

SERVIDYNE, INC.
Form 10-Q
December 15, 2006

Table of Contents

**SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
QUARTERLY REPORT
Pursuant to Section 13 or 15(d) of
the Securities Exchange Act of 1934
For the quarter ended October 31, 2006
Commission file number 0-10146
SERVIDYNE, INC.**

(Exact name of registrant as specified in its charter)

Georgia

58-0522129

(State or other jurisdiction of
incorporation or organization)

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

1945 The Exchange, Suite 300, Atlanta, GA 30339-2029

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (770) 953-0304

Former name, former address, former fiscal year, if changed since last report: N/A

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

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated Filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares of \$1.00 par value Common Stock of the Registrant outstanding as of November 30, 2006, was 3,527,170.

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

ITEM 4. CONTROLS AND PROCEDURES

PART II. OTHER INFORMATION

ITEM 1A. RISK FACTORS

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

ITEM 5. OTHER INFORMATION

ITEM 6. EXHIBITS

SIGNATURES

EX-31.(A) SECTION 302 CERTIFICATION OF CEO

EX-31.(B) SECTION 302 CERTIFICATION OF CFO

EX-32.(A) SECTION 906 CERTIFICATION OF CEO

EX-32.(B) SECTION 906 CERTIFICATION OF CFO

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS**SERVIDYNE, INC.
CONSOLIDATED BALANCE SHEETS**

| | (Unaudited) October 31, 2006 | April 30, 2006 |
|---|---|----------------|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 5,763,668 | \$ 7,329,805 |
| Restricted cash | | 418,594 |
| Receivables (Note 4) | 3,210,432 | 2,420,368 |
| Less: Allowance for doubtful accounts | (26,611) | (11,061) |
| Costs and earnings in excess of billings | 61,264 | 286,824 |
| Deferred income taxes | 622,927 | 622,927 |
| Note receivables | 300,100 | 902,505 |
| Other | 1,723,487 | 966,454 |
| | | |
| Total current assets | 11,655,267 | 12,936,416 |
| | | |
| INCOME-PRODUCING PROPERTIES, net | 25,470,033 | 20,724,917 |
| PROPERTY AND EQUIPMENT, net | 810,780 | 843,204 |
| RESTRICTED CASH | 1,946,121 | 3,241,310 |
| OTHER ASSETS: | | |
| Real estate held for future development or sale | 1,632,358 | 1,925,427 |
| Intangible assets, net (Note 8) | 3,692,221 | 3,109,376 |
| Goodwill (Note 8) | 5,458,717 | 5,458,717 |
| Other | 4,313,265 | 4,170,889 |
| | | |
| Total assets | \$ 54,978,762 | \$ 52,410,256 |
| | | |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| CURRENT LIABILITIES: | | |
| Trade and subcontractors payables | \$ 446,523 | \$ 705,647 |
| Accrued expenses | 1,911,903 | 2,028,196 |
| Accrued incentive compensation | 442,500 | 471,619 |
| Billings in excess of costs and earnings | 154,714 | 211,676 |
| Current maturities of long-term debt | 1,133,422 | 1,167,192 |
| | | |
| Total current liabilities | 4,089,062 | 4,584,330 |
| | | |
| DEFERRED INCOME TAXES | 3,591,115 | 3,710,599 |
| OTHER LIABILITIES | 1,917,631 | 1,879,037 |
| MORTGAGE NOTES PAYABLE, less current maturities | 23,412,775 | 19,806,542 |
| OTHER LONG-TERM DEBT, less current maturities | 1,468,000 | 1,483,000 |

| | | |
|--|----------------------|---------------|
| Total liabilities | 34,478,583 | 31,463,508 |
| COMMITMENTS AND CONTINGENCIES (Note 11) | | |
| SHAREHOLDERS EQUITY: | | |
| Common stock, \$1 par value; 5,000,000 shares authorized; 3,695,336 issued and 3,527,170 outstanding at October 31, 2006, 3,695,336 issued and 3,532,180 outstanding at April 30, 2006 | 3,695,336 | 3,695,336 |
| Additional paid-in capital | 4,821,844 | 4,803,133 |
| Deferred stock compensation | | (4,420) |
| Retained earnings | 12,777,618 | 13,227,076 |
| Treasury stock, common shares; 168,166 at October 31, 2006, and 163,156 at April 30, 2006 | (794,619) | (774,377) |
| Total shareholders equity | 20,500,179 | 20,946,748 |
| | \$ 54,978,762 | \$ 52,410,256 |

See accompanying notes to consolidated financial statements.

Table of Contents

SERVIDYNE, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

| | SECOND QUARTER ENDED OCTOBER 31, | | FIRST SIX MONTHS ENDED OCTOBER 31, | |
|---|---|--------------|---|--------------|
| | 2006 | 2005 | 2006 | 2005 |
| REVENUES: | | | | |
| Building performance experts | \$ 3,238,652 | \$ 2,844,335 | \$ 5,854,067 | \$ 5,863,593 |
| Rental income | 1,649,989 | 1,513,588 | 3,175,132 | 3,044,022 |
| | 4,888,641 | 4,357,923 | 9,029,199 | 8,907,615 |
| Interest | 82,133 | 51,898 | 175,790 | 98,091 |
| Other | 32,054 | 240,960 | 97,101 | 253,871 |
| | 5,002,828 | 4,650,781 | 9,302,090 | 9,259,577 |
| COSTS AND EXPENSES: | | | | |
| Building performance experts | 2,113,354 | 1,770,934 | 3,829,384 | 3,269,809 |
| Rental property operating expenses, excluding interest | 1,049,655 | 999,801 | 1,982,334 | 1,963,620 |
| | 3,163,009 | 2,770,735 | 5,811,718 | 5,233,429 |
| Selling, general and administrative | | | | |
| Building performance experts | 1,066,445 | 1,072,355 | 2,221,021 | 2,173,223 |
| Real estate | 254,064 | 185,512 | 460,768 | 449,092 |
| Parent | 1,027,720 | 736,043 | 1,800,037 | 1,635,595 |
| | 2,348,229 | 1,993,910 | 4,481,826 | 4,257,910 |
| Interest costs incurred | 462,519 | 413,703 | 868,407 | 786,367 |
| | 5,973,757 | 5,178,348 | 11,161,951 | 10,277,706 |
| GAIN ON SALE REAL ESTATE, net of costs of sale of \$504,563, \$612,124, \$504,563 and \$612,124, respectively | 1,545,437 | 542,130 | 1,545,437 | 542,130 |
| EARNINGS (LOSS) BEFORE INCOME TAXES FROM CONTINUING | 574,508 | 14,563 | (314,424) | (475,999) |

OPERATIONS

| | | | | |
|--|-------------------|-------------|---------------------|--------------|
| INCOME TAX EXPENSE (BENEFIT) | 218,557 | 5,534 | (119,480) | (180,879) |
| EARNINGS (LOSS) FROM CONTINUING OPERATIONS | 355,951 | 9,029 | (194,944) | (295,120) |
| DISCONTINUED OPERATIONS: Loss from discontinued operations, adjusted for applicable income tax benefit of \$0, \$(19,577) \$0, and \$(39,729), respectively | | (31,943) | | (64,820) |
| NET EARNINGS (LOSS) | \$ 355,951 | \$ (22,914) | \$ (194,944) | \$ (359,940) |
| NET EARNINGS (LOSS) PER SHARE BASIC AND DILUTED: | | | | |
| From continuing operations | \$.10 | \$.00 | \$ (.06) | \$ (.08) |
| From discontinued operations | | (.01) | | (.02) |
| NET EARNINGS (LOSS) PER SHARE BASIC AND DILUTED | \$.10 | \$ (.01) | \$ (.06) | \$ (.10) |
| DIVIDENDS PER SHARE | \$ 0.036 | \$ 0.036 | \$ 0.072 | \$ 0.072 |
| WEIGHTED AVERAGE SHARES OUTSTANDING BASIC AND DILUTED | 3,531,600 | 3,531,180 | 3,531,850 | 3,530,811 |

See accompanying notes to consolidated financial statements.

