert the program into an energy efficiency program. Under this proposed program the Company would receive credit for reducing energy consumed through the use of the installed equipment on a steady state basis, rather than on demand.

Table of Contents

To determine if the ComEd VNPP asset was impaired, the Company analyzed two scenarios: one in which it is successful in restructuring the contract with ComEd under terms it has proposed; and one in which it continues to operate under the existing contract with no changes. In preparing its impairment analysis the Company projected a set of cash flow streams for each scenario. It then compared the present value of these cash flow streams, discounted at its cost of capital, to the carrying value of the ComEd VNPP asset. Under both scenarios the carrying value of the asset exceeded the present value of the future cash flows, indicating some degree of asset impairment. The indicated impairment ranged from approximately $443,000 under the first scenario to approximately $1,078,000 under the second scenario. Since the Company can not currently determine the probability of either scenario occurring, it has used an average value of the two scenarios to arrive at the impairment loss of $760,488. The Company has reduced the carrying value of the ComEd VNPP asset by this amount and recorded a non-cash charge to its earnings in an equal amount during the quarter ended September 30, 2006. This charge has been included in the loss attributable to the Company s Energy Technology segment in Note 15 Business Segment Information.

The remaining carrying value of $434,788 will be depreciated as revenue is recognized under the related contract. If the Company is not successful in restructuring its contract with ComEd a further impairment of the asset will likely be warranted.

Note 9 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 or nine months ended September 30, 2006 and 2005 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 (all quantities have been adjusted for the 1 for 15 reverse stock split effected on June 15, 2006):

	Three Months Ended September 30		**Nine months Ended September 30**	
	2006	**2005**	**2006**	**2005**
Weighted average shares issuable upon exercise of outstanding options	9,154,287	790,450	3,670,592	771,833
Weighted average shares issuable upon exercise of outstanding warrants	1,117,231	968,866	1,089,874	877,382
Weighted average shares issuable upon conversion of preferred stock [(1)]		1,529,136	1,016,974	1,508,150
Weighted average shares issuable upon conversion of convertible debt [(2)]		144,552	236,520	121,889
Total	10,271,518	3,433,004	6,013,960	3,279,254

(1) All of the outstanding shares of convertible preferred stock were converted to common stock on June 29, 2006.

(2) All of the convertible debt was retired or converted into common stock on June 29, 2006.

As discussed in Note 4 to the Company s annual report for the year ended December 31, 2005, 166,149 shares of common stock (split adjusted) are being held in escrow for the benefit of the former shareholders of Maximum Performance Group (MPG) to be released over the two year period following the acquisition of MPG on April 30, 2005 if MPG achieves certain revenue targets during the period. Any shares not issued to the selling shareholders will be returned to the Company at the end of the two year period. As of September 30, 2006, no shares had been released from escrow. These escrow shares have not been included in the calculation of the weighted average common shares outstanding since their release from escrow is contingent on achieving the revenue targets.

Table of Contents

Note 10 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. In addition, some customers have purchased extended warranties for the Company s products that extend the base warranty for up to ten years. The Company records the estimated cost that may be incurred under its warranties at the time 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 warranty liability is adequate and that the judgment applied is appropriate, the estimated liability for warranties could differ materially from actual future warranty costs. Changes in the Company s warranty liability are as follows:

	Three Months Ended September 30		**Nine months Ended September 30**	
	2006	**2005**	**2006**	**2005**
Balance, beginning of period	$ 192,581	$ 206,895	$ 208,300	$ 151,008
Warranties issued	18,540	24,000	47,790	105,798
Settlements	(18,020)	(10,741)	(62,989)	(36,652)
Balance, as of September 30	$ 193,101	$ 220,154	$ 193,101	$ 220,154

Note 11 Inventories

Inventories consisted of the following:

	September 30, 2006	**December 31, 2005**
Raw materials	$ 871,234	$ 919,832
Finished goods	433,598	537,957
	$ 1,304,832	$ 1,457,789

Note 12 Line of Credit

On June 29, 2006, Laurus Master Fund, Ltd. (Laurus) exercised its right to convert all of the outstanding balance on the Company s line of credit of $943,455 plus $7,410 in accrued interest into 950,865 shares of the Company s common stock, and the line was terminated. The revolving note contained antidilution provisions which automatically adjusted the conversion price of the note to $1.00 per share: the price at which we issued shares of common stock in the PIPE Transaction. Laurus would have received 59,902 shares of common stock upon conversion of the revolving note utilizing the conversion price prior to this adjustment, but as a result of the adjustment it received 943,455 shares. The market value of the 883,553 additional shares it received as a result of the adjustment, which was capped at the amount converted including the accrued interest, was recorded as interest expense in the amount of $950,865. On June 29, 2006, the market price of the Company s common stock was $1.15 per share, as a result the Company recognized an additional $1,112 of non-cash interest expense calculated as the

difference between the market price ($1.15) and the conversion price ($1.00) of the 7,410 shares of common stock issued in satisfaction of the accrued interest expense.

Note 13 Term Loan Repayment

On June 29, 2006, the Company repaid the outstanding balances on its two term loans held by Laurus, along with accrued interest thereon and related prepayment penalties and fees. The total cash payment to Laurus made on June 29, 2006 was as follows:

Principal	$ 5,038,030
Interest through the date of repayment	40,568
Prepayment penalties	516,071
Related fees	6,749
Total payment	$ 5,601,418

Note 14 Dividends

Dividends are comprised of the following:

	Three Months Ended September 30		Nine months Ended September 30	
	2006	**2005**	**2006**	**2005**
Accrual of Dividend on Series E Convertible Preferred	$	$ 344,000	$ 698,000	$ 1,017,800
Deemed dividend associated with change in conversion price of the Series E Convertible Preferred Stock			23,085,467	
Deemed dividend associated with change in exercise price of warrants issued to the preferred investors			564,258	
Total	$	$ 344,000	$ 24,347,725	$ 1,017,800

The holders of the Company s Series E convertible preferred stock converted all of their shares of preferred stock into common stock on June 29, 2006.

Table of Contents

Note 15 Business Segment Information

The Company is organized and manages its business in two distinct segments: the Energy Technology segment, and the Energy Services 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 eMAC line of HVAC and lighting controllers and the EnergySaver line of lighting controllers. Operations of Lime Energy Co. (formerly known as Electric City Corp.) and Maximum Performance Group, Inc. are included in this segment. Lime Energy is headquartered, and most of its operations are located, in Elk Grove Village, Illinois. Maximum Performance Group is headquartered in New York, New York, and has an office in San Diego, California where most of its technical and engineering operations are located.

The Energy Services segment includes the operations of Parke Industries, LLC and Kapadia Energy Services, Inc. Parke, which the Company acquired effective June 30, 2006, designs, engineers and installs energy efficient lighting upgrades for commercial and industrial users. Kapadia, which the Company acquired effective September 27, 2006, provides energy engineering services to assist customers in improving their energy efficiency and to better manage their energy costs. Kapadia also designs, engineers and manages the installation of energy efficient lighting upgrades for commercial and industrial users, but unlike Parke contracts the installation to third party electrical contractors. Parke is headquartered in Glendora, California and has offices in Danville and Carmel, California. Kapadia is headquartered in Peekskill, New York and has an office in Ventura, California.

Prior to March 31, 2006 the Company also operated a Building Control and Automation segment, which was comprised of its Great Lakes Controlled Energy subsidiary. This segment provided integration of building and environmental control systems for commercial and industrial customers. The Company sold Great Lakes effective March 31, 2006.

The following is the Company s business segment information:

	Three Months Ended September 30		Nine Months Ended September 30	
	2006	**2005**	**2006**	**2005**
Revenues:				
Energy Technology	$ 1,110,000	$ 1,123,000	$ 3,591,000	$ 2,924,000
Energy Services	1,020,000		1,020,000	
Total	2,130,000	1,123,000	4,611,000	2,924,000
Operating Loss:				
Energy Technology	(1,916,000)	(1,433,000)	(3,813,000)	(3,002,000)
Energy Services	(479,000)		(479,000)	
Corporate Overhead	(1,803,000)	(456,000)	(3,289,000)	(1,205,000)
Total	(4,198,000)	(1,889,000)	(7,581,000)	(4,207,000)
Interest Income/ (Expense), net	80,000	(77,000)	(3,131,000)	(384,000)
Loss from Continuing Operations	(4,118,000)	(1,966,000)	(10,712,000)	(4,591,000)

Table of Contents

	September 30, 2006	December 31, 2005
Total Assets:		
Energy Technology	$ 16,716,406	$ 16,424,460
Energy Services	10,832,315	
Building Control and Automation		674,514
Total	$ 27,548,721	$ 17,098,974

Note 16 Subsequent Event

In June 2006, the Company s Board of Directors approved and it announced a 1 for 15 reverse split of its common stock, effective on June 15, 2006. The Company s common stock has been trading on this basis since that date. The Company did not ask its stockholders to approve the Reverse Split in June because it did not believe it was necessary based on the advice of its outside counsel. Thereafter, on June 29, 2006, the Company closed on the following transactions (collectively, the June 29 Transactions):

(1) A private placement of 17,850,000 shares of our common stock at a price of $1 per share as discussed in Note 18(c)

(2) Conversion of all of the outstanding shares of our Series E Convertible Preferred Stock into 21,648,346 as discussed in Note 18(d)

(3) Acquisition of Parke as discussed in Notes 5 and 18(g)

(4) Conversion of the Laurus line of credit into common shares as discussed in Note 12.

All of the June 29 Transactions were premised on the belief of the parties that the Reverse Split was completed and valued the common stock at a price of $1 per share.

In September 26, 2006, the Company acquired Kapadia Consulting, Inc. (as discussed in Note 6). The common shares issued in this acquisition were also premised on the belief of a completed reverse split.

Subsequently, the Company discovered that although the Board had approved the Reverse Split, in the view of Delaware counsel the Reverse Split was not effective until it is set forth in an amendment to the Company s Certificate of Incorporation (which required approval by its stockholders) and was filed with the Delaware Secretary of State. As a result, on January 22, 2007, the Company obtained shareholder approval and on January 23, 2007 it filed the amendment with the Delaware Secretary of State, at which time the reverse split was deemed effective.

Not all of the Company s outstanding common stock was affected similarly. The June 29 Transactions and the Kapadia acquisition are on a different footing than applies with respect to Pre-June 15 shares because the shares of common stock issued in those transactions were newly issued by the Company and not outstanding prior to June 15, 2006. It was the intention of the parties to the June 29 transactions and the Kapadia Acquisition that each of the recipients of the shares thereunder would receive a stated specific number of shares that were being issued after the Reverse Split. If the Reverse Split is treated as not having occurred prior to such issuances but rather on the date the amendment was filed (January 23, 2007), then the recipients in the June 29 Transactions and the Kapadia Acquisition each received shares on an incorrect basis. That is, they received shares on a post-split basis, but should have received shares on a pre-split basis. Accordingly, in conjunction with obtaining shareholder approval for the reverse split, we issued additional shares of common stock so that each of the

recipients of the June 29 Transactions and the Kapadia Acquisition would have the specific number of post-Reverse split shares that were the basis of the original transactions. As a result, all share amounts presented in the accompanying financial statements for these transactions have been retroactively restated to reflect the revised number of shares of common stock.

Note 17 Name Change

On September 13, 2006, the Company changed its name to Lime Energy Co. by merging with a wholly owned subsidiary set up solely for the purpose of effecting the name change. In connection with the name change, the Company s ticker symbol changed to LMEC effective on September 22, 2006.

Note 18 Equity Issuances

a) During the first three months of 2006, two holders of the Company s Series E Convertible Preferred Stock converted a total of 7,130 shares of Series E Convertible Preferred Stock into 47,533 shares of common stock (quantity adjusted for the reverse split).

b) Effective March 31, 2006, the Company received 14,194 shares of its common stock as part of the sale of its Great Lakes Controlled Energy Corporation subsidiary to Messrs. Eugene Borucki and Denis Enberg (quantity adjusted for the reverse split).

c) On June 29, 2006, in a private placement pursuant to Regulation D under the Securities Act of 1933, as amended, the Company entered into a Securities Purchase Agreement and issued to 17 investors, including 10 existing holders of the Company s Series E Convertible Stock, for an aggregate purchase price of $17,875,000, 17,875,000 shares of the Company s common stock (the PIPE Transaction). The Company used $2.72 million of the proceeds to fund the cash consideration for the acquisition of Parke; approximately $5.6 million to prepay two convertible secured term loans and related prepayment penalties and accrued interest owed to Laurus Master Fund Ltd.; $400,000 to pay off Parke s line of credit and $90,079 for transaction related costs. The balance of the gross proceeds of approximately $9 million will be used by the Company for working capital and other general corporate purposes.

Table of Contents

d) Concurrently with the closing of the PIPE Transaction pursuant to the Securities Purchase Agreement described in Note 18(c), the holders of all of the Company s outstanding Series E Preferred Stock converted such shares into 21,648,346 shares of the Company s common stock, and agreed that, upon the conversion, all agreements related to the Preferred Stock would be terminated. The Series E Preferred Stock as originally issued was convertible at $6.67 per share into 1,574,027 shares of the Company s common stock (adjusted for the reverse stock split), however, the Series E contained antidilution provisions which automatically reduced the conversion price of the Series E to the $1.00 per share issuance price of common stock in the PIPE Transaction. This adjustment in the conversion price resulted in 20,074,319 additional shares being issued upon conversion of the Series E. The value of these additional shares of $23,085,467 (valued at the market price of $1.15 per share) was treated as a deemed dividend which the Company recorded by offsetting a dividend charge to additional paid-in capital, without any effect on total stockholders equity.

e) A number of the Company s common stock warrants, most of which are held by former holders of the Company s Series E Convertible Preferred Stock, contain antidilution provisions that automatically adjust the exercise price on the warrants to the issuance price of any security convertible into the Company s common stock if the price is less than the exercise price on the holder s warrant. Prior to the PIPE Transaction the exercise price on these warrants ranged from $13.50 per share to $15.00 per share (adjusted for the reverse split). The issuance of common stock in the PIPE Transaction caused the exercise price on these warrants to automatically be reduced to $1.00 per share. The Company compared the value of the warrants prior to the adjustment to the value of the warrants after the adjustment, using a modified Black-Scholes Option Pricing Model, and determined that the value had increased by $297,868. The weighted average assumptions used for this analysis were as follows: risk free rate of 5.04%, expected volatility of 109.4%, expected dividend of $0 and expected life of 2.2 years. This increase in value was treated as a deemed dividend and recorded by offsetting a dividend charge to additional paid-in-capital, without any effect on total stockholders equity.

f) Immediately following completion of the PIPE Transaction and prepayment of the Laurus term loans, Laurus elected to convert the entire outstanding balance on its revolving line of credit, along with accrued interest thereon, into 950,865 shares of the Company s common stock. In addition, in consideration of the issuance by the Company of 392,596 shares of common stock, Laurus agreed to a) waive the payment of liquidated damages due as a result of the Company s failure to register shares of common stock into which the November 2005 $5 million term loan was convertible, and b) terminate the requirement that the Company pay it a portion of the cash flows generated by VNPP projects for a period of 5 years following the repayment of the November 2005 $5 million convertible term loan. The fair value of these shares, totaling $451,485 as determined based on the quoted market price of the shares, was recorded as additional interest expenses for the nine months ended September 30, 2006.

g) On June 30, 2006, the Company acquired Parke P.A.N.D.A. Corporation for consideration consisting of 5,000,000 shares of Lime Energy common stock and cash of $2,720,000. Please see Note 5 for additional information regarding the acquisition of Parke P.A.N.D.A. Corporation.

h) During the six month period that the Company s Series E Convertible Stock was outstanding in 2006, the Board of Directors declared dividends payable on the Series E Convertible Preferred Stock of $698,000. The dividends were paid with 6,980 additional shares of Series E Convertible Preferred Stock. These Series E shares were converted into common stock on June 29, 2006.

i) During July 2006, the Company issued a consultant a three year warrant to purchase 60,000 shares of its common stock at $1.00 per share as partial consideration for services provided the Company. This warrant was valued at $25,200 using a modified Black-Sholes option pricing model utilizing the following assumptions: risk free rate of 5.108%, expected volatility of 91.4%, expected dividend of

Table of Contents

$0 and expected life of three years. The value of the warrant was charged to operations during the second quarter of 2006.

j) On September 26, 2006, the Company acquired Kapadia Consulting, Inc., effective September 30, 2006. Consideration consisted of 500,000 shares of Lime Energy common stock and cash of $1,106,064. Please see Note 6 for additional information regarding the acquisition of Kapadia Consulting, Inc.

