

Tecogen Fourth Quarter 2017 Results

March-21-2018

Confirmation #13677173

Page 1

**Tecogen**

**Fourth Quarter 2017 Results**

**March-21-2018**

**Confirmation #13677173**

Operator: Greetings, and welcome to the Tecogen Fourth Quarter and Year End 2017 Earnings Call. At this time, all participants are in a listen-only mode. A brief question-and-session will follow formal presentation. If anyone should require operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Ms. Bonnie Brown, Chief Accounting Officer.

Thank you. You may begin.

Ms. Bonnie Brown: Thank you, Michelle.

Good morning, and thank you all for joining our year end 2017 earnings call. On the call with me today are John Hatsopoulos and Ben Locke, our co-CEOs, Robert Panora, our President and Chief Operating Officer, and Jeb Armstrong, our Director of Capital Markets.

Before we begin, I'd like to read our Safe Harbor statement. This conference call and any accompanying documents containing forward-looking statements, which may describe strategies, goals, outlooks or other non-historical matters or projected revenues, income, returns or other financial measures that may include words such as believe, expect, anticipate, intend, plan, estimate, project, target, potential, will, should, could likely or may and similar expressions intended to identify forward-looking statements.

These statements are only predictions and involve known and unknown risks, uncertainties and other factors that may cause our actual results to differ materially from those expressed or implied by such forward-looking statements. Given these uncertainties, you should not place undue reliance on these forward-looking statements. Forward-looking statements speak only as of the date on which they are made, and we undertake no obligation to update or revise any forward-looking statements.

In addition to those factors described in our annual report on Form 10-K and our quarterly reports on Form 10-Q under risk factors among the factors that could cause actual results to differ materially from past and projected future results, are the following - fluctuations in demand for our products and services, competing technological developments, issues relating to research and development, the availability of incentives, rebates and tax benefits relating to our products and services, changes in the regulatory environment relating to our products and services, integration of acquired business operations and the ability to obtain financing on favorable terms to fund existing operations and anticipated growth.

In addition to GAAP financial measures, this presentation includes certain non-GAAP financial measures, including adjusted EBITDA, which exclude certain expenses as described in the presentation. We use adjusted EBIT as an internal measure of business operating performance and believe that the presentation of non-GAAP financial measures provides a meaningful perspective of the underlying operating performance of our current business and enables investors to better understand and evaluate our historical and perspective operating performance by eliminating items that vary from period-to-period without correlation to our core operating performance and highlights trends in our business that may not otherwise be apparent when relying solely on GAAP financial measures.

I'll now turn the call over to John Hatsopoulos for some opening remarks.

Mr. John Hatsopoulos: Good morning, ladies and gentleman. As you probably know by now that this is my last conference call since I'm retiring by an annual meeting from both the board and as CEO of the Company. But, I wanted to take couple of minutes to, number one, assure that I'm not leaving the company. I'm going to be there as we file with the SEC for the next three years. I have an agreement after our annual meeting to be there for next three years. And my job will be mostly to advise if asked on financial matters and also answer any questions some investors might have. So, my office with Ann Marie Pacheco and myself will be there for at least another three years.

I also want to take one minute to thank the three teams that made this record quarter possible and hopefully a tremendous future for our company. Number one, our investors - as you all know, our investors suffered for a while, and there wasn't much we can do other than try and make the company a huge success that I hope will be. The second group I want to thank is our management team headed by Ben Locke, Bonnie Bell and Bob Panora. They made it all possible. I was there to advise them and help them, but Ben and his team and the other two people seems they have been responsible for the success that we had. Last but not least, I want to thank our Board of Directors headed by Angelina Galiteva, who's our chairperson, for the support and tremendous amount of work that they've done in creating the stability and the future of the company.

With that, I would like to pass it on to Ben Locke that now you see--well, he'll co-CEO for another few weeks, but after that, he'll be the exclusive CEO of the company, as he deserves.

Thank you.

Mr. Ben Locke: Thanks, John.

Mr. John Hatsopoulos: Ben?

Mr. Ben Locke: Yes. Thank you, John. And on behalf of the company, we want to really extend our thanks to John for taking the company through the years to where we are today as successful. It really is a page out of the success of the Thermo Electron book, which is root the company in sound engineering science, good people with strong financial acumen, and that leads to success. And I think John guiding the company to where we are today, we've demonstrated that. So for that, I think our management team and I hope the investors will thank John for that.

So, turning to the earnings call, as the agenda indicates on Slide 4, I'll start by reviewing the company's performance and financial results for the quarter along with recent achievements and accomplishments. Bob will then give an overview of our emissions technology

development, followed by Bonnie with more detail on the financials. I'll then have some final remarks on future opportunities we expect to see as we move forward into 2018. Then we'll take questions.

As always, I'd like to start off reminding those who may be new to our company about Tecogen's core business model shown on Slide 5 - 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.

Turning to Slide 6, 2017 was a record year for the company in terms of financial performance. Our 2017 revenue was 33.2 million, an almost 36 percent increase over 2016. And more importantly, our adjusted EBIT of \$533,000 in the fourth quarter was not only a record, it also marked the sixth consecutive quarter and the first full calendar year of positive operational results with adjusted EBITDA for the full year 2017 coming in at 1.1 million.

Moving to Slide 7, you can see that the positive results carried all the way through to the bottom line. We achieved record net income for the fourth quarter of 269,000, resulting in full year net income of \$47,000. This full year profitability is a major accomplishment for the

company and was the result of strong performances across the board from product sales to our installation and services segment to our ADG fleet of on-site utility sites.

Products revenue increased 45 percent in the fourth quarter compared to the fourth quarter of 2016 to a record 4.6 million, bringing product revenue for the full year to 13 million, a 21 percent increase over 2016. The growth was a result of ongoing strong order flow from both new customers, such as the 800 KW CHP orders for several New York City apartment buildings and the 150 CHP system installed in a major pharmaceutical company in New Jersey, announced earlier this year, and existing orders, existing customers, such as the chiller replacements at St. John's Riverside Hospital and Bulova Corporate Center, both of which were replacements for existing Tecochills.

We expect a strong order flow to continue as enthusiasm for our InVerde e+ continues to grow due to its superiority over other CHP systems in our size range. And we expect our chiller sales will continue to improve as the HVAC market increasingly recognizes the tremendous value of so-called mechanical CHP for applications such as indoor growing, ice rinks and traditional applications such as hospitals and other industrial applications.

Service and installation revenue once again rose higher to 4.1 million for the quarter, a 5 percent increase over the fourth quarter of 2016, and 16.4 million for the year, up 19 percent versus 2016.

Turnkey installation service has been a key driver in this segment as more customers recognize that Tecogen installations ensure the best quality and economic savings that can be achieved for our project. ADG's energy production revenue of 1.5 million was steady and consistent with prior results as the fleet provides a nice baseline of revenues and cash flow for the company.

Gross margins continue to hold strong at close to 37 percent for the fourth quarter and 39 percent on a full-year basis. Energy production gross margin was also in line with expectations. Our goal continues to be achieving gross margins in the 35 to 40 percent range. Consequently, gross profit grew 40 percent in the fourth quarter to 3.8 million when including ADG. As I previously noted, EBITDA increased to a record 533,000 for the quarter, lifting full year EBITDA to 1.1 million. This is important as we prudently increase our operating cost to maintain growth while continuing to identify ways to save the company money in the long run and adjust for the consolidated company, including the implementation of new internal software systems, which will ultimately improve our operational efficiency.

We are also continuing to invest in our sales team. We extended our sales agent network considerably in 2017 and also implemented an advanced sales platform to increase our outbound sales generation and lead process, which is helping streamline lead qualification and project development. We will continue to invest in the sales team going forward as the 2017 results show it's one of the best ways to grow our business.

Moving on to Slide 8, our exceptional results for 2017 has established Tecogen as a profitable and self-sustaining business that will allow us to continue investing in future growth. A key indicator of our ability to sustain momentum is our backlog, which stood at 15.7 million at year-end. This is a record not only a year-end basis but also on a quarter-end basis. I will discuss the backlog a bit further shortly.

As a result of our financial success of the past few quarters, just before the end of 2017, we were able to retire the 3.15 million in convertible debt on our balance sheet. We had the opportunity to retire it a full year before it became due, which not only freed us of the debt's restrictive covenants, but also enables us to better utilize the borrowing capacity on our balance sheet should the need arise. We are currently in the process of securing a bank line of credit that will allow us access to the capital needed to continue growing our business. Our goal is to finalize this working capital line of credit in the second quarter.

And finally, in addition to achieving full year profitability, a significant accomplishment in 2017 was the completion of the American DG acquisition in May of 2017. ADG is now an important source of stable, high-margin revenue that helps balance out the volatility in our other revenue streams.

I'd like to now turn to our backlog, as shown on Slide 9. As previously mentioned, the backlog stood at a record 15.7 million at year-end, and as of this Monday, it was 17.4 million. It is important to remember that this backlog is comprised of product and installation services and does not include the steady revenue contributions of our service segment and our energy production segment.

As our earnings press release indicated, we have broad and diverse customer base. While multiunit residential continues to be a big portion of our business, we are seeing increased interest in healthcare, the industrial and manufacturing space, and in indoor growing. We continue to target sustaining the backlog at over \$10 million.

Slide 10 outlines some of the key market and regulatory drivers that continue to help drive our product offering. I will touch on them briefly now and then follow-up at the end of the call how they integrate into our 2018 outlook. Indoor agriculture continues to emerge as an important driver of near-term revenue growth. In the fourth quarter, we announced three chillers to be

installed at another Massachusetts grow facility and two chillers sold to a cucumber grow facility in Ontario. We are continuing to work with project developers and consulting engineers on many more grow related applications for our Tecochill product and expect more orders in this segment in 2018.

Next, as I mentioned on our third quarter call, we are continuing to build high-level relationships with entities that can bring multiple projects to the table. Whether it be energy service companies, ESOS, property management firms, engineering companies or energy efficiency consultants, Tecogen is recognized as a leader in product technology, installation engineering, service and maintenance, and overall reputation as the premier CHP company in the country. This also extends to the on-site utility partners who choose Tecogen for projects that are financed by third parties.

Our product performance and long-term service reputation are key considerations when financing companies enter long-term agreements with customers.

Lastly, as we are becoming more involved with micro-grid programs that require automated controls for on and off grid operation, we will see more projects developing in 2018. I will talk more about this at the end of the call.

Next, the situation on the regulatory front is becoming more favorable to Tecogen. The federal budget bill passed into law in February of 2018 extended the 10 percent investment tax credit or ITC for new combined heat and power projects through the end of 2021 and retroactively back for the start of 2017. The ITC had expired at the end of 2016. In management's view, the ITC extension signals the growing appreciation among lawmakers and regulators for cogeneration. This appreciation extends to the state level via the continuation of state run incentives such as New York's NYSERDA rebate program, New Jersey's SmartStart program, and the Mass Save program here in our home state.

Next, electric utilities are starting to embrace CHP as a means for supporting areas with constrained electrical capacity, as evidenced by new programs in the Con Ed territories as well as other large utilities. As distributed generation becomes a larger part of our country's overall electrical supply infrastructure, more interactive and responsive power control technologies are being required by utilities to allow distributed generation assets to play an important role in grid stabilization. I will talk more about this at the end of the call.

Lastly, one final point on regulation that provides a nice segue to Bob's discussion on emissions and was discussed in yesterday's press release - the South Coast Air Quality Management District in California has adopted our Ultra level emissions for stationary, non-emergency internal combustion engines as Best Available Control Technology or BACT. This validation of

our Ultera emissions technology as BACT sets the stage for other states to adopt similar emission standards across the country.

Turning to emissions, Bob will outline the exciting accomplishments we have achieved in our PERC funded fork truck development program, our continuing efforts to retrofit other stationary engines with our Ultera emissions technology and of course our progress with our automotive emissions technology program as we pick up where our ULTRATEK joint venture left off in late 2017.

With that, I'd like to turn it over to Bob. Bob?

Mr. Bob Panora: Good morning, and thank you, Ben. And thank you, John, for those kind words. It's appreciated.

My discussion today will cover our initiatives pertaining to Tecogen's Ultera emissions technology that I have been reporting on regularly. I will first review progress regarding the research grant awarded to Tecogen from the propane industry for adapting the Ultera technology to propane fueled fork trucks. As I will discuss in more detail in a moment, our testing was highly successful in attaining the reduction levels that we had hoped to achieve. Several days ago, our results were presented to our manufacturing partner in a conference call

and received positively. Upon concluding, they requested a meeting in our facility in late April to view the system and its operation, which of course we look forward to.

Second, I will provide the status of our automotive program since the dissolution of ULTRATEK in November. We are continuing our efforts utilizing outside expertise. The initial portion of this work is now underway at our subcontractor, a well known, very respected organization - again, more detail momentarily.

Lastly, I'll provide an update in several miscellaneous areas, including will be the special generators in Southern California that were retrofitted with the Ultera emissions system and the SoCal regulatory news announced yesterday in our press release that Ben just alluded to that establishes a new Best Available Control Technology for rich-burn engines. This follows our successful permitting of Tecogen CHP units in the South Coast District and the subsequent review of our technology.

Let's begin with the fork truck. Now, as announced in late 2016, the PERC, Propane Education and Research Council, PERC, has provided the company with a research grant to demonstrate Ultera's emissions reduction capability in a propane fueled fork truck. The project has significant potential for the 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 issue. From the program outset, the industry interest was strong because of the acute importance of managing emissions in the indoor setting but also because of new regulations particularly in California.

The national regulations require fork trucks to utilize engines certified to a single level for each pollutant with optional tiers available. In California, there is a lower mandatory base level, but there are several optional tiers that are lower still, the most stringent tier being the near zero category, which is 127th of the national certification level. We cannot find examples that list the near zero fork trucks, so we believe the certification has yet to be attained. California also requires owners to maintain average pollution levels of their fleets to be below a certain prescribed value. Larger fleets have stricter requirements than smaller ones. If the average is not maintained, all the trucks need to be retired and replaced with cleaner ones.

On the positive side, the state currently incentivizes both electric fork trucks and over the road trucks meeting their own near-zero standard. This strongly suggests the potential for incentivizing the Ultera technology if near zero status is attained.

Given these regulatory and market drivers, we were able to secure a commitment from a major fork truck company to support the Tecogen engineering team and to supply a fork truck for

testing. The truck was received a year ago, and we have progressed through fabrication to testing, which is just about complete.

Slide 13 depicts a representative test run for our fork trucks under heavy use. In this heavy lift test, the truck is subjected to 20 repeated lifts in a 12 minute period. This is a strenuous duty cycle as the weight, 4,300 pounds, is close to 5,000 pound rating of the truck. The chart shows the emissions from the truck associated with these heavy lifts on top in blue on the measured carbon monoxide emissions while below in red the concurrent measurements for nitrogen oxides or NOx. The solid lines in each chart depict the concentrations before entering the Ultra stage - that is, after the factory supplied after-treatment system - while the dashed lines are post Ultra emissions, the final emissions exiting into the atmosphere.

Beginning with CO measurements pre-Ultra, represented by the solid blue line, we can see familiar excursions in the 8 to 900 parts per million range as engine loading is cycled. However, in looking at the dashed blue line, the concentration leaving the Ultra is very close to zero with 99 percent of what would have been expelled from the factory equipped truck being eliminated on a corrected mass basis. NOx removal, as shown in the bottom chart by comparing the two red lines, solid and dashed, is 24 percent over the cycle. This is in line with our gasoline vehicle test performed at AVL.

We are also able to report on the Ultera removal efficiency of total hydrocarbons, or THC.

Although we were unable to prepare a chart for today's call - we just completed these tests - we can say approximately 58 percent of the hydrocarbons leaving the primary after-treatment system was eliminated by Ultera. We know the regulations treat total hydrocarbons and NOx as a single pollutant, their emitted weights are added together and required to be below a single prescribed limit. As such, the hydrocarbon removal is very significant.

In the next slide, our strategy to reduce NOx to near zero values is shown. Here we alter the engine tuning sets that the factor after-treatment that's highly effective in the elimination of NOx. As shown in the lower graph, NOx concentrations are very low from the first stage of the factory after-treatment process, completely eliminated by Ultera. The detrimental side effect of this tuning is the factory system is less effective in treating CO, as shown in the solid blue line.

However, the dashed blue line showing the post Ultera emissions shows that the CO is effectively eliminated in the Ultera process. Hence, tail type emissions for both NOx and CO are very near zero. While this test was done at low load, this tuning strategy has been successfully utilized to great effect in our Tecogen CHP products under all operating conditions.

In summary, these results, while expected, are still exceptional in their effectiveness. Moreover, we see a direct path to a near zero propane fueled fork truck. As mentioned, we have presented this data in detail to senior staff at the fork truck company via teleconference. As they found the results compelling, they plan to visit Tecogen in late April.

Moving on to our gasoline automotive work, as discussed in our last earnings call, it was agreed by all parties to dissolve the ULTRATEK joint venture. It was further approved that Tecogen would obtain ownership of the portfolio of intellectual property for \$400,000, which deducted from our portion of cash on hand, netted Tecogen \$1.6 million. The dissolution process is complete, and we have initiated the next chapter of the program. Our goal is to upgrade one or more vehicles with Ultera that show full implementation of the technology with specialized automotive grade components.

This will enable potential partners to have confidence in their evaluation, especially regarding cost base and reliability. We have funded the initial phases of this work to a highly respected subcontractor that is expert in automotive power train and after-treatment development. Their initial work will require about four months and focus on optimizing our catalyst formulations. Later phases will focus on component development followed by completion and testing of the refined prototype.

I want to add that we recently submitted a new paper to the SAE international for their World Congress Exhibition in April. After peer review, it was accepted for presentation at the Congress on Tuesday, April 10th. The full paper will be published in the SAE Journal, which is a distinction reserved for those considered to be of higher significance.

In our stationary Ultera market, we have completed our engine generator retrofit project. Recall that this customer had a number of generators needing to be permitted. However, they were not qualified for the typical 200 hour standby generator exemption, as they would operate for several thousand dollars annually.

As was mentioned in our last call, the units are fully operational and meeting the required emissions levels from both our measurements and the customers. We do not have an update on the final step in the process and official third-party test. It is our understanding that they have managed to postpone this test while they work out some unrelated issues.

As mentioned earlier in the call, we announced today that the Air Regulated in Southern California have reset Best Available Control Technology or BACT for engine generators powered by engines - in our case, rich-burn engines. To do so, air quality experts at the South Coast Air Quality Management District needed to complete a lengthy review process to determine that a reliable cost-effective technology was available. That technology was Ultera, and their review

was based on CHP units that we have permitted in their district. Once this best available technology is listed in the BACT clearinghouse, it may be utilized by other districts in other areas of the country with air quality mitigation concerns. As stated in our press release, BACT rule change validates the Ultera technology while giving products an important market advantage--our products an important market advantage that we expect to migrate from Southern California.

Finally, we were pleased to hear from one of our original customers for Ultera in the stationary market. They reached out to us last month after several years and told us they were very pleased with their experience and requested price and delivery information for Ultera kits in new larger sizes. These quotations, which were quite substantial were submitted about a week ago, and we await their feedback.

With that, I will turn the call to Bonnie Brown.

Ms. Bonnie Brown: Thank you, Bob.

I'd like to start with a discussion regarding the acquisition of ADG and how it's been presented in the financial statements of Tecogen for those of you who may not have joined our previous calls. Since ADG became wholly owned subsidiary of Tecogen in May of 2017, ADG's operations

are included in and consolidated with Tecogen's operations as of that date. Therefore, the revenues and cost of sales for our new energy production revenue stream includes the operations of ADG only after May 18th, essentially seven months. Also, the necessary valuations and analyses have been completed and the purchase accounting has been finalized as of year-end.

Moving on to the year end results, Slide 16 contains some of the highlights of the year-on-year financial results. First, total revenues for the year increased by 35.6 percent compared to 2016, bringing annual revenues to a record 33 million. Product revenues alone grew 21.2 percent compared to 2016 with a 5 percent increase in sales of cogeneration modules and 64 percent increase in chiller sales.

Total service revenue grew 19 percent for the year compared to 2016 and continued its steady growth, delivering well over half of our product and service revenue for the year. Long term service contract and parts revenue grew 1.8 percent on a year-over-year basis and continue to provide a reliable annuity like revenue stream. We also have our new energy production revenue from our ADG sites, which added 3.8 million to our total revenues for the year. This revenue stream adds an important second source of annuity like revenue with its long term contracts.

Product gross margin was 38.3 percent for 2017 compared to 33 percent for 2016. This improvement is due to the implementation of production efficiencies in material, labor and factory utilization efforts. Service margin declined to 37.7 percent for 2017 compared to 41.9 in '16. Installation projects, which carry a lower margin and service maintenance contracts, were a higher percentage of the product mix as compared to last year, bringing the overall service margin down on a comparative basis.

Energy production activities from the ADG fleet provided a 46.9 percent gross margin and 1.8 million in gross profit, bringing our consolidated gross margin to 39 percent for the year and consolidated gross profit to 13 million for 2017 compared to 9.3 million for 2016, an increase of 3.7 million or 39.3 percent in gross profit year-over-year.

Net income attributable to Tecogen for the year was 47,000 compared to a loss of 1.1 million in 2016. Net income per share, both basic and diluted, was at breakeven for 2017 versus a loss of 6 cents per share in the prior year. Other comprehensive loss of 165,000 represents an unrealized loss due to market fluctuations of the shares of EuroSite Power, owned by our subsidiary ADG. This loss represents the fluctuation of market price from period-to-period with an unrealized gain or loss recorded as other comprehensive income or loss at the end of the period in accordance with GAAP's mark-to-market rules.

Slide 17 presents backlog and historical adjusted EBITDA trends. A weekly backlog chart of product and turnkey service revenues currently at 17.4 million as of Monday, is consistently well ahead of management's goal to exceed 10 million. As always, backlog does not include a projection of service contract or energy production revenues.

Looking at the adjusted EBITDA schedule, we achieved positive adjusted EBITDA for the year of 2017 1.1 million compared to an adjusted EBITDA loss of 503,000 in 2016, a significant improvement of 1.6 million. Adjusted EBITDA for the fourth quarter of 2017 was 533,000 compared to 160,000 for Q4 of 2016, an improvement of 373,000. At the same time, we continue to invest heavily in the company's future through increased investments in selling and R&D activities throughout the year.

Turning to slide 18, let's review the charts that track our metrics using a trailing four quarters model. Starting with the chart on the left, total revenue for the trailing four quarter period reached 33.2 million including energy production revenue and 29.4 million without the energy production revenue. This chart illustrates the trend of increasing revenues over time in all revenue categories. The energy revenue is represented by the small gray right most bars in the chart circled in green, which includes approximately seven months of ADG's earnings. The chart on the right side illustrates the growth trend of our gross margin in blue along with a decreasing trend line of G&A and selling cost as a percentage of revenues over time in green. On an

annual basis, the company delivered an overall gross margin of 39 percent at the top of management's targeted range of 35 to 40 percent--effective cost controls and sales initiatives to continue to produce these results.

Operational expenses, although higher in absolute terms, have improved 8.8 percent year-over-year as a percentage of revenue, dropping to 38.3 percent of revenue for the year of 2017 compared to 42 percent for 2016. Overhead cost control efforts continue to remain a focus in 2018. There are, however, three components affecting the dollar rise in expenses that warrant mentioning. First is a consolidation within Tecogen's financials of the costs associated with ADG's operations. Second is our increased investment in selling and R&D activities, investing in our future. And third are the one-time costs associated with the ADG merger.

In addition, we are happy to report that, in 2017, we repaid the convertible notes held by Michaelson of 3.150 million plus its accrued interests fully discharging our obligations under this agreement. As of year-end 2017, the only debt remaining on our balance sheet is the loan due to a related party of 850,000 plus its associated accrued interest.

The targets of the company remain the same. Management works to consistently exceed goals and deliver gross margins and backlog levels that we have continued to maintain throughout the year.

Now, I'll turn the call back to Ben to conclude our discussion.

Mr. Ben Locke: Thank you, Bonnie.

So, as we look forward to the rest of 2018, the trends towards Tecogen's clean, reliable, distributed generation systems continue to be in our favor. Each year, the century utility model is changing to be more inclusive of distributed generation to the point where it's being regarded as an essential part of our country's grid infrastructure. Tecogen is uniquely positioned to take advantage of these trends, which represent significant untapped potential of our CHP technology.

Our InVerde e+ CHP system has supplemental inputs to accept other distributed generation inputs such as battery, storage and solar, and our on board CERT micro grid controllers are the most cost-effective way to provide customers and project owners with both low cost on-site electricity and energy production as well as lucrative grid support services, such as demand response, reactive power support and frequency response, all with near zero criteria emissions for our Ultra emission system.

Oftentimes, solar and/or storage alone does not have sufficient economics to provide the necessary financial returns needed for widespread adoption. However, with the foundational economics of combined heat and power, these additional revenue streams supplement the financials to reduce the ROI of projects, which will lead them to more widespread adoption. The recent determination of the Ultera technology as Best Available Control Technology further solidifies the role of Tecogen systems and the broader distributed generation model.

In 2018, we expect to embark on micro grid projects, featuring the InVerde e+ technology as a centerpiece of a micro grid system that provides compelling economics and return on investment, vital grid stabilization services, resiliency of the grid outages and disruptions and near zero criteria emissions. There are already significant examples of this taking place, particularly in California and in New York, which both represent the large utility perspective and the need for distributed generation technology to support grid stability.

And finally, there is the need for resiliency that, in this age of real-time information availability, is core to every business, institution, and individual. Whether it's weather related outages, as we are all too familiar with here in the Northeast recently, or other types of events, such as cyber attacks that can interrupt the grid, the need for electric stability and reliability to maintain connection with the outside world is essential to our way of life.

The outlook for Tecogen has never been more promising. Our core business, selling, installing and servicing cogeneration and chiller systems, is profitable, scalable and provides a fundamental revenue and profit stream that will allow Tecogen to continue growth in our core markets as well as new markets. Our advanced micro grid controls technology are already in place to take advantage of grid stabilization needs and support strategies. And our Ultra emissions technology has been accepted as the best available approach for engine generation. And our emissions technology, whether it's upgrading existing stationary engine systems, retrofitting fork trucks to be near zero emission or improving gasoline vehicle emissions to meet emerging, stringent air regulations, promises tremendous upside for the company. As I've stated before, it is a great time to be a Tecogen shareholder, and I hope to continue our tremendous achievements throughout 2018.

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

Operator: Thank you. We will now be conducting a question-and-answer session. If you'd like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you'd like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment please while we poll for questions.

Our first question comes from the line of James Jang with Maxim Group. Please proceed with your question.

Mr. James Jang: Hey, good afternoon, guys.

Mr. Ben Locke: Good morning, James.

Mr. James Jang: So--good morning. So, you guys were ahead of our estimates, which is always good news. So, I want to ask about I guess the growth in sales and the backlog. How have you been achieving this? Have you built out larger sales force, or is the sales force now segmented for each, I guess, customer type, or what have you been doing differently?

Mr. Ben Locke: I'd say, James, it's a combination of things. It's taking a look at where we've had success in sales in the past, and more importantly, where we've not had success, different sales techniques and approaches and obviously focusing on the ones that are most productive. Our sales team is very effective, and it's a combination of sales and engineering. As I've mentioned previously and even in this call, it's very important to have sound engineering when customers contemplate putting in these systems, and I think our team is nothing but professional and equipped for that challenge. And so, I'd say that's probably one of our

strongest points is our ability to conduct sales in a way that provides security in our customers, whether they be engineering company, ESCOs, etc., that we really know what we're talking about and we're not just trying to sell them a piece of equipment.

Mr. James Jang: I know your sales force is a little--it's really specialized. Are you basically--essentially, you have engineers that are out selling these systems. Correct?

Mr. Ben Locke: Yes, in addition to kind of peer sales approaches of outreach, trade shows, etc., etc. So, there's really no one thing. It's the combination of things that we focused that have shown the best success.

Mr. James Jang: Okay. So, in terms of I guess revenue growth, can you achieve further growth with the current CO source, or would you need to grow that team out more?

Mr. Ben Locke: Well, we're always thinking of growing the sales team. I mentioned Thermo Electron. George Hatsopoulos had a model, which is you hire good people, whether you need them or not, if they're good people, and in the long run, you'll get what you need out of them. And I think that holds true with our outlook. We have good people on our staff, and we'll grow that as need be. We also have--I think I've mentioned this before, James--outside sales tools at

our disposal, whether it'd be manufacturers' representatives or sales agents. Increasing those has the concurrent effect of increasing sales.

And I think the last thing I'd say, James, that it is relevant to this, and I mentioned of course, is developing these relationships with customers that have large portfolios of projects available to them. Of course, that's a better way to do things, and if you're able to get into a REIT or property management company and show success, you're just gonna--success breeds success. And I think we have shown ourselves to be quite successful in the past few years, and that's leading to more projects.

Mr. James Jang: Okay, great. So, shifting to my favorite topic, Ultera emissions, it seems the project is doing well, you're hitting the targets I guess that you guys had laid out previously. Have you reached out to, I guess, end users or warehouses or some of the bigger places like Amazon and Wal-Mart to see what their interest would be in some of these--in this technology for their fork trucks?

Mr. Bob Panora: This is Bob Panora.

Mr. James Jang: Hey, Bob.

Mr. Bob Panora: Thanks for the question. Hi. It's a good question. The fact is we haven't yet, and we have to be coordinated with our partners, namely the propane industry and also the manufacturer depending on how he would like--we have to coordinate with them. From my past experience, the gas companies and in this case propane companies, have very substantial marketing capabilities and money. And they could be a very key ally.

Several days ago--I didn't talk about this in my story I just gave--they invited us to present before their committee, their big technical committee the results, which is very positive. And I think that that ends up pushing to all the individual companies that are members. Then they also asked us to prepare a technical paper for their World Technical Conference, which I--I don't know if it's a national or global, what it is exactly, but it is an opportunity for us to prepare a scientific paper. And of course, what has happened is that people looking at that data say, wow, I've got to talk to my local customers about this technology and begin to promote it. So, that's the opportunities there, but we're just really at the cusp of now looking outside the lab and saying, wow, we have something here, let's see how we can promote it. So, that'll be happening soon I imagine.

Mr. James Jang: Okay, great. So, I just have one--I have one more on Ultera. So, I know you're aware the IMO 2020 rule right now for all ocean going vessels to limit their particular matter

and covering and NOx and everything. Have you guys explored anything on that side, on the maritime side? Have you guys had any inquiries about the Ultera possibly working there?

Mr. Bob Panora: We have, but from a different angle. The ports are extremely worried about the pollution from the incoming ships, and so they can tell the ships to turn the diesel engines off and switch to electric power from a local source. There might be a natural gas turbine that's on the pier or something. But, where they really are hurting, as well--and this is from talking to people associated with the LA area--is that these fork trucks, these big trucks, all going in and out. There's tremendous activity there, and that's an area they really have to do a lot--do some work on. And I think that's an opportunity for us at some point with Ultera, maybe sooner with the fork trucks than other trucks, but that's definitely something that I was made aware of.

Mr. James Jang: Okay. All right, great. Thanks. That's all I have.

Mr. Ben Locke: Thanks, James.

Operator: Thank you. Our next question comes from Amit Dayal with Rodman and Renshaw. Please proceed with your question.

Mr. Amit Dayal: Thank you. Good morning, everyone, and congratulations on a strong 2017.

Mr. Ben Locke: Thanks, Amit.

Mr. Amit Dayal: In regards to the backlog, how much of ESCO related projects are in the backlog? Could you provide any color on that?

Mr. Ben Locke: How many of what type of projects? Sorry, I didn't catch you there.

Mr. Amit Dayal: The ESCO projects, the energy service company--.

Mr. Ben Locke: --Oh, the ESCOs. Yeah, Amit, I don't have that broken out in front of me. It's a meaningful number, to be sure. It's not inconsequential. But, I don't have it in front of me, so I'm sorry, I can't answer you precisely on that.

Mr. Amit Dayal: That's fine. The question was probably driven more around just trying to see how much--how this is evolving for you guys as a channel for getting the products out there. So, any granularity on how this--these partnerships can contribute in the future and what role they will play in terms of your overall strategy would be helpful.

Mr. Ben Locke: Yeah. Well, I can give you a little bit of color, but it's a much more long and thoughtful discussion that maybe we can have a cup of coffee sometime. But in general, these ESCOs enter long-term agreements with the customers, 15, sometimes 20 years. In fact, CHP can sometimes extend the length of the agreement that the ESCO is able to establish with a municipality or a school district, etc. And so, because of the long-term agreements, they need to know that the equipment is going to last that long, number one, be maintained, and most importantly, deliver the prescribed ROI that's been promised to the customer and relied upon by the financial folks at the ESCO.

And I'd say that's probably the biggest concern with ESCOs is that they do business with a company that is able to ensure those things. And I think that's where Tecogen's reputation and our excellence has really shown the like to the ESCOs that we can be relied upon for that. And that's growing. There's more and more companies out there, Amit, that are looking at the financial benefits of this, and they--I don't say they won't care, but if it's distributed generation, it's just the financial asset to them. And it's just another portfolio, if you will, of stocks that they maintain. And that's important because they turn to us for all the technical details, for all the service, all the run time and everything, and as long as we deliver the numbers that we say we're going to deliver, they're happy. And then they rinse and repeat, if you will.

So, I think we've demonstrated that tremendously, and we're going to see more projects with ESCOs going forward. Again, sorry I can't break out the number of backlog, but it is meaningful in there.

Mr. Amit Dayal: That's fine. Appreciate the color. And in regards to these ITC extensions, has that accelerated any conversations or negotiations that you were having, and how has that added to the pipeline, or do you see that happening maybe later in the year for you?

Mr. Ben Locke: Yeah, absolutely. I mean we're very in a lot of communication with our customers to indicate, hey, look, if you've got a tax liability here, if you talk with your tax professionals and you're able to take advantage of this, it can knock a couple years off your ROI. And a project that might have a middling ROI of four or five years suddenly becomes a very achievable ROI of maybe two or three years. So, indeed, we are reaching back, even the customers that we already sold 2017, because as we indicated, it's retroactive to January 1st. But more importantly, to all of our customers that we have not closed deals with, this could be the decision maker on them making the decision to proceed.

Mr. Amit Dayal: Understood. And then from a margin perspective, is there any chance service margins bounce back, or should we assume the 4Q '17 levels as a good indicator for the next at least few quarters?

Mr. Ben Locke: Sure. Well, that segment is a combination of our service as well as our installations, and the service margins are usually pretty reliable, some small fluctuations. The installation margins change quarter-to-quarter because that's just the nature of doing construction, if you will. I know you try to aim for as best margins as you can, and sometimes, your margins are eroded as projects maybe have some slight overruns or maybe you decided to be cost competitive with the bid, for example. So, those margins change, and I think that's generally what is driving the changes in that segment's margins from quarter-to-quarter.

Sufficed to say that we sometimes tolerate these lower installation margins, because from my perspective, I would rather have--take maybe a little bit of a cut on the installation margin but knowing that I'm gonna have 15 years of really solid service revenue because I took the extra time with an installation. That's something that I'm embracing of. The ADG margins, as well, they're generally--Bob--?

Mr. Bob Panora: --Yeah, well, I want--I should make a point about what happened in the merger is that a fraction of our service contracts, I don't know if it was say 10 percent or thereabouts, were to this separate company ADG that is no longer a separate company. So, in terms of the cost and the margins of the service department, they're absolutely the same and

very good. And just in the elimination step when you combine the financials of ADG into one company, you lose their revenue basically. So that's--.

Mr. Ben Locke: --That's a great point. Thank you.

Mr. Bob Panora: Yeah, that confused me, too. That's why when I was looking at it, what the heck happened here, the--it was because of the ADG change in the accounting.

Mr. Amit Dayal: Got it. Thank you for that. And just one last one from me - on the emissions front, it seems that we continue to make a lot of good technical progress, meet all the requirements I guess in terms of what regulators are looking for, etc. How does this from a timeline point of view start getting more mainstream or sort of commercial level deployment, and where are the bottlenecks in terms of--is it more just regulation or is it customer hesitancy to move forward with these teams in a more meaningful way? Like, how does this start contributing larger fashion to overall growth of the company?

Mr. Bob Panora: Good question. This is Bob Panora. It is a--it's a long process, for sure, to get into these larger industries that are very conservative. But, one strategy I think that'll help us a lot is I see the fork truck as being rather near term comparatively, and you have to perhaps--you have to move up the food chain a little bit in the industry to get acceptance. So, part of our

strategy is to go into the smaller markets, the ones that aren't supersensitive about cost and huge complicated organizations to moves and go up through there. So, it's going to be a fairly long process to make serious penetration into these big companies, but I think, ultimately, we'll get there. But, it's not trivial to get their attention or to get their buy-in on change.

Mr. Amit Dayal: Good. Yeah, that's all I have, guys. Thank you so much.

Mr. Bob Panora: Thank you.

Mr. Ben Locke: Thanks, Amit.

Operator: Thank you. Our next question comes from Roger Liddell with Clear Harbor Asset Management. Please proceed with your question.

Mr. Ben Locke: Hi, Roger.

Mr. Roger Liddell: Good morning. I'd like to probe a little further on the trajectory of adoption among the utilities and large-scale customers. You touched on it earlier, I recognize that. But, it will--taking the example of Con Ed, my recollection is that there was perhaps a five year period from willing acceptance or wary acceptance of the Tecogen offering to nowadays a

supportive, welcoming, partnering--these are my terms not yours. You can characterize it as you wish. But, it's taken a long time to get here. How should we think about--New Jersey incentives have been in place, and yet I can recall only a handful of announcements regarding New Jersey contracts. Yet, one would have thought that there'd be a more Con Ed like acceptance and demonstrable contract wins. [Unintelligible] you had a sale in Boston, call it a year ago, and there's a first to my knowledge. I should think with pipeline constraints into Massachusetts, there would be a frenzy of trying to get efficient equipment in place. Could you help me understand?

Mr. Ben Locke: Sure, Roger. Good question. New Jersey is--indeed, there's--the SmartStart program is very good there. Electric rates aren't as expensive in New Jersey as we see in New York, to be sure. Electric rates are a little more modest. Certainly, some of the more punitive demand charges are much less in New Jersey. And therefore, when you do an economic analysis, your ROIs, they just tend to be a little bit longer, the incentives notwithstanding. With that said, though, Roger, we're seeing those rates creep up. We're also seeing more of a demand component.

And we look at utility bills all the time, day-in, day-out, week-to-week. And we're seeing in New Jersey some of these electric rates slowly start to creep up, not quite to the levels of Manhattan and New York, but getting up there.

And then the last thing I'll say on that is I think the resiliency piece and this micro grid piece that I've been talking about, I think that's really starting to get recognized now, and the--again, the value stacking model where it's not just the ROI of the electricity and the power you're delivering but also the ability to potentially participate in demand response or KVAR support or some of these other things. That's now slowly starting to get understood, and I'm hoping that'll lead us to get more activity in New Jersey.

Now, Boston is a little bit of a different story, Roger. Boston is unusual in that the electrical network in downtown Boston is very restrictive to distributed generation as a whole, not just CHP but solar and battery storage and everything. It's what's called a spot network, and they're very restrictive in the how much DG they can put in a spot network. I think it's one-fifteenth of the building's minimum import or something like that. So, just the actual regulations of putting DG into Boston is tricky. And that's something that we've talked with the Massachusetts regulators about, and the solar folks have fought the good fight, as well, to no avail thus far.

Hopefully, that's something we can slowly start to pull down and get more distributed generation in Boston because the electric rates are very compelling in Boston. And again, all these power--all these snowstorms, people need to keep their lights on. And I'm hoping that

that additional benefit will outweigh the concerns the utility has about putting DG in the spot network.

Mr. Roger Liddell: Good. That's useful. And I think the cyber vulnerability is something--look at the publicity, front pages of newspapers in the past week or two - that's a huge threat.

The second question then is California Best Available Control Technology. I'm not an expert on the Clean Air Act, but BACT really means something that a new applicant, a competitor would have to meet or exceed your equipment's capability to comply with the strictures of the Clean Air Act. Am I getting this correctly? Isn't this a much more significant development than might be apparent from just the press release?

Mr. Bob Panora: Yes, you're getting it correctly, but I'll put in a caveat. If, for example, if you're in the Southern California district that made the BACT for that district, certainly, that's the case. Now, if I'm in another district in California, I have a new engine, I want to get it permitted, that permitting officer in that other district could and should in fact go to the clearinghouse of what is the latest technology for that class of equipment - in this case, a natural gas engine. They could very well, and they should, look at the permit and say, well, I'm going to apply this new standard that just popped up in California, and that's within their purview to do that.

And it doesn't just mean California, either. It would be--that clearinghouse would be available to somebody in Massachusetts, a permitting officer in Massachusetts. So, nothing changes overnight, but our expectation is it'll migrate as things do, as districts become aware of it to wider places. And as we--I think I said in my presentation, we're very hopeful that that will become a competitive advantage to Tecogen in other areas of the country, as it has been, but it'll become more so.

Mr. Roger Liddell: Okay, thanks so much.

Mr. Ben Locke: Thanks, Roger.

Operator: Thank you. Our next question comes from George Sim [sp] with Trilogy Capital. Please proceed with your question.

Mr. George Sim: Yeah, hi. Really good year here - I'm seeing very many positive things, and I want to complement you on your presentation today. It was just outstanding--.

Mr. Ben Locke: --Thank you--.

Mr. George Sim: --And having--especially in the financial sections, having the key things highlighted so we knew what to look at, I really appreciate that. I wish more companies would do that.

I do have one question about your SG&A. It has been on a decline with the exception of the bump in the '16, but what's your target for SG&A going forward?

Mr. Ben Locke: Yeah, George, I don't think we're giving any targets going forward. We're trying to stay out of making those type of arrangements. Sufficed say, as I said in my comments, we're going to continue to grow the business and adding on SG&A, particularly the S part, in my thinking, is an important part. But rest assured, we are absolutely laser focused on cost controls and making sure that our spending, despite this great result, doesn't get out of control. So, again, I'm not going to give any guidance to what our SG&A is going forward, but sufficed to say we are going to be growing the team but try maintain our cost controls.

Mr. George Sim: All right, that gives me a little bit of perspective here that I can put into what I'm going to model. I wonder, too, if you could comment on the unfavorable contract liability. It's a big number, and I'm not sure I understand it completely.

Ms. Bonnie Brown: Okay, I'll take that one. So, that's a result of the acquisition of American DG Energy. So, we--in acquiring that company, we acquired a bunch of contracts that go along with the sites. And those contracts need to produce a certain margin in order for them to be exciting to any purchaser of the company. So, because we buy them as they are, they may not produce 35 percent margin, which is what we were--our goal, Tecogen's goal was in buying the company. The unfavorable contract liability allows it to produce that 35 percent margin by putting a number on the balance sheet that is amortized over the life of the contract, and it's all non-cash. It's similar to depreciation but works in the opposite direction so that the assets will produce the--or should produce the margin of 35 percent or better.

Mr. George Sim: All right. But, some of these contracts go up 12, 15 years, right?

Ms. Bonnie Brown: Right.

Mr. George Brown: So, this is going to be carried for a long time?

Ms. Bonnie Brown: Right, it'll be amortized out over the life of each contract, contract-by-contract.

Mr. George Sim: All right. And if I'm understanding correctly, the total amount of long-term debt is about 850,000?

Ms. Bonnie Brown: That's right, it's short-term.

Mr. George Sim: Okay, that's short term.

Ms. Bonnie Brown: Yeah.

Mr. George Sim: So--all right, good deal. All right, that pretty well covers what I wanted to know. Thank you very much.

Mr. Ben Locke: Yeah, thank you for listening in.

Operator: Thank you. Our next question comes from Michael Zuk with Oppenheimer and Co. Please proceed with your question.

Mr. Michael Zuk: Good morning and congratulations on 2017.

Mr. Ben Locke: Thanks, Mike.

Mr. Michael Zuk: I want to turn the attention to indoor farming. Right now, of course indoor farming has one high profile product that may or may not be long term, and I'm sure there's lots of short term opportunities. But, I'm most interested in the cucumber operation in Canada. Could that be a beta test for expanding our long-term farming, marketing and effort into, should we say, the vegetable growing arena across North America?

Mr. Ben Locke: Yeah, Mike, that's our hope, particularly with high value crops where the threat of having the crop spoil or something because of a utility outage or some such thing is just too much for them to bear. So, that particular location, that cucumber was CHP, traditional electric CHP. As I mentioned, a more thoughtful approach to a lot of these indoor growers, they tend to go to the chillers because the thinking being why go through all this effort to generate these precious electrons with CHP only to have them be consumed by a giant electric chiller, right? So, why not just take care of the electric chilling component directly with natural gas engine driven chillers?

And that notion, it just takes a little while for engineering consultants and project advisors to understand. But, again, through the efforts I think of our team of spending time with these engineers, explaining how mechanical CHP works, they're starting to understand it, and we're starting to see ourselves get specked into it more-and-more. So, absolutely, Mike, I think this is

scalable. Whether it'd be the chillers or fundamental CHP, I think you're going to see a lot more of it as these crops--particularly, as this farm to table initiative really tries to take hold where people want locally grown produce that they can get quickly and not something that's travelled across the country frozen in a truck.

Mr. Michael Zuk: And then a follow--.

Mr. John Hatsopoulos: --Ben, this is John Hatsopoulos. May I interrupt you for one second?

Mr. Ben Locke: Yeah, of course, John.

Mr. John Hatsopoulos: Ben, they just opened--this is an surprising comment from Mike, which is great news. Here in the Bahamas, they've just opened the first cucumber plant, which is air conditioned, and they're selling throughout the Bahamian Islands cucumbers that are made in Nassau, Bahamas. This is the first commercial food product that the Caribbean that I know of that kind of level, not mangos and papayas and whatever. Anyway, I was just amazed that they just opened it up. It's only about three miles from my house.

Mr. Michael Zuk: Good to know.

Ben, a follow up question on one of my favorite subsidiaries - what's going on with ILIOS, if anything?

Mr. Ben Locke: Yeah, so we're still marketing the ILIOS product. Ultimately, I make decisions on where I want our sales team focused, and when I find a vein of activity, particularly these grow things with our chillers, I put all of our resources on--not all of our resources, but I focus our resources on that. So, the ILIOS still absolutely has a play in our portfolio. It becomes a product that we try to specify in some cases, but sometimes, it just ends up being the one that lags behind in favor of a chiller or a CHP system. And while I'd love to have ILIOS' sales be just as much as chillers, I'll take the sales where they make the most sense from an ROI standpoint. So, you'll still be seeing more of ILIOS, Mike. It's just that these other products fit so much better in our core markets.

Mr. Michael Zuk: And then one final follow-up - I know that we have a prison facility. I believe it's in Maine. And I think it's been operational for three or four years, if I'm not mistaken. Can we use that facility as a beta test example to move into that market, because it seems to me that we have a perfect product, and cost and efficiency in that arena is an important factor to politicians?

Mr. Bob Panora: Yeah, Mike. It's Bob Panora. I've been in that site actually, but as a guest, at a sports event, actually, but anyway. That's actually not the first prison. We've done other prisons. And I think--and I'm not up to speed as much as Ben would be on--we're doing prisons, as well, elsewhere now.

Mr. Ben Locke: Yeah, yeah, we're doing the one in Brooklyn, the MDC prison in Brooklyn. There's one in Arizona, Pima County I want to think it is. In general, Mike--and this is maybe not a pleasant way to look at it, but any facility that has beds, as you know, as I've talked to you, Mike, is a good fit for CHP. But, more importantly, if you can schedule when the hot water use occurs in those facilities so much the better. And prisons fit that bill perfectly where they can control the use of hot water throughout the day, and so prisons absolutely are.

The one thing, a little bit of downside of prisons is typically they're located in areas that don't have commensurate very high electric rates. They're off in the distance somewhere and with a utility that doesn't have very high electric rates, of course the Brooklyn MDC being the exception. But in general, you're correct - prisons are indeed a great market for us. It's something that we are constantly pursuing. Oftentimes, they end up in bidding processes. Here in Massachusetts, they sent them all out to bid, and you do the best you can with other efficiency measures. But, they are a good market for us.

Mr. Michael Zuk: Well, again, congratulations. I'm looking forward to a successful 2018. And specifically to John Hatsopoulos, congratulations on all of your efforts over the years to bring the company to fruition. I think we have a wonderful opportunity going forward.

Mr. Ben Locke: Thanks, Mike.

Operator: Thank you.

Mr. John Hatsopoulos: Thank you, Mike.

Operator: Our final question will come from the line of Alex Blanton with Clear Harbor Asset Management. Please proceed with your question.

Mr. Alex Blanton: Yes, hello. I'd like to focus--.

Mr. Ben Locke: --Hi, Alex.

Mr. Alex Blanton: Hi. How are you? I'd like to focus on the gross margin. You have said that your target is 35 to 40 percent. And I just refer quickly to the fact that you have a backlog target of 10 million, and you're 70 percent over that now, and you haven't changed that. Could

it be that the gross margin target is like that because--I know that your service gross margin will depend on the mix, and you've discussed that. But, if you look at the incremental profit margin on the gross--on the product side, it was 64 percent for 2017. In other words, gross profit went up 1.446 million, and sales went up 2.269 million on the product side so that 64 percent of the sales dollars fell to the gross profit line in 2017.

I'm not sure how much of that is due to mix, but could you discuss the possibility that those incremental profit margins, high ones will continue so that the product gross margin would rise considerably out of the target range? It would seem likely to me, based on the fact that you have disruptive technology, and therefore, you should have superior pricing power for that product.

Mr. Ben Locke: Yeah, you'd think. But, this is a--it is a bit of a competitive landscape, Alex. I'm not gonna ignore that there's competitors out there. In fact, I'm quite aware of them. And technology superiority aside, sometimes, customers look at first cost. And I can explain the CERT micro grid algorithm all day to them and the Ultera emissions technology and the need and etc., etc., but ultimately, sometimes, projects are first cost oriented, and other technologies can creep in. And in those situations, we'll be as aggressive as we need to be to get the project. Obviously, we're not in the business of losing money. But, there are cases

where we need to be more aggressive at the expense of margin, and that's a delicate balance that we face quarter-to-quarter.

In general, I think that's what why we give that range, because indeed, we're able to get good margin on some projects and situations like I just described, not as good in others. They all tend to bring in that range of 35 to 40 percent, and that's why we put our guidance there.

Mr. Alex Blanton: Yeah, but could you just focus on the product side? As I say, the incremental profit margin on the product side, well, your margins went from 33 percent to 38 percent. So, what's the possibility that they continue to rise on the product side? [Unintelligible] the operation. That's what I'm saying. In the manufacturing operation, there is leverage. You have fixed cost, and so therefore, as volume rises, you should have some increase in the margin there.

Mr. Ben Locke: Yeah, no, I absolutely hear what you're saying, Alex, and understand it. Indeed, we're producing these InVerde e+s. We've got to the point where it's very lean, very fast, they go down the line, they go out the door. And it's a nice good margin process for doing that. We're here in Waltham, Massachusetts. I look around me, all the buildings around me, and there're very well paid people paying high rents. Could we produce these things elsewhere and make a little bit margin? Quite possibly.

So, I understand exactly what you're asking, Alex. And can we leverage our ability, our manufacturing ability to get better margins? Quite possibly. It's something that we're looking at as we think of expanding business and what potential we have for more manufacturing here in Waltham versus someplace else. It's just too early for--to concretely put any prediction on that of how we'll do it, except to say that you're on the right path, that we do have a lot of manufacturing leverage to get our margins up.

Operator: Thank you. Our next question comes from Joe Vidich with Manalapan Oracle Capital. Please proceed with your question.

Mr. Ben Locke: Good morning.

Mr. Joe Vidich: Thanks. Yeah, good morning. Thanks for taking my call. I have a few questions actually, the first being, so your backlog is 17.4 million. My assumption is that you should be able to deliver that within the next 12 months. Is that a correct assumption?

Mr. Ben Locke: Not so much, and I'll tell you why. The backlog consists of projects that could have any number of time horizons. They could have a time horizon of just a few months because maybe we're selling it to a manufacturers' rep who's got the customer lined up, and

we deliver the unit, and it gets installed quite quickly. And then on the other extreme, Joe, it could be of a full turnkey installation where we're supplying the product and the installation labor, and it just takes a longer time with all the other things going on in that building to go. So, that backlog could stretch out for a longer timeframe.

And then there's a third part, too, and this is--and again, I can't give you exact precision on this, but there's a portion of the backlog that's new construction, and that new construction has its own timetable. And it's great that we're part of the blueprints and part of the plan to put CHP in there, but we're behind every other milestone and project schedule of that new construction building. Therefore, it's in the backlog. Maybe they have three CHP units that's in our backlog, but construction's not gonna be ready to accept it to some point later in the future. So, with all of that hedging, you're right, the majority of our backlog does probably get achieved within a year's time frame, but there is an amount of it that can extend longer because of those reasons I just mentioned.

Mr. Joe Vidich: Okay, okay, that's great. That clarifies that. The other question I have is, with regard to Ultera, you talked about there being incentives in California when you do achieve--when it gets--when you get certification for the emissions. I was wondering what those incentives are, and then a little more detail on Ultera. It's my assumption, and maybe I'm

wrong, that the biggest markets for emissions controls are in places like India and China. And I was just wondering what the company's focus is in terms of looking into those markets?

Mr. Bob Panora: Okay, the first question is you asked about the incentives and so forth. So, what I was talking about was incentives in California specifically for fork trucks that might be available. Now, what I said was the zero fork trucks that are electric operated, they essentially get a very, very healthy rebate when the customer goes to buy one. So, they'll incentivize it. And I've heard--and I can't say that I know this for sure, but it's tens of thousands of dollars. It's not a little rebate that they get. And I don't know what part of the state office has that I, probably the air regulation district, but it's very healthy.

And also, if you have a normal truck, like a big truck that will be a garbage truck or something like that, if they have a near zero technology, they would also qualify for healthy incentive, not zero, near zero.

So, what I believe is possible and with a little bit of pushing a little bit is, if you have a near zero fork truck, you should, by logic, you should be able to--there is a category near zero in California. If we attain that level, then we would qualify for a rebate, as well, which we'll have to work the gas company, work with the regulators and work something else. But, I think we could follow the path that's already been set by the other technologies.

And as far as looking elsewhere, we have not been oblivious to what's going on, particularly in India, and we--I can't say much about what we know and what we've done there. But, we're not unaware of those opportunities, and we will pursue them as they become available.

Mr. Joe Vidich: Okay, that sounds great. And just in terms of what the next few milestones are for Ultera, how would you categorize what the two or three next milestones you're looking for?

Mr. Bob Panora: Yeah. What we want to do is we want to move forward with this fork. That's--we hope that's fairly near term, and that could be based on what we--when we really engage with the propane industry, I would presume, if they like what they see, and I don't know why they wouldn't, they would begin to discuss how their marketing groups would get this thing out there. And we've gone down that path with the natural gas industry for our chillers, for our cogen. And generally, what they would want is something like demonstrations, showcases of it, and so forth. And again this has to be coordinated with the manufacturer. Again, we have to we have to consummate that deal.

So, that I think is fairly--I hope is fairly near term, if not full production type stuff, but maybe fleets that get modified or field tests with demonstrations and that sort of thing. But, that's from my past experience.

Now the other--what was the other--oh, the other near-term thing that we're very focused on is we have got to get a working prototype for the automotive sector. And we know what we need to do. We need to show that it's a very low cost feature, it fits well into the space that we have, and it's made with components that the automakers are familiar with, and they're not afraid of reliability and so forth. And that's the goal, and we want to be there with that within about a year-and-a-half or something like that. And once we've done that and have all our ducks in a row, then we can play our card to go speak to people. That's our plan, anyway.

Mr. Joe Vidich: Okay, great, great. I appreciate it, and I wish you a lot of luck.

Mr. Bob Panora: Thanks, Joe.

Mr. Ben Locke: Thanks a lot.

Operator: Thank you. We have run out of time for today's call. I would like to turn the call back over to management for any closing remarks.

Tecogen Fourth Quarter 2017 Results

March-21-2018

Confirmation #13677173

Page 58

Mr. Ben Locke: Hi. Well, once again, thank you all for participating in our conference call.

We're quite pleased with our result, and we expect to share more good news as it happens.

And with that, we'd like to sign off. Have a nice day, everyone.