Tecogen Inc. [TGEN]
Third-Quarter 2016 Earnings Conference call
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Company Participants:
Ariel Babcock; Director, IR
John Hatsopoulos; Co-CEO
Benjamin Locke; Co-CEO
Robert Panora; President and COO
David Garrison; CFO, Secretary and Treasurer

Analysts and Investors:
Sameer Joshi; Rodman & Renshaw
Amit Dayal; Rodman & Renshaw
Alex Blanton; Clear Harbor Asset Management
Michael Zuk; Oppenheimer & Co.

Presentation:

Operator: Good morning and welcome to the Tecogen third-quarter 2016 earnings conference call. (Operator Instructions) There will be an opportunity for you to ask questions at the end of today's presentation. (Operator instructions) For your information, this conference is being recorded.

A recording of this conference call will be available for playback approximately one-half hour after the end of the call and will remain available until Thursday, November 17, 2016. Individuals may access the recording by dialing 877-344-7529 from inside the U.S., 855-669-9658 from Canada, or 412-317-0088 from outside the US. Enter the replay conference number, 10094780, followed by the pound sign.

Now I would like to introduce Ariel Babcock, Tecogen's Director of Investor Relations.

Ariel Babcock: Thank you. Good day, and thank you all for joining us on our third-quarter earnings conference call.

Speaking on the call today are John Hatsopoulos and Benjamin Locke, our Co-CEOs. Also joining us today with prepared remarks are Robert Panora, our President and Chief of Operations, and David Garrison, Tecogen's Chief Financial Officer.

During the call, we will be referencing slides posted on the Investor Relations section of our website at tecogen.com.

Before we begin, I'd like to remind you that this presentation includes forward-looking statements within the meaning of Section 27A of the Securities and Exchange Act of 1933, and

Section 21E of the Securities and Exchange Act of 1934. Such statements include declarations regarding the intent, belief, or current expectations of the Company and its management team.

Prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve a number of risks and uncertainties that can materially and adversely affect the actual results as identified from time to time in the Company's SEC filings. Forward-looking statements provided here-in are as-of the specified date and not reaffirmed or updated at any time.

I will now turn it over to John, Co-CEO, for some opening remarks. John?

John Hatsopoulos: Ariel, thank you very much. Ladies and gentlemen, I'd like to take pride and thanks to the team headed by Ben Locke and Bob Panora for the wonderful success they're making of Tecogen, it appears, and I hope it's going to continue for years to come.

With that, Ben can give you a heck a lot better information than I can. With that, I'd like Ben Locke to take over.

Benjamin Locke: Thanks, John. So I'd like to start off the call by reminding those who may be new to the Company about Tecogen's core business model as shown on slide 4: heat, power, and cooling that is cheaper, cleaner, and more reliable. Our proprietary technology for improving efficiency, emissions, and grid resiliency is truly disruptive to the traditional methods of heating, cooling, and powering buildings and infrastructure. Tecogen's clean energy technology has been revolutionizing distributed generation for residential, commercial, and industrial customers for over two decades.

This is an exciting time for Tecogen and our shareholders. The third quarter of this year saw Tecogen achieve several important milestones. It will set the stage for long-term success of the Company.

Turning to slide 5, first and most significantly, we obtained not only cash flow positive results for the quarter, but achieved profitability of just over $200,000, and as I'll detail later in the call, we achieved this through significant margin improvements, not just through increased revenue.

Second, as announced last week, we entered into an agreement to acquire American DG Energy which, subject to shareholder vote and SEC approval, will create a vertically-integrated merged company with dependable, annuity-type revenues from ADG assets, adding to the existing revenue streams of Tecogen. I will address the key areas of importance of the merged company in just a few minutes.

And lastly, we made great progress with regard to our Ultera emissions technology. We received research grant funding from the Propane Council to demonstrate the viability of our emissions technology and fork trucks. This program, which is not part of the ULTRATEK automobile project, aims to develop a retrofit emissions system for fork trucks to reduce their emissions to levels acceptable for air quality and indoor work environments. This work will build off of and supplement ongoing activity within ULTRATEK emissions technology project.

Also, we obtained air permits for our Ultera retrofitted standby generators in the South Coast Air Quality Management district. This district has the strictest emissions regulations in the entire country, if not the world, and once source tests are complete, we'll be the first natural-gas engine to be permitted under these strict emission limits. Bob will provide more detail on both these endeavors later in the call.

So on slide 6, I'd like to go in a little detail and point out the key developments that have allowed our sales team to become successful for this quarter, and expecting success through the fourth quarter and into 2017.

First, we are seeing very positive reception of our newest product offering, the InVerde e+ in our new equipment monitoring package built around GE Equipment Insight. The new e+, with improved efficiency, better economics, quieter operation, lower turndown, and rapid black start for emergency standby capability, along with other improvements, reinforces our goal of providing customers with the most advanced clean energy technology available. There are no other engine-driven CHP systems in our class that could match these attributes.

Next, our cloud-based monitoring capability, using the GE Equipment Insight system, allows both customers and our Tecogen service experts the ability to monitor and analyze equipment performance in real-time. It also gives customers a portal and dashboard to instantly view savings and operating metrics reinforcing the equipment's value proposition.

Turning to sales, we are continuing to see strong repeat business with our core project partners. These partners are a mix of mechanical and/or electrical contractors, ESCOs, property management companies, and visionary project developers that see the benefits of our advanced CHP systems and microgrid technology over any other type of system.

A new market for our gas engine-driven chillers is also emerging. The advent of indoor growing facilities for new markets, such as medical marijuana and hydroponic growing facilities has stimulated the need for chillers that do not require significant amount of expensive three-phase power for large electric chillers. And because of our clean emissions from a CO and NOx standpoint, the CO2 exhaust from our engines can actually be piped into the growing area which accelerates the growth rate of the plant and eliminates the need for growers to purchase expensive canisters of CO2 currently used. While we did not ship many chillers in the third quarter, we currently have 10 chillers and heat pumps in our backlog with many more projects in the development stages.

Similarly, we're seeing increased awareness in sales of the products offered through our joint venture, TTcogen. Initial sales are focused around the smaller 35 kW CHP system, but as we build new relationships and expand existing relationships, we expect to see increased sales of the large megawatt systems, as well as sales in the biogas applications, which were not possible with the existing Tecogen equipment.

Turning to slide 7, I'll review the key financial metrics for our Company; revenues, margin, and sales backlog. Our revenues were a little over $6.6 million for the quarter compared to $4.7

million in the third quarter of last year. This revenue increase is due to a 53% growth in product sales over the prior-year quarter, primarily attributable to increased cogeneration sales. We also saw a 34% increase in service revenues over the prior-year quarter. Our gross profit for the quarter was approximately $2.77 million compared to $1.67 million for the third quarter of 2015.

Operating expenses for quarter decreased 2.6% from the third quarter of 2015 to a little over $2.5 million in keeping with our goal to deliver full-year operating expense near $10 million. We continue to believe our effort to keep OpEx contained is paying off, and we are on track to reach this goal.

All of these improvements contributed to an increase in our overall gross margin to 41.9% compared to 35.7% in the third quarter of 2015. This is well above management's targeted range of 35% to 40% gross margin, and it is a direct result of product enhancements, manufacturing efficiencies, and overall cost-saving measures.

And most importantly, as I've previously mentioned, we achieved the bottom line positive net income of just under $208,000. This milestone is a result of substantial effort by management to get better performance out of every aspect of our business, from sales to service, manufacturing to engineering, we have put Tecogen in the position for continued success going forward.

Moving on to backlog on slide 8; backlog at the end of the third quarter was $11.4 million, and as of Monday, November 7, backlog of products and installations was at $13.1 million, well above management's goal of maintaining backlog above $10 million. Note that this backlog is for Tecogen products only, and does not include service, nor does it include any orders received by TTcogen for TEDOM products. The backlog for TTcogen is starting to grow, and we expect to give more detail on it in the coming quarters as it becomes material to Tecogen revenues.

Dave will give some more details on the financials in a few minutes, but needless to say, we are pleased with the results of the quarter and hope to build on it in the coming quarters.

Turning to slide 9, I'd like to now discuss the recent announcement of Tecogen's acquisition of American DG in a stock-for-stock merger. As many of our investors know, American DG has been a customer of Tecogen's equipment and maintenance service since they were spun-out in 2005. Since then, ADG has grown their North American fleet to 92 systems totaling 5,445 kW of installed capacity with total approximate lifetime contract value of $203 million.

In 2015, ADG undertook an initiative to scale back on short-term growth plans and focus on improving operation and profitability of their existing fleet with the goal of optimizing margins, improving cash flow, and overall stabilization of their balance sheet. As a result, as ADG's past few quarters indicate, and further emphasized by the results released this morning, ADG has made tremendous improvements along these lines.

Many of the improvements in ADG's operations were a direct result of more interaction with Tecogen engineers and ADG operations from early 2015 to now to help diagnose and fix their fleet. In the past, Tecogen service technicians would just provide maintenance on the CHP units and were not involved in the engineering and operations of their systems. In 2015, ADG began

outsourcing the complex engineering and diagnostics of their systems to Tecogen. As a result, through the dedication and the reinvigorated efforts of the ADG staff, the fleet has made tremendous strides. While there is still more that can be done to further improve the ADG fleet, it became clear that the synergies between the two companies were compelling, and the prospect of a merged company became a priority for Tecogen.

As detailed in the press release last week, both Boards of Tecogen and ADG unanimously approved a definitive agreement where each share of American DG stock will be exchanged for 0.092 shares of Tecogen stock pending stockholder and SEC approval. We see four areas that the merger will benefit both Tecogen and ADG shareholders.

First, there are many areas for operating costs improvements such as duplicative auditing and corporate expenses. The merger will also allow far more efficient service of the ADG fleet. For example, in the past, a Tecogen technician would travel in a Tecogen vehicle to the site to perform maintenance on the CHP unit and a separate ADG technician, in a ADG vehicle, would travel to the site to perform maintenance on what's called balance of plant, which is the ancillary heat exchanges, pumps, and other equipment ADG maintains to keep its system in good working order. The merged company will allow more efficient deployment of service technicians from a time and travel standpoint.

Similarly, having a consolidated inventory will improve purchasing economics and shipping costs. We expect to identify other areas for operational and administrative cost savings as we move forward with the integration.

A second aspect of the merger will have a beneficial impact on Tecogen's financials of the associated deprecation values of each site. Currently ADG has very good cash flows and margins from their fleet, but because of depreciation, the financial picture is not compelling. When the merger occurs, an asset re-evaluation will occur, which will significantly decrease the depreciation expense on the fleet. So on Tecogen's books, the fleet will have much healthier financials than they did on American DG's books.

Third, with full control in effect, Tecogen can now contribute even more technical guidance and engineering effort to improve site operation and profitability. We anticipate even better cash flows from the ADG fleet and already dramatically improved cash flows we have seen in the past quarters.

Last, and most compelling, is the steady, predictable revenue streams that Tecogen will have from the ADG fleet. This revenue stream, along with our steady service revenue stream, will help dampen the ebbs and flows of the sales cycle to provide a more predictable cash flow and financials for the Company. As the press release indicated, on a combined basis, approximately half of the Company's annual revenue is expected to be from stable, long-term, contracted sources.

In conclusion, we believe that the acquisition of American DG will substantially enhance Tecogen's prospects going forward as a vertically-integrated, technically-advanced company.

I'd like to now turn it over to Bob for more discussion on our progress with the Ultera emissions technology, followed by Dave, who will give some more details on the financials. I will then wrap up with some final remarks before we take questions. Bob?

Robert [Bob] Panora: Good morning, and thank you, Ben. I will be updating listeners on the technology developments today in three areas. First, I will discuss our progress of bringing online, the special generators in Southern California that were retrofitted with the Ultera emission system, (inaudible) that our customer could operate these units without annual, hourly limitation. Second, I will discuss the research grant award to Tecogen last month from the Propane Industry for adapting Ultera technology to propane-fueled fork trucks. Lastly, I have an update regarding the progress made by a subsidiary [sic – joint venture affiliate], ULTRATEK, in the automotive application of Ultera.

In our previous earning reports, we discussed a SoCal project that concerned a customer owning a group of natural-gas fuel generators that need to be operated frequently. As the run hours exceed the maximum allowed for emergency generators, the units must meet the standard for continuous-power generation. These are the same standards as our cogeneration products where we have [been] successfully permitted, however, the simple generator receives no heat recovery credit in sending its emissions level under the standard. As such, the emissions levels required to meet these engines are the lowest we are aware of anywhere, and have not yet been achieved by any engine.

As reported before, a sample generator was purchased in 2015 and updated at Tecogen with the Ultera system. It worked extremely well, and the customer proceeded to apply for permits for this test generator and also for their existing on-site units that would be retrofitted. Last October, the phase-two order was received for Tecogen to ship the test generator to the customer and complete the retrofit of the others. The PO was for about $500,000. The test generator and retrofit kits were shipped in Q4 of last year.

Events unrelated to the project, however, delayed the program for the first part of this year. However, the delay now has ended, and the project is, again, proceeding in earnest. We are pleased that the generators have received their permits to operate, as Ben said, and we will be proceeding with on-site retrofit work over the next few months. The operating permits require a third-party source test to be completed within 180 days of commissioning. The customer will schedule that, the order and timing of the test, but we would anticipate the generator that was shipped from our factory, already fully-equipped with the Ultera system, to be the first on that schedule, most likely in Q4.

I want to reiterate the significance of the successful outcome of this program. Achieving these limits, essentially the same as the fuel cell, will enable simple generators to be applied without hesitation to demand response in peak-shaving applications, an important milestone for the Ultera technology.

Moving on to our October 18 announcement regarding fork truck application with Ultera; as announced, the Propane Education & Research Council, PERC, has provided the Company with a research grant to demonstrate Ultera emissions reduction capability in a propane-fueled fork

truck. I want to point out that the technology rights for the fork truck application reside with Tecogen, and we're specifically excluded from our agreement with our automotive-focused subsidiary [sic – joint venture], ULTRATEK.

