Tecogen

First Quarter 2018 Results

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Operator: Greetings, and welcome to the Tecogen First Quarter 2018 Results Conference Call.

At this time, all participants are in a listen-only mode. A question-and-session will follow the 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.

I would now like to turn the conference over to your host, Ms. Bonnie Brown, Chief Accounting Officer. Please go ahead.

Bonnie Brown: Thank you, Hector [sp].

Good morning, and thank you all for joining our first quarter 2018 earnings call. On the call with me today are Ben Locke, our CEO and Robert Panora, our President and Chief Operating Officer.

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 belief, 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 excludes certain expenses as described in the presentation. We use adjusted EBITDA as an internal measure of the business operating performance, and we believe that the presentation of non-GAAP financial measures provides a meaningful perspective of the underlying operating performance of our current business and enable investors to better understand and evaluate our historical prospective 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 call over to Ben for business update.

Ben Locke: Thank you, Bonnie.

As the agenda on Slide 4 indicates, 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 will then have some final remarks before we take questions.

As always, I'd like to start off by 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 traditional methods of heating, cooling and powering buildings and infrastructure.

Turning to Slide 6, the first quarter of 2018 continued our trend of profitability with revenues of just under $10.2 million, an almost 49% increase over the first quarter of 2017. This brings our trailing four quarters revenue to $36.5 million and represents the sixth quarter of profitability over the past seven quarters, with the exception being in Q2 of 2017 when we completed the ADG acquisition. And importantly, we achieved adjusted EBITDA of $304,000 in the first quarter compared to the $191,000 in the first quarter of 2017. This is our seventh consecutive

quarter of positive adjusted EBITDA, which further demonstrates the sustained success we have achieved over the past 21 months.

Moving on to Slide 7, you can see that the positive results carried all the way to the bottom line with net income for the first quarter coming in at $21,000. While this is lower than our profit of $45,000 in the first quarter of 2017, it was tempered by unrealized loss in our EuroSite Holdings of around $20,000, and approximately $10,000 non-recurring cost related to the ADG acquisition.

Looking at the different components of revenue, product sales increased 31% in the first quarter of 2018 to $3.67 million as compared to product revenues of $2.8 million in Q1 of 2017. The growth was a result of strong ongoing orders from both new customers and existing customers with a noticeable increase in chiller sales, which I will talk about in just a few minutes.

Service and installation revenue increased to $4.7 million for the quarter, a 17% increase over the first quarter of 2017. Turnkey installations have been a key driver in this segment as more customers recognize that Tecogen installations ensure the best quality and economic savings that could be achieved for a project.

ADG's energy production revenue of $1.78 million was an improvement over prior results, due partially to increased runtime of the fleet during the cold winter months as well as continual improvement of the fleet capability. Gross margins continue to hold strong at 37.7% for the first quarter, in line with our goal of maintaining gross margins between 35% and 40%.

Moving on to Slide 8, we've continued to maintain a pipeline of business in our backlog that will ensure success in future quarters. Our backlog stood at $14.6 million at the end of the first quarter and is currently $16.6 million as of yesterday, May 14. A reminder that our backlog does not include service backlog as well as the ADG backlog on a quarterly basis. And as I mentioned, chiller sales are becoming a larger component of our backlog 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 uses.

And lastly, as our recent press release indicated, we obtained a line of credit from Webster Business Credit Corporation in the first quarter for up to $10 million. This line of credit allows us the financial flexibility to both grow our core business as well as our emissions technology development in fork trucks and automobiles. As a result of this line of credit, we were able to pay-off our final debt to a related party of $850,000 plus accrued interest.

Turning to emissions, Bob will outline the exciting development we have achieved in our PERC-funded fork truck development program, our continuing efforts to retrofit other stationary engines with Ultera emissions technology, and of course, our progress with the automotive emissions technology program. Bonnie will then follow-up with more detail on the financials.

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

Bob Panora: Good morning, and thank you, Ben. 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 discussed in our first quarter earnings call, our testing was highly successful in obtaining the reduction levels that we had hoped to achieve. Further, our results were presented to our manufacturing partner in March via a conference call and received positively with a follow-on commitment to meet at our facility for a more detailed discussion. This meeting to accommodate schedules will now take place on May 23. Second, I will provide the status of our automotive program, which is underway with our subcontractor. Lastly, I will update a few miscellaneous items.

Let's begin with the fork truck, starting with a brief review. As announced in late 2016, the 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 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 issue. From the program onset, 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 was 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 this certification level 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 fork trucks and over-the-road trucks meeting this Near Zero standard. This strongly suggests the potential for incentivizing the Ultera technology if a 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 our testing. The truck was received a year ago, and we have progressed through fabrication to testing, which is now just about complete.

In our last earnings call, we presented our test results in a test we developed to characterize the impact of the Ultera process in the fork truck application. Recall this heavy lift test, the truck is repeated--is subjected to repeated lifts through a given test period. This is a strenuous duty cycle as the weight, 4,300 pounds, is close to the 5,000 pound rating of the truck.

I've summarized our testing from the March earnings call in the table on the left of Slide 11, but added a second data set from a third-party testing company which utilized laboratory grade instrumentation like that used in our AVL test program. The data compares the emissions reduction attained by the Ultera process relative to that from the emissions after treatment provided by the manufacturer.

As shown in the table, Ultera provides an improvement of 99% according to our test equipment and 91% according to the third-party instrumentation. Total hydrocarbons removal, THC, was improved by over 52% according to the third-party, while our instrumentation did not include the device to measure this pollutant. Ultera improved NOx removal by 24% and 29% as measured by our instruments and that of the third-party, respectively. While we reported our results in the first quarter call, we are pleased to add here that the more sophisticated third-party instruments closely match our measurements.

On the right-hand side of table 11 are two graphs that depict a different completed--a different test completed at low load that demonstrate the strategy we intend to use to obtain Near Zero NOx and CO emissions. In this test, we altered the engine tuning such that factory after-treatment is highly effective in the elimination of NOx.

As shown in the lower graph, NOx concentrations are very low from the first stage of factory after-treatment, and virtually eliminated by Ultera. The detrimental side effect of this tuning is that 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, tailpipe emissions for both NOx and CO are very Near Zero. While this test was done at low load, this tuning strategy has been utilized to great effect in our Tecogen CHP products under all operating conditions.

We have one final test planned for the fork truck. We will repeat the test, but utilize the third-party to determine the chemical constituents that make up of the mix of hydrocarbons getting past the factory after-treatment system. By precisely [sic] identifying these chemicals, the catalyst recipe using the Ultera stage can be altered to target these more effectively. We hope to do this work in the next few weeks.

In summary, these results, while expected, are still exceptional in their effectiveness. We see a direct path to Near Zero propane fork truck and look forward to our upcoming meeting next week with the manufacturer.

A couple of additional notes regarding the program - two weeks ago, we presented these results to the National Meeting of the Propane Industry in St. Louis. We feel the members were enthusiastic about our results and technology potential and foresee the group's members, which are companies that sell propane commercially, will be an important ally in our efforts to move the technology forward. The PERC staff, which organized and the hosted event, have encouraged us to submit a paper to their scientific forum held in October, which of course we plan to do.

Moving on to our gasoline automotive work, as reported in our first quarter call, we have contracted with a highly respected independent institute that specializes in Powertrain research and development to continue the technical portion of the work. Our goal is to upgrade one or more vehicles with Ultera to show the full implementation of the technology with specialized automotive grade components. This will enable potential partners to have confidence in their evaluation, especially regarding cost, based on the reliability.

We have funded the initial phase of this work to our subcontractor. Their initial work, which is mid-way at this point, requires about four months, four to five months and is focusing on optimizing our catalyst formulations. The later phases will focus on, first, on component development followed by completion and testing of the refined prototype.

Lastly, I want to update listeners on a few miscellaneous items. In early May, we were informed that our EU patent application from the Ultera process has been allowed, which means formal patent grants will be forthcoming. This is our foundation patent for the technology, which means it is an important milestone as we regard the European countries as important future markets. To put this in context, this patent has been obtained in about a dozen other countries, including the U.S., Canada, Mexico, Australia, while still being in process in India and Japan.

We mentioned in our last call we would be applying for public funds to supplement our mobile Ultera work with our subcontractor. This grant was submitted in April to a Southern California State Agency. We are optimistic as to its prospects as the Ultera process is well known and highly regarded there.

The listeners may recall that our press release on March 20, which announced the So Cal regulatory change to what is considered Best Available Control Technology. As we explained in the release, Ultera was highly impactful in prompting the new stricter standard adopted in that region.

The last item from our Q1 call was that we have quoted additional Ultera systems to an old customer in the stationary engine market. However, they're still considering our proposal, so I have no update today.

With that, I will turn the call to Bonnie Brown

Bonnie Brown: Thanks, Bob.

Moving on to the first quarter results, Slide 13 contains some of the highlights of the year-on-year financial results. First, total revenues for the quarter increased by 49% compared to Q1 of

'17. Product revenues alone grew by 31% compared to 2017 with a 274% increase in chiller sales year-on-year. Total service revenue grew 17% for the quarter compared to Q1 '17 and continued its steady growth, delivering well over half of our product and service revenue for the quarter.

Long-term service contracts and part sales decreased slightly by 2% on a year-over-year basis and continue to provide its reliable annuity-like revenue stream. We also have our energy production revenue from our ADG sites, which added $1.8 million to our total revenues for the quarter. This revenue stream adds an important second source of annuity-like revenue with its long-term contracts.

Product gross margin was 34.4% for Q1 compared to 37.4% for Q1 of '17. Service margin was 41% for Q1 '18 compared to 46.1% for '17. Installation projects, which carry a lower margin than 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 36% gross margin and $637,000 in gross profit, bringing our consolidated gross margin to 38% for the quarter and consolidated gross profit to $3.8 million for Q1 2018 compared to $2.9 million for Q1 of 2017, an increase of

$923,000 or 32% in gross profit year-over-year. Net income attributable to Tecogen for the quarter was $21,000 compared to $45,000 for Q1 '17.

As Bob, discussed earlier, we have invested heavily in R&D relating to emissions in the fork truck project. These costs for Q1 2018 amounted to $302,000 and are included in operating expenses for the quarter. Additionally, it should be noted that, due to a change in accounting standards, Q1 '18 net income includes the unrealized loss of $20,000 due to market fluctuations in the EuroSite Power Inc. common stock owned by ADG. In past periods, these unrealized fluctuations were presented in other comprehensive income or loss in the income statement, falling well below--falling below the net income line.

In January 2016, The Financial Accounting Standards Board, or FASB, issued an accounting standard update related to investment in equity securities requiring unrealized holding gains and losses to be included in net income. Prior to this update, the unrealized holding gains and losses related to such securities were included in the accumulated other comprehensive income and not in determining net income. The accounting standard became effective for the company beginning the first quarter of 2018 and is applied by a means of accumulative effect adjustment on the balance sheet of January 1, 2018. Net income per share, both basic and diluted, was at breakeven for both the first quarter of '18 and '17.

Slide 14 presents backlog and historical adjusted non-GAAP EBITDA. On the left is our weekly backlog chart of product and turnkey service projects. At the end of Q1 '18, backlog was $14.6 million and is currently at $16.6 million as of yesterday. Backlog at the end of Q1 '17 was $13.6 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 Q1 '18 of $304,000 compared to $191,000 in Q1 of '17, an improvement of $113,000. 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 quarter, which increased by an aggregate of $350,000.

Turning to Slide 15, 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 36.5. This chart illustrates the trend's increasing revenues over time in all revenue categories. The energy revenue is represented by the yellow right most bars in the chart, circled in green, which includes approximately 10 months of ADG's earnings. The chart on the right side illustrates the growth trend of our gross margin in blue along with the decreasing line of G&A and selling cost as a percentage of revenues over time in green. We expect cost controls and sales initiatives to continue to produce these results.

Operational expenses, although higher in absolute terms, have improved 10.7% year-over-year as a percentage of revenue, dropping to 37% of revenue for Q1 '18 compared to 41.4% for Q1 '17. Overhead cost control efforts continue and remain a focus going into 2018. There are, however, two components affecting the dollar rise in expenses that warrant mentioning. First is the consolidation within Tecogen's financials of the cost associated with ADG's energy producing operations. And second is our increased investment in selling and R&D activities, investing in the future.

On March 27, Tecogen completed the purchase of the 50% interest of TTcogen owned by TEDOM A.S for $72,600 [sic]. This purchase provides Tecogen with full ownership of all the in process contracts held by TTcogen as well as the exclusive right to market, sell and distribute Tedom's T35 combined heat and power equipment with an agreed upon territory. Tecogen will continue to provide services for Tedom equipment sold by TTcogen and by Tecogen.

In addition, we are happy to report that, in May of 2018, we entered into an agreement with Webster Business Credit Corporation for a secured revolving line of credit for up to $10 million with terms of three years. The availability of funds is based on percentages of the company's eligible accounts receivable and inventory balances. Upon closing, we used the available funds to repay the notes due to a related party of $850,000 plus the accrued interest, fully

discharging our obligations under this agreement. The company plans to use the credit line for working capital and for expansion and growth.

Management continues to work to exceed its goals, and the liquidity that this $10 million credit line provides will improve our ability to focus on growth and reduce our cost of operations and borrowing. With working capital, we will be better positioned to take on larger projects.

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

Ben Locke: Thanks, 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. Tecogen is uniquely positioned to take advantage of trends in the utility industry that value cogeneration as a means of improving our country's grid infrastructure. The InVerde e+ system with onboard CERTS microgrid controllers is the most cost-effective way for 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.

And all of this is accomplished with Near Zero criteria emissions from our Ultera emission system, which was acknowledged earlier this year as Best Available Control Technology, or BACT, for stationary non-emergency generator emissions.

With regard to our emissions technology development, we're making great progress on both our fork truck emissions retrofit and our automotive emissions. As Bob mentioned, we expect to share a fork truck results with PERC and the fork truck manufacturer later this month with the goal of defining a follow-up demonstration to retrofit a fork truck fleet or a subset of a fleet with the Ultera missions.

Our automotive emissions technology is also making excellent progress as we continue to develop a prototype using a subcontract R&D group with global recognition in vehicle Powertrain and emissions after-treatment development. We expect the first phase to be developed--development to be done this spring, and as Bob mentioned, we are actively seeking partners for the next phase.

Similar to the fork truck effort, our goal is to locate a suitable partner to possibly retrofit a small fleet of vehicles, potentially trucks initially, with the Ultera emissions technology to demonstrate its performance and implementation in a vehicle.

Our presentation at the SAE World Congress in April generated interest in the industry, and our recent patent award in the European Union gives us freedom to explore partnerships or other arrangements with European automobile manufactures and suppliers. And as Bob mentioned, we're exploring options for funding the next stages of the automotive emissions technology, and of course, we'll share development so they occur.

I am very excited about the prospects for Tecogen in 2018 and beyond. We continue to demonstrate profitable operations in our core markets. We are successfully addressing new market opportunities, such as indoor growing, and our emissions technology is getting closer to being demonstrated in both fork trucks and eventually automotive applications. It's a great time to be a Tecogen shareholder, and I hope to continue our tremendous achievements throughout the year.

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

Operator: Thank you. At this time, we will be conducting a question-and-answer session. If you would 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 the 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 Amit Dayal with H.C. Wainwright. Please proceed with your question.

Amit Dayal: Thank you.

Ben Locke: Good morning, Amit.

Amit Dayal: Good morning, everyone. Good morning, good morning. Hey, congratulations on the execution coming through. On the chiller sales, just wanted to see if you guys are doing anything more specific around driving sales in that space, or is this just sort of an organic demand from the market that is discovering your solution that is coming to you?

Ben Locke: Yeah, we're being very outgoing in terms of developing that market segment. There are trade shows--well, there's lots of trade shows, but picking out the best trade shows--for example, on indoor growing, we represent ourselves there. Trade shows for other chiller applications, HVAC shows for example--there's many mainstream HVAC shows that we participate in. And we're being very, very aggressive that way from an outgoing standpoint.

The key to chiller sales is it's not as much direct-to-customer as it is you've got an intermediary, which is oftentimes an engineering company, that's hired by the facility to design the entire facility as well as the HVAC component to it. And so, a lot of our effort has been meeting with the engineering companies and developing relationships with them to get them to understand that engine driven chilling is indeed a very promising economic alternative to traditional electric chilling.

And I think we've been very successful in getting these engineering companies to understand that, to understand the economics and to present that to their clients as a viable solution. So, I'm very happy with our efforts to reach those markets. And we're being very aggressive, as I said, with trade shows and other type events.

Amit Dayal: That's great. Do you think there is any seasonality with chillers sales? I know it's still early in terms of developing this market for you, but is this industry susceptible to any seasonality?

Ben Locke: Yeah, there is a bit, Amit. There--certainly on the East Coast where the sparks spread--the economic returns of engine-driven chillers are the best. There's a cooling season. And everyone needs to have their equipment online in April. This was a weird year this year. It

got hot early. But, yes, there's a cooling season than we typically will see a lot of orders for in the third or fourth quarter, even the first quarter, because they want to get them online in time for the cooling season.

Now with that said, we still--that's for traditional cooling. For the growing applications, it is not so much seasonality--certainly for the West Coast, not so much seasonality. But, there is a little bit to it. And there are indeed--chillers fail, and when they fail, there's, as you can imagine, a big hurry up to get them replaced, which is why--tying it back to the Webster line of credit is very important. That allows us the financial flexibility to keep some of the major components of chiller manufacturing on hand. So, if were to get an emergency request for a chiller, which we've gotten in the past, we would able to respond and get them a chiller quickly to potentially address their need.

So, I know that's a long answer, but yes, there's a bit of seasonality to it.

Amit Dayal: No, that was helpful, actually. And just maybe one last one for me - on this May 23 meeting, I guess one of the goals is to come to some agreement with finding a fleet of fork trucks that we can demonstrate this maybe in a live setting. Is that--I just wanted to make sure I understood that correctly, or is this something else on the agenda, as well, that you want to accomplish from this May 23 meeting on the PERC side?

Ben Locke: Bob, why don't you answer that?

Bob Panora: I'm sorry, I was looking at the screen. Could you repeat that again, please?

Amit Dayal: Yeah, so this May 23 meeting for the PERC effort, just wanted to make sure I understood the agenda for that meeting. Is it to basically see if we can find a fleet of fork trucks where we can get a demo setup going, or is there--are there other items on the agenda for that?

Bob Panora: I think the main items are to review what we've done. They can get a close look at the device and the components associated with it. And they are going to take that back. And of course, if they're impressed, which I think they will be, it'll be discussed with their supplier for the engine to that, which is part of the same company - it's another division. And I think they will try to work out some next part of the program.

And I'm going to recommend things of that sort at the end of the meeting, and I think it'll head there. But, I think the main goal is to have them fully understand what we're doing, get an idea of how easy or difficult it is, and then bring that story back to the engine supplier that supplies the components, which again is part of the same company.

Ben Locke: It would certainly be a natural progression for that to occur to try to have this--make this fork truck manufacturer identify a small fleet of trucks that could be retrofit. And that's the beauty of the Ultera for this application - it's readily amenable to be retrofit. It doesn't have to be incorporated in a new fork truck design. You saw the pictures that Bob showed - it fit right under there and you wouldn't even notice it's there once the fork trucks reassemble. So, doing a field retrofit of a small fleet I think is--would be a reasonable next step, and we're hoping that this meeting later this month, that'll come across the manufacturer.

Bob Panora: We do--I do have a specific opportunity in mind, which I can't talk about, but--that I think I'm going to bring forth. But, that's where that meeting will head at the end I hope.

Operator: Thank you. If you would like to ask a question, please press star, one on your telephone keypad. As a reminder, if you would like to ask a question, please press star, one on your telephone keypad. One moment please while we poll for questions.

Our next question comes from the line of Patrick Murphy with the Maxim Group. Please proceed with your question.

Ben Locke: Good morning, Patrick.

Patrick Murphy: Hey, guys, good morning. I'm just curious, can you describe that sales cycle for the indoor growing sector? Is that comparable to the traditional CHP product sell-through?

Ben Locke: A bit - it is, as I mentioned before, a sale that's governed in some part by the involvement of engineering companies, which I think is a very good thing to have a qualified engineer verify our economic projections, verify all of the benefits that we're proposing to facility owner, really substantiates what we're saying as opposed to the building owner just believing our salesman. It has that verification of it.

So, it tends to be somewhat directed and organized. As the facilities are being built and the engineering is being done, we become part of the drawings, and then once you're part of the drawings, it goes through construction, etc.

But, with that said, we have had some happen very quickly. Here in Massachusetts, you might know the legalization of recreational use of marijuana has created a tremendous swell of activity in getting growing facilities up and running. And we're involved in some way, shape or form with almost all of those projects. And some of them are going much quicker than others, much to my delight. And some of them do take a little bit longer, as opposed to cogeneration sales. Cogeneration sales sometimes follow that same trajectory, meaning that there's a third-

party engineering company involved and etc. Sometimes, the cogeneration sales ends up being a complete customer reach where you're selling to a condo board or individual hotel owner, and you're subject to the whims and vagaries of a sale to an individual in terms of timing.

But, I think to summarize, in general, the chiller sales tend to be a bit more structured because you're oftentimes dealing with engineering companies or developers that are preparing an overall package for the facility.

Patrick Murphy: Okay, that's very helpful. A follow-up - in terms of backlog, can you give us some color on the average project price that's included in that backlog? And do you have any major projects that you expect to hit either next quarter or the following?

Ben Locke: Yeah, we don't typically provide that level of detail to our backlog. I will tell you that the backlog consist of product sales, units physically going out the door, as well as the--in some cases, the installation of those. And a typical example would be a cogeneration sale of a unit could be between $100,000 and $200,000, but the full installation of that, the revenues involved with that could be upwards of $0.5 million or more, because of course, the installation has revenues associated with mechanical and plumbing, etc.

So, we don't break out that in the backlog. I will say the backlog, generally, that the unit sales happened within typically two or three quarters for them to be realized whereas the installations take longer, potentially upwards of a year sometimes to do a very complex cogen installation. But, sufficed to say, the backlog moves through pretty regularly. You see it ebb and flow, and I think you might have seen Bonnie's graphic earlier when you show the kind of peaks and valleys as we go through the backlog and gets rejuvenated. So, it's a healthy mix.

And then the last thing I want to say is, please remember, it does not include the service revenue, which is kind of steady-ready each quarter at around--coming in consistently as well as the ADG revenue. So, those two components are not in the backlog.

Patrick Murphy: All right, thank you, that's very helpful.

Operator: Our next question comes from the line of Hayden Cole [sp] with Banshee [sp] Holdings. Please proceed with your question

Ben Locke: Good morning, Hayden

Hayden Cole: Good morning. Congratulations on a great quarter and--.

Ben Locke: --Thank you.

Hayden Cole: --Overall trend into '18. Everything looks really promising. I was hoping that you all might be able to give us an update on the catalyst that's being developed at the Southwest Research Institute, and if there is any color that you can tell us about that, what the rest of the timeline is there?

Bob Panora: Right, this is Bob Panora. Thanks for the question. The catalyst being developed, I think there are approximately a half a dozen formulations that, after all the testing we did at AVL, we saw what was going in and what was going out of the emission system, and identified species and so forth. And we look for our science people, which is Achmed [sp] and the folks that are doing the testing, to recommend what would enhance what we saw and what we'd like to do. Again, I don't think I have any results that I can report, but I think it's going fine. And I think about another two months, they'll be done with that.

And a lot of what they're looking at is, in the surface chemistry of the catalyst, if--we identified a mechanism that we didn't know about until we did the testing in AVL whereby, in the acceleration and deceleration of a vehicle, there is a certain amount of storage of chemistry that causes NOx to get deleted and have reported like 25% to 30%. And that was a surprise to us. And we're--a lot of what we're looking at the catalyst is to enhance the chemical storage

that takes place in the ups and downs of acceleration and deceleration that will enhance that, plus a few other things that I can't talk about.

But, the way they do the testing is they built--well, they order or get from the supplier small coupons that are a couple of inches in diameter, and they test them with very specific gases at certain rates of simulating acceleration and deceleration. And they can identify all sorts of properties. That's probably more than you wanted to know, but that's the gist of it.

Ben Locke: Yeah, and I'll just add a very important consideration of why we're doing this work is I think we've got a very good understanding now of how this actually could be deployed in a vehicle and--in terms of very practical questions such as geometry or weight, cost, performance, all of those things that are very important questions that we've been asked. And so, this round of testing is--accounts for all of that. And we're feeling very comfortable about each of those things.

Certainly don't see any impending showstopper of this thing needs to be the size of a refrigerator on any car. No, it's going to be actually something that's very manageable, something that would be considered an OEM part that you could go underneath the car without too much headache, and again, with the idea of a retrofit. So, this work that's being done by our subcontractor always has the idea of practical implementation in mind, which I

think is very, very important as we move this forward hopefully to a retrofit, understanding that doing a deal, an end run deal with the car manufacturer might be a very long timeline to get that, whereas doing a retrofit of a very modest fleet of vehicles, say a truck fleet, for example, could be something we can consider on a reasonable timeline with equal success in my eyes in terms of demonstrating the viