

# alphaDIRECT MANAGEMENT SERIES

JUNE 19, 2018

## IN FOCUS: CAPSTONE TURBINE CORP., AND ITS RECENT DEVELOPMENTS WITHIN THE AFTERMARKET SERVICE BUSINESS

This report focuses on Capstone Turbine Corporation (NASDAQ: CPST), and their recent developments within the aftermarket service business.



Source: [www.alphadirectadvisors.com](http://www.alphadirectadvisors.com)

### THE alphaDIRECT INSIGHT

Capstone offers an industry leading factory protection plan (FPP) that is unique in the small-scale distributed generation marketplace. In our opinion, this product is a critical factor in helping Capstone achieve its short-term and long-term financial goals. By offering aftermarket services, Capstone is able to generate a longer and more predictable revenue stream and cash flow from the service offering. We believe the current overall attachment rate is 37%, but certain markets are better suited than others. Specifically, the energy efficiency market has presented an exceptional opportunity for aftermarket services and has become a key segment for Capstone. Attachment rates in this segment are currently greater than 50%. Geographic expansion has also presented new opportunities, and this is especially true in emerging markets.

### CPST Business Snapshot

**HQ:** Chatsworth, California  
**Nasdaq Ticker:** CPST (NASDAQ)  
**Full Time Employees:** 151  
**Stock Price:** \$1.54\*  
**Market Cap:** \$99.708M\*  
**Website:** [www.capstoneturbine.com](http://www.capstoneturbine.com)  
 \*As of June 18, 2017



#### About alphaDIRECT Advisors

alphaDIRECT Advisors (ADA), a division of EnergyTech Investor, LLC, is an Investor Intelligence and publishing firm that creates and implements digital content and programs to help investors better understand a company's key drivers including industry dynamics, technology, strategy, outlook and risks as well as the impact they could have on the stock price. ADA's expertise encompasses a variety of sectors including Clean Transportation, Emerging EnergyTech, Energy Services, Smart Buildings, Solar, Water Value Chain and Industrial. ADA was founded by Wall Street veteran and research analyst, Shawn Severson, after seeing a significant shift in the investment industry that resulted in less fundamental research conducted on small cap companies and a significant decline in information available to all investors. ADA's mission is to bridge that information gap and engage companies and investors in a way that opens information flow and analytical insights.

To learn more, visit:  
[www.alphadirectadvisors.com](http://www.alphadirectadvisors.com)  
 or follow us on LinkedIn or Twitter.

## Participants

**Mr. Jeff Foster**  
**Senior Vice President, Customer Service**  
**Capstone Turbine Corporation**

Mr. Foster joined Capstone in 2013, initially serving as the Director of the Program Management Office (PMO). Mr. Foster joined Capstone from Exelis Inc. (originally ITT Corporation) where he was a Senior Director leading both a Business area with full P&L responsibility and a PMO. He holds a Master of Business Administration (MBA) from The Foster School of Business at the University of Washington in Seattle, is a graduate of the ITT Corporation Executive Leadership Development program at Ashridge University in the United Kingdom, is a Certified Six Sigma Black Belt, was a certified Project Management Professional (PMP)® from the Project Management Institute and is a U.S. Navy veteran.

**Mr. Shawn Severson**  
**Founder and CEO**  
**alphaDIRECT Advisors**

Mr. Severson is the founding partner and CEO of alphaDIRECT Advisors (ADA). He has over 20 years of experience as a senior research analyst covering the technology and cleantech industries. Prior to founding ADA, he led the Energy, Environmental and Industrial Technologies practice at the Blueshirt Group. Mr. Severson was frequently ranked as a top research analyst including one of the Wall Street Journal's "Best on the Street" stock pickers and multiple awards as Starmine's top three stock pickers.

## ABOUT CAPSTONE TURBINE CORPORATION

Capstone Turbine Corporation is the world's leading developer and manufacturer of clean-and-green microturbine power generation systems and was first to market with its high-efficiency air bearing turbine technology. Capstone has shipped thousands of microturbines to customers worldwide. These innovative and award-winning systems have logged millions of documented runtime operating hours and are compliant with current and future emissions regulations.

With over 97 distributors and Original Equipment Manufacturers (OEMs) worldwide, Capstone's low-emission microturbines serve multiple vertical markets with industry-leading reliability and efficiency. Capstone offers a comprehensive product lineup, providing scalable solutions from 30kW to 30MW. Capstone microturbines can also operate on a variety of gaseous or liquid fuels and are the ideal solution for today's distributed generation needs.