The project has significant benefit potential for this industry as these vehicles generally operate indoors where health concerns are magnified. In recent years, the market share for propane trucks has been eroded by battery-operated versions, to a large extent, because of this [emission] issue. This market launch has occurred despite significant disadvantages of the battery systems. That is, they are more costly and often unable to operate a complete full shift because of energy storage limitations.

We have received strong interest from the industry and have obtained written commitment from two leading manufacturers to work with us in a development effort. The program will start in the beginning of 2017, and is scheduled to be completed in nine months. Our task at hand is to demonstrate the emissions impact of a fork truck equipped with the Ultera device. The truck will be supplied by one of the partners. The work will be completed at the Tecogen facility in Waltham, and again, it should complete in nine months.

I want to mention that the market size for propane trucks is approximately 70,000 units per year in the United States, and that's the propane ones. The electric ones are also pretty close to that number, and of course, worldwide, it's a very big market.

ULTRATEK is the next topic that I want to cover. ULTRATEK is, of course, the 50%-owned Tecogen subsidiary [sic – approximately 43% owned joint venture affiliate], formed in January, whose purpose is to demonstrate the emissions after-treatment process on gasoline-powered vehicles. This work has been funded primarily by strategic investors in Europe, and of course, this relates [to] the heightened awareness of pollution brought on by the Volkswagen scandal.

In our last call, and the one previous, I pointed out that this story has not subsided and that it was still actively being reported. That assessment remains accurate today as the follow-up continues with major developments being reported, even in the last week. For the Ultera process to fit, of course, it's a gasoline engine, as I said before, this category has not been implicated in any improper testing, however, there is a (inaudible) that said that pollution output measured in a controlled laboratory-drive cycle significantly [under]represents the true emissions output of vehicles of this type of real-world driving.

As such, there is an expectation that the certification process will be altered in some aspect to correct this shortcoming. The Ultera strengths are well-suited to this issue because the system provides robust performance, especially in the extreme edges of operation; that being high acceleration, deceleration, heavy loading, and so forth.

Recently, we were made aware that our assessment that the shortcomings of existing certification methods would eventually be modified to include some sort of supplemental on-road testing was, indeed, validated. In fact, over the next few years, the EU certification will phase in a portion of the process to include on-road testing. The test protocol specifically applies to the EU 6c

emission regulation which will implement real-driving emissions, or RDE, in 2017 to 2020 timeframe.

A Reuters news story from October 14 articulates the distress the RDE protocol will cause automakers; General Motors, Renault, and Volkswagen. These makers have announced that they're highly-advanced small engines, both diesel and gasoline, may not be viable when subject to the RDE test. This will result in a return to larger, less efficient engines that are less susceptible to the emissions irregularities that would be exposed by RDE.

Thus, we are encouraged by this development as it sets a highly-positive regulatory environment for our technology without requiring a special effort on our part. We are hopeful that the RDE-type of protocol will be incorporated into our domestic certification process at some point.

During our last call, I discussed that we would be in the second phase of vehicle testing in AVL involving two vehicles, one with European emissions package, not sold here; the other European but with a U.S.-certified emissions system. The testing was completed as scheduled, just wrapping up at the end of October. We were successful in accomplishing our goals for the second phase.

The Ultera device was fine-tuned and more accurately sized for the test vehicle, providing us with excellent documentation of the system's effectiveness through a wider range of simulated driving conditions. We were able to showcase its effectiveness with the type of vehicle highlighted in the Reuters news story as being problematic; a very small, high-powered density engine vehicle, featuring a very small, high-density engine, with these advanced features for fuel economy.

We have scientific paper related to our ULTRATEK project in process, specifically, two abstracts appeared several months ago, were accepted by the Society of Automotive Engineers, or SAE, as topics for upcoming conferences in early 2017. The data from this second-phase testing was included and highlighted, in fact, in the first paper draft submitted last week for the SAE peer review. That paper will be for an April conference. We will provide our draft [for] the second conference later this month.

With the second-phase completion and the SAE papers, we will have a solid foundation to move forward to engage the industry, and we look forward to updating you on our progress in the future.

That concludes my discussion. I'll turn the call now to Dave Garrison to discuss the financial parts.

John Hatsopoulos: Bob, before you -- this is John Hatsopoulos. Maybe you should mention how much cash we have in this partnership, so people don't worry that we'll run out of money.

Robert Panora: I wish I had the number, exact, but it's roughly $12 million, something like that that's still on-hand, yes.

John Hatsopoulos: So, we are very well capitalized.

Robert Panora: Yes.

John Hatsopoulos: That's the point I was trying to make. Thank you.