Note 19 Related Party Transactions

During January 2006, the Company entered into a consulting agreement with Parke Industries to provide sales and marketing consulting services. Parke Industries is a company owned by Daniel Parke, one of the Company s directors. Pursuant to the consulting agreement the Company agreed to pay Parke Industries $10,000 per month and to reimburse it for any expenses incurred as a result of its work. The Company paid Parke Industries a total of $61,155 during the nine months ended September 30, 2006. This agreement was terminated in May 2006.

As described in Note 18(c), on June 29, 2006 the Company completed a sale of shares of its common stock to a group of 17 investors, including 10 (of the total of 11) holders of its Series E Preferred Stock (the PIPE Transaction) and, as described in Note 18 (d), all 11 Series E Preferred holders agreed to convert all of the outstanding Series E Preferred into common stock. Three of the investors in the PIPE Transaction (Messrs. Asplund, Kiphart and Valentine) were also Series E Preferred stockholders and also are members of the Company s board of directors. Also, on June 29, 2006, the Company acquired Parke P.A.N.D.A. Corporation, a company owned by The Parke Family Trust, whose trustees and beneficial owners are Daniel Parke, another of the Company s directors, and his spouse.

Due to potential conflicts of interest resulting from (i) the beneficial ownership of Parke P.A.N.D.A. Corporation by Daniel Parke, and (ii) certain members of the Company s Board (Messrs. Asplund, Kiphart and Valentine) beneficially owning shares of Series E Convertible Preferred Stock and agreeing to purchase shares of common stock in the PIPE Transaction and concurrently convert their shares of Series E Convertible Preferred stock into shares of the Company s common stock, the Company s board established a special committee comprised solely of disinterested, independent directors to review, negotiate and approve the acquisition of Parke and the PIPE Transaction. The special committee retained an investment bank to act as its financial advisor and outside counsel to assist it in its review of these transactions. The investment bank reviewed the terms and conditions of the proposed acquisition of Parke and delivered to the special committee an opinion to the effect that the purchase price paid for Parke was fair to the Company from a financial point of view. It also provided information, advice and analysis on the structure and pricing of the PIPE Transaction and a proposed rights offering. Outside counsel assisted the special committee in its review of these transactions and advised the committee on its duties and responsibilities. After considering all of the information it had gathered, the committee concluded that these transactions were fair to the Company and in the best interests of the Company and its stockholders and approved the Parke acquisition and the PIPE Transaction.

In August 2006, the Company retained Corporate Resource Development, Inc. (CRD), a company owned by William Carey, one of Lime Energy s directors, to provide sales and marketing training and support. Under the agreement, which was reviewed and approved by Lime Energy s Board of Directors, the Company will pay CRD $52,500, plus expenses for its services. In January 2006, prior to Mr. Carey s appointment to Lime s Board, CRD was retained to provide sales consulting services to the Company and was paid $10,000 plus expenses for its services.

Table of Contents

INDEPENDENT AUDITORS REPORT

To the Stockholders of
Maximum Performance Group, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Maximum Performance Group, Inc. and Subsidiaries (the Company) as of December 31, 2004 and 2003, and the related consolidated statements of operations and accumulated deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Maximum Performance Group, Inc. and Subsidiaries as of December 31, 2004 and 2003, and the results of its operations and its cash flows for each of the years then ended in conformity with accounting principles generally accepted in the United States of America.

Table of Contents

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company has incurred a net loss during the year ended December 31, 2004 of $2,077,584, has an accumulated deficit of $4,852,559 at December 31, 2004 and cash flows used in operating activities of $1,933,523 during the year ended December 31, 2004. These conditions raise substantial doubt about its ability to continue as a going concern. Management s plans regarding those matters are also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Marcum & Kliegman LLP
April 25, 2005
Melville, New York

Table of Contents

MAXIMUM PEFORMANCE GROUP, INC.
AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
December 31, 2004 and 2003

	2004	2003
ASSETS		
CURRENT ASSETS		
Cash	$ 8,259	$ 31,114
Accounts receivable, less allowance for doubtful accounts of $15,300 in 2004 and 2003	455,505	185,669
Inventory	381,198	481,715
Advances to suppliers	349,872	
Costs and estimated earnings in excess of billings on uncompleted contracts	33,950	131,845
Prepaid expenses and other current assets	23,408	20,162
	1,252,192	850,505
PROPERTY AND EQUIPMENT, Net	784,734	762,584
OTHER ASSETS	19,712	24,628
TOTAL ASSETS	$ 2,056,638	$ 1,637,717

The accompanying notes are an integral part of these consolidated financial statements

F-73

Table of Contents

MAXIMUM PEFORMANCE GROUP, INC.
AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
December 31, 2004 and 2003

	2004	2003
LIABILITIES AND STOCKHOLDERS DEFICIT		
CURRENT LIABILITIES		
Current maturities of long-term debt	$ 27,710	$ 26,861
Current maturities of capital lease obligations	5,522	4,337
Accounts payable	685,069	581,013
Accrued expenses	610,123	323,969
Customer advances	228,742	769,370
Due to stockholders	108,345	237,773
Due to affiliate	28,519	143,882
Deferred revenue, short-term portion	1,329,993	597,610
Total Current Liabilities	3,024,023	2,684,815
OTHER LIABILITIES		
Long-term debt, net of current maturities	17,689	45,399
Capital lease obligations, net of current maturities	4,739	8,522
Other liabilities	9,309	8,076
Deferred revenue, long-term portion	1,547,137	1,659,580
Total Other Liabilities	1,578,874	1,721,577
TOTAL LIABILITIES	$ 4,602,897	$ 4,406,392

The accompanying notes are an integral part of these consolidated financial statements

F-74

Table of Contents

MAXIMUM PEFORMANCE GROUP, INC.
AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET, Continued
December 31, 2004 and 2003

	2004	2003
LIABILITIES AND STOCKHOLDERS DEFICIT, Continued		
Mandatorily Redeemable Preferred stock		
Series B-1 preferred stock; $.001 par value; 640,000 shares authorized, issued and outstanding (liquidation preference- $800,000)	$ 400,000	$
Series B preferred stock; $.001 par value; 3,200,000 shares authorized, 1,440,000 issued and outstanding (liquidation preference- $4,500,000)	900,000	
Series A-1 preferred stock; $.001 par value; 1,000,000 shares authorized, issued and outstanding (liquidation preference- $2,000,000)	1,000,000	
Series A preferred stock; $.001 par value; 6,300,000 shares authorized, issued and outstanding (liquidation preference- $6,300,000)	6,300	6,300
STOCKHOLDERS DEFICIT		
Common stock; $.001 par value; 12,647,508 shares Authorized; none issued and outstanding		
Accumulated deficit	(4,852,559)	(2,774,975)
TOTAL STOCKHOLDERS DEFICIT	(4,852,559)	(2,774,975)
TOTAL LIABILITIES AND STOCKHOLDERS DEFICIT	$ 2,056,638	$ 1,637,717

The accompanying notes are an integral part of these consolidated financial statements

F-75

Table of Contents

MAXIMUM PEFORMANCE GROUP, INC.
AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF OPERATIONS
AND ACCUMULATED DEFICIT
For the Year Ended December 31, 2004 and 2003

	2004	2003
NET SALES	$ 2,312,315	$ 2,341,441
COST OF SALES	1,610,880	2,315,675
GROSS PROFIT	701,435	25,766
OPERATING EXEPNSES		
Product Support	419,098	405,210
Research and development	125,841	160,796
Depreciation and amortization	92,932	61,337
Impairment charge		392,152
Selling expenses	769,290	537,000
General and administrative expenses	1,330,197	1,201,080
TOTAL OPERATING EXPENSES	2,737,358	2,757,575
OPERATING LOSS	(2,035,923)	(2,731,809)
OTHER EXPENSE		
Interest expense, net	37,457	31,407
Other expenses	4,204	
TOTAL OTHER EXPENSE	41,661	31,407
NET LOSS	(2,077,584)	(2,763,216)
ACCUMULATED DEFICIT Beginning	(2,774,975)	
Recapitalization		(11,759)
ACCUMULATED DEFICIT Ending	$ (4,852,559)	$ (2,774,975)

The accompanying notes are an integral part of these consolidated financial statements

MAXIMUM PEFORMANCE GROUP, INC.
AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS
For the Year Ended December 31, 2004 and 2003

	2004	2003
CASH FLOWS FROM OPERATING ACTITIVIES		
Net loss	$ (2,077,584)	$ (2,763,216)
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	92,932	61,337
Provision for doubtful accounts		15,300
Impairment charge		392,152
Changes in operating assets and liabilities:		
Accounts receivable	(269,836)	(195,511)
Inventory	100,517	(333,449)
Costs and estimated earnings in excess of billings on uncompleted contracts	97,895	(131,845)
Advances to suppliers	(349,872)	
Prepaid expenses and other current assets	(3,246)	(12,421)
Accounts payable	104,056	581,013
Accrued expenses	286,154	(185,384)
Deferred revenue	619,940	1,881,807
Customer advances	(540,628)	769,370
Other liabilities	1,233	8,076
Other assets	4,916	(24,628)
TOTAL ADJUSTMENTS	144,061	2,825,817
NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES	(1,933,523)	62,601
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition costs		(133,288)
Purchases of property and equipment	(115,082)	(268,766)
NET CASH USED IN INVESTING ACTIVITIES	$ (115,082)	$ (402,054)

The accompanying notes are an integral part of these consolidated financial statements

F-77

Table of Contents

MAXIMUM PEFORMANCE GROUP, INC.
AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS, Continued
For the Year Ended December 31, 2004 and 2003

	2004	2003
CASH FLOWS FROM FINANCING ACTITIVIES		
Proceeds of loans from stockholders	$ 270,572	$ 237,773
Principal repayments of long-term debt	(26,861)	(9,304)
Repayments of capital lease obligations	(2,598)	(1,784)
Proceeds of loans from affiliate		143,882
Repayment of loans to affiliate	(115,363)	
Proceeds from the Issuance of Series A-1 preferred stock	1,000,000	
Proceeds from the Issuance of Series B preferred stock	900,000	
NET CASH PROVIDED BY FINANCING ACTIVITIES	2,025,750	370,567
NET (DECREASE) INCREASE IN CASH	(22,855)	31,114
CASH - Beginning	31,114	
CASH - Ending	$ 8,259	$ 31,114
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the years for:		
Interest	$ 38,054	$ 31,410
Non-cash investing and financing activities:		
Net assets and liabilities in the following amounts were exchanged for the issuance of Series A Mandatorily Redeemable Preferred Stock:		
Accounts receivable	$	$ 5,458
Inventory	$	$ 148,265
Prepaid expense and other current assets	$	$ 7,741
Goodwill	$	$ 258,864
Accrued expenses	$	$ (509,352)
Deferred revenue	$	$ (375,383)
Fixed assets	$	$ 458,948
Recapitalization	$	$ 11,759
Preferred stock	$	$ (6,300)
Issuance of Series B-1 preferred stock issued for repayment of stockholders loans	$ 400,000	$
Equipment acquired under capital leases and debt obligations	$	$ 96,207

The accompanying notes are an integral part of these consolidated financial statements

F-78

Table of Contents

MAXIMUM PEFORMANCE GROUP, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 Organization and Business

Maximum Performance Group, Inc. (MPG) or (the Company) is a Delaware corporation, formed on December 10, 2002 for the purpose of acquiring certain assets and liabilities of Maximum Energy Services, Inc. (MES) and Pentech Solutions, Inc. (Pentech). On February 13, 2003, the Company completed the acquisition of the MES assets through a merger with its wholly owned subsidiary, Maximum LLC (The LLC) and simultaneously acquired all of the outstanding stock of Pentech. Prior to this date, MPG was inactive.

In connection with the transactions, MPG issued 6,300,000 shares of its Series A Preferred stock (Series A Stock), of which 3,675,000 shares were issued to the former shareholders of MES and 2,625,000 shares were issued to the former stockholders of Pentech. In accordance with the provisions of SFAS No. 141, Business Combinations , The LLC was determined to be the acquiring entity, and as such, its net liabilities were recorded at their carryover basis of $8,084. The purchase price of Pentech was $135,913 and was composed of the mandatorily redeemable preferred stock with an estimated value of $2,625 and acquisition costs associated with the transaction of $133,288. The acquisition cost of Pentech was allocated to the following assets and liabilities:

Assets:		
Inventory	$ 143,967	
Fixed assets	107,300	
Prepaid expenses and other current assets	13,199	
Goodwill	392,152	
		$ 656,618
Liabilities:		
Accounts payable, and accrued expenses	509,353	
Deferred income	11,352	
		$ 520,705
Purchase Price		$ 135,913

The 6,300,000 shares of Series A Stock have a liquidation preference of $1 per share, aggregating $6,300,000.

MPG is a technology based, energy and asset management provider. Through the application of the Company s web-based software and enabling hardware, it ensures the customer s energy consuming assets are performing at their most efficient level. This optimal performance is accomplished through the Company s unique methods of continuous commissioning, asset monitoring and intelligence-based performance algorithms.