Capstone is a member of the U.S. Environmental Protection Agency's Combined Heat and Power Partnership which is committed to improving the efficiency of the nation's energy infrastructure and reducing emissions of pollutants and greenhouse gases. A DQS-Certified ISO 9001:2015 and ISO 14001:2015 certified company, Capstone is headquartered in the Los Angeles area with sales and/or service centers in the United States, Latin America, Europe, Middle East and Asia.



Jeff Foster, SVP, Customer Service

**Shawn Severson:** First, I would like to thank you, Jeff, for taking time to speak with us today. Today our focus will be on recent developments within your aftermarket service business. However, before we get started can you start by giving us a quick introduction of yourself?

**Jeff Foster:** Sure, I started at Capstone just over five years ago, in early 2013. I originally came in to run the Program Management Office (PMO). In that role, the achievement I am most proud of was the successful launch of our new Signature Series product line, which not only repackaged our microturbines into a modern, aesthetically pleasing, quieter and more robust enclosure, but also completely updated our C200 microturbine engine, improving both the performance and the reliability to meet the growing combined heat and power vertical.



Capstone's Signature Series Systems - Source: [www.capstoneturbine.com](http://www.capstoneturbine.com)

Prior to coming to Capstone, I spent 24 years in the defense industry with the last seven years in an executive position running a business area with full P&L responsibility. During that phase of my career, I worked in Operations, Engineering, Aftermarket, and PMO. Additionally, I served customers both domestically and in several international markets. Lastly, I am proud to say I am a military veteran, a six-sigma black belt and a Program Management Professional with

an MBA from the University of Washington, in Seattle.

I assumed my current role leading our Aftermarket Service business in late 2015, just as we were launching the new Signature Series, with the charter to both lead the update of our legacy microturbines, with the improvements developed during the Signature Series product development program, improving customer satisfaction with our products, and to continue to grow both the top and bottom line of our Service Business.

**Shawn Severson:** Thank you, Jeff. Could you start by giving us a brief overview of Capstone's aftermarket support and service business?

**Jeff Foster:** Absolutely. At Capstone we provide a number of state-of-the-art aftermarket products and services – including training, installation, commissioning support, aftermarket technical support, overhauls, upgrades, spare parts, service management tools and software for our Distribution partners, and lastly but very important is our industry-leading Factory Protection Program - referred to as our FPP. Over the past few years, as our Distribution partners have matured and grown their businesses, we are providing dramatically less direct Field Service activities. This has been part of our longer-term strategy to continue to move customer-touching functions to our distribution network, thereby improving customer intimacy and speed of support.

In support of this longer-term strategy, over the past year we have invested in our UK facility. This facility was in the past primarily

a field services hub where we deployed Capstone field engineers to provide direct support on-site to customers of our microturbine systems. As our Distributors have matured, adding their own field engineers (many of whom once worked directly for Capstone), we have retooled this facility through both capital investments and new personnel to be an EU-based remanufacturing and technical support facility.



Capstone's UK Remanufacturing & Support Facility.  
Located in Gosport, UK Source: [www.capstoneturbine.com](http://www.capstoneturbine.com)

Over the past year, we have added a logistics coordinator, test technicians, technical support engineers, and we have built up the first increment of an equipment remanufacturing capability, including local test capability. We have plans over the next few years to continue this investment, as it improves our support response times and saves us significantly on shipping time and costs, thereby continuing to improve our industry leading availability and customer satisfaction.

**Shawn Severson:** Can you talk about your standard factory protection plan (FPP) and how Capstone's aftermarket service offerings are different compared to what other service plans and contracts are offering customers?

**Jeff Foster:** We are very proud of our industry-leading FPP offering, as it really is unique in the small-scale distributed generation marketplace. The FPP is essentially an insurance program for customers that purchase our products. Capstone covers, through our Distribution partners, all scheduled and unscheduled maintenance activities – with no fine print and zero exceptions. All we need to ensure is that the product is being installed and used properly. This provides great peace of mind to our customers and significantly helps them when doing their operational planning, as the expenditures for maintaining this critical asset are fixed and level loaded over time. Additionally, the program ensures that scheduled maintenance activities happen on schedule, which further helps to ensure the product is running at peak performance. Much like an automotive consumer will be more likely to change their oil on time and with the proper replacement oil, if the service is already provided and paid for by the local car dealership. We provide two basic offerings; parts only FPP and a parts and labor FPP, each with different contract lengths to accommodate the range of users we see in the marketplace.