David Garrison: Thanks, Bob. Here's some highlights from the year-on-year financial results. Total revenues increased 41% compared to the same prior-year period and 16% on a sequential basis. Product revenues grew 53% compared to the same prior-year period and 18% on a sequential basis. The volume of the cogeneration modules showed steady growth, with a special increase in the new InVerde e+ modules.

Total service revenue continued its steady growth delivering well over half of our revenues for the quarter. The Company posted a 10% increase in service contract and parts revenues on a year-over-year basis. This increase was the 15th consecutive quarter of year-over-year quarterly contract service revenue growth. Year-over-year comparisons adjust for the seasonality of that Tecogen service revenue. These long-term contracted maintenance and service agreements accounts for nearly one-third of the total Company's revenue providing a reliable annuity-like revenue stream.

Cost of sales in products realized many benefits from the improvements implemented with the e+ line of InVerde. The new product has cost-effective manufacturing processes that will further reduce costs with continued growth and volume.

Service costs continued improvement as the installation group focused on higher value-added services coupled with operational efficiencies from our maintenance and service experts.

With combined gross margins of over 40% and product margins at 40%, management is at the high point of our target range and the highest quarterly gross margin achieved since the start of public reporting in 2013. Gross margin improvement and expense reduction programs continue as management focuses on maintaining these strong margins in the future. And of course, to note, we were profitable for the first quarter since public reporting began in 2013 as well.

Looking at the graphic charts that we track our metrics; starting with the chart in the upper left-hand corner, total revenue for the trailing four-quarter period is $21.6 million, a year-over-year decline. While the quarterly revenues have been improving over the past nine months, we expect the recent growth cycle to continue into next year, and in the longer term, benefiting from our other joint venture initiatives.

The chart in the upper right illustrates the growth in our gross margin. As you can see, on a trailing four-quarter basis, management delivered a gross margin of 38%, solidly in our targeted range of 35% to 40%. We expect cost controls and sales initiatives to continue to deliver margins growing to the top of that range.

In the lower right is a chart of our operational expenses. Management's effort to lower operating expenses has been producing results. Our goal of delivering approximately $10 million in operating expense for the full year remains solidly in place.

Finally, in the lower left, the backlog chart plots our weekly backlog, currently at $13.1 million as of Monday, November 7. This backlog is well ahead of management's goal to exceed $10 million in product and turnkey service revenue. As a reminder, backlog does not include the service contract revenues or the sales of TEDOM products by the TTcogen team.

The targets of the Company remain the same. Management works to meet its goal to continue delivering gross margins in the 35% to 40% range, maintain a backlog of product and installation sales above $10 million, and deliver stable operating expenses of approximately $10 million on a 12-month basis.

And with that, I turn it back to Ben Locke for closing remarks.

Benjamin Locke: Thanks, Dave. In closing, I'd like to thank Tecogen shareholders for the dedication and patience as we shape the Company for future success.

I'm encouraged by the accomplishments we've all achieved in all aspects of our business. We have a great team of engineers, service technicians, sales professionals, and business leaders that have contributed to reaching the success our shareholders expect.

Going forward, we expect to build on the achievement of the third quarter. Our relationships with strategic partners for the CHP projects are strong and will continue to contribute repeat sales. No other CHP products can provide the technological innovation and economic savings of our products. Our reputation and history, as a provider of reliable power and turnkey installation and service of CHP systems is unmatched.

Our [addressable] markets quadrupled with the addition of TTcogen equipment and additional chiller market applications. We have substantially improved our operating expenses in cost of goods sales which has improved our product margins. We have reached an agreement with American DG to acquire a fleet of assets that provide a steady, reliable stream of cash generation for many years going forward.

And lastly, we are positioning Tecogen to maximize the potential of our Ultera emissions technology, whether it be through our stationary engine retrofit projects as evidenced by our South Coast air permit success, our PERC-funded fork truck program which had clear, defined channels to commercialization, or our ULTRATEK automotive joint venture with game-changing economic and environmental impacts. It is clear that our patented emissions technology will ultimately contribute substantial financial gains for the Company going forward.

As I stated at the beginning of our call, it's a great time to be a Tecogen shareholder. I'm excited to welcome American DG shareholders to our family when we finalize the merger approval process.

Lastly, we owe much of our success to the vision and insightfulness of our founders, John and George Hatsopoulos, who have personally invested and guided us so we can reach this point. Without their perseverance, we would not have reached the milestones we outlined today.

With that, I'd like to turn it over to the operator for questions.

Questions & Answers:

Operator: (Operator Instructions) Sameer Joshi; Rodman & Renshaw.

Sameer Joshi: Good morning, guys, and congratulations on a great quarter. As far as the American DG merger goes, do you expect any regulatory challenges for ultimately closing the deal?

John Hatsopoulos: We really don't. We haven't had any pushback from anybody up to now. We think -- unfortunately, it's a 40-page filing with the SEC, but after that, hopefully we'll be well on our way.

Sameer Joshi: Okay. In terms of revenues, should we expect chiller revenues to be lumpy, or do you expect them to be low going forward because it has been lumpy, as you know, but going forward, do we expect them to be at this level?

Benjamin Locke: The chiller revenues, they follow a seasonal cycle. Most folks want to get their chillers replaced before the cooling season starts in April/May timeframe. So the smart ones gets their orders in the fourth quarter, and then the guys that drag the heel, get their orders in the first quarter, and then, of course, rush to get them in. So it's lumpy in that aspect, Sameer.

We see the trickle of orders start to come in the third quarter. We typically see a fair amount in the fourth quarter. As I mentioned, we've got a bunch in the backlog already. The intent is to get them built, tested, and delivered, so they can be installed by the cooling season. That's for the northeast, but in California, it is a little more steady, but that's generally your answer there.

Sameer Joshi: As far as the fork truck opportunity goes, how close are you to revenues? I know it is just the beginning for you, given the PERC funding, but after nine months, do you think you will actually have one of these partners that you're working with that would like to receive orders from them?

Benjamin Locke: I think it certainly is too soon to tell. Bob and his team are looking forward to getting the project done with PERC, and one aspect of the project that is exciting, as Bob mentioned, we did receive letters of support from two fork truck manufacturers, and we're going to get a fork truck from one of them. So that allows us for a lot of interaction with them as the testing goes on.

If we're successful, presumably we'll be able to talk with them about some type of business arrangement, but what that might look like it's too early to tell right now.

Sameer Joshi: One last one from me; as far as the European regulatory market for RDE is concerned, how quickly do you think, maybe 2017 to 2020, but when do you see yourself being a player in that sector?

Robert Panora: Again, this is Bob Panora, thanks for the question. I think it's a little too early to tell as well. And the answer really unfolds with deeper conversations with suppliers and we're not there yet. But I think the fact that they're going to be faced with this problem, I think will help a lot with the interest. Then we'll see where they have the biggest problems, but we really haven't got to that point yet, so it's hard for me to say.

Benjamin Locke: I would say that it's been a stated objective of ULTRATEK to get the data and have an unassailable compilation of that data. And working with AVL is part of that strategy. They're a very reputable automotive testing facility.

The SAE paper is a significant validation that our data will be accepted, because the most important aspect, as you might imagine, in approaching any type of business arrangement with this, whether it's with an automobile manufacturer or a component supplier, the most important thing is to make sure our data is unassailable and verified by all accounts.

So that's the task at-hand for Bob, and they've done an admirable job getting there thus far, and I think 2017 is going to be an exciting time as we start to consider the business arrangements for ULTRATEK.

John Hatsopoulos: One thing I want to add to this is that this, and I know how we've said it before, but I'm repeating it to remind everybody, that this technology is fully patented and insured by Lloyds of London. So, it's not as if companies can go and copy us, and tell us, like they did years ago at Thermo Electron, sue us, you'll run out of money. In this case, it's Lloyds of London to run out of money, so we're fully protected on our patents and our technology.

Sameer Joshi: Great. Thanks a lot for this. I will take other questions offline. Thanks.

Operator: Amit Dayal; Rodman & Renshaw.

Amit Dayal: Hi, (inaudible) progress. It looks like a lot of interesting catalysts building up over there. I just want to refer to one question and I will follow up with you guys after, gross margin improves look really impressive. My question - is this sustainable, and what does the American DG margin do the gross margin?

Benjamin Locke: Sure, I can start to answer that, and I'll ask Dave to fill in an area that need more detail, but achieving this margin, it wasn't a fluke. I'll tell you that. We've had a lot of product improvements. We've done a lot of work with our supply chain, with our vendors, with our manufacturing process; all of which are geared towards getting the margins higher on our products. I think these margins are sustainable. Of course, they're going to vary from time to time, but I think this is the range of margins that we'll be shooting for, and we hope that going forward.

Now, turning to the ADG margins, the ADG margins are quite healthy. The work that ADG has done in the past few quarters to improve each of their site's performance and get more run time has done a lot towards getting good margins. Where ADG just had trouble financially is the depreciation associated with those sites was quite high, so once you go back -- included depreciation, the gross margin was very low. But on a pure cash flow basis, on a non-EBITDA, a non-GAAP EBITDA cash flow basis, very good margins. I think they're going to be consistent with the margins that we're already having here at Tecogen.

Amit Dayal: Great. Just one more from my side; any TTcogen sales in the third quarter?

Benjamin Locke: Sorry, any TTcogen sales?

Amit Dayal: Yes.

Benjamin Locke: Yes. We have sold a few units. Some are in the stages of -- and as you can imagine, we don't build them here. They're built by our European partner. We had some sales orders in the third quarter. They [the equipment] arrived here, and now they're going to be dispatched to the sites to be installed.

We have an additional backlog, again, we've not disclosed the backlog of TTcogen yet, it's still kind of in the early stages. As I mentioned, most of the orders in the near term, are going to be these 35 kW units. And there was a the natural, pent-up demand for those things because as we, in our natural course of TTcogen sales, come across buildings where our 100 kW unit is oversized -- it would only run 3,000, 4,000 hours a year. Perfect for these 35 kW, so there was a natural, built-up market for 35 kW. It was kind of the first area for us to investigate, and we're having a lot of traction there.

I expect, in the coming quarters, I'll probably be giving more color to what the sales volume for TTcogen and the backlog, we're just not quite there yet.

Amit Dayal: Thank you so much. That's all I have.

Operator: Alex Blanton; Clear Harbor Asset Management.

Alex Blanton: Good morning. Just a comment at the beginning; I don't know if it's my equipment or yours, but the sound keeps cutting out every couple of minutes for a brief second, so you miss numbers and things like that when that happens. I don't know why that's happening.

Benjamin Locke: Okay. We'll talk with our call service and make sure that that --

Alex Blanton: Now, you mentioned that OpEx was down, and of course, this affected your margin and your products. What's the limitation on that? Your product sales are up 53%, service is up 10%, but operating expense is down. How long can you keep that going before you have to raise that operating expense, and what's the target on the percent of sales for that item?

David Garrison: Alex, this is Dave Garrison. That's -- right now, we don't measure or think about operational expenses that way. We have a team right now that is not at what we would consider a capacity problem looking forward. We don't expect that to rise in the near term. Obviously, if other areas of the Company accelerate dramatically, we would consider expanding those roles, and that would possibly increase the operational expenses. But again, at this time, and in the near term, we're very focused on keeping those costs kept at that level.

Alex Blanton: I understand that, but eventually it would have to go up. So I was wondering, what is your target percent of sales for that?

David Garrison: We're not going to provide any projections on that.

Alex Blanton: Okay. Secondly, the merger, American DG, is that going to be accretive?

David Garrison: Yes.

Alex Blanton: Oh, it will be accretive. How much can we look at then?

Benjamin Locke: Alex, it's too early to tell. As you might know, the process, reaching the deal, was an important milestone. Now it becomes the kind of the climb up Everest to get the SEC approvals, to get all of the necessary documentation together. I don't think we want to be putting anything out there until that's all done.

Alex Blanton: Okay. What kind of revenue do they have? What's it going to add to revenue?

Benjamin Locke: Their revenues, you can look at their filing this morning, but it's around $1.5 million per quarter. I think it was a little over $1.5 million this quarter.

Alex Blanton: What's this filing you're talking about?

Benjamin Locke: ADG released their earnings this morning.

Alex Blanton: Oh, okay.

John Hatsopoulos: We're not giving you inside information on this one because it's public already, and at 1:00 pm, we have a ADG conference call which you're more than welcome to participate. We'll cover a lot of these questions at that time.

Alex Blanton: Do you have the dial-in number for that?

Benjamin Locke: You can look at the press release, Alex, it's all in there.

Alex Blanton: Okay.

Benjamin Locke: We're going to focus on the Tecogen stuff.

John Hatsopoulos: Alex, maybe -- this is John Hatsopoulos. Maybe we don't have you on the ADG mailing list. We'll make sure, as soon as I leave this room, to send it to you right away.

Alex Blanton: Okay. Thank you. Now, the gross margin you mentioned. I wasn't quite clear on what you said. After you have combined, the gross margin will be consistent with what you have?

Benjamin Locke: Yes, I think so. I can't tell you within the exact points, but yes. Yes, we don't expect any substantial deviation.

Alex Blanton: It's not going to get diluted at all. Okay. What is the -- what do you feel is the longer term -- I mean, you reduced costs now, and you talked about more efficient processes for manufacturing, and so on. Do you have a target for gross margin? What's possible there?

Benjamin Locke: Alex, we consistently give out our guidance on what our target is for gross margin, between 35% and 40%.

Alex Blanton: I know, but you're above that now because you've improved your processes, so obviously, that target is out the window. Isn't it?

Benjamin Locke: I wouldn't say it's out the window --

Alex Blanton: Except for a mix.

Benjamin Locke: Yes.

Alex Blanton: Mix could affect it, but aside from that, you're above that now. So where are you going?

Benjamin Locke: Well, at this point, we're not going to change our outlook for margin. I think we're comfortable with what we've stated, and if we feel it's time to change our outlook, we'll do that.