Table of Contents

SERVIDYNE, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
(UNAUDITED)

| | Common Stock Shares | Common Stock Amount | Additional Paid-In Capital | Deferred Stock Compensation | Retained Earnings | Treasury Stock | Total |
|---|--------------------------------|--------------------------------|---|--|------------------------------|---------------------------|--------------|
| BALANCES at April 30, 2004 | 3,327,628 | \$3,327,628 | \$2,963,874 | \$(26,855) | \$14,412,663 | \$(679,783) | \$19,997,527 |
| Net earnings | | | | | 1,800,358 | | 1,800,358 |
| Common stock issued | 29,973 | 29,973 | 104,108 | (39,175) | | | 94,906 |
| Stock compensation expense | | | | 51,868 | | (5,159) | 46,709 |
| Cash dividends declared - \$.29 per share (adjusted for subsequent stock dividend) | | | | | (1,026,089) | | (1,026,089) |
| BALANCES at April 30, 2005 | 3,357,601 | 3,357,601 | 3,067,982 | (14,162) | 15,186,932 | (684,942) | 20,913,411 |
| Net earnings | | | | | 525,766 | | 525,766 |
| Common stock issued | 1,800 | 1,800 | 6,660 | (8,460) | | | |
| Stock compensation expense | | | | 18,202 | | (1,871) | 16,331 |
| Stock option exercise | 732 | 732 | 2,196 | | | | 2,928 |
| Cash dividends declared - \$.14 per share (adjusted for subsequent stock dividend) | | | | | (511,688) | | (511,688) |
| Stock dividend declared - 10% at market value on date declared | 335,203 | 335,203 | 1,726,295 | | (1,973,934) | (87,564) | |
| BALANCES at April 30, 2006 | 3,695,336 | 3,695,336 | 4,803,133 | (4,420) | 13,227,076 | (774,377) | 20,946,748 |

| | | | | | | |
|--|--------|-------|--|-----------|----------|-----------|
| Net loss | | | | (194,944) | | (194,944) |
| Common stock acquired | | | | | (19,747) | (19,747) |
| Stock compensation expense | 18,711 | 4,420 | | | (495) | 22,636 |
| Cash dividends declared - \$.072 per share | | | | (254,514) | | (254,514) |

BALANCES at

October 31,

2006 3,695,336 \$3,695,336 \$4,821,844 \$ \$12,777,618 \$(794,619) \$20,500,179

See accompanying notes to consolidated financial statements.

Table of Contents

SERVIDYNE, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

| | FIRST SIX MONTHS ENDED OCTOBER 31, | |
|---|---|-----------------|
| | 2006 | 2005 |
| CONTINUING OPERATIONS: | | |
| Cash flows from operating activities: | | |
| Net loss | \$ (194,944) | \$ (359,940) |
| Loss from discontinued operations, net of tax | | 64,820 |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Gain on sale of real estate | (1,545,437) | (542,130) |
| Depreciation and amortization | 827,638 | 647,139 |
| Deferred tax benefit | (119,480) | (282,451) |
| Provision for (recovery of) doubtful accounts, net | 39,050 | (50,041) |
| Stock compensation expense | 22,636 | 11,699 |
| Cash surrender value | (62,627) | (60,829) |
| Straight-line rent | (10,443) | (3,405) |
| Changes in assets and liabilities: | | |
| Receivables | (910,044) | 711,281 |
| Costs and earnings in excess of billings | 225,560 | 46,422 |
| Note receivables | 602,405 | (623,031) |
| Other current assets | (757,033) | (180,468) |
| Other assets | 1,063 | (134,327) |
| Trade and subcontractors payable | (259,124) | 73,456 |
| Accrued expenses | (152,310) | (361,621) |
| Accrued incentive compensation | (29,119) | (632,967) |
| Billings in excess of costs and earnings | (56,962) | (335,264) |
| Other liabilities | (55,279) | 61,130 |
| Net cash used in operating activities | (2,434,450) | (1,950,527) |
| Cash flows from investing activities: | | |
| Release of restricted cash held in escrow | 418,594 | 8,272,399 |
| Deposit of cash proceeds from sale of real estate held in escrow | (1,946,121) | |
| Proceeds from sale of real estate | 1,867,052 | 617,140 |
| Additions to income-producing properties, net | (195,973) | (355,897) |
| Additions to property and equipment, net | (63,705) | (148,158) |
| Additions to intangible assets, net | (495,508) | (474,143) |
| Additions to real estate held for sale or future development | (28,546) | |
| Acquisition of Stewartsboro, net of cash released from escrow | (1,870,447) | |
| Net cash (used in) provided by investing activities | (2,314,654) | 7,911,341 |
| Cash flows from financing activities: | | |

Edgar Filing: SERVIDYNE, INC. - Form 10-Q

| | | |
|---|---------------------|-----------------|
| Debt proceeds | 6,700,000 | |
| Debt repayments | (529,076) | (515,827) |
| Mortgage repayment | (2,600,000) | |
| Repurchase of Common Stock | (19,747) | |
| Deferred loan costs paid | (113,696) | |
| Cash received on stock option exercise | | 2,928 |
| Cash dividends | (254,514) | (257,423) |
| Net cash provided by (used in) financing activities | 3,182,967 | (770,322) |
| DISCONTINUED OPERATIONS: | | |
| Operating activities | | 68,616 |
| Investing activities | | |
| Financing activities | | (27,102) |
| Net cash provided by discontinued operations | | 41,514 |
| Net (decrease) increase in cash and cash equivalents | (1,566,137) | 5,232,006 |
| Cash and cash equivalents at beginning of period | 7,329,805 | 1,402,645 |
| Cash and cash equivalents at end of period | \$ 5,763,668 | \$ 6,634,651 |
| Supplemental disclosure of noncash financing activities: | | |
| Issuance of common stock under Stock Award Plan | \$ | \$ 4,455 |
| <i>See accompanying notes to consolidated financial statements.</i> | | |

Table of Contents

SERVIDYNE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
OCTOBER 31, 2006, AND APRIL 30, 2006
(UNAUDITED)

NOTE 1. ORGANIZATION AND BUSINESS

Servidyne, Inc. (formerly Abrams Industries, Inc. , together with its subsidiaries, the Company) was organized under Delaware law in 1960. In 1984, the Company changed its state of incorporation from Delaware to Georgia. The Company (i) provides building performance expert services to owners and operators of commercial real estate; and (ii) engages in commercial real estate investment and development.

Prior to this fiscal year, the Company reported on three segments: Energy Facilities and Solutions, Energy Services, and Real Estate. In the first quarter of fiscal 2007, the Company combined the operations of the Energy Facilities and Solutions and Energy Services Segment into one integrated segment, Building Performance Experts. This segment provides comprehensive energy, infrastructure and productivity services to owners and operators of commercial real estate.

NOTE 2. UNAUDITED STATEMENTS

The accompanying unaudited consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements have been condensed or omitted pursuant to such rules and regulations, although management believes that the accompanying disclosures are adequate to make the information presented not misleading. In the opinion of management, the accompanying financial statements contain all adjustments, consisting of normal recurring accruals, that are necessary for a fair statement of the results for the interim periods presented. These financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company s Annual Report on Form 10-K for the year ended April 30, 2006. Results of operations for interim periods are not necessarily indicative of annual results.

NOTE 3. SIGNIFICANT ACCOUNTING POLICIES

On May 1, 2006, the Company adopted Statement of Financial Accounting Standard (SFAS) 123(R), *Share-Based Payment (revised 2004)*. SFAS 123(R) requires that all equity awards to employees be expensed by the Company over the requisite service period. The Company adopted this standard using the modified prospective method. Under this method, the Company records compensation expense for all awards it granted after the date it adopted the standard. In addition, as of the effective date, the Company was required to record compensation expense for any unvested portion of the previously granted awards that remained outstanding at the date of adoption. The adoption of SFAS 123(R) at that time did not have an impact on the Company s financial position or results of operations as there were no unvested equity awards that required an accounting change as of May 1, 2006.

Prior to the adoption of SFAS 123(R), the Company accounted for equity-based compensation under the provisions and related interpretations of Accounting Principles Board (APB) 25, *Accounting for Stock Issued to Employees*. Accordingly, the Company was not required to record compensation expense when stock options were granted to employees as long as the exercise price was no less than the fair value of the stock at the grant date. Under SFAS 123, *Accounting for Stock-Based Compensation*, as amended by SFAS 148, *Accounting for Stock-Based Compensation Transition and Disclosure*, the

Table of Contents

Company continued to follow the guidance of APB 25, but provided pro forma disclosures of net earnings (loss) and net earnings (loss) per share as if the Company had adopted the provisions of SFAS 123. The Company computed the value of all stock option awards granted for the quarter ended October 31, 2005, using the Black-Scholes option pricing model. If the Company had accounted for its stock-based compensation awards in accordance with SFAS 123, pro forma results for the quarter and six month periods ended October 31, 2005, would have been as follows:

| | Quarter Ended October 31, 2005 | Six Months Ended October 31, 2005 |
|---|--------------------------------------|--|
| Net loss, as reported | \$ (22,914) | \$ (359,940) |
| Add: Stock-based compensation | 6,654 | 16,057 |
| Deduct: Total stock-based compensation expense as determined under fair value based method for all awards, net of related tax effects | (28,013) | (58,655) |
| Add: Forfeitures, net of related tax effects | 7,073 | 9,659 |
| Pro forma net loss | \$ (37,200) | \$ (392,879) |
| Net loss per share: | | |
| Basic and diluted as reported | \$ (0.01) | \$ (0.10) |
| Basic and diluted pro forma | \$ (0.01) | \$ (0.11) |

The Company has three outstanding types of equity-based incentive compensation instruments in effect with employees, non-employee directors and outside consultants: stock options, stock appreciation rights and restricted stock.

The Company's net earnings (loss) includes \$16,358 and \$22,636 for the second quarter and first six months ended October 31, 2006, respectively, of total equity-based compensation expense and \$6,216 and \$8,602, of related income tax benefits. All of this expense was included in selling, general and administrative expense in the consolidated statements of operations.

Stock Options

A summary of the options activity for the six months ended October 31, 2006, is as follows:

| | Options to Purchase Shares | Weighted Average Exercise Price |
|---------------------------------|----------------------------------|--|
| Outstanding at April 30, 2006 | 757,390 | \$ 4.68 |
| Granted | | |
| Exercised | | |
| Forfeited | (83,229) | 4.59 |
| Outstanding at October 31, 2006 | 674,161 | \$ 4.69 |
| Vested at October 31, 2006 | 674,161 | \$ 4.69 |

None of the stock options were in-the-money as of October 31, 2006.

Table of Contents

A summary of information about all stock options outstanding as of October 31, 2006, is as follows:

| Exercise Price | Number of Outstanding and Exercisable Options | Weighted Average Remaining Contractual Life (Years) |
|----------------|---|---|
| \$4.64 | 569,140 | 5.39 |
| \$4.77 | 4,400 | 8.64 |
| \$4.82 | 74,800 | 8.40 |
| \$5.45 | 25,821 | 7.63 |

Stock Appreciation Rights

The Company awarded 312,000 stock appreciation rights (SARs) on June 26, 2006. The Company had not previously awarded SARs. The SARs vest over a five-year period in which 30% of the SARs vest in year three, 30% in year four and 40% in year five, with an early vesting provision that 100% of the SARs vest if the stock price closes at or above \$20/share for ten consecutive business days. A summary of the SARs activity for the six months ended October 31, 2006, is as follows:

| | Options to Purchase Shares | Weighted Average Exercise Price |
|---------------------------------|----------------------------|---------------------------------|
| Outstanding at April 30, 2006 | | \$ |
| Granted | 312,000 | 4.14 |
| Exercised | | |
| Forfeited | (9,000) | 4.14 |
| Outstanding at October 31, 2006 | 303,000 | \$ 4.14 |
| Vested at October 31, 2006 | | \$ |

The Company estimates the fair value of each option grant on the date of grant using the Black-Scholes option-pricing model. The risk free interest rate utilized in the Black-Scholes calculation is the interest rate on the U.S. Treasury Bill having the same life as the expected life of the Company's option awards. Expected life of the options granted was based on the estimated holding period of the option award. Expected volatility is based on the historical volatility of the Company's stock over a five year period using the month end stock price. The SARs granted had the following assumptions and fair value:

| | |
|---------------------------------|---------|
| Expected life (years) | 5 |
| Dividend yield | 2.99% |
| Expected stock price volatility | 36.17% |
| Risk free interest rate | 5.11% |
| Fair value of SARs granted | \$ 0.81 |

The Company's net earnings (loss) for the quarter and six months ended October 31, 2006, includes \$15,356 and \$20,647, respectively, of equity-based compensation expense related to the vesting of the SARs. Related income tax benefits were \$5,835 and \$7,846 for the second quarter and six months ended October 31, 2006, respectively. All of this expense was included in selling, general and administrative expenses in the consolidated statement of operations.

Table of Contents*Shares of Restricted Stock*

Periodically, the Company has awarded shares of restricted stock to employees, non-employees, directors and outside consultants. The awards were previously accounted for under APB No. 25, recorded at fair market value on the date of grant as deferred compensation expense, and compensation expense was recognized over the vesting period on a straight-line basis, net of forfeitures. Upon adoption of SFAS 123(R), \$4,420 of deferred compensation expense related to the Company's shares of restricted stock was reclassified to additional paid in capital. As of October 31, 2006, there was \$1,936 of total unrecognized compensation cost related to shares of restricted stock which will be recognized over the ensuing six months. For the quarter ended October 31, 2006, and October 31, 2005, restricted stock equity-based compensation expense related to the vesting of shares of restricted stock was \$1,002 and \$5,330, respectively. In the six months ended October 31, 2006, and October 31, 2005, equity-based compensation expense related to the vesting of shares of restricted stock was \$1,989 and \$12,569, respectively. The following table summarizes restricted stock activity for the six months ended October 31, 2006:

| | Number of Restricted Shares of Stock | Weighted Weighted Average Grant Date Fair Value |
|---|---|---|
| Non-vested restricted stock at April 30, 2006 | 3,430 | \$ 4.68 |
| Granted | | |
| Vested | (2,420) | 4.95 |
| Forfeited | (110) | 4.95 |
| Non-vested restricted stock at October 31, 2006 | 900 | \$ 4.45 |

NOTE 4. RECEIVABLES

All net contract and trade receivables are expected to be collected within one year.

NOTE 5. DISCONTINUED OPERATIONS*Construction Segment*

During fiscal 2004, the Company made the decision to curtail its operations as a general contractor, and pursuant to this decision, all operating activities ceased. The former Construction Segment has been classified as a discontinued operation.

Real Estate Sales of Income-Producing Properties

The Company is in the business of creating long-term value by periodically realizing gains through the sale of existing real estate assets, and then redeploying its capital by reinvesting the proceeds from such sales. Effective as of fiscal 2003, the Company adopted SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, which requires, among other things, that the operating results of certain income-producing assets, sold subsequent to April 30, 2002, be included in discontinued operations in the statements of operations for all periods presented. The Company classifies an asset as held for sale when the asset is under a binding sales contract with minimal contingencies, and the buyer is materially at risk if the buyer fails to complete the transaction. However, each potential transaction is evaluated based on its separate facts and circumstances. Pursuant to this standard, as of October 31, 2006, the Company had no income-producing properties that were classified as held for sale.

On January 30, 2006, the Company sold its professional medical office building located in Douglasville, Georgia, and recognized a pre-tax gain of approximately \$1.37 million. As a result of this transaction, the Company's financial statements have been prepared with the results of operations and cash flows shown as discontinued operations. All historical statements have been restated in accordance with SFAS 144.

Table of Contents

Summarized financial information for discontinued operations for the quarters and six month periods ended October 31, 2006, and October 31, 2005, is as follows:

| | Second Quarter Ended October 31, | | Six Months Ended October 31, | |
|--|---|-------------|---|-------------|
| | 2006 | 2005 | 2006 | 2005 |
| REVENUES: | | | | |
| Construction | \$ | \$ | \$ | \$ 40 |
| Rental properties | | 191,683 | | 355,392 |
| Total revenues | | 191,683 | | 355,432 |
| COSTS AND EXPENSES: | | | | |
| Construction cost and expenses | | (25,964) | | (25,964) |
| Rental property operating expenses, including depreciation | | 143,715 | | 274,350 |
| Interest expense | | 59,162 | | 118,603 |
| Construction selling, general & administrative | | 66,290 | | 92,992 |
| Total costs and expenses | | 243,203 | | 459,981 |
| Loss from discontinued operations | | (51,520) | | (104,549) |
| Income tax benefit | | (19,577) | | (39,729) |
| Loss from discontinued operations, net of tax | \$ | \$ (31,943) | \$ | \$ (64,820) |

NOTE 6. OPERATING SEGMENTS

In the prior fiscal year, the Company reported operating results in three segments: Energy Facilities and Solutions, Energy Services and Real Estate. The Company has combined the operations of the Energy and Facilities Solutions Segment and the Energy Services Segment into one integrated segment, Building Performance Experts. All amounts in the accompanying financial statements reflect the restatement of the segments so that they are consistent with the current year presentation. The table below shows selected financial data on a segment basis. Net earnings (loss) is total revenues less operating expenses, including depreciation, interest, and income taxes. In this presentation, management fee expense charged by the Parent Company has not been allocated to the Segments.

Table of Contents

| For the Quarter Ended October 31, 2006 | Building Performance Experts | Real Estate (1) | Parent | Eliminations | Consolidated |
|--|---|----------------------------|---------------|---------------------|---------------------|
| Revenues from unaffiliated customers | \$3,238,652 | \$3,699,989 | \$ | \$ | \$6,938,641 |
| Interest and other income | 7,772 | 299,202 | 35,830 | (228,617) | 114,187 |
| Intersegment revenue | | 126,596 | | (126,596) | |
| Total revenues from continuing operations | \$3,246,424 | \$4,125,787 | \$ 35,830 | \$(355,213) | \$7,052,828 |
| Net earnings (loss) | \$ (126,282) | \$1,204,424 | \$(725,687) | \$ 3,496 | \$ 355,951 |
| | | | | | |
| For the Quarter Ended October 31, 2005 | Building Performance Experts | Real Estate (1) | Parent | Eliminations | Consolidated |
| Revenues from unaffiliated customers | \$2,844,335 | \$2,667,842 | \$ | \$ | \$5,512,177 |
| Interest and other income | 10,948 | 418,476 | 9,010 | (145,576) | 292,858 |
| Intersegment revenue | | 134,705 | | (134,705) | |
| Total revenues from continuing operations | \$2,855,283 | \$3,221,023 | \$ 9,010 | \$(280,281) | \$5,805,035 |
| Net earnings (loss) | \$ (182,607) | \$ 661,738 | \$(468,243) | \$ (8,799) | \$ 2,089 |
| | | | | | |
| For the Six Months Ended October 31, 2006 | Building Performance Experts | Real Estate (1) | Parent | Eliminations | Consolidated |
| Revenues from unaffiliated customers | \$5,854,067 | \$5,225,132 | \$ | \$ | \$11,079,199 |
| Interest and other income | 54,849 | 644,423 | 52,517 | (478,898) | \$ 272,891 |
| Intersegment revenue | | 250,739 | | (250,739) | \$ |
| Total revenues from continuing operations | \$5,908,916 | \$6,120,294 | \$ 52,517 | \$(729,637) | \$11,352,090 |
| Net earnings (loss) | \$ (418,910) | \$1,530,389 | \$(1,313,417) | \$ 6,994 | \$ (194,944) |
| | | | | | |
| For the Six Months Ended October 31, 2005 | Building Performance Experts | Real Estate (1) | Parent | Eliminations | Consolidated |

| | | | | | |
|---|-------------|-------------|---------------|-------------|--------------|
| Revenues from unaffiliated customers | \$5,863,593 | \$4,198,276 | \$ | \$ | \$10,061,869 |
| Interest and other income | 11,263 | 572,617 | 13,640 | (245,558) | 351,962 |
| Intersegment revenue | | 261,893 | | (261,893) | |
| Total revenues from continuing operations | \$5,874,856 | \$5,032,786 | \$ 13,640 | \$(507,451) | \$10,413,831 |
| Net earnings (loss) | \$ (21,211) | \$ 794,335 | \$(1,084,196) | \$ (7,335) | \$ (318,407) |

Table of Contents

(1) The Company is in the business of creating long-term value by periodically realizing gains through the sale of income-producing properties and the sale of real estate held for future development or sale and, therefore, in this presentation the Real Estate Segment's net earnings includes earnings from discontinued operations, pursuant to SFAS 144, that resulted from the sales of certain income-producing properties, and earnings included in continuing operations that resulted from the gain on sale of other real estate assets.

The following is a reconciliation of segment revenues shown in the table above to consolidated revenues on the statements of operations for the quarters and six month periods ended October 31, 2006, and October 31, 2005:

| | Quarter Ended October 31, | | Six Months Ended October 31, | |
|--|------------------------------|--------------|---------------------------------|---------------|
| | 2006 | 2005 | 2006 | 2005 |
| Consolidated Segment revenues | \$ 7,052,828 | \$ 5,805,035 | \$ 11,352,090 | \$ 10,413,831 |
| Revenues on sales of real estate held for sale | (2,050,000) | (1,154,254) | (2,050,000) | (1,154,254) |
| Total consolidated revenues | \$ 5,002,828 | \$ 4,650,781 | \$ 9,302,090 | \$ 9,259,577 |

The following is a reconciliation of segment net earnings (loss) shown in the table on the previous page to consolidated net earnings (loss) on the statements of operations for the quarters and six month periods ended

October 31, 2006, and October 31, 2005:

| | Quarter Ended October 31, | | Six Months Ended October 31, | |
|--|------------------------------|------------|---------------------------------|-------------|
| | 2006 | 2005 | 2006 | 2005 |
| Consolidated Segment net earnings (loss) | \$355,951 | \$ 2,089 | \$(194,944) | \$(318,407) |
| Discontinued Construction Segment net loss | | (25,003) | | (41,533) |
| Consolidated net earnings (loss) | \$355,951 | \$(22,914) | \$(194,944) | \$(359,940) |

NOTE 7. EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share is computed by dividing net earnings (loss) by the weighted average shares outstanding during the reporting period. Diluted earnings (loss) per share is computed giving effect to dilutive stock equivalents resulting from outstanding stock options, stock warrants and stock appreciation rights. The dilutive effect on the number of common shares for the second quarter of fiscal 2007 and fiscal 2006 was zero shares for both periods. The dilutive effect on the number of common shares for the first six months of fiscal 2007 and fiscal 2006 was zero and 86,267 shares, respectively. Because the Company had a loss from continuing operations for the second quarter of fiscal 2006 and the six months ended October 31, 2006, and October 31, 2005, all stock equivalents were antidilutive during these periods, and therefore, are excluded when determining the diluted weighted average number of shares outstanding. Even though the Company had earnings from continuing operations for the second quarter ended October 31, 2006, there were no related stock options, SARs or warrants which would cause a dilutive effect on the weighted average number of shares outstanding.

Table of Contents**NOTE 8. GOODWILL AND OTHER INTANGIBLE ASSETS**

The gross carrying amounts and accumulated amortization for all of the Company's intangible assets as of October 31, 2006, are as follows:

| | Gross Carrying Amount | Accumulated Amortization |
|--|-----------------------------|-----------------------------|
| Intangible assets, subject to amortization: | | |
| Proprietary building performance expert software applications | \$ 2,890,294 | \$ 1,060,303 |
| Acquired computer software | 451,428 | 417,528 |
| Real estate lease costs | 1,537,380 | 786,736 |
| Customer relationships | 218,000 | 123,593 |
| Deferred loan costs | 831,370 | 569,694 |
| Non-compete agreements | 23,948 | 23,948 |
| Other | 28,660 | 15,764 |
| | \$ 5,981,080 | \$ 2,997,566 |
| Intangible assets, not subject to amortization: | | |
| Trademark | \$ 708,707 | \$ |
| Goodwill | \$ 5,458,717 | \$ |
| Aggregate amortization expense for all amortized intangible assets | | |
| For the three months ended October 31, 2006 | | \$210,107 |
| For the six months ended October 31, 2006 | | \$367,380 |
| For the three months ended October 31, 2005 | | \$133,933 |
| For the six months ended October 31, 2005 | | \$247,904 |

NOTE 9. ACQUISITIONS

On July 14, 2006, Stewartsboro Crossing, LLC, a newly-formed wholly-owned subsidiary of the Company, acquired a shopping center located in Smyrna, Tennessee. The Company used the net cash proceeds from the sale of its former medical office building, which proceeds had been held in escrow by a qualified third party intermediary, as well as interim bank financing, to purchase the income-producing property for approximately \$5.27 million, including the costs associated with completing the transaction. A permanent mortgage, replacing the interim bank financing, was subsequently put in place as discussed below. The acquisition was structured in order to qualify the sale and acquisition as a deferred tax free exchange under Internal Revenue Code Section 1031.

Table of Contents

The following table summarizes estimated fair values of the assets acquired at the date of acquisition as follows:

| | Purchase of Stewartsboro | Estimated Useful Life |
|-----------------------|--------------------------------|-----------------------------------|
| Land | \$ 1,300,140 | Indefinite |
| Land improvements | 240,684 | 15 years |
| Building | 3,385,911 | 39 years |
| Intangible assets | 341,020 | Over remaining lives of leases |
| Total assets acquired | \$ 5,267,755 | |

The assets and results of operations have been included in the Company's financial statements since the date of acquisition.

On September 8, 2006, the Company replaced its interim bank loan of \$2.6 million with a permanent loan in the amount of \$4.1 million. The loan bears interest at 6.26% with interest only payments for the first twelve months, and then the loan will be amortized using a 30 year amortization period until it matures on October 1, 2016.

NOTE 10. DISPOSITIONS

On August 29, 2006, the Company sold its former manufacturing and warehouse facility located in downtown Atlanta, Georgia, for a sales price of \$2,050,000, resulting in a pre-tax gain on the sale of approximately \$1,545,000. After selling expenses, the sale generated cash proceeds of approximately \$1,867,000. This sale is recorded in continuing operations on the accompanying consolidated statements of operations as gain on sale of real estate, net of costs of sale. The Company currently intends to use the net proceeds from this sale to acquire an additional income producing property, which would qualify the sale and proposed acquisition under Internal Revenue Code Section 1031 for federal income tax deferral, and has placed the proceeds with a qualified third party intermediary in connection therewith.

NOTE 11. COMMITMENTS AND CONTINGENCIES

The Company is subject to legal proceedings and other claims that arise in the ordinary course of business. While the resolution of these matters cannot be predicted with certainty, the Company believes that the final outcome of these matters will not have a material adverse effect on the Company's financial position or results of operations. See Item 1A, Risk Factors, in the Company's Annual Report on Form 10-K for the year ended April 30, 2006.

NOTE 12. SUBSEQUENT EVENTS

On November 1, 2006, the Company sold its owned shopping center located in Morton, Illinois, for a sales price of \$3,550,000, resulting in a pre-tax gain on the sale of approximately \$3,083,000. After selling expenses, repayment of the mortgage loan and associated costs the sale generated cash proceeds of approximately \$1,300,000. The sale will be included in the results of operations for the quarter ended January 31, 2007. The Company currently intends to use the net proceeds from this sale to acquire an additional income producing property, which would qualify the sale and proposed acquisition under Internal Revenue Code Section 1031 for federal income tax deferral, and has placed the proceeds with a qualified third party intermediary in connection therewith.

Pursuant to SFAS 144, as of October 31, 2006, this income-producing property did not meet the

Table of Contents

requirements for classification as real estate held for sale. However, as a result of this transaction, all historical financial information related to the sale will be reclassified as discontinued operations for the quarter ended January 31, 2007. Summarized financial information that is currently included in rental income and net earnings that will be reclassified to discontinued operations is as follows:

| | Quarter Ended October 31, | | Six Months Ended October 31, | |
|--|------------------------------|------------|---------------------------------|------------|
| | 2006 | 2005 | 2006 | 2005 |
| Rental income from continuing operations | \$ 115,807 | \$ 115,807 | \$ 231,613 | \$ 231,613 |
| Net earnings | \$ 29,486 | \$ 34,962 | \$ 66,910 | \$ 69,633 |

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

The following discussion should be read in conjunction with the consolidated financial statements, including the notes to those statements, which are presented elsewhere in this report. The Company also recommends that this discussion and analysis be read in conjunction with the management's discussion and analysis section and the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended April 30, 2006.

The Company's fiscal year 2007 will end April 30, 2007.

In the following charts, changes in revenues, costs and expenses and changes in selling, general and administrative expenses from period to period are analyzed on a segment basis. For net earnings and similar profit information on a consolidated basis, please see the Company's consolidated financial statements.

Pursuant to SFAS 144, the figures shown in the following charts for all periods presented do not include Real Estate Segment revenues, costs and expenses, and selling, general and administrative expenses, generated by certain formerly owned income-producing properties which have been sold; such amounts have been reclassified to discontinued operations. See Critical Accounting Policies - Discontinued Operations later in this discussion and analysis section. Results of operations of the second quarter and first six months of fiscal 2007, compared to the second quarter and first six months of fiscal 2006

REVENUES From Continuing Operations

For the second quarter of fiscal 2007, consolidated revenues from continuing operations, including interest income and other income, and net of intersegment eliminations, were \$5,002,828, compared to \$4,650,781 for the second quarter of fiscal 2006, an increase of approximately 8%. For the first six months of fiscal 2007, consolidated revenues from continuing operations were \$9,302,090, compared to \$9,259,577 for the first six months of fiscal 2006, an increase of less than 1%.

The figures in Chart A are segment revenues from continuing operations, net of intersegment eliminations, and do not include interest income or other income.

Table of Contents

CHART A
REVENUES FROM CONTINUING OPERATIONS SUMMARY BY SEGMENT
(Dollars in Thousands)

| | Second Quarter Ended | | Amount Increase (Decrease) | Percent Increase (Decrease) | Six Months Ended | | Amount Increase (Decrease) | Percent Increase (Decrease) |
|----------------------|----------------------|---------------------|----------------------------------|-----------------------------------|---------------------|---------------------|----------------------------------|-----------------------------------|
| | October 31, 2006 | October 31, 2005 | | | October 31, 2006 | October 31, 2005 | | |
| Building Performance | | | | | | | | |
| Experts (1) | \$3,239 | \$2,845 | \$394 | 14 | \$5,854 | \$5,864 | \$ (10) | (0) |
| Real Estate (2) | 1,650 | 1,513 | 137 | 9 | 3,175 | 3,044 | 131 | 4 |
| | \$4,889 | \$4,358 | \$531 | 12 | \$9,029 | \$8,908 | \$121 | 1 |

NOTES TO CHART A

(1) Building Performance Experts Segment revenues from continuing operations increased \$394,000 or 14% for the second quarter of fiscal 2007, compared to the same period in fiscal 2006, primarily due to:

(a) an increase in revenues of approximately \$250,000 related to lighting projects; and

(b) an increase of approximately \$149,000 related to energy engineering services.

Building Performance Experts Segment revenues from continuing operations decreased \$10,000 for the first six months of fiscal 2007, compared to the same period in fiscal 2006, primarily due to:

(a) the recognition of one-time revenues of approximately \$589,000 in the first quarter of fiscal 2006 from a consulting services contract that was substantially performed in prior periods and did not have any associated costs and expenses in the period (see Chart B);

offset by:

(b) an increase in fiscal 2007 in revenues of approximately \$268,000 related to lighting projects; and

(c) an increase in fiscal 2007 in revenues of approximately \$307,000 related to energy engineering services.

(2) Real estate revenues from continuing operations increased \$137,000 or 9% for the second quarter of fiscal 2007, and \$131,000 or 4% for the first six months of fiscal 2007, compared to the same periods in fiscal 2006, primarily due to:

- (a) an increase in rental income related to (1) successful leasing activities that led to higher rental revenues of \$72,000 and \$99,000 for the second quarter and first six months of fiscal 2007, respectively; and (2) rental revenues of \$138,000 and \$167,000 for the second quarter and first six months of fiscal 2007, respectively, as the result of the purchase of a shopping center in Smyrna, Tennessee, in July 2006.

offset by:

- (b) a decrease in leaseback income of approximately \$78,000 and \$157,000 for the second quarter and first six months of fiscal 2007, respectively, resulting from the sale in fiscal 2006 of the Company's former leaseback shopping center located in Bayonet Point, Florida.

Table of Contents

The following table indicates the backlog of contracts and rental income for the next twelve months, by industry segment.

| | October 31, | |
|-------------------------------------|-------------------|-------------------|
| | 2006 | 2005 |
| Building Performance Experts (a) | \$ 6,038,000 | \$ 5,290,000 |
| Real Estate (b) | 6,428,000 | 5,910,000 |
| Less: Intersegment eliminations (c) | (556,000) | (540,000) |
| Total Backlog | \$ 11,910,000 | \$ 10,660,000 |

(a) The increase in Building Performance Experts backlog is primarily due to an increase in lighting upgrade projects, energy engineering contracts, and customers upgrading to the Company's new proprietary Web/wireless building performance software offerings. Backlog includes some contracts that can be cancelled with less than one year's notice, and assumes cancellation provisions will not be invoked. The cancellation rate for such contracts in the previous twelve months was approximately 4.1% (\$218,121).

(b) Real Estate backlog increased primarily due to approximately \$464,000 of rental revenues related to the shopping center located in Smyrna, Tennessee, acquired by the Company in July 2006, and an increase in net rental revenues of \$234,000 related to successful leasing activities at other properties. These increases are offset by a decrease of approximately \$180,000 in rental revenues resulting from the sale of the Company's former leaseback shopping center located in Bayonet Point, Florida, in April 2006. Also, included in Real Estate backlog as of October 31, 2006, is approximately \$463,000 related to the Company's shopping center

located in
Morton, Illinois,
that was sold on
November 1,
2006 (see Note
12 - Subsequent
Events).

- (c) Represents
rental income at
the Company's
headquarters
building to be
paid to the Real
Estate Segment
by the Parent
Company and
its other
operating
segment.

COSTS AND EXPENSES APPLICABLE TO REVENUES

From Continuing Operations

As a percentage of total segment revenues from continuing operations (See Chart A), the total applicable costs and expenses (See Chart B) were 65% and 64% for the second quarters of fiscal 2007 and 2006, respectively, and 64% and 59% for the first six months of fiscal 2007 and 2006, respectively. In reviewing Chart B, the reader should recognize that the volume of revenues generally will affect the amounts and percentages presented.

The figures in Chart B are net of intersegment eliminations.

Table of Contents

CHART B
COSTS AND EXPENSES APPLICABLE TO REVENUES
FROM CONTINUING OPERATIONS BY SEGMENT

(Dollars in Thousands)

| | Second Quarter Ended | | Percent of Segment Revenues for | | Six Months Ended | | Percent of Segment Revenues for | |
|----------------------|----------------------|---------------------|---|---|---------------------|---------------------|---|---|
| | October 31, 2006 | October 31, 2005 | Second Quarter Ended October 31, 2006 | Second Quarter Ended October 31, 2005 | October 31, 2006 | October 31, 2005 | Six Months Ended October 31, 2006 | Six Months Ended October 31, 2005 |
| Building Performance | | | | | | | | |
| Experts (1) | \$2,113 | \$1,771 | 65 | 62 | \$3,830 | \$3,270 | 65 | 56 |
| Real Estate (2) | 1,050 | 1,000 | 64 | 66 | 1,982 | 1,964 | 62 | 65 |
| | \$3,163 | \$2,771 | 65 | 64 | \$5,812 | \$5,234 | 64 | 59 |

NOTES TO CHART B

- 1) On a dollar basis, Building Performance Experts costs and expenses from continuing operations increased \$342,000 or 19% for the second quarter of fiscal 2007, and \$560,000 or 17% for the first six months of fiscal 2007, compared to the same periods of fiscal 2006, primarily as a result of the increase in revenues.

Building
Performance
Experts costs

and expenses as a percentage of revenues from continuing operations increased 3% for the second quarter of fiscal 2007, compared to the same period of fiscal 2006, primarily due to the changes in the mix of services and products.

Building Performance Experts costs and expenses as a percentage of revenues from continuing operations increased 9% for the first six months of fiscal 2007, compared to the same period of fiscal 2006, primarily due to:

- (a) the absence of associated costs of expenses for the one-time revenue from a consulting services contract in the first quarter of fiscal 2006; and
 - (b) changes in the mix of services and products.
- 2) On a dollar basis, Real Estate costs and expenses from continuing operations increased \$50,000 or 5% for the second quarter of fiscal 2007, compared to the same period of fiscal 2006, primarily due to:
- (a) an increase in rental operating costs and expenses of approximately \$115,000 related to the shopping center located in Smyrna, Tennessee, acquired in July 2006;

offset by:

- (b) the absence of lease costs of approximately \$73,000 as a result of the sale in April 2006 of the Company's former leaseback shopping center located in Bayonet Point, Florida.

On a dollar basis, Real Estate costs and expenses from continuing operations increased \$18,000 for the first six months of fiscal 2007, compared to the same period of fiscal 2006, primarily due to:

- (a) an increase in rental operating costs and expenses of approximately \$130,000 related to a shopping center located in Smyrna, Tennessee, acquired in July 2006; and

- (b) an increase in operating expenses of approximately \$39,000 primarily for periodic repairs and maintenance at one of the Company's office properties;

offset by:

17

Table of Contents

- (c) the absences of lease cost of approximately \$145,000 as a result of the sale in April 2006 of one of the Company's former leaseback shopping centers located in Bayonet Point, Florida.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES**From Continuing Operations**

For the second quarters of fiscal 2007 and 2006, total selling, general and administrative expenses (SG&A) from continuing operations, net of intersegment eliminations, were \$2,348,229 and \$1,993,910 respectively, and as a percentage of consolidated revenues from continuing operations, these expenses were 48% and 46%, respectively. For the first six months of fiscal 2007 and 2006, total SG&A expenses from continuing operations, net of intersegment eliminations, were \$4,481,826 and \$4,257,910, respectively, and as a percentage of consolidated revenues from continuing operations, these expenses were 50% and 48%, respectively. In reviewing Chart C, the reader should recognize that the volume of revenues generally will affect the amounts and percentages presented. The percentages in Chart C are based upon expenses as they relate to segment revenues from continuing operations (Chart A), except that parent and total expenses relate to consolidated revenues from continuing operations.

CHART C**SELLING, GENERAL AND ADMINISTRATIVE EXPENSES****FROM CONTINUING OPERATIONS BY SEGMENT**

(Dollars in Thousands)

| | Second Quarter Ended | | Percent of Segment Revenues for Second Quarter Ended | | Six Months Ended | | Percent of Segment Revenues for Six Months Ended | |
|----------------------|----------------------|------------------|--|------------------|------------------|------------------|--|------------------|
| | October 31, 2006 | October 31, 2005 | October 31, 2006 | October 31, 2005 | October 31, 2006 | October 31, 2005 | October 31, 2006 | October 31, 2005 |
| Building Performance | | | | | | | | |
| Experts (1) | \$1,066 | \$1,072 | 33 | 38 | \$2,221 | \$2,173 | 38 | 37 |
| Real Estate (2) | 254 | 186 | 15 | 12 | 461 | 449 | 15 | 15 |
| Parent (3) | 1,028 | 736 | 21 | 17 | 1,800 | 1,636 | 20 | 18 |
| | \$2,348 | \$1,994 | 48 | 46 | \$4,482 | \$4,258 | 50 | 48 |

NOTES TO CHART C

- (1) Building Performance Experts SG&A expense as a percentage of revenues from continuing operations decreased for the second quarter of fiscal 2007, compared to the same

period of fiscal 2006, primarily due to the related increase in revenues and SG&A expenses remaining constant.

On a dollar basis, Building Performance Experts SG&A expense from continuing operations for the first six months of fiscal 2007, increased \$48,000 or 2%, compared to the same period of fiscal 2006, primarily due to an increase in sales and marketing efforts.

- (2) On a dollar basis, Real Estate SG&A expense from continuing operations in the second quarter of fiscal 2007, increased \$68,000 or 37%, compared to the same period of fiscal 2006, primarily due to an increase in consulting fees of approximately \$20,000 and an increase in legal and professional fees of

approximately
\$41,000 related
to transaction
activity.

Table of Contents

- (3) On a dollar basis and as a percentage of revenues from continuing operations, Parent SG&A expenses from continuing operations, increased \$292,000 or 40% and \$164,000 or 10% in the second quarter and for the first six months of fiscal 2007, respectively, compared to the same periods of fiscal 2006, primarily due to:
- (a) an increase in consulting fees of approximately \$80,000 related to the sales and marketing efforts for the Company for both the second quarter and first six months of fiscal 2007; and
 - (b) an increase in personnel related costs of approximately \$216,000 and \$98,000 for the second quarter and first six months of fiscal 2007, respectively.

Liquidity and capital resources

Between April 30, 2006, and October 31, 2006, working capital decreased by approximately \$786,000. Operating activities used cash of approximately \$2,434,000 primarily due to:

- (a) the deposit into escrow the prepayment of a loan cost of approximately \$407,000 related to the sale of the Company's shopping center located in Morton, Illinois;
- (b) a net increase in accounts receivable and costs and earnings in excess of billings of approximately \$685,000 primarily due to the timing of billing and receipt of payments;
- (c) a decrease in trade and subcontractors payables, accrued expenses, billings in excess of costs and earnings, and other liabilities of approximately \$527,000 due to the timing and submission of payments;
- (d) cash payments of \$279,000 related to the incentive compensation generated by the successful achievement of Company-wide earnings and performance goals in fiscal 2006; and
- (e) current year losses from continuing operations.

Investing activities used cash of approximately \$2,315,000 primarily due to:

- (a) the purchase of the shopping center located in Smyrna, Tennessee, for approximately \$5,270,000 to complete the Company's tax-free exchange under Internal Revenue Code Section 1031. The acquisition

used the proceeds of approximately \$3,241,000 from the sale of the Company's former medical office building, which proceeds had been held in escrow by a qualified third party intermediary at April 30, 2006, and interim bank financing for the balance of \$2.6 million (see financing activities below);

- (b) additions to income-producing properties of \$196,000 primarily related to tenant and building improvements; and
- (c) additions to intangible assets of \$496,000 primarily related to new software development efforts for the Company's proprietary Web/wireless software.

offset by:

- (d) the release of approximately \$419,000 previously held in escrow for the intended purpose of purchasing a replacement property as part of an Internal Revenue Code Section 1031 federal tax deferred exchange for the Company's former leaseback shopping center located in Bayonet Point, Florida, which was sold in April 2006, as the Company did not use these funds to purchase a replacement property.

Financing activities provided cash of \$3,183,000 primarily due to:

- (a) the proceeds from the permanent loan of \$4,100,000 on the Company's shopping center located in Smyrna, Tennessee, which replaced the interim bank loan of \$2,600,000;

offset by:

- (b) scheduled principal payments of mortgage notes and other long-term debt of approximately \$529,000; and

- (c) payment of two regular quarterly cash dividends to shareholders of approximately \$255,000.

Table of Contents

On September 8, 2006, the Company replaced its interim bank loan of \$2.6 million with a permanent loan in the amount of \$4.1 million. The loan bears interest at 6.26% with interest only payments for the first twelve months, and then the loan will be amortized using a 30 year amortization period until it matures on October 1, 2016. The new loan provided additional cash to the Company of approximately \$1.527 million.

The Company anticipates that its existing cash balances, equity, potential proceeds from sales of real estate, potential cash flows provided by financing or refinancing of debt obligations, and cash flows generated from operations will, for the foreseeable future, provide adequate liquidity and financial flexibility to meet the Company's needs to fund working capital, capital expenditures, debt service, and investment activities.

Critical Accounting Policies

A critical accounting policy is one which is both important to the portrayal of the Company's financial position and results of operations, and requires the Company to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying consolidated financial statements and related notes. In preparing these financial statements, the Company has made its best estimates and used its best judgments regarding certain amounts included in the financial statements, giving due consideration to materiality. The application of these accounting policies involves the exercise of judgment and the use of assumptions regarding future uncertainties, and as a result, actual results could differ from those estimates. Management believes that the Company's most critical accounting policies include:

Revenue Recognition

Revenues derived from implementation, training, support and base service license fees from customers accessing the Company's proprietary building performance software on an application service provider (ASP) basis follow the provisions of Securities and Exchange Commission Staff Accounting Bulletin (SAB) 104, *Revenue Recognition*. For these sources of revenues, the Company recognizes revenue when all of the following conditions are met: there is persuasive evidence of an arrangement; service has been provided to the customer; the collection of fees is probable; and the amount of fees to be paid by the customer is fixed and determinable. The Company's license arrangements do not include general rights of return. Revenues are recognized ratably over the contract terms beginning on the commencement date of each contract. Amounts that have been invoiced are recorded in accounts receivable and in revenue or deferred revenue, depending on the timing of when the revenue recognition criteria have been met. Additionally, the Company defers such direct costs and amortizes them over the same time period as the revenue is recognized.

Energy engineering and consulting services are accounted for separately and are recognized as the services are rendered in accordance with SAB 104. Sales of proprietary client services computer software solutions and hardware products are recognized when products are sold.

Lighting project revenues are reported on the percentage-of-completion method, using costs incurred to date in relation to estimated total costs of the contracts to measure the stage of completion. Original contract prices are adjusted for change orders in the amounts that are reasonably estimated based on the Company's historical experience. The cumulative effects of changes in estimated total contract costs and revenues (change orders) are recorded in the period in which the facts requiring such revisions become known, and are accounted for using the percentage-of-completion method. At the time it is determined that a contract is expected to result in a loss, the entire estimated loss is recorded.

The Company leases space in its income-producing properties to tenants and recognizes minimum base

Table of Contents

rentals as revenue on a straight-line basis over the lease term. The lease term usually begins when the tenant takes possession of, or controls the physical use of, the leased asset. Generally, this occurs on the lease commencement date. In determining what constitutes the leased asset, the Company evaluates whether the Company or the tenant is the owner of the improvements. If the Company is the owner of the improvements, then the leased asset is the finished space. In such instances, revenue recognition begins when the tenant takes possession of the finished space, typically when the improvements are substantially complete. If the Company concludes that the improvements belong to the tenant, then the leased asset is the unimproved space, and any improvement allowances funded under the lease are treated as lease incentives that reduce the revenue recognized over the term of the lease. In these circumstances, the Company begins revenue recognition when the tenant takes possession of the unimproved space. The Company considers a number of different factors in order to evaluate who owns the improvements. These factors include (1) whether the lease stipulates the terms and conditions of how an improvement allowance may be spent; (2) whether the tenant or the Company retains legal title to the improvements; (3) the uniqueness of the improvements; (4) the expected economic life of the improvements relative to the length of the lease; and (5) who constructs or directs the construction of the improvements. The determination of who owns the improvements is subject to significant judgment. In making the determination, the Company considers all of the above factors; however, no one factor is determinative in reaching a conclusion. Certain leases may also require tenants to pay additional rental amounts as partial reimbursements for their share of property operating and common area expenses, real estate taxes, and insurance, which are recognized when earned. In addition, certain leases require retail tenants to pay incremental rental amounts, which are contingent upon their store sales. These percentage rents are recognized only if and when earned and are not straight-lined.

Revenue from the sale of real estate is recognized when all of the following has occurred: (a) the property is transferred from the Company to the buyer; (b) the buyer's initial and continuing investment is adequate to demonstrate a commitment to pay for the property; and (c) the buyer has assumed all future ownership risks of the property. Costs of sales related to real estate are based on the specific property sold. If a portion or unit of a development property is sold, a proportionate share of the total cost of the development is charged to cost of sales.

Income-Producing Properties and Property and Equipment

Income-producing properties are stated at historical cost, and are depreciated for financial reporting purposes using the straight-line method over the estimated useful lives of the assets. Significant additions that extend asset lives are capitalized and are depreciated over their respective estimated useful lives. Normal maintenance and repair costs are expensed as incurred. Interest and other carrying costs related to real estate assets under active development are capitalized. Other costs of development and construction of real estate assets are also capitalized. Capitalization of interest and other carrying costs is discontinued when a project is substantially completed or if active development ceases. The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Property and equipment are recorded at historical cost, and are depreciated for financial reporting purposes using the straight-line method over the estimated useful lives of the respective assets.

Valuation of Goodwill and Other Intangible Assets

Goodwill and intangible assets with indefinite lives are reviewed for impairment on an annual basis or whenever events or changes in circumstances indicate that the carrying basis of an asset may not be recoverable. The recoverability of assets to be held and used is measured by a comparison of the carrying basis of the asset to the future net discounted cash flows expected to be generated by the asset. If an asset is determined to be impaired, the impairment to be recognized is determined by the amount

Table of Contents

by which the carrying amount of the asset exceeds the asset's estimated fair value. Assets to be disposed of are reported at the lower of their carrying basis or estimated fair value less estimated costs to sell. The most significant assumptions in the impairment analysis are estimated future revenue growth, estimated future profit margins and discount rate. The Company estimates future revenue growth by utilizing several factors, which include revenue currently in backlog, commitments from long standing customers, targeted revenue from qualified prospects, and revenues expected to be generated from new sales or marketing initiatives. The discount rate is determined by an average cost of the Company's equity and debt.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to be applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date.

Discontinued Operations

The Company adopted SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, effective in fiscal 2003, which requires, among other things, that the gains and losses from the disposition of certain income-producing real estate assets, and associated liabilities, operating results, and cash flows be reflected as discontinued operations in the financial statements for all periods presented. Although net earnings are not affected, the Company has reclassified results that were previously included in continuing operations as discontinued operations for qualifying dispositions under SFAS 144.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in the Company's market risk since April 30, 2006. Refer to the Company's Annual Report on Form 10-K for the fiscal year ended April 30, 2006, for detailed disclosures about quantitative and qualitative disclosures about market risk.

ITEM 4. CONTROLS AND PROCEDURES

Management has evaluated the Company's disclosure controls and procedures as defined by Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report. This evaluation was carried out with the participation of the Company's Chief Executive Officer and Chief Financial Officer. No system of controls, no matter how well designed and operated, can provide absolute assurance that the objectives of the system of controls are met, and no evaluation of controls can provide absolute assurance that the system of controls has operated effectively in all cases. The Company's disclosure controls and procedures, however, are designed to provide reasonable assurance that the objectives of disclosure controls and procedures are met. Based on management's evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective, as of the end of the period covered by this report, to provide reasonable assurance that the objectives of disclosure controls and procedures were met. There was no change in the Company's internal control over financial reporting that occurred during the period covered by this quarterly report on Form 10-Q that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, the reader should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in the Company's Annual Report on Form 10-K for the fiscal year ended April 30, 2006, which could materially affect the business, financial condition or future operating results. Additional risks and uncertainties not currently known to the Company or that the Company currently deems to be immaterial also could materially affect the Company's business, financial condition and/or operating results.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

At the Company's Annual Meeting of Shareholders, held on September 13, 2006, the shareholders voted upon and approved the nominees for the Board of Directors. The voting was as follows:

| | DIRECTORS | VOTES FOR | VOTES WITHHELD |
|--------------------------|-----------|-----------|----------------|
| Alan R. Abrams | | 2,903,824 | 269,448 |
| David L. Abrams | | 2,120,289 | 1,052,893 |
| J. Andrew Abrams | | 2,903,384 | 269,888 |
| Samuel E. Allen | | 3,066,472 | 106,800 |
| Gilbert L. Danielson | | 3,066,362 | 106,910 |
| Melinda S. Garrett | | 2,907,471 | 265,801 |
| Robert T. McWhinney, Jr. | | 3,067,412 | 105,860 |

ITEM 5. OTHER INFORMATION

On December 13, 2006, in consideration of the need to make more shares available under the 2000 Stock Award Plan for equity awards to motivate and retain key employees, the Company's Chief Executive Officer and Executive Vice President voluntarily elected to forfeit 37,500 and 12,500 stock option awards previously granted, respectively.

ITEM 6. EXHIBITS

31(a) Certification of Chief Executive Officer, pursuant to Rules 13a-14(a)/15d-14(a)

31(b) Certification of Chief Financial Officer, pursuant to Rules 13a-14(a)/15d-14(a)

32(a) Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes Oxley Act 2002

32(b) Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes Oxley Act 2002

Table of Contents

SIGNATURES

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

SERVIDYNE, INC.

(Registrant)

Date: December 15, 2006

/s/ Alan R. Abrams
Alan R. Abrams
Chief Executive Officer

Date: December 15, 2006

/s/ Mark J. Thomas
Mark J. Thomas
Chief Financial Officer