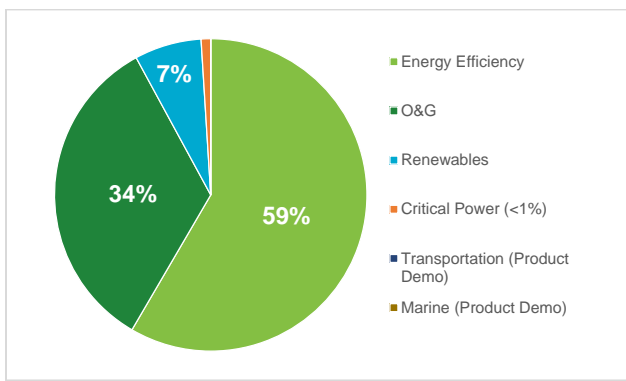
**Shawn Severson:** So, compared to last year when we spoke about Capstone's aftermarket service business, have you seen any meaningful shifts as far as which sectors are experiencing the best opportunities?

**Jeff Foster:** As you know, we do not provide guidance, but I can tell you that we have indeed seen a shift in the marketplace over the past year. As Capstone has continued to diversify both geographically and with an



increased Energy Efficiency market share, we have seen heavier adoption of the FPP. We have grown the FPP in double digits year-over-year for the past few years, even as we had seen the sale of microturbine product decline due to multiple significant macro-economic headwinds. Now as these headwinds have subsided and, in some cases, started to become tailwinds, we expect continued growth in product shipment and as a result the FPP business.

industrial customers, commercial buildings, etc.), typically prefer to have a “womb to tomb” purchasing and support model and are very big fans of the predictable life cycle costs. This feature really helps to sell our product. Capstone has reinvented ourselves, even during our macro-economic downturn, with a much broader market and geographical footprint and we can see the effects of this in our strong FPP growth. Additionally, we are seeing a high adoption rate in emerging markets, as these customers do not yet have the infrastructure in place to support indigenously, so they are very interested in our Distributor-led, factory-backed maintenance offering to ensure their critical power investments are always available.



FY18 Market Mix- Percentage of Shipments. Source: [www.capstoneturbine.com](http://www.capstoneturbine.com)

Additionally, this past year we began publishing Warranty Expiration Notices (WEN) and FPP Expiration Notices (FEN) to help our distributors manage this portion of their business. Of particular note, the FENs have shown a very high “follow-on sale” rate, signifying that the customers that have the FPP are very happy with the services provided and the peace of mind they get from having predictable maintenance costs.



Capstone's Signature Installation with iCHP. Source: [www.capstoneturbine.com](http://www.capstoneturbine.com)

**Shawn Severson:** Following up on my previous question, where are some of the best emerging sectors for aftermarket that investors should keep their eyes on?

**Shawn Severson:** Last year Capstone mentioned that oil and gas had been the most challenging sector and with the lowest attachment rate. Do you have any updates on the attachment rate since your long-term warranty program was launched as part of your efforts to expand and grow within this sector?

**Jeff Foster:** Most obviously, the Energy Efficiency market is the top adopter of the FPP, as these customers (hotels, hospitals,

**Jeff Foster:** Yes, you are correct in that historically we had seen a lower adoption rate for the FPP in our oil and gas market segment. However, we are now seeing that

begin to shift and change. For background, this market had traditionally been very self-sufficient with highly technical indigenous employees embedded on-site to support their high-tech products and based on the ever-changing demand for oil they were less inclined to sign a longer-term maintenance contract. However, over this past year, commodity costs and general inflationary pressures continue to grow, oil prices have stabilized, and Capstone has held our FPP pricing flat. This has brought the oil and gas customers back to re-evaluate the FPP program cost and benefits. In recent months we have signed a number of very large multi-MW FPP contracts with existing oil and gas customers, and we expect to sign more moving forward as they approach their overhaul cycle in the coming years.

**Shawn Severson:** Could you discuss the key growth drivers within this business segment?

**Jeff Foster:** The key to getting a customer to put a long-term maintenance contract in place is to do it as close to the point of sale as is possible. Although, we are now seeing adoption of the FPP in oil and gas, as noted in my last response, five years after initial purchase of the product due to the great ROI people are seeing in the offering, it is always more difficult to re-visit this years down the line. It is particularly difficult when the customer has had little or no maintenance issues with the microturbine product. Like any extended warranty or insurance policy, it is easiest to sell at the time of product purchase and its value is always underappreciated until it is needed.