Alex Blanton: Okay. It's kind of like your backlog target. You're way above it, but you're still maintaining the same target, so that's kind of out [of] date. The other thing on ULTRATEK, you mentioned major developments in the last week, and then you mentioned something, some Reuters news story. Is that what you're talking about, the major development, or is it something else?

Robert Panora: Let me -- I'll try to answer your question. This is Bob Panora. Hi, Alex. What we were thinking, or hoping that, from the industry, the people we talked to, that there would be added pressure on regulators to make the testing more difficult. In other words, by including driving on real roads where you couldn't really prepare for the test, which would make the emissions on vehicles less good and perhaps lead to problems.

The major development that's happened, Alex, is that the Europeans, as we have heard rumors, they actually have adopted what they call RDE, which is real-driving experience, whatever it was, RDE. That will be phased in over the next three years, where vehicle manufacturers will have the requirement of an on-road test with portable equipment in the trunk, or so-to-speak, where they will have to show their performance.

They've publicly -- these three vehicle manufacturers have publicly expressed their concern through that Reuters news article on October 14, where they're saying well, if our trend has been to very small, high-density, power-density engines that turbo-drive, so on and so forth, they get very, very good mileage. They're saying that's going to reverse that. We're not going to be able to use those type of engines anymore. We're going to have to go back to bigger displacement, not our naturally-aspirated engines that will not pollute as much (inaudible) they're going to lose a lot more fuel on the road.

That's some great news for us because our anticipation of that has happened with this real-driving requirement that has been put into the regulation, and that's an opportunity for us because that's where we shine. I hope I answered your question, Alex.

Ariel Babcock: Alex, if you don't mind, we're going to take, since we're getting close to the top of the hour here, we're going to move on, and I'd be happy to follow up with you offline if you have further questions. Operator, next question, please.

Operator: Absolutely. Michael Zuk; Oppenheimer.

Michael Zuk: Good morning, everybody, and congratulations on a monumental event by being profitable in the quarter. This question is, I guess, directed at you Ben. What's the current status of the Ilios project? What are we doing there, and what plans do you have to expand that effort?

Benjamin Locke: Sure. Ilios is doing quite well. And Ilios, it's kind of fallen into the sales channel, very similar to our chiller sales, because the water source unit that we've talked about in the past, I'm sure you know, provides chilling to the building as well as the heat. It ends up being the candidate for buildings that are looking to supplement their chilling. We're having good success with that.

Sometimes an Ilios lead will lead to a chiller lead, which is good. Sometimes a chiller lead can lead to an Ilios application if we need something undersized. So that's my long of way saying that Ilios product sales are doing well. The fleet is absolutely growing. I'd like it grow a little quicker, but being somewhat of a new product out there, you meet with a little bit of more work from the engineering community to accept it and spec it in.

So that's my long answer of saying, Mike, the Ilios is still doing quite well.

John Hatsopoulos: I should add that it's now part of Tecogen. It's not a separate company anymore. We have merged it, and it's in the revenue side of Tecogen.

Michael Zuk: And one follow-up on the Ilios, what's the mix between power sources between natural gas and propane, and are you emphasizing one over the other?

Benjamin Locke: I think it's mostly propane because, again, the value proposition for it is you can tell them that we're going to put this unit in here, and they're going to use two-thirds less propane than what they were using before, and that with two-thirds less gas, it would be okay number, but propane is -- natural gas is under $1.00 a therm typically. Propane is upwards of $3.00 a therm. So you're telling these folks that they're going to reduce their propane bill from $80,000 a year down to $30,000 a year.

So it finds itself in markets where propane costs are very high, and that leads you to all sorts of great places to travel, although I don't get to go there, but like the Caribbean Islands and places where the propane costs are very high.

Michael Zuk: Again, congratulations on the quarter. I look forward to continued progress. Thanks.

Operator: (Operator Instructions)

John Hatsopoulos: We have to move on because I'm pretty sure we have the ADG conference call. If there is one more question, we'll do it over the next three or four minutes, and that's about it.

Operator: Understood. Thank you very much. (Operator Instructions) Alex Blanton.

Alex Blanton: Thank you. I just wanted to mention on that Reuters news story, you might want to put that on your website so it's available to everybody, because it sounds like that's a major development.

Benjamin Locke: Yes, I agree with you. I thought about that as I was doing the script last night. We'll look to do that.

Robert Panora: Yes. In fact, we expect -- Alex, it's a good comment. We expect to have several updates to our website in the near future. We'll absolutely make sure that gets up there.

Alex Blanton: Okay. Thank you.

Robert Panora: Alright. Thank you, everyone.

John Hatsopoulos: Thank you, everybody. Thank you very much. I apologize for shutting it off at this point because we've got to get moving for our next meeting.

Operator: Thank you very much, everyone. I would like to thank everyone for participating. This concludes today's conference call. You may now disconnect.