MAXIMUM PEFORMANCE GROUP, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 Organization and Business, continued

MPG delivers technologies to provide mechanical system intelligence. These technologies become an enabling tool in which the Company s clients achieve documented energy savings, reduction in maintenance expenditures, increased asset life and improve management process. The specific technologies include:

eMAC HVAC and lighting applications-this is a monitoring, communication and control device designed specifically for natural gas and electric heat, direct expansion cooling, and HVAC systems.

Maximum Performance Software-ensures customer s facility systems are continually commissioned through three specific modules-(a) monitoring and verification, (b) scheduling optimization, and (c) real time optimal control.

MPG also performs special projects. These projects encompass lighting system and mechanical upgrades.

NOTE 2 Summary of Significant Accounting Policies

Management s Liquidity Plans

The Company had a net loss of $2,077,584 for the year ended December 31, 2004 and cash flows used in operating activities during the year ended December 31, 2004 of $1,933,523.

Management estimates that it will require additional resources during 2005, based upon its current operating plan and condition. The Company is currently investigating additional financing alternatives, including equity financing. There is no assurance that capital in any form would be available to the Company, and if available, on terms and conditions that are acceptable. The success of the Company depends upon many factors, including securing increased sales for its products and obtaining adequate additional financing on acceptable terms. The uncertainties regarding the availability of continued financing and adequate revenues raise substantial doubt about the Company s ability to continue as a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. The financial statements do not include any adjustments relating to the recoverability of the recorded assets or the classification of liabilities that may be necessary should the Company be unable to continue as a going concern.

In September 2004, the Company engaged a consultant to investigate financing and merger alternatives. This has lead to the possible sale of the Company (see Note 12).

Principles of Consolidation

The financial statements include the accounts of MPG and its subsidiaries (The LLC and Pentech). All intercompany balances and transactions have been eliminated in consolidation.

MAXIMUM PEFORMANCE GROUP, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 Summary of Significant Accounting Policies, continued

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash

The Company considers all highly liquid instruments with maturities of three months or less to be cash equivalents. At December 31, 2004 and 2003, the Company did not have any cash equivalents. The Company at times has cash deposits in excess of the maximum amounts insured by the FDIC.

Inventory

The Company maintains a finished goods inventory consisting of monitoring units (eMAC units) purchased from a contract manufacturer and spare components. Inventory is stated at the lower of cost (first-in, first-out) or market value. Advances to supplier represent amounts paid to a supplier for future purchases of inventory.

Accounts Receivable

The Company provides credit, in the normal course of business, to its customers. The Company maintains an allowance for doubtful customer accounts for estimated losses that may result from the inability of the Company s customers to make required payments. Management determines the allowances based on historical collection experience, current economic and market conditions, and a review of the current status of each customer s trade accounts receivable.

Revenue Recognition

The Company derives its revenues principally from the sale of its web-based software and enabling hardware (eMAC units) and from monitoring and energy management support maintenance services. The Company recognizes revenue when persuasive evidence of an arrangement exists, the product has been delivered, the price is fixed or determinable and collectibility is probable.

Many of the Company s contracts contain multiple element arrangements which include undelivered services essential to the functionality of delivered products. Accordingly, revenue from such arrangements is recognized ratably over the maintenance term, provided all other revenue criteria have been met.

MAXIMUM PEFORMANCE GROUP, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 Summary of Significant Accounting Policies, continued

Revenue Recognition, continued

Amounts billed in advance from customers related to services not yet provided are recorded as deferred revenue.

Revenue Recognition (Percentage of Completion)

MPG accounts for long-term construction contracts and recognizes revenue for financial statement purposes under the percentage of completion method. MPG performs projects that encompass lighting system upgrades and mechanical system upgrades.

The amount of revenue recognized at the financial statement date is the portion of the total contract price that the costs expended to date bears to the anticipated total costs, based on current estimates of costs to complete. Contract costs include materials unique to or installed in the project and subcontract costs.

In accordance with normal construction industry practice, the Company includes in current assets and current liabilities, amounts relating to construction contracts realizable and payable over a period in excess of one year. The length of the company s contacts varies, but is typically between three months to two years. Revisions in estimates of costs and earnings during the life of the contracts are reflected in the accounting period in which such revisions become known. At the time a material loss on a contract becomes known, the entire amount of the estimated loss is recognized in the financial statements.

The asset Costs and estimated earnings in excess of billings on uncompleted contracts in the accompanying combined financial statements represents revenues earned in excess of amounts billed.

Fixed Assets

Fixed assets are recorded at cost. Depreciation is calculated on the straight-line basis in amounts sufficient to amortize the cost of the assets over their estimated useful lives (generally three to five years) beginning when the asset is put into use. Leasehold improvements are amortized over shorter of the estimated life or the related lease term. Expenditures for maintenance and repairs are charged to operations as incurred.

Software Development Costs

In accordance with Statement of Financial Account Standards (SFAS) No. 86, Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed, the Company capitalizes costs incurred to develop new software products upon determination that technological feasibility has been established upon completion of the working model. Costs incurred by the Company prior to establishment of technological feasibility are charged to expense.

Table of Contents

MAXIMUM PEFORMANCE GROUP, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 Summary of Significant Accounting Policies, continued

Software Development Costs, continued

Approximately $632,000 and $521,000 of software costs are not being amortized as of December 31, 2004 and 2003, respectively, as they have not yet been placed in service.

Goodwill

The Financial Accounting Standards Board (FASB) issued Statement on Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets. SFAS No. 142 provides guidance on how to account for goodwill. The most substantive change is that goodwill will no longer be amortized, but instead will be tested for impairment periodically. In 2003, the Company completed its annual impairment testing of goodwill, which indicated that the carrying value of goodwill associated with the Pentech acquisition exceeded its fair value and required an adjustment for this impairment. This was due primarily to significant losses incurred by the Company since the acquisition of Pentech. The Company recorded an impairment charge of $392,152 for the year ended December 31, 2003.

Income Taxes

The Company provides for income taxes utilizing the liability method whereby deferred items are based on differences between the financial reporting and tax bases of assets and liabilities and are measured based on the tax rates expected to be in effect when the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred income tax assets and the amounts expected to be realized.

Impairment of Long-Lived Assets

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset is not recoverable. At such time as impairment in value of a long-lived asset is identified, the impairment will be measured in accordance with SFAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets, as the amount by which the carrying amount of a long-lived asset exceeds its fair value. To determine fair value, the Company employs an expected present value technique, which utilizes multiple cash flow scenarios that reflect the range of possible outcomes and an appropriate discount rate.

MAXIMUM PEFORMANCE GROUP, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 Summary of Significant Accounting Policies, continued

Fair Value of Financial Instruments

The Company calculates the fair value of financial instruments and includes this additional information in the notes to financial statements when the fair value is different than the book value of those financial instruments. When the fair value approximates book value, no additional disclosure is made. As of December 31, 2004 and 2003, the carrying value of all financial instruments approximated fair value.

Concentration of Credit Risk

Certain financial instruments potentially subject the Company to concentrations of credit risk. These financial instruments consist primarily of cash and accounts receivable. The Company places its cash with a high-credit quality financial institution to limit its credit exposure. During 2004, two customers accounted for 36%, and 15% of revenue, respectively. Accounts receivable from these customers at December 31, 2004 totaled approximately $7,000 and $187,000, respectively. During 2003, three customers accounted for 37%, 27% and 16% of revenue, respectively. Accounts receivable from these customers at December 31, 2003 totaled approximately $33,000, $22,000 and $12,000, respectively. The Company retains a security interest in hardware until the full purchase price, including taxes and additional charges have been paid. The Company maintains ongoing credit evaluations of its customers.

NOTE 3 Costs, Estimated Profits and Billing on Uncompleted Contracts

Summarized as follows:

	2004	2003
Costs incurred on uncompleted contracts	$ 103,856	$ 442,135
Estimated profits	155,693	68,644
Total	259,549	510,779
Less: billings to date	225,599	378,934
Net	$ 33,950	$ 131,845

These amounts are included in the accompanying consolidated balance sheet under the following captions:

Costs and estimated profit in excess of billings on uncompleted contracts	$ 33,950	$ 131,845

Table of Contents

MAXIMUM PEFORMANCE GROUP, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 Fixed Assets

Fixed assets consist of the following components at December 31, 2004 and 2003:

	2004	2003
Machinery and equipment	$ 63,280	$ 61,511
Vehicles	81,564	81,564
Computer equipment	113,299	111,173
Software	657,982	546,795
Leasehold improvements	22,878	22,878
	939,003	823,921
Less accumulated depreciation	154,269	61,337
Fixed assets, net	$ 784,734	$ 762,584

NOTE 5 Related Party Transactions

Amounts due to stockholders and affiliate represent unsecured demand obligations bearing interest at an annual rate of 6%.

NOTE 6 Long-Term Debt

Long-term debt at December 31, 2004 and 2003 consist of the following:

	2004	2003
Vehicle note due in thirty-six (36) monthly installments of $556, including principal and interest at the prime rate (was 5.07% at December 31, 2004) per annum through March 2006, collateralized by the underlying vehicle.	$ 7,899	$ 14,566
Vehicle note due in thirty-six (36) monthly installments of $612, including principal and interest at 3.84% per annum through July 2006, collateralized by the underlying vehicle.	11,262	18,030
(Sub-total forward)	$ 19,161	$ 32,596

Table of Contents

MAXIMUM PEFORMANCE GROUP, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 Long-Term Debt, continued

	2004	2003
(Sub-total forward)	$ 19,161	$ 32,596
Vehicle note due in thirty-six (36) monthly installments of $596, including principal and interest at 4.14% per annum through August 2006, collateralized by the underlying vehicle.	11,491	18,015
Vehicle note due in thirty-six (36) monthly installments of $643, including principal and interest at 4.41% per annum through December 2006, collateralized by the underlying vehicle.	14,747	21,649
Total Long-Term Debt	45,399	72,260
Less: Current Maturities	27,710	26,861
Total Long-Term Debt, Net of Current Maturities	$ 17,689	$ 45,399

Annual maturities of long-term debt are as follows:

For the Year Ending December 31,	Amount
2005	$ 27,710
2006	17,689
Total	$ 45,399

NOTE 7 Capitalized Lease Obligations

During 2003, the Company obtained various equipment under capital leases expiring at various dates through February 2007 with effective interest rates varying from 9.94% to 27.68% per annum. Assets and liabilities under capital leases are recorded at the lower of the present values of the minimum lease payments or the fair values of the assets. The leased equipment is included in property and equipment and is being depreciated over its estimated useful life.

F-86

Table of Contents

MAXIMUM PEFORMANCE GROUP, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7 Capitalized Lease Obligations, continued

Future annual minimum lease payments under these capital leases are:

For the Year Ending December 31,	Amount
2005	$ 6,759
2006	4,795
2007	373
Total minimum lease payments	11,927
Less: amounts representing interest	1,666
Total capital lease obligation	10,261
Less: current portion	5,522
Capital lease obligation, less current portion	$ 4,739

The capitalized lease obligations are collateralized by equipment which has a cost of approximately $14,643 and accumulated depreciation of approximately $6,409 and $1,647 at December 31, 2004 and 2003, respectively. Equipment depreciation of $4,762 and $1,647 respectively, has been included in depreciation expense for the years ended December 31, 2004 and 2003.

NOTE 8 Lease Commitments

The Company leases its facilities under non-cancelable operating leases. The New York City and San Diego facility leases expire in June 2009 and April 2005, respectively. In addition, the Company has various operating leases for office equipment. Rental expense under all operating leases for the year ended December 31, 2004 and 2003 was $139,148 and $78,626, respectively.

Future minimum rental payments under non-cancelable operating leases are summarized as follows:

For the Year Ending December 31,	Amount
2005	$ 130,518
2006	110,975
2007	103,795
2008	98,831
2009	45,256
Total	$ 489,375

NOTE 9 Mandatorily Redeemable Preferred Stock

Series A Preferred Stock

The terms of the Series A Stock are as follows:

Dividend Provisions: The holders of the Series A Stock are entitled to receive dividends at the rate of $.08 per share per annum (the Series A Dividends). Series A Dividends are payable when, as and if declared by the Board of Directors. As of December 31, 2004, no Series A Dividends were declared by the Company.

Liquidation Preference: The holders of Series A Stock are entitled to receive upon any liquidation or deemed liquidation, prior and in preference to any distribution or payment to the holders of common stock, an amount equal to $1.00 (the Original Issue Price) for each share of Series A Stock plus an amount equal to any declared but unpaid dividends on such respective shares.

Redemption: Upon the written request of the holders of at least 50% of the then-outstanding shares of Preferred Stock (the Requesting Holders), the Company shall on February 1, 2008 (the Redemption Date) redeem, all of the shares of Series A Stock held by the Requesting Holders for the sum of $1.00 per share and an amount equal to all dividends declared but unpaid thereon up to the Redemption Date.

Conversion: Each share of Series A Stock is convertible, at the option of the holder, at any time after the date of issuance, into such number of fully paid and non-assessable shares of common stock as is determined by dividing the Original Issue Price by the Series A Conversion Price. The initial Series A Conversion Price is $1.00 per share.

Automatic Conversion: Each share of Series A Stock is automatically converted into shares of common stock at the Series A Conversion Price at the time in effect for such shares immediately upon the earlier of the closing of (i) A Qualified Public Offering, as defined or, (ii) the date specified by writing consent or agreement of the holders of at least 75% of the then outstanding shares of Preferred Stock.

Voting Rights: Each share of Series A Stock is entitled to a number of votes equal to the number of shares of common stock into which such shares of Series A Stock held by such holder could then be converted.

Series A-1 Preferred Stock

In January 2004, the Company issued 1,000,000 shares of Series A-1 preferred stock and received proceeds of $1,000,000. The Series A-1 preferred Stock has a par value of $.001 per share.

NOTE 9 Mandatorily Redeemable Preferred Stock, continued

The terms of the Series A-1 Stock are as follows:

Dividend Provisions: The holders of the Series A-1 Stock are entitled to receive dividends at the rate of $.08 per share per annum (the Series A-1 Dividends). Series A-1 Dividends are payable when, and if declared by the Board of Directors.

Liquidation Preference: The holders of Series A-1 Stock are entitled to receive upon any liquidation or deemed liquidation, prior and in preference to any distribution or payment to the holders of common stock and Series A-1 holders, an amount equal to $2.00 (the Original Issue Price) for each share of Series A-1 Stock plus an amount equal to any declared but unpaid dividends on such respective shares.

Redemption: Upon the written request of the holders of at least 50% of the then-outstanding shares of Preferred Stock (the Requesting Holders), the Company shall on February 1, 2008 (the Redemption Date) redeem, all of the shares of Series A Stock held by the Requesting Holders for the sum of $2.00 per share and an amount equal to all dividends declared but unpaid thereon up to the Redemption Date.

Conversion: Each share of Series A-1 Stock is convertible, at the option of the holder, at any time after the date of issuance, into such number of fully paid and non-assessable shares of common stock as is determined by dividing the Original Issue Price by the Series A-1 Conversion Price. The initial Series A-1 Conversion Price is $1.00 per share.

Automatic Conversion: Each share of Series A-1 Stock is automatically converted into shares of common stock at the Series A-1 Conversion Price at the time in effect for such shares immediately upon the earlier of the closing of (i) A Qualified Public Offering, as defined or, (ii) the date specified by writing consent or agreement of the holders of at least 75% of the then outstanding shares of Preferred Stock.

Voting Rights: Each share of Series A-1 Stock is entitled to a number of votes equal to the number of shares of common stock into which such shares of Series A-1 Stock held by such holder could then be converted.

Series B and B-1 Preferred Stock

At various dates from August 2004 through October 2004, the Company issued 1,440,000 shares of Series B preferred stock. The Series B preferred stock has a par value of $.001 per share. The Company received proceeds of $900,000 or $.625 per share in connection with this issuance.

In August 2005, the Company issued 640,000 shares of Series B-1 preferred stock for two $200,000 promissory notes due to shareholders or $.625 per share. The par value of the Series B-1 preferred stock is $.001 per share.

NOTE 9 Mandatorily Redeemable Preferred Stock, continued

The terms of the Series B and B-1 Stock are as follows:

Dividend Provisions: The holders of the Series B and B-1 Stock are entitled to receive dividends at the rate of $.08 per share per annum (the Series B and B-1 Dividends). Series B and B-1 Dividends are payable when, as and if declared by the Board of Directors.

Liquidation Preference: The holders of Series B and B-1 Stock are entitled to receive upon any liquidation or deemed liquidation, prior and in preference to any distribution or payment to the holders of common stock, an amount equal to $3.125 and $1.25, respectively (the Original Issue Price) for each share of Series B and B-1 Stock plus an amount equal to any declared but unpaid dividends on such respective shares.

Redemption: Upon the written request of the holders of at least 50% of the then-outstanding shares of Preferred Stock (the Requesting Holders), the Company shall on February 1, 2008 (the Redemption Date) redeem, all of the shares of Series B and B-1 Stock held by the Requesting Holders for the sum of $3.125 and $1.25 per share respectively and an amount equal to all dividends declared but unpaid thereon up to the Redemption Date.

Conversion: Each share of Series B and B-1 Stock is convertible, at the option of the holder, at any time after the date of issuance, into such number of fully paid and non-assessable shares of common stock as is determined by dividing the Original Issue Price by the Series B and B-1 Conversion Price. The initial Series B and B-1 Conversion Price is $.625 per share.

Automatic Conversion: Each share of Series B and B-1 Stock is automatically converted into shares of common stock at the Series A Conversion Price at the time in effect for such shares immediately upon the earlier of the closing of (i) A Qualified Public Offering, as defined or, (ii) the date specified by writing consent or agreement of the holders of at least 75% of the then outstanding shares of Preferred Stock.

Voting Rights: Each share of Series B and B-1 Stock is entitled to a number of votes equal to the number of shares of common stock into which such shares of Series B and B-1 Stock held by such holder could then be converted.

NOTE 10 Income Taxes

For the years ended December 31, 2004 and 2003, no income tax provision was recorded as a result of the Company incurring losses and the net deferred tax asset being fully offset by a valuation allowance due to the uncertainty of the realization of these accounts. At December 31, 2004 and 2003, the Company has net operating loss carryforwards of approximately $5,130,000 and $3,233,000, respectively, which can be utilized against future profits until 2024.

MAXIMUM PEFORMANCE GROUP, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 10 Income Taxes, continued

Deferred income taxes reflect the net effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The Company s gross deferred tax assets at December 31, 2004 of approximately $2,781,000 relate primarily to net operating loss carryforwards, deferred revenues, and depreciation and amortization. At December 31, 2004 and 2003, a valuation allowance was recorded to fully offset the net deferred tax assets.

NOTE 11 Retirement Plan

MPG adopted and implemented a Safe Harbor 401(k) Plan for the plan year that begins January 1, 2003. For the 2003 plan year, the Company provided a matching contribution for eligible participants. The matching contribution was a dollar-for-dollar matching contribution on salary deferrals up to 3% of compensation and then fifty-cents on the dollar matching contribution on salary deferrals from 4% to 5% of compensation. The Company made contributions to the plan of $62,681 and $27,062 for the years ended December 31, 2004 and 2003, respectively. Participants are 100% vested in this matching contribution.

NOTE 12 Subsequent Event

On March 1, 2005, the Company entered into a letter of intent to sell all of its outstanding capital stock to Lime Energy Co. (formerly known as Electric City Corp.) (ELC), a publicly held company which is in a similar line of business as MPG. The estimated purchase price of up to $7.5 million, is composed of cash and common stock of ELC. Closing of the sale is subject to various conditions contained in the letter agreement.

Table of Contents

MAXIMUM PERFORMANCE GROUP, INC.
CONDENSED CONSOLIDATED BALANCE SHEET

	March 31 2005 (unaudited)
Assets	
Current Assets	
Cash and cash equivalents	$ 11,760
Accounts receivable, net	300,604
Inventories	357,662
Advances to suppliers	407,086
Prepaid expenses and other	16,943
Total Current Assets	1,094,055
Net Property and Equipment	798,217
Other Assets	19,712
	$ 1,911,984

See accompanying notes to condensed consolidated financial statements

F-92

Table of Contents

MAXIMUM PERFORMANCE GROUP, INC.
CONDENSED CONSOLIDATED BALANCE SHEET

	March 31, 2005 (unaudited)
Liabilities and Stockholders Equity	
Current Liabilities	
Current maturities of long-term debt and capital lease obligations	$ 33,434
Accounts payable	629,079
Accrued expenses	673,129
Customer advances	332,155
Due to stockholders	164,580
Due to affiliate	28,919
Billings in excess of costs and estimated earnings on uncompleted contracts	36,148
Deferred revenue	1,150,579
Total Current Liabilities	3,048,023
Long-Term Debt, less current maturities	14,074
Other Liabilities	9,227
Deferred Revenue	1,625,448
Total Liabilities	4,696,772
Mandatorily Redeemable Preferred Stock	2,306,300
Stockholders Deficit	
Common stock, $.0001 par value; 12,647,508 shares authorized; none issued and outstanding	
Accumulated deficit	(5,091,088)
Total Stockholders Deficit	(5,091,088)
	$ 1,911,984

See accompanying notes to condensed consolidated financial statements

F-93

Table of Contents

MAXIMUM PERFORMANCE GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

Three months ended, March 31	2005	2004
Revenue	$ 850,312	$ 300,292
Cost of Sales	477,042	379,599
Gross Profit (Loss)	373,270	(79,307)
Operating Expenses		
Product support	80,377	121,598
Research and development	2,839	50,360
Depreciation and amortization	23,287	31,217
Selling expenses	140,705	201,500
General and administrative expenses	353,309	347,634
	600,517	752,309
Operating loss	(227,247)	(831,616)
Other Income (Expense)		
Interest expense	(5,328)	(6,101)
Other expense	(5,954)	(3,470)
Total other income (expense)	(11,282)	(9,571)
Net Loss	$ (238,529)	$ (841,187)

See accompanying notes to condensed consolidated financial statements

F-94

Table of Contents

MAXIMUM PERFORMANCE GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

Three months ended March 31	2005	2004
Cash Flow from Operating Activities		
Net loss	$ (238,529)	$ (841,187)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	23,287	31,217
Accrued interest payable on notes payable	1,334	4,909
Changes in assets and liabilities		
Accounts receivable	154,901	(391,300)
Inventories	23,536	24,675
Costs and estimates in excess of billings on uncompleted contracts	33,950	79,590
Billings in excess if costs and estimated earnings on uncompleted contracts	36,148	
Advances to suppliers	(57,214)	
Prepaid expenses and other current assets	6,465	(32,681)
Accounts payable	(55,989)	(256,897)
Accrued expenses	63,006	131,076
Deferred revenue	(101,104)	494,854
Customer advances	103,413	(185,226)
Other liabilities	(82)	837
Other assets		4,919
Net cash used in operating activities	(6,878)	(935,214)
Cash Flows Used In Investing Activities		
Purchase of property and equipment	(36,770)	(33,567)
Net cash used in investing activities	(36,770)	(33,567)
Cash Flows Provided by (Used in) Financing Activities		
Proceeds of loans from stockholders	165,000	30,500
Payment on loans from stockholders	(109,669)	(41,217)
Proceeds from long-term debt		2,126
Payment on long-term debt	(8,153)	(7,706)
Proceeds of loans to affiliate		23,521
Payment on loans to affiliate	(29)	(57,859)
Proceeds from issuance of mandatorily redeemable preferred stock		1,000,000
Net cash provided by financing activities	47,149	949,365

Net Increase (Decrease) in Cash and Cash Equivalents		**3,501**		**(19,416)**
Cash and Cash Equivalents, at beginning of period		**8,259**		**31,114**
Cash and Cash Equivalents, at end of period	**$**	**11,760**	**$**	**11,698**
Supplemental Disclosure of Cash Flow Information				
Cash paid during the periods for interest	**$**	**1,610**	**$**	**1,210**

See accompanying notes to condensed consolidated financial statements

F-95

Table of Contents

Maximum Performance Group, Inc.
Notes to Financial Statements

Note 1 Basis of Presentation

The accompanying unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2005 and 2004 are not necessarily indicative of the results that may be expected for the fiscal year ended December 31 2005. For further information, refer to the Company s annual December 31, 2004 and 2003 financial statements and footnotes included elsewhere in this registration statement.

Note 2 Inventories

Inventories consisted of the following:

	March 31, 2005
Raw materials	$
Work in process	
Finished goods	357,662
	$ 357,662

Note 2 Related Party Transactions

As of March 31, 2005 the Company owed $164,580 and $28,919 to stockholders and affiliates, respectively. These amounts represent unsecured demand obligations bearing interest at an annual rate of 6%.

Note 3 Customer Concentration

Two customers accounted for 54% and 11% of Company s revenue during the three month period ended March 31, 2005. Accounts receivable from these customers at March 31, 2005 totaled approximately $25,000 and $36,000 respectively. One customer accounted for 64% of the Company s revenue during the three month period ended March 31, 2004. Accounts receivable from this customer at March 31, 2004 totaled approximately $345,000.

Note 4 Reclassification

Certain accounts in the prior year financial statements have been reclassified for comparative purposes to conform with the presentation in the current year financial statements. These reclassifications have no effect on previously reported income.

Table of Contents

Note 5 Subsequent Event

Pursuant to an Agreement and Plan of Merger (the Merger Agreement) dated as of April 29, 2005, by and among Lime Energy Co. (formerly known as Electric City Corp.), (Lime Energy) MPG Acquisition Corporation, a wholly-owned subsidiary of Lime Energy (Merger Subsidiary), and Maximum Performance Group, Inc. (MPG), on May 3, 2005, Lime Energy acquired MPG pursuant to the merger of MPG with and into Merger Subsidiary, with Merger Subsidiary continuing as the surviving corporation under the name Maximum Performance Group, Inc.

The merger consideration consisted of approximately $1,644,000 in cash, approximately 2,520,000 shares of Lime Energy common stock and approximately 2,510,000 additional shares which have been placed in escrow. If MPG s revenues during the two years following the merger exceed an aggregate of $5,500,000 the escrow shares will be released to the former stockholders of MPG at the rate of 202 shares for every $1,000 of revenue in excess of such amount. The escrow shares are also available to satisfy any indemnification claims which Lime Energy may have under the Merger Agreement. As a result of the merger, Merger Subsidiary became responsible for the liabilities of MPG. The acquisition will be recorded using the purchase method of accounting.

Table of Contents

Report of Independent Registered Public Accounting Firm

Parke P.A.N.D.A. Corporation
Glendora, California

We have audited the accompanying balance sheets of Parke P.A.N.D.A. Corporation as of December 31, 2005 and 2004, and the related statements of income, stockholder s equity and cash flows for the two year period ended December 31, 2005. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Parke P.A.N.D.A. Corporation at December 31, 2005 and 2004, and the results of its operations and its cash flows for the two year period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

Chicago, Illinois
August 11, 2006

/s/ BDO SEIDMAN, LLP

Table of Contents

Parke P.A.N.D.A. Corporation
Balance Sheets

December 31,	**2005**	**2004**
Assets		
Current Assets		
Cash	**$ 152,412**	**$ 5,579**
Accounts receivable, net of allowance of $10,000 at December 31, 2005 and 2004	**329,316**	**332,682**
Inventories	**158,796**	**57,312**
Other		**614**
Total Current Assets	**640,524**	**396,187**
Net Property and Equipment *(Note 3)*	**54,299**	**39,611**
Intangibles, net of amortization of $2,059 and $1,602 at December 31, 2005 and 2004, respectively	**229**	**686**
	$ 695,052	**$ 436,484**

F-99

Table of Contents

Parke P.A.N.D.A. Corporation
Balance Sheets

December 31,	**2005**	**2004**
Liabilities and Stockholder s Equity		
Current Liabilities		
Line of credit (Note 4)	**$**	**$ 38,646**
Current maturities of long-term debt (Note 5)	**5,564**	**9,821**
Accounts payable	**235,355**	**111,005**
Accrued expenses	**56,698**	**30,187**
Due to stockholder		**32,332**
Total Current Liabilities	**297,617**	**221,991**
Long-Term Debt, less current maturities (Note 5)	**8,170**	**13,734**
Total Liabilities	**305,787**	**235,725**
Commitments (Note 6)		
Stockholder s Equity		
Common stock, no par value; 1,000,000 shares authorized, 1,000 issued and outstanding at December 31, 2005 and 2004	**10,000**	**10,000**
Accumulated earnings	**379,265**	**190,759**
Total Stockholder s Equity	**389,265**	**200,759**
	$ 695,052	**$ 436,484**

Table of Contents

Parke P.A.N.D.A. Corporation
Statements of Income

	Year ended December 31, 2005	Year ended December 31, 2004
Revenue	**$ 3,342,731**	**$ 2,012,638**
Expenses		
Cost of sales	**2,120,765**	**1,307,047**
Selling, general and administrative	**838,092**	**568,956**
	2,958,857	**1,876,003**
Operating Income	**383,874**	**136,635**
Other Expense		
Interest expense	**8,300**	**8,940**
Net Income	**$ 375,574**	**$ 127,695**

F-101

Table of Contents

Parke P.A.N.D.A. Corporation
Statements of Stockholder s Equity

	Common Shares	Common Stock	Accumulated Earnings	Total Stockholder s Equity
Balance, January 1, 2004	**1,000**	**$ 10,000**	**$ 63,064**	**$ 73,064**
Net income for the year ended December 31, 2004			**127,695**	**127,695**
Balance, December 31, 2004	**1,000**	**$ 10,000**	**$ 190,759**	**$ 200,759**
Stockholder distribution			**(187,068)**	**(187,068)**
Net income for the year ended December 31, 2005			**375,574**	**375,574**
Balance, December 31, 2005	**1,000**	**$ 10,000**	**$ 379,265**	**$ 389,265**

F-102

Table of Contents

Parke P.A.N.D.A. Corporation
Statements of Cash Flows

	Year ended December 31, 2005	Year ended December 31, 2004
Cash Flows From Operating Activities		
Net income	$ 375,574	$ 127,695
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	20,194	12,821
Changes in assets and liabilities		
Accounts receivable	3,366	(62,751)
Inventories	(101,484)	(32,472)
Other current assets	614	24,509
Accounts payable	124,350	55,678
Accrued expenses	26,511	8,146
Net cash provided by operating activities	449,125	133,626
Cash Flows Used in Investing Activities		
Purchase of property and equipment	(34,425)	(8,746)
Cash Flows Used in Financing Activities		
Payments on line of credit	(38,646)	(91,370)
Payments on long-term debt	(9,821)	(9,512)
Shareholder advance		1,830
Payments on stockholder loan	(32,332)	
Distribution to stockholder	(187,068)	
Net cash used in financing activities	(267,867)	(99,052)
Net Increase in Cash	146,833	25,828
Cash, at beginning of year	5,579	(20,249)
Cash, at end of year	$ 152,412	$ 5,579
Supplemental Disclosure of Cash Flow Information		
Interest paid during the year	$ 8,300	$ 8,940

Parke P.A.N.D.A. Corporation
Notes to Financial Statements

Note 1 Description of Business

Parke P.A.N.D.A. Corporation (the Company), a California S corporation headquartered in Glendora, California, is an energy services provider specializing in the design, engineering and installation of energy efficient lighting upgrades for commercial and industrial users. The Company s principal customers are located in California.

Note 2 Summary of Significant Accounting Policies

Inventories

Inventories are stated at the lower of cost or market. Cost is determined utilizing the first-in, first-out (FIFO) method.

Property and equipment

Property and equipment are recorded at cost. Depreciation is calculated on the straight-line basis in amounts sufficient to amortize the cost of the assets over their estimated useful lives (generally three to five years) beginning when the asset is placed into service. Expenditures for maintenance and repairs are charged to operations as incurred.

Impairment of Long-Lived Assets

The Company records impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of those items. Our cash flow estimates are based on historical results adjusted to reflect our best estimate of future market and operating conditions. The net carrying value of assets not recoverable is reduced to fair value. Our estimates of fair value represent our best estimate based on industry trends and reference to market rates and transactions.

Revenue Recognition

The Company s contracts are of relatively short duration; therefore revenue is recognized on the completed contract basis. Based on the completed-contract method, revenue is recognized when delivery of the product has occurred and installation is complete, title has passed to the customer and collectability is reasonably assured.

Allowance for Doubtful Accounts

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. The allowance is largely based upon specific knowledge of customers from whom collection is determined to be doubtful and our historical collection experience with such customers. If the financial condition of our customers or the economic environment in which they operate were to deteriorate, resulting in an inability to make payments, or if our estimates of certain customer s ability to pay are incorrect, additional allowances may be required. At December 31, 2005 and 2004, the Company had a $10,000 allowance for doubtful accounts.

Income Taxes

The Company has elected S corporation status and, accordingly, is not a tax-paying entity for federal income tax purposes. Its stockholder has consented to include the losses or income of the Company on his individual federal tax returns. However, the Company is a tax-paying entity for California Franchise tax purposes.

Table of Contents

Parke P.A.N.D.A. Corporation
Notes to Financial Statements

Concentration of Risk

Certain financial instruments potentially subject the Company to concentrations of credit risk. These financial instruments consist primarily of cash and accounts receivable. The Company places its cash with a high-credit quality financial institution to limit its credit exposure. During 2005 one customer accounted for approximately 20% of the Company s revenue. There were no outstanding accounts receivable from this customer at December 31, 2005. No customer accounted for more than 10% of the Company s revenue during 2004. The Company maintains ongoing credit evaluations of its customers.

The Company has relationships with multiple suppliers and seeks competing bids for its material purchases. During 2005, the Company purchased approximately 39% and 38% of its materials from two suppliers of which approximately $27,000 and $86,000, respectively, was included in accounts payable at December 31, 2005. During 2004, the Company purchased approximately 73% of its materials from four suppliers, of which approximately $73,000 was included in accounts payable at December 31, 2004.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Advertising, Marketing and Promotional Costs

Expenditures on advertising, marketing and promotions are charged to operations in the period incurred and totaled approximately $11,000 and $18,000 for the periods ended December 31, 2005 and 2004, respectively.

Note 3 Property and Equipment

Major classes of property and equipment consist of the following:

December 31,	**2005**	**2004**
Furniture	**$ 530**	**$ 530**
Office equipment	**25,850**	**10,915**
Transportation equipment	**69,886**	**50,396**
	96,266	**61,841**
Less accumulated depreciation	**41,967**	**22,230**
	$ 54,299	**$ 39,611**

Note 4 Line of Credit

The Company has a line of credit with a bank that provides for borrowings of the lesser of (1) $400,000, or 80% of the aggregate of eligible accounts receivable. The line of credit accrues interest on outstanding balances at the lender s prime rate (7.25% as of December 31, 2005) plus 1.09% and matures on July 25, 2006. Borrowings under this line of credit are secured by substantially all of the Company s assets and are guaranteed by the Company s stockholder.

Parke P.A.N.D.A. Corporation
Notes to Financial Statements

There were borrowings of $0 and $38,646 under the line of credit at December 31, 2005 and 2004, respectively.

Note 5 Long-Term Debt

Long-term debt at December 31, 2005 and 2004 consisted of the following:

December 31,	**2005**	**2004**
Vehicle note due in forty-eight (48) monthly installments of $405, including principal and interest at 6.9% per annum, through January 2006	**$ 403**	**$ 5,064**
Vehicle note due in sixty (60) monthly installments of $430 through July 2008	**13,331**	**18,491**
Total debt	**13,734**	**23,555**
Less current portion	**5,564**	**9,821**
Total long-term debt	**$ 8,170**	**$ 13,734**

The aggregate amounts of long-term debt maturing in each of the next five years as of December 31, 2005, are as follows:

2006	**$ 5,564**
2007	**5,160**
2008	**3,010**
	$ 13,734

Note 6 Lease Commitments

The Company leases office space in Glendora, California from an entity owned by the Company s stockholder which expires on January 1, 2007. Total rent expense for this office space was $26,400 during 2005.

Future minimum rentals payments under this lease as of December 31, 2005 are as follows:

Year ending December 31,	**Total**
2006	**$ 42,000**
Total	**$ 42,000**

Parke P.A.N.D.A. Corporation
Notes to Financial Statements

Note 7 Related Party Transactions

As discuss in Note 6, the Company leases office space in a building owned by the Company s stockholder.

During the year ended December 31, 2005, the Company recognized revenue of $39,350 for the sale of products and services to a company which is majority owned by the Company s stockholder. There were no accounts receivable from this customer as of December 31, 2005.

Note 8 Subsequent Event

On June 30, 2006, all of the capital stock of the Company was acquired by Lime Energy Co. (formerly known as Electric City Corp.) for $2.72 million in cash and Lime Energy Co. stock valued at $5 million.

Table of Contents

PARKE P.A.N.D.A. CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEET

	June 30 2006 (unaudited)
Assets	
Current Assets	
Cash and cash equivalents	$ 1,710
Accounts receivable, net	711,598
Inventories	142,789
Prepaid expenses and other	7,088
Total Current Assets	863,185
Net Property and Equipment	79,917
Other Assets	115
	$ 943,217

See accompanying notes to condensed consolidated financial statements

F-108

Table of Contents

PARKE P.A.N.D.A. CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEET

	June 30, 2006 (unaudited)
Liabilities and Stockholder s Equity	
Current Liabilities	
Line of credit	$ 400,000
Current maturities of long-term debt	10,172
Accounts payable	338,536
Accrued expenses	73,575
Customer advances	367
Total Current Liabilities	822,650
Long-Term Debt, less current maturities	35,591
Total Liabilities	858,241
Stockholder s Equity	
Common stock, no par value; 10,000 shares authorized; 10,000 issued and outstanding	10,000
Accumulated earnings	74,976
Total Stockholder s Equity	84,976
	$ 943,217

See accompanying notes to condensed consolidated financial statements

F-109

PARKE P.A.N.D.A. CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

Six Months ended, June 30	2006	2005
Revenue	$ 1,883,830	$ 1,747,569
Expense		
Cost of Sales	1,169,365	1,118,120
Selling, general and administrative	520,263	359,533
	1,689,628	1,477,653
Operating income	194,202	269,916
Other Expense		
Interest expense	2,491	2,483
Net Income	$ 191,711	$ 267,433

See accompanying notes to condensed consolidated financial statements

F-110

Table of Contents

PARKE P.A.N.D.A. CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

Six Months ended June 30	2006	2005
Cash Flow from Operating Activities		
Net income	$ 191,711	$ 267,433
Adjustments to reconcile net income to net cash used in operating activities		
Depreciation and amortization	11,984	8,102
Changes in assets and liabilities		
Accounts receivable	(382,282)	(666,904)
Inventories	16,007	9,096
Costs and estimated profits in excess of billings on uncompleted contracts		(81,380)
Prepaid expenses and other current assets	(7,088)	(186)
Accounts payable	103,181	259,067
Accrued expenses	16,877	57,251
Customer advances	367	
Net cash used in operating activities	(49,243)	(147,521)
Cash Flows Used In Investing Activities		
Purchase of property and equipment	(2,476)	(32,115)
Cash Flows (Used in) Provided by Financing Activities		
Borrowings on line of credit, net of repayments	400,000	200,989
Payment on loans from stockholders		(15,000)
Payment on long-term debt	(2,983)	(4,871)
Stockholder distribution	(496,000)	
Net cash (used in) provided by financing activities	(98,983)	181,118
Net (Decrease) Increase in Cash and Cash Equivalents	(150,702)	1,482
Cash and Cash Equivalents, at beginning of period	152,412	5,579
Cash and Cash Equivalents, at end of period	$ 1,710	$ 7,061
Supplemental Disclosure of Cash Flow Information		
Cash paid during the periods for interest	$ 1,637	$ 2,483
Non-cash investing activity:		

Financed capital purchase	**$ 35,012**	**$**

See accompanying notes to condensed consolidated financial statements

F-111

Table of Contents

Parke P.A.N.D.A. Corporation
Notes to Financial Statements

Note 1 Basis of Presentation

The accompanying unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the six months ended June 30, 2006 and 2005 are not necessarily indicative of the results that may be expected for the fiscal year ended December 31, 2006. For further information, refer to the Company s annual December 31, 2005 and 2004 financial statements and footnotes included as exhibit 99.1 in this Form 8-K/A.

Note 2 Inventories

Inventories consisted of the following:

	June 30, 2006
Raw materials	$ 142,789
Work in process	
Finished goods	
	$ 142,789

Note 3 Customer Concentration

One customer accounted for 15% of Company s revenue during the six month period ended June 30, 2006. Accounts receivable from this customer at June 30, 2006 totaled approximately $245,000. Two customers accounted for 21% and 11% of the Company s revenue during the six month period ended June 30, 2005, respectively. Accounts receivable from these customers at June 30, 2005 were approximately $259,000 and $50,000, respectively.

Note 4 Line of Credit

The Company has a line of credit with a bank that provides for borrowings of the lesser of $400,000, or 80% of the aggregate of eligible accounts receivable. The line of credit accrues interest on outstanding balances at the lender s prime rate (8.25% as of June 30, 2006) plus 1.09% and matures on July 25, 2006. Borrowings under this line of credit are secured by substantially all of the Company s assets and are guaranteed by the Company s stockholder. There were borrowings of $400,000 and $239,635 under the line of credit at June 30, 2006 and 2005, respectively.

Table of Contents

Note 5 Related Party Transactions

The Company leases office space in Glendora, California from an entity owned by the Company s stockholder. The lease expires on January 1, 2007. Total rent expense for this office space was $20,500 and $13,200 for the six months ended June 30, 2006 and 2005, respectively.

During the six months ended June 30, 2006, the Company recognized revenue of $30,895 for the sale of products and services to a company which is majority owned by the Company s stockholder. There were no accounts receivable from this customer as of June 30, 2006.

Note 6 Subsequent Event

Pursuant to an Agreement and Plan of Merger (the Merger Agreement) dated as of June 30, 2006, by and among Lime Energy Co. (formerly known as Electric City Corp.), (Lime Energy) MPG Acquisition Corporation, a wholly-owned subsidiary of Lime Energy (Merger Subsidiary), and Parke P.A.N.D.A. Corporation (Parke), Lime Energy acquired Parke pursuant to the merger of Parke with and into Merger Subsidiary, with Merger Subsidiary continuing as the surviving corporation under the name Parke Industries, LLC.

The merger consideration consisted of $2,720,000 in cash and 5,000,000 shares of Lime Energy common stock. As a result of the merger, Merger Subsidiary became responsible for the liabilities of Parke. The acquisition will be recorded using the purchase method of accounting.

Table of Contents

UNAUDITED PRO FORMA
CONDENSED COMBINED FINANCIAL STATEMENTS

The following unaudited pro forma condensed combined financial statements with respect to Lime Energy Co. (formerly known as Electric City Corp.) are based on our historical consolidated financial statements. Set forth below are the following unaudited pro forma condensed combined financial statements:

The unaudited pro forma condensed combined statement of operations for the nine months ended September 30, 2006, assuming the business combination between Lime Energy Co. and Parke P.A.N.D.A. Corporation occurred as of January 1, 2005 and combining the September 30, 2006 historical statement of operations for Lime Energy Co. and the June 30, 2006 historical statement of operations for Parke P.A.N.D.A. Corporation, and

The unaudited pro forma condensed combined statement of operations for the year ended December 31, 2005, assuming the business combination between Lime Energy Co., Maximum Performance Group, Inc. and Parke P.A.N.D.A. Corporation occurred as of January 1, 2005 and combining the December 31, 2005 historical statement of operations for Lime Energy Co., the statement of operation for Maximum Performance Group, Inc. for the four months ended April 30, 2005 and the December 31, 2005 historical statement of operations for Parke P.A.N.D.A. Corporation. Maximum Performance Group, Inc. (MPG), a manufacturer of a line of HVAC controllers, was acquired effective May 1, 2005, thus the results of operations for the first four months of 2005 are not contained in the Lime Energy Co. historical financials for the twelve months ended December 31, 2005.

The unaudited pro forma condensed combined financial statements are presented for informational purposes only, are based on certain assumptions that we believe are reasonable and do not purport to represent our financial condition or our results of operations had the business combination occurred on or as of the dates noted above or to project the results for any future date or period. In the opinion of management, all adjustments have been made that are necessary to present fairly the unaudited pro forma condensed combined financial information.

The unaudited pro forma condensed combined financial statements do not reflect any benefits from potential cost savings or revenue synergies resulting from this business combination.

The merger will be treated as a purchase business combination for accounting purposes, and Parke P.A.N.D.A. Corporation s assets acquired and liabilities assumed will be recorded at their fair value.

In connection with the business combination, Parke merged with and into the wholly owned subsidiary of Lime Energy (Parke Acquisition LLC). In connection with the merger, all membership interests of Parke Acquisition as of the merger date shall remain membership interests of the surviving corporation. In total Parke s stockholder received $2,720,000 in cash and 5,000,000 shares of Lime Energy Co. common stock.

We have not completed a final assessment of the fair values of assets and liabilities of Parke and the related business integration plans. The assessment will not be completed until the full review of the assets has been completed. We expect that the ultimate purchase price allocation will include adjustments to the fair values of identifiable intangible assets (some of which will have indefinite lives) and liabilities, including the establishment of any potential liabilities associated with business integration plans. Accordingly, to the extent such assessments indicate that the fair value of the assets and liabilities differ from their net book values, such differences would be allocated to those assets and liabilities.

Table of Contents

UNAUDITED PRO FORMA
CONDENSED COMBINED STATEMENT OF OPERATIONS
FOR THE NINE MONTH PERIOD ENDED SEPTEMBER 30, 2006

	Historical Lime Energy Co.	Historical Parke P.A.N.D.A. Corporation	Pro Forma Adjustments	Pro Forma Lime Energy Co.
Revenue	$ 4,611,321	$ 1,883,830	$	$ 6,495,151
Expenses				
Cost of sales	3,474,496	1,169,365		4,643,861
Selling, general and administrative	7,957,736	520,263	(156,450)*a*	8,321,549
Impairment loss	760,488			760,488
	12,192,720	1,689,628	(156,450)	13,725,898
Operating income (loss)	(7,581,399)	194,202	156,450	(7,230,747)
Other Income (Expense)				
Interest income	125,646			125,646
Interest expense	(3,256,755)	(2,491)		(3,259,246)
Total other expense	(3,131,109)	(2,491)		(3,133,600)
Income (loss) from continuing operations	(10,712,508)	191,711	156,450	(10,364,347)
Loss from discontinued operations	(21,425)			(21,425)
Net Income (Loss)	(10,733,933)	191,711	156,450	(10,385,772)
Plus Preferred Stock Dividends	(24,347,725)			(24,347,725)
Net Loss Available to Common Shareholder	$ (35,081,658)	$ 191,711	$ 156,450	$ (34,733,497)
Basic and diluted net loss per common share from:				
Continuing operations	(1.83)			(1.43)
Discontinued operations	(0.00)			(0.00)
Basic and Diluted Net Loss Per Common Share	$ (1.83)			$ (1.43)

Weighted Average Common Shares Outstanding	**19,198,805**	**5,000,000*b* 2,720,000*c***	**24,315,289**

F-115

Table of Contents

UNAUDITED PRO FORMA
CONDENSED COMBINED STATEMENT OF OPERATIONS
FOR THE TWELVE MONTH PERIOD ENDED DECEMBER 31, 2005

	Historical Lime Energy Co.	Maximum Performance Group Four Months Ended April 30, 2005	Pro Forma Adjustments	Sub-total	Historical Parke P.A.N.D.A. Corporation	Pro Forma Adjustments	Pro Forma Lime Energy Co.
Revenue	$ 3,693,429	$ 256,682	$	$ 3,950,111	$ 3,342,731		$ 7,292,842
Expenses							
Cost of sales	3,691,854	581,729		4,273,583	2,120,765		6,394,348
Selling, general and administrative	6,078,098	1,126,106	235,882*d*	7,440,086	838,092	439,000*e*	8,717,178
	9,769,952	1,707,835	235,882	11,713,669	2,958,857	439,000	15,111,526
Operating income (loss)	(6,076,523)	(1,451,153)	(235,882)	(7,763,558)	383,874	(439,000)	(7,818,684)
Other Income (Expense)							
Interest income	58,737			58,737			58,737
Interest expense	(602,990)	(971)		(603,961)	(8,300)		(612,261)
Total other expense	(544,253)	(971)		(545,224)	(8,300)		(553,524)
Income (loss) from continuing operations	(6,620,776)	(1,452,124)	(235,882)	(8,308,782)	375,574	(439,000)	(8,372,208)
Loss from discontinued operations	(251,962)			(251,962)			(251,962)
Net Income (Loss)	(6,872,738)	(1,452,124)	(235,882)	(8,560,744)	375,574	(439,000)	(8,624,170)
	(1,851,345)			(1,851,345)			(1,851,345)

Plus Preferred Stock Dividends							
Net Loss Available to Common Shareholder	**(8,724,083)**	**(1,452,124)**	**(235,882)**	**(10,412,089)**	**375,574**	**(439,000)**	**(10,475,515)**
Basic and diluted net loss per common share from:							
Continuing operations	**(2.65)**						**(1.00)**
Discontinued operations	**(0.08)**						**(0.03)**
Basic and Diluted Net Loss Per Common Share	**(2.73)**						**(1.03)**
Weighted Average Common Shares Outstanding	**3,190,664**					**5,000,000*b*** **2,720,000*c***	**10,190,664**

F-116

NOTES TO UNAUDITED PRO FORMA
CONDENSED COMBINED STATEMENTS OF OPERATIONS

(a) To adjust amortization expense related to the Parke s identifiable intangible assets assuming the business combination occurred as of January 1, 2005.

(b) Represents the shares of Lime Energy common stock issued as consideration to Parke s stockholder.

(c) Represents that portion of the shares issued as part of the Private Placement to generate the cash used to acquire Parke assuming the business combination occurred as of January 1, 2005.

(d) To record four additional months of amortization expense related to the Maximum Performance Group s identifiable intangible assets assuming the business combination occurred as of January 1, 2005.

(e) To record twelve months of amortization expense related to the Parke s identifiable intangible assets assuming the business combination occurred as of January 1, 2005.

Table of Contents

PART II
INFORMATION NOT REQUIRED IN PROSPECTUS

Indemnification Of Directors And Officers

Subsection (a) of Section 145 of the Delaware General Corporation Law empowers a corporation to indemnify any person who was or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the corporation) by reason of the fact that he or she is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him or her in connection with such action, suit or proceeding if he or she acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his or her conduct was unlawful.

Subsection (b) of Section 145 empowers a corporation to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the corporation to procure a judgment in its favor by reason of the fact that he or she is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys fees) actually and reasonably incurred by him or her in connection with the defense or settlement of such action or suit if he or she acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the best interests of the corporation and except that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the corporation unless and only to the extent that the Court of Chancery or the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all of the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the Court of Chancery or such other court shall deem proper.

Section 145 further provides that to the extent a director or officer of a corporation has been successful in the defense of any action, suit or proceeding referred to in subsection (a) and (b) or in the defense of any claim, issue or matter therein, he or she shall be indemnified against expenses (including attorneys fees) actually and reasonably incurred by him or her in connection therewith; that the indemnification provided by Section 145 shall not be deemed exclusive of any other rights to which the indemnified party may be entitled; and that the scope of indemnification extends to directors, officers, employees, or agents of a constituent corporation absorbed in a consolidation or merger and persons serving in that capacity at the request of the constituent corporation for another. Section 145 also empowers a corporation to purchase and maintain insurance on behalf of a director or officer of the corporation against any liability asserted against him or her or incurred by him or her in any such capacity or arising out of his or her status as such whether or not the corporation would have the power to indemnify him or her against such liabilities under Section 145.

Article VIII of Lime Energy s By-laws specifies that Lime Energy shall indemnify its directors, officers, employees and agents to the full extent that such right of indemnity is permitted by law. This provision of the By-laws is deemed to be a contract between Lime Energy

and each director and officer who serves in such capacity at any time while such provision and the relevant provisions of the Delaware General Corporation Law are in effect, and any repeal or modification thereof shall not offset any right to indemnification in respect of action, suit or proceeding theretofor or thereafter brought or threatened based in whole or in part upon any such state of facts. The amendment or repeal of such provision of the By-Laws may be effected by the affirmative vote of the holders of a majority in interest of all outstanding capital stock of Lime Energy entitled to vote, in person or by proxy, at any annual or special meeting in which a quorum is present. The By-Laws may also be amended, adopted or repealed in whole or in part by actions of the majority of the whole board of directors.

Lime Energy has executed indemnification agreements with certain officers pursuant to which Lime Energy has agreed to indemnify such parties to the full extent permitted by law, subject to certain exceptions, if they become subject to an action because of serving as a director, officer, employee, agent or fiduciary of Lime Energy.

Section 102(b)(7) of the Delaware General Corporation Law enables a corporation in its certificate of incorporation to limit the personal liability of members of its board of directors for violation of a director s fiduciary duty of care. This section does not, however, limit the liability of a director for breaching his or her duty of loyalty, failing to act in good faith, engaging in intentional misconduct or knowingly violating a law, authorizing unlawful payments of dividends or unlawful redemptions or stock purchases as contemplated by Section 174 of Delaware General Corporation Law, or from any transaction in which the director derived an improper personal benefit. This section also will have no effect on claims arising under the federal securities laws.

Lime Energy s Certificate of Incorporation, as amended, limits the liability of its directors as authorized by Section 102(b)(7). To amend such provisions the Company would require the affirmative vote of the holders of a majority of the voting power of all outstanding shares of the capital stock of Lime Energy.

Lime Energy has obtained liability insurance for the benefit of its directors and officers which provides coverage for losses of directors and officers for liabilities arising out of claims against such persons acting as directors or officers of Lime Energy (or any subsidiary thereof) due to any breach of duty, neglect, error, misstatement, misleading statement, omission or act done by such directors and officers, except as prohibited by law.

Other Expenses Of Issuance And Distribution

The following table sets forth the costs and expenses payable by the registrant in connection with the sale of the common stock being registered. All of the amounts shown are estimates except the Securities and Exchange Commission (the Commission) registration fee.

SEC Registration Fee	$ 4,129
Legal Fees and Expenses	44,500
Accounting Fees and Expenses	25,000
Costs of Printing	15,000
Miscellaneous Expenses	12,000
Total	$ 100,629

We will pay all of the expenses incident to the registration, offering and sale of the shares of our common stock offered by this registration statement.

Recent Sales Of Unregistered Securities

Set forth below is information regarding shares of common stock and preferred stock issued, and options granted, by the Registrant within the past three years. Also included is the consideration, if any, received by the Registrant for such shares, and upon exercise of options and warrants and information relating to the section of the Securities Act, or rule of the SEC under which exemption from registration was claimed.

2004 Transactions

a) During fiscal 2004, holders of our Series A Convertible Preferred Stock converted 145,000 shares of Series A into 96,667 shares of common stock. All shares of our Series A Convertible Preferred Stock were originally issued in private placements to accredited investors pursuant to Regulation D which took place in 2001, or were subsequently issued as dividends on outstanding shares of Series A Preferred.

b) Also during 2004, holders of our Series E Convertible Preferred Stock converted 5,067 shares of Series E Convertible Preferred Stock into 33,780 shares of common stock. All shares of our Series E Convertible Preferred Stock were originally issued in a private transactions described under d) below not involving a public offering, or were subsequently issued as dividends on outstanding shares of Series E Preferred.

c) 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 333,333 shares of our common stock and 5 year warrants to purchase 116,667 additional shares of common stock at $36.30 per share. We used $7,000,006 of the proceeds to facility the Redemption and Exchange (described below). The balance of the funds were used to pay transaction costs and for general corporate purposes.

On March 22, 2004, we entered into a Redemption and Exchange Agreement with the holders of our outstanding Series A Convertible Preferred Stock, Series C Convertible Preferred Stock and Series D Convertible Preferred Stock (collectively, the Old Preferred Stock) under which we redeemed 538,462 shares of the outstanding Old Preferred Stock which were convertible into 358,975 shares of common stock, at a redemption price equivalent to $19.50 per common share for a total cost of $7,000,006, 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 Old Preferred Stock (the Exchange) on a 1 for 10 basis (one share of Series E Preferred exchanged for 10 shares of Old Preferred Stock). All of the Old 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 (and subsequently extended to December 31, 2004). Such Series E warrants issued were 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.

Except as with respect to dividends, the Series E Preferred had substantially the same rights as the shares of Old Preferred Stock that it replaced, including:

special approval rights with respect to certain actions by us, including any issuance of shares of capital stock by us 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 us or any of our subsidiaries;

a conversion price of $15.00 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 us in a private transaction; and

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

The Series E Preferred accrued dividends at a rate of 6% (versus 10% for the Old Preferred) per annum, which at our option could be paid by issuing more shares of Series E Preferred.

Morgan Keegan & Company, Inc. acted as placement agent for us 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 $195,393.

d) During fiscal 2004, we received proceeds of $485,000 in connection with the exercise of 12,333 common stock warrants and 3,000 Series E Convertible Preferred warrants. The proceeds from the exercise of these warrants was used for general corporate purposes.

e) During fiscal 2004, we issued warrants to purchase 8,000 shares of our common stock at prices between $15.00 and $23.25 per share to consultants for services received. The warrants were valued at $42,600 using a modified Black-Sholes option pricing model utilizing the following assumptions: risk free rate of 1.607% to 2.772%, expected volatility of 42.5 to 53.6%, expected dividend of $0 and expected life of 2 to 3 years. The value of the warrants was charged to operations during the period.

f) During fiscal 2004, Laurus Master Fund Ltd. converted $270,864 of principal and $4,736 of accrued interest on our outstanding $1,000,000 Convertible Term Note (issued in September, 2003) into 8,667 shares of our common stock.

g) During fiscal 2004, we satisfied the accrued dividend on our preferred stock of $1,636,780 though the issuance of 16,368 shares of our Series E Preferred stock.

2005 Transactions

h) During 2005, two holders of our Series E Convertible Preferred Stock converted 2,167 shares of Series E Convertible Preferred Stock into 14,447 shares of common stock.

i) During 2005, we issued the following warrants:

II-4

Table of Contents

On February 10, 2005, Delano Group Securities, LLC received a five year warrant to purchase 2,000 shares at $15.45 per share, pursuant to an agreement to provide investment banking services. Delano Group Securities, LLC, is a company owned by Mr. David Asplund, one of our directors and effective January 23, 2006 our CEO. The warrant was valued at $13,200 using a modified Black-Sholes option pricing model utilizing the following assumptions: risk free rate of 2.53%, expected volatility of 45.3%, expected dividend of $0 and expected life of 5 years. The value of the warrant was charged to operations during the period.

M&A Railroad and Electric Supply, LLC received a three year warrant to purchase 6,667 options at $16.95 per share to as part of a legal settlement. This warrant was valued at $35,000 using a modified Black-Sholes option pricing model utilizing the following assumptions: risk free rate of 2.767%, expected volatility of 45.0%, expected dividend of $0 and expected life of 3 years. Of the total warrant value $33,000 was charged to operations during the forth quarter of 2004 and $2,000 was charged to operations during the first quarter of 2005.

On April 28, 2005, Laurus Master Fund, Ltd. received a warrant to purchase 26,667 shares of our common stock in exchange for our consent to our entering into the PIPE Transaction described under j) below and acquiring MPG, as well as waiving our right to adjust the conversion price on our convertible term note and convertible revolving note. The warrant has an exercise price of $15.00 per share and a term of five years. The warrant was valued at $160,000 using a modified Black-Sholes option pricing model utilizing the following assumptions: risk free rate of 2.941%, expected volatility of 43.7%, expected dividend of $0 and expected life of 5 years. The value of the warrant was charged to interest expense during 2005.

Various consultants received warrants to purchase 27,333 shares of our common stock with exercise prices between $15.00 and $15.45 per share and terms of three to ten years. The warrants were valued collectively at $144,600 using a modified Black-Sholes option pricing model utilizing the following assumptions (depending on the warrant being valued): risk free rate of 2.366% to 3.029%, expected volatility of 40.7% to 46.5%, an expected dividend of $0 and an expected life of 3 to 10 years. The values of the warrants were charged to operations during the 2005.

j) On April 28, 2005 we issued to five (5) institutional investors, for an aggregate gross purchase price of $5,625,000, 416,667 shares of our common stock and 42 month warrants to purchase 208,333 additional shares of common stock at $15.75 per share (collectively the PIPE Transaction or the PIPE). Warrants to purchase 140,000 shares of common stock were immediately exercisable and the remaining warrants became exercisable six months after closing on October 28, 2005. Net proceeds from the transaction were approximately $5,413,000, of which approximately $1,644,000 was used to fund the acquisition of Maximum Performance Group, Inc. The balance were used to pay transaction costs and for general corporate purposes.

Delano Group Securities LLC and Mr. David Valentine acted as advisors on the PIPE Transaction. We paid Delano Group Securities LLC $16,250 and 3,333 shares of common stock and Mr. Valentine 3,333 shares of common stock for their services. Mr. Asplund and

Mr. Valentine both were serving as directors of Lime Energy and effective January 23, 2006, Mr. Asplund became our CEO.

k) On May 3, 2005 we issued 166,149 shares of common stock in connection with the acquisition of Maximum Performance Group, Inc. (MPG). In addition, 166,149 shares of common stock are being held in escrow and will be issued in the event MPG meets specific performance criteria during the two year period following the acquisition. No escrow shares have been released as of January 24, 2007.

Delano Group Securities LLC acted as an advisor on the acquisition of MPG and was paid $82,176 and 8,366 shares of common stock for our services. These shares were valued at $15.00 per share, which was the closing market price of our common stock on April 28th. In addition, we will issue up to 8,366 additional shares of common stock to Delano as the MPG shares held in escrow are released. Delano Group Securities LLC is owned by Mr. David Asplund, one of Lime Energy s directors and effective January 23, 2006, our CEO.

l) On November 22, 2005 we entered into a securities purchase agreement with Laurus Master Fund, Ltd. (Laurus) whereby we issued to Laurus a $5 million secured convertible term note and a warrant to purchase 133,333 shares of our common stock at $17.40 per share anytime prior to November 22, 2012. The warrants were valued at $920,000 using a modified Black-Sholes option pricing model utilizing the following assumptions: risk free rate of 4.034%, expected volatility of 67.4%, expected dividend of $0 and expected life of 7 years. The value of the warrants was recorded as a discount to the term loan and will be amortized over the term of the underlying debt utilizing the effective interest method.

This term loan was retired through a cash payment on June 29, 2006 before the shares issuable upon conversion of the term loan were registered for resale. No portion of the term loan was converted to common stock while the note was outstanding.

m) During the year ended December 31, 2005, our Board of Directors declared dividends payable on our Series E Convertible Preferred Stock of $1,366,900. The dividends were paid with 13,699 additional shares of Series E Convertible Preferred Stock.

2006 Transactions

n) During the first three months of 2006, two holders of our Series E Convertible Preferred Stock converted a total of 7,130 shares of Series E Convertible Preferred Stock into 47,533 shares of common stock.

o) Effective March 31, 2006, we received 14,194 shares of our common stock as part of the sale of our Great Lakes Controlled Energy Corporation subsidiary to Messrs. Eugene Borucki and Denis Enberg. These shares have been returned to the status of authorized, unissued shares of common stock.

p) On June 29, 2006 we entered into a Securities Purchase Agreement and issued to 17 investors, including 10 existing holders of our Series E Convertible Stock, for an aggregate purchase price of $17,875,000, 17,875,000 shares of our common stock (the PIPE Transaction). We used $2.72 million of the proceeds to fund the cash consideration for the acquisition of Parke P.A.N.D.A. Corporation; approximately $5.6 million to prepay two convertible secured term loans and related prepayment penalties and accrued interest owed to Laurus Master Fund Ltd.; $400,000 to pay off Parke s line of credit and $90,079 for

transaction related costs. The balance of the gross proceeds of approximately $9 million has been and will be used for working capital and other general corporate purposes, except that $1,250,000 was used to pay the cash portion of the acquisition price for Kapadia Consulting, Inc. on September 26, 2006, as described under v) below.

q) Concurrently with the closing of the PIPE Transaction pursuant to the Securities Purchase Agreement described above, the holders of all of our outstanding Series E Preferred Stock converted such shares into 21,648,346 shares of our common stock. The Series E Preferred Stock as originally issued was convertible at $15.00 per share but this had been adjusted pursuant to private placements we made in 2005. Prior to the PIPE Transaction, the conversion price was $6.67 per share and the outstanding Series E shares were convertible into 1,574,027 shares of our common stock (adjusted for the reverse stock split), however, the Series E contained antidilution provisions which automatically reduced the conversion price of the Series E to the $1.00 per share issuance price of common stock in the PIPE Transaction. This adjustment in the conversion price resulted in 20,074,319 additional shares being issued upon conversion of the Series E.

r) A number of our common stock warrants, all but one of which are held by former holders of our Series E Convertible Preferred Stock (the exception is a warrant held by an affiliate of a former holder of Series E Preferred), contain antidilution provisions that automatically adjust the exercise price on the warrants to the issuance price of any security convertible into our common stock if the price is less than the exercise price on the holder s warrant. Prior to the PIPE Transaction, the exercise price on these warrants ranged from $13.50 per share to $15.00 per share (adjusted for the reverse split). The issuance of common stock in the PIPE Transaction caused the exercise price on these warrants to automatically be reduced to $1.00 per share.

s) Immediately following completion of the PIPE Transaction and prepayment of the Laurus term loans, Laurus elected to convert the entire outstanding balance on its revolving line of credit, along with accrued interest thereon, into 950,865 shares of our common stock. In addition, in consideration of our issuance of 392,596 shares of common stock, Laurus agreed to (i) waive the payment of liquidated damages due as a result of our failure to register shares of common stock into which the November 2005 $5 million term loan was convertible, and (ii) terminate the requirement that we pay it a portion of the cash flows generated by VNPP projects for a period of 5 years following the repayment of the November 2005 $5 million convertible term loan.

t) On June 30, 2006, we issued 5,000,000 shares to the Parke Family Trust as part of the consideration in the acquisition of Parke P.A.N.D.A. Corporation.

u) During the first six months of 2006, our Board of Directors declared dividends payable on our Series E Convertible Preferred Stock of $698,000. The dividends were paid with 6,980 additional shares of Series E Convertible Preferred Stock.

v) On July 25, 2006, we issued a three year warrant to purchase 60,000 shares of our common stock at $1.00 per share to Bristol Capital, Ltd..

w) On September 26, 2006, we issued 500,000 shares of our common stock to Pradeep and Susan Kapadia as part of the consideration in the acquisition of Kapadia Consulting, Inc.

Table of Contents

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 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. Certain of the purchasers also represented that they were accredited investors as defined in Regulation D and were acquiring such securities for investment for their own account and not for distribution. 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.

Table of Contents

(1) **EXHIBITS**

Exhibit Number	**Description of Exhibit**
2.01 (12)	Agreement and Plan of Merger, dated as of April 29, 2005, by and among Electric City Corp., MPG Acquisition Corporation, and Maximum Performance Group, Inc.
2.02 (19)	Agreement and Plan of Merger, dated as of May 19, 2006, by and among Electric City Corp., Parke Acquisition LLC, and Parke P.A.N.D.A. Corporation
2.03(21)	Joinder And Amendment To Agreement And Plan Of Merger by and among Electric City Corp., Parke Acquisition LLC, and Parke P.A.N.D.A. Corporation, Daniel Parke and Daniel W. Parke and Michelle A. Parke as Trustees for the Parke Family Trust.
2.04(26)	Agreement and Plan of Merger dated September 26, 2006 by and among Lime Energy Co., Kapadia Acquisition, Inc., Kapadia Consulting, Inc., and Pradeep Kapadia.
3.01 *	Certificate of Incorporation
3.02 *	Certificate of Amendment to Certificate of Incorporation dated August 30, 2001.
3.03 *	Certificate of Amendment to Certificate of Incorporation, dated July 31, 2002.
3.04 *	Certificate of Amendment to Certificate of Incorporation, dated May 4, 2005.
3.05 *	Certificate of Amendment to Certificate of Incorporation, dated January 22, 2007.
3.06 *	Certificate of Ownership and Merger Merging Lime Energy Subsidiary Company into Electric City Corp.
3.07 *	Certificate of Designations, Preferences and Relative, Participating, Optional and Other Special Rights of Preferred Stock and Qualifications, Limitations and Restrictions Thereof of Series A Convertible Preferred Stock of Electric City Corp. dated August 30, 2001.
3.08 *	Certificate of Designation of the Relative Rights and Preferences of the Series B Convertible Preferred Stock of Electric City Corp. dated October 13, 2000
3.09 *	Certificate of Designations, Preferences and Relative, Participating, Optional and Other Special Rights of Preferred Stock and Qualifications, Limitations and Restrictions Thereof of Series C Convertible Preferred Stock of Electric City Corp. dated June 3, 2002.
3.10 *	Certificate Of Designations, Preferences And Relative, Participating, Optional And Other Special Rights Of Preferred Stock And Qualifications, Limitations And Restrictions Thereof Of Series D Convertible Preferred Stock Of Electric City Corp. dated June 26, 2003
3.11 *	Certificate Of Designations, Preferences And Relative, Participating, Optional And Other Special Rights Of Preferred Stock And Qualifications, Limitations And Restrictions Thereof Of Series E Convertible Preferred Stock Of Electric City Corp. dated March 18, 2004

3.12 (1)	By-laws
3.13 (4)	Bylaws, as amended
3.14 (9)	Charter of Audit Committee, as restated.
3.15 (9)	Charter of Governance and Nominating Committee
4.01*	Specimen Subscription Certificate
4.02 (3)	2001 Stock Incentive Plan

Exhibit Number	Description of Exhibit
4.03 (8)	Amended and Restated Investor Rights Agreement, dated as of March 19, 2004 made by and among Electric City Corp. and Newcourt Capital USA Inc., CIT Capital Securities, Inc., Morgan Stanley Dean Witter Equity Funding, Inc., Originators Investment Plan, L.P., Cinergy Ventures II, LLC, Leaf Mountain Company, LLC, SF Capital Partners, Ltd., Richard Kiphart, David P. Asplund, John Thomas Hurvis Revocable Trust, John Donohue, Augustine Fund, LP, And Technology Transformation Venture Fund, LP
4.04 (10)	Amended and Restated Directors Stock Option Plan
4.05 (11)	Form of Common Stock Warrant Used to Pay Certain Vendors
4.06 (11)	Form of Common Stock Warrant (with Cashless Exercise Provision) Used to Pay Certain Vendors
4.07 (12)	Form of Common Stock Warrant, With Vesting Period issued April 28, 2005
4.08 (12)	Form of Common Stock Warrant, Without Vesting Period issued April 28, 2005
4.09 (12)	Stock Trading Agreement dated as of April 29, 2005
4.10 (13)	Warrant Certificate dated November 22, 2005 to Purchase 2,000,000 shares of common stock Par Value $0.0001 Per Share, of Electric City Corp. issued to Laurus Master Fund, Ltd.
4.11 (13)	Registration Rights Agreement dated November 22, 2005 by and between Electric City Corp. and Laurus Master Fund, Ltd.
4.12(20)	Amendment to 2001 Stock Incentive Plan
4.13(21)	Employee Stock Option Agreement dated June 30, 2006 between Electric City Corp. and Daniel Parke
4.14(22)	Employee Stock Option Agreement dated July 11, 2006 between Electric City Corp. and David Asplund
4.15(22)	Employee Stock Option Agreement dated July 11, 2006 between Electric City Corp. and Daniel Parke
4.16(22)	Employee Stock Option Agreement dated July 11, 2006 between Electric City Corp. and Jeffrey Mistarz
4.17(22)	Employee Stock Option Agreement dated July 11, 2006 between Electric City Corp. and Leonard Pisano
4.18(23)	Employee Stock Option Agreement dated August 15, 2006 between Electric City Corp. and Jeffrey Mistarz
5.01*	Opinion of Schwartz Cooper Chartered with respect to the legality of the common stock being registered.
10.01(1)	Sales, Distribution and Patent License Agreement, dated January 1, 1998, by and between Giorgio Reverberi and Joseph C. Marino

10.02(1)	Sublicense Agreement, dated June 24, 1998, by and between the Electric City Corp. and Joseph C. Marino
10.03(6)	Common Stock Purchase Warrant dated September 11, 2003 issued by Electric City Corp. in favor of Laurus Master Fund, Ltd.

Table of Contents

Exhibit Number	Description of Exhibit
10.04(6)	Common Stock Purchase Warrant dated September 11, 2003 issued by Electric City Corp. in favor of Laurus Master Fund, Ltd.
10.05 (8)	Securities Purchase Agreement dated March 19, 2004, between Electric City Corp. and Security Equity Fund, Mid Cap Value Series, SBL Fund, Series V, Security Mid Cap Growth And SBL Fund, Series J
10.06 (8)	Redemption and Exchange Agreement dated March 19, 2004, by and among Electric City Corp. and Newcourt Capital USA Inc., Morgan Stanley Dean Witter Equity Funding, Inc., Originators Investment Plan, L.P., Cinergy Ventures II, LLC, Leaf Mountain Company, LLC, SF Capital Partners, Ltd., Richard Kiphart, David P. Asplund, John Thomas Hurvis Revocable Trust, John Donohue, Augustine Fund, LP, And Technology Transformation Venture Fund, LP
10.07 (14)	Third Amended and Restated Mortgage, Assignment of Rents and Security Agreement dated December 13, 2005 by Electric City Corp. and American Chartered Bank.
10.08 (14)	Amended and Restated Mortgage Note made and entered into on the 13th day of December 2005, by and among American Chartered Bank and Electric City Corp., and Great Lakes Controlled Energy Corporation.
10.09 (17)	Employment Agreement, dated as of May 3, 2005, between Maximum Performance Group, Inc. and Leonard Pisano
10.10 (15)	Consulting agreement with John Mitola dated January 21, 2006
10.11(16)	Employment Agreement, dated as of January 23, 2006, between the Company and David Asplund
10.12(18)	Stock Purchase Agreement dated as of April 3, 2006 between Electric City Corp., Eugene Borucki and Denis Enberg
10.13(18)	Non-Competition, Non-Disclosure And Non-Solicitation Agreement Dated as of March 31, 2006 between Electric City Corp. and Eugene Borucki
10.14(19)	Non-Competition, Non-Disclosure And Non-Solicitation Agreement Dated as of March 31, 2006 between Electric City Corp. and Denis Enberg
10.15(21)	Securities Purchase Agreement dated June 29, 2006 by and amoung the Company and the investors listed therein.
10.16(21)	Employment Agreement, dated as of June 30, 2006, between Parke Acquisition, LLC and Daniel Parke
10.17(21)	Non-Competition Agreement dated as of June 30, 2006 by and among Electric City Corp., Parke Acquisition, LLC and Daniel Parke
10.18(21)	First Amendment to Commercial Lease Agreement dated as of June 30, 2006 by and between M&D Investments and Parke Industries, LLC

10.19(23)	Employment Agreement, dated as of August 15, 2006, between the Company and Jeffrey Mistarz
14.1(7)	Code of Ethics For Chief Executive Officer And Chief Financial Officer of Electric City Corp.
14.2(24)	Code of Business Conduct And Ethics (All Officers, Directors and Employees)

Table of Contents

Exhibit Number	Description of Exhibit
21(24)	List of subsidiaries
23.01*	Consent of BDO Seidman LLP
23.02*	Consent of Schwartz Cooper Chartered (contained in exhibit 5.1).
23.03*	Consent of Marcum & Kliegman, LLP
23.04*	Consent of Rittenhouse Capital Partners, LLC
23.05*	Consent of BDO Seidman LLP
24	Power of Attorney (included on signature page hereto)
99.1 *	Form of Instructions For Use of Electric City Subscription Rights
99.2 *	Form of Notice of Guaranteed Delivery for Subscription Rights
99.3 *	Form of Letter to Stockholders who are Record Holders
99.4 *	Form of Letter to Stockholders who are Beneficial Holders
99.5 *	Form of Letter to Clients of Stockholders who are Beneficial Holders
99.6 *	Form of Nominee Holder Certification Form
99.7 *	Form of Beneficial Owner Election Form
99.8 *	Substitute Form W-9 for Use with Rights Offering

* Filed herewith

(1) Incorporated herein by reference to Electric City Corp. s registration statement on Form 10SB filed on September 9, 1999 (No. 000-2791).

(2) Incorporated herein by

reference to Electric City Corp. s Current Report on Form 8-A filed with the SEC on December 8, 2000 (No. 0-2791).

(3) Incorporated herein by reference to the Company s definitive Proxy Statement for the 2000 Annual Meeting of Stockholders, filed August 14, 2001 (No. 0-2791)

(4) Incorporated herein by reference to Electric City Corp. s Annual Report on Form10-KSB for the year ended December 31, 2001, filed April 15, 2002 (No. 0-2791).

(5) Incorporated herein by reference to Electric City Corp. s Annual Report on Form10-KSB for the year ended December 31, 2002, filed March 31, 2003 (No. 0-2791).

(6) Incorporated herein by reference to Electric City Corp. s Current Report on Form 8-K dated September 11, 2003 filed with the SEC on September 16, 2003 (No. 0-2791).

(7) Incorporated herein by reference to Electric City Corp. s Annual Report on Form10-KSB for the year ended December 31, 2003, filed March 29, 2004 (No. 0-2791).

(8) Incorporated herein by reference to Electric City Corp. s Current Report on Form 8-K dated March 19, 2004 filed with the SEC on March 23, 2004 (No. 0-2791).

(9) Incorporated herein by reference to the Company s definitive Proxy Statement for the 2004 Annual Meeting of Stockholders, filed April 30,

2004
(No. 0-2791)

(10) Incorporated herein by reference to Electric City Corp. s Quarterly Report on Form 10-Q for the period ended March 31, 2004, filed with the SEC on May 13, 2004 (No. 0-2791).

Table of Contents

(11) Incorporated herein by reference to Electric City Corp. s Annual Report on Form10-K for the year ended December 31, 2004, filed March 31, 2005, as amended April 14, 2005 (No. 0-2791).

(12) Incorporated herein by reference to Electric City Corp. s Current Report on Form 8-K dated April 28, 2005 filed with the SEC on May 4, 2005 (No. 0-2791).

(13) Incorporated herein by reference to Electric City Corp. s Current Report on Form 8-K dated November 22, 2005 filed with the SEC on November 30, 2005, as amended on February 9, 2006 (No. 0-2791).

(14) Incorporated herein by reference to Electric City

Corp. s Current Report on Form 8-K dated December 13, 2005 filed with the SEC on December 15, 2005 (No. 0-2791).

(15) Incorporated herein by reference to Electric City Corp. s Current Report on Form 8-K dated January 22, 2006 filed with the SEC on January 26, 2006 (No. 0-2791).

(16) Incorporated herein by reference to Electric City Corp. s Current Report on Form 8-K dated January 22, 2006 filed with the SEC on February 22, 2006 (No. 0-2791).

(17) Incorporated herein by reference to Electric City Corp. s Annual Report on Form10-K for the year ended December 31, 2005, filed with the SEC on March 21, 2006 (No. 0-2791).

(18) Incorporated herein by reference to Electric City Corp. s Current Report on Form 8-K dated April 3, 2006 filed with the SEC on April 7, 2006 (No. 0-2791).

(19) Incorporated herein by reference to Electric City Corp. s Current Report on Form 8-K dated May 19, 2006 filed with the SEC on May 22, 2006 (No. 0-2791).

(20) Incorporated herein by reference to Electric City Corp. s Proxy Statement on Form 14A filed with the SEC on April 28, 2006 (No 0-2791).

(21) Incorporated herein by reference to Electric City Corp. s Current Report on Form 8-K dated June 29, 2006 filed with the SEC on July 6, 2006 (No. 0-2791).

(22) Incorporated herein by reference to Electric City Corp. s Current Report on Form 8-K dated July 11, 2006 filed with the SEC on July 17, 2006 (No. 0-2791).

(23) Incorporated herein by reference to Electric City Corp. s Current Report on Form 8-K dated August 15, 2006 filed with the SEC on August 18, 2006 (No. 0-2791).

(24) Incorporated herein by reference to Electric City Corp. s Annual Report on Form10-K for the year ended December 31, 2005, filed March 21, 2006 (No. 0-2791).

(25) Incorporated herein by reference to Lime Energy Co. s Current Report on Form 8-K dated September 13, 2006 filed with the SEC on September 15, 2006

(No. 0-2791).

(26) Incorporated herein by reference to Lime Energy Co. s Current Report on Form 8-K dated September 26, 2006 filed with the SEC on September 29, 2006 (No. 0-2791).

Table of Contents

UNDERTAKINGS

Rule 415 Offering.

The undersigned Registrant hereby undertakes:

(1) To file, during any period in which offers or sales are being made, a post-effective amendment to this Registration Statement:

(i) To include any prospectus required by Section 10(a)(3) of the Securities Act of 1933,

(ii) To reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the Registration Statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than 20 percent change in the maximum aggregate offering price set forth in the Calculation of Registration Fee table in the effective registration statement,

(iii) To include any material information with respect to the plan of distribution not previously disclosed in the Registration Statement or any material change to such information in the Registration Statement;

provided, however, that:

(A) paragraphs (1)(i) and (1)(ii) do not apply if the registration statement is on Form S-8, and the information required to be included in a post-effective amendment by such clauses is contained in reports filed with or furnished to the Securities and Exchange Commission by the Registrant pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934 that are incorporated by reference in the Registration Statement; and

(B) Paragraphs (1)(i), (1)(ii) and (1)(iii) do not apply if the registration statement is on Form S-3 or Form F-3 and the information required to be included in a post-effective amendment by those paragraphs is contained in reports filed with or furnished to the Securities and Exchange Commission by the Registrant pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934 that are incorporated by reference in the Registration Statement, or is contained in a form of prospectus filed pursuant to Rule 424(b) that is part of the Registration Statement.

(C) Provided further, however, that paragraphs (1)(i) and (1)(ii) do not apply if the registration statement is for an offering of asset backed securities on Form S-1 or Form S-3, and the information required to be included in a post-effective amendment is provided pursuant to Item 1100(c) of Regulation AB.

Table of Contents

(2) That, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial *bona fide* offering thereof.

(3) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering.

(4) That, for purposes of determining liability under the Securities Act of 1933 to any purchaser:

(i) If the registrant is relying on Rule 430B:

(A) Each prospectus filed by the registrant pursuant to Rule 424(b)(3) shall be deemed to be part of the registration statement as of the date the filed prospectus was deemed part of and included in the registration statement; and

(B) Each prospectus required to be filed pursuant to Rule 424(b)(2), (b)(5), or (b)(7) as part of a registration statement in reliance on Rule 430B relating to an offering made pursuant to Rule 415(a)(1)(i), (vii), or (x) for the purpose of providing the information required by Section 10(a) of the Securities Act of 1933 shall be deemed to be part of and included in the registration statement as of the earlier of the date such form of prospectus is first used after effectiveness or the date of the first contract of sale of securities in the offering described in the prospectus. As provided in Rule 430B, for liability purposes of the issuer and any person that is at that date an underwriter, such date shall be deemed to be a new effective date of the registration statement relating to the securities in the registration statement to which that prospectus relates, and the offering of such securities at that time shall be deemed to be the initial *bona fide* offering thereof. Provided, however, that no statement made in a registration statement or prospectus that is part of the registration statement or made in a document incorporated or deemed incorporated by reference into the registration statement or prospectus that is part of the registration statement will, as to a purchaser with a time of contract of sale prior to such effective date, supersede or modify any statement that was made in the registration statement or prospectus that was part of the registration statement or made in any such document immediately prior to such effective date; or

(ii) If the Registrant is subject to Rule 430C, each prospectus filed pursuant to Rule 424(b) as part of a registration statement relating to an offering, other than registration statements relying on Rule 430B or other than prospectuses filed in reliance on Rule 430A, shall be deemed to be part of and included in the registration statement as of the date it is first used after effectiveness. Provided, however, that no statement made in a registration statement or prospectus that is part of the registration

statement or made in a document incorporated or deemed incorporated by reference into the registration statement or prospectus that is part of the registration statement will, as to a purchaser with a time of contract of sale prior to such first use, supersede or modify any statement that was made in the registration statement or prospectus that was part of the registration statement or made in any such document immediately prior to such date of first use.

(5) That, for the purpose of determining liability of the Registrant under the Securities Act of 1933 to any purchaser in the initial distribution of the securities:

The undersigned Registrant undertakes that in a primary offering of securities of the undersigned Registrant pursuant to this registration statement, regardless of the underwriting method used to sell the securities to the purchaser, if the securities are offered or sold to such purchaser by means of any of the following communications, the undersigned Registrant will be a seller to the purchaser and will be considered to offer or sell such securities to such purchaser:

(i) Any preliminary prospectus or prospectus of the undersigned Registrant relating to the offering required to be filed pursuant to Rule 424;

(ii) Any free writing prospectus relating to the offering prepared by or on behalf of the undersigned Registrant or used or referred to by the undersigned Registrant;

(iii) The portion of any other free writing prospectus relating to the offering containing material information about the undersigned Registrant or its securities provided by or on behalf of the undersigned Registrant; and

(iv) Any other communication that is an offer in the offering made by the undersigned Registrant to the purchaser.

The undersigned Registrant hereby undertakes to supplement the prospectus, after the expiration of the subscription period, to set forth the results of the subscription offer, the transactions by the underwriters during the subscription period, the amount of unsubscribed securities to be purchased by the underwriters, and the terms of any subsequent reoffering thereof. If any public offering by the underwriters is to be made on terms differing from those set forth on the cover page of the prospectus, a post-effective amendment will be filed to set forth the terms of such offering.

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the Registrant pursuant to the foregoing provisions, or otherwise, the Registrant has been advised that, in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than for the payment by the Registrant of expenses incurred or paid by a director, officer or controlling person of the Registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the Registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the

Table of Contents

question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

Table of Contents

SIGNATURES

Pursuant to with the requirements of the Securities Act of 1933, the registrant has duly caused this registration statement to be signed on its behalf by the undersigned, in the City of Elk Grove Village, State of Illinois, on the 26th day of January 2007.

LIME ENERGY CO.

By: /s/ David Asplund
David Asplund
Chief Executive Officer

Pursuant to the requirements of the Securities Act of 1933, this registration statement has been signed by the following persons in the capacities and on the dates indicated.

By: /s/ Jeffrey Mistarz
Jeffrey Mistarz
Principal Accounting Officer
January 26, 2007

Table of Contents

POWER OF ATTORNEY

The undersigned hereby constitutes and appoints David Asplund and Jeffrey Mistarz, and each of them, as his true and lawful attorneys-in-fact and agents, jointly and severally, with full power of substitution and resubstitution, for and in his stead, in any and all capacities, to sign on his behalf this amendment to the Registration Statement on Form S-1 in connection with the registration of common stock by the registrant and offering thereof pursuant hereto and to execute any amendments thereto (including post-effective amendments), including a registration statement filed pursuant to Rule 462(b), or certificates that may be required in connection with this Registration Statement, and to file the same, with all exhibits thereto, and all other documents in connection therewith, with the Securities and Exchange Commission and granting unto said attorneys-in-fact and agents, and each of them, jointly and severally, the full power and authority to do and perform each and every act and thing necessary or advisable to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, jointly or severally, or their or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Act of 1933, this Registration Statement has been signed by the following persons in the capacities below.

Signature	Title	Date
/s/ David Asplund David Asplund	Chief Executive Officer	January 26, 2007
/s/ Jeffrey Mistarz Jeffrey Mistarz	Chief Financial Officer, Treasurer and Assistant Secretary (principal financial officer and principal accounting officer)	January 26, 2007
/s/ Richard Kiphart Richard Kiphart	Chairman of the Board	January 26, 2007
/s/ Gregory Barnum Gregory Barnum	Director	January 26, 2007
/s/ William Carey William Carey	Director	January 26, 2007
/s/ Daniel Parke Daniel Parke	Director	January 26, 2007
/s/ Gerald Pientka Gerald Pientka	Director	January 26, 2007
/s/ David Valentine David Valentine	Director	January 26, 2007