The other key driver is when customers realize that by signing a long-term factory

backed FPP they are now on the same side of the ledger, as both the factory and the customer benefit from the positive performance of the microturbine and both suffer to different degrees by poor performance. This is 180 degrees from the traditional razor and razor blade model employed by most of our competition as they benefit and profit from poor performance of the product after the expiration of the one-year standard warranty. At the end of the day, Capstone wants to be long-term distributed energy partners with our customers and be in full alignment from a product performance perspective.

**Shawn Severson:** Can you expand a bit on how your strategy to engage customers in long-term maintenance partnership at the time of sale (or after the manufacturer's warranty expires)?

**Jeff Foster:** We are very excited to now be offering the FPP bundled at the point of initial sale with the microturbine system. By bundling these two, we can secure long-term relationships with customers, ensure critical maintenance activities are occurring as planned, and lastly there is working capital benefits to Capstone, as these plans are purchased and paid for at the time of sale, providing Capstone with critical cash flow to help continue to grow our business. As with any insurance-type of program, the larger the pool of insured, the better we can manage the customer-to-customer risk, thereby helping us to continue margin growth in the aftermarket.

**Shawn Severson:** Can you provide us with an update on the aftermarket business impact on margins and the percentage of

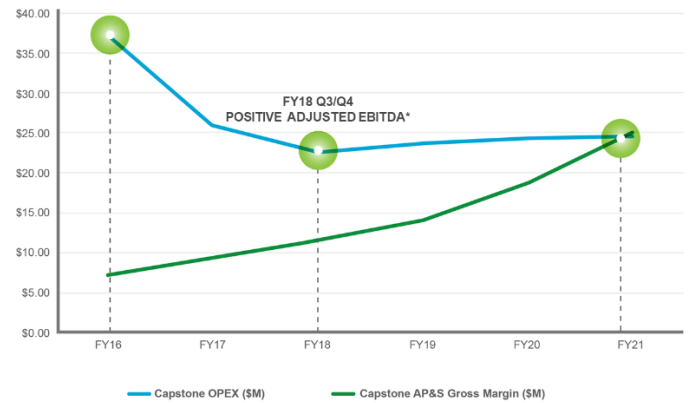
revenue it represents today and how this changed at Capstone over the past year?

**Jeff Foster:** We are very pleased with the progress on improving the margins in the aftermarket. In FY18 Q4, we reported greater than 45% gross margin in the aftermarket for the first time ever. As our FPP business grows, this highlights the potential for a continuing sustainable margin in the aftermarket business. Our FPP revenue stream is very predictable – but I need to point out that the quarter-to-quarter costs can be a bit lumpy as regularly scheduled maintenance actions can create some significant variance (i.e. a large site working its way through the system). However, over the long-term, we see the margins expanding and we are targeting 50% gross margins for the aftermarket business for the long-term. This means that with \$10M in quarterly aftermarket revenue, we will be absorbing the operating expenses for all of Capstone. This is our target over the next couple of years.

**Shawn Severson:** What are the next upcoming milestones/targets that investors should look for?

**Jeff Foster:** The aftermarket business revenue and margins on a year-over-year basis are good indicators. On a quarter-to-quarter basis, these can look better or worse based on a number of variables including service work in the pipeline or the somewhat seasonal buying from customers. In FY18, we for the first time exceeded \$9M in quarterly aftermarket revenue and 45% gross margin, and our next milestone will be \$10M and 50% gross margin. Again, I expect this will not be linear from a quarter-to-

quarter basis, but we will see the growth in both revenue and margin year-over-year.



Aftermarket Gross Margin/OPEX Absorption Timeline - Source: [www.capstoneturbine.com](http://www.capstoneturbine.com)

Lastly, we will be more regularly posting press releases for major FPP contract awards and/or new product awards with bundled FPPs. Additionally, as we are trying to be as transparent as possible with the investor community especially as we enter this period of expected growth, we have become much more active on social media these days. So I highly recommend to those that are interested in Capstone's products, aftermarket business and overall company activity, to follow us on Twitter at @CapstoneTurbine or @Darren\_Jamison.

**Shawn Severson:** Lastly, what do you see as the biggest risks or challenges to executing your long-term strategy for the aftermarket business?

**Jeff Foster:** Well, we have seen significant benefits from the expansion of our UK facility so we are watching the BREXIT process closely, as this facility is providing much value to our bottom line right now. We do not expect BREXIT to pose a significant threat at this time, but we will monitor the process moving forward.

Second is that we have made substantial investments in both the Distributor sales and support model. We feel this model allows us to grow significantly faster than if we were needing to make all of the capital investments ourselves. We have a model distributor program and the distributors that have aligned themselves with this model (i.e. E-Finity whom you spoke with last time) have seen the best customer satisfaction and the highest growth rates.

Distributor management, maturity, investment, and growth are key areas of focus for us over the next year, as we are constantly evaluating them against our model distributor program through the use of Key Performance Indicators (KPIs).

**Shawn Severson:** Thank you very much for your time today, Jeff. We look forward to another conversation with Capstone in the near future.

**Jeff Foster:** Thank you. I very much appreciated the opportunity to share our aftermarket business with you.



## SHAWN SEVERSON FOUNDER AND CEO

Mr. Severson founded *alphaDIRECT* Advisors (ADA), a division of EnergyTech Investor, LLC, in 2016 after seeing a significant communication and information gap developing between companies and the financial community. Mr. Severson has over 20 years of experience as a senior research analyst covering the technology and cleantech industries. Previously, he was Managing Director at the Blueshirt Group where he was the head of the Energy, Environmental and Industrial Technologies practice. Prior to the Blueshirt Group, Mr. Severson was at JMP Securities where he was a Senior Equity Research Analyst and Managing Director of the firm's Energy, Environmental & Industrial Technologies research team. Before joining JMP, he held senior positions at ThinkEquity, Robert W. Baird (London) and Raymond James. He began his career as an Equity Research Associate at Kemper Securities. He was frequently ranked as a top research analyst including one of the Wall Street Journal's "Best on the Street" stock pickers and multiple awards as Starmine's top three stock pickers.



## DISCLOSURE

*alphaDIRECT* Advisors (ADA), a division of EnergyTech Investor, LLC, is an Investor Intelligence and Publishing firm, not a licensed broker, broker dealer, market maker, investment banker, or underwriter. This report is published solely for informational purposes and is not to be construed as an offer to sell or the solicitation of an offer to buy any security in any state. This is not a complete analysis of every material fact regarding any company, industry or security.

ADA may offer its opinions in its articles, reports and interviews concerning featured companies, or the business spaces and market segments in which they operate. Any opinions are provided solely for the general opinionated discussion of its readers and viewers, and therefore should not be considered to be complete, precise, accurate, or current investment advice, and all investment decisions are solely the responsibility of the reader.

A fee has been paid for the sponsored material contained herein (the "Sponsored Materials"), by the indicated Company. Additionally, ADA may perform consulting or advisory services for Companies that ADA produce and publish Sponsored Materials for.

The Sponsored Materials are not and should not be construed as an offer to sell or the solicitation of an offer to purchase or subscribe for any investment. No information in the Sponsored Materials should be construed as individualized investment advice. A licensed financial advisor should be consulted prior to making any investment decision. ADA makes no guarantee, representation or warranty and accepts no responsibility or liability as to its accuracy or completeness of the Sponsored Materials.

ADA assumes no warranty, liability or guarantee for the current relevance, correctness or completeness of any information provided. Furthermore, we assume no liability for any direct or indirect loss or damage or, in particular, for lost profit, which you may incur as a result of the use and existence of the information, provided within the Sponsored Materials. We may distribute our reports through other organizations or companies.

The ADA content may contain "forward-looking statements," as that term is used in the federal securities laws. Forward-looking statements may be identified by words such as "expects," "objective," "intend," "targeted," "plan" and similar phrases. These forward-looking statements are subject to numerous assumptions, risks and uncertainties described in the Companies' filings with the Securities and Exchange Commission that may cause the Companies' actual results to be materially different from any future results expressed or implied in such statements.

The Companies caution readers not to place undue reliance on these forward-looking statements, which speak only as of the date of the release of the investor content. The Companies undertake no obligation, and specifically disclaim any obligation, to release any revisions to any forward-looking statements to reflect events or circumstances after the date of the release or to reflect the occurrence of unanticipated events.

[WWW.ALPHADIRECTADVISORS.COM](http://WWW.ALPHADIRECTADVISORS.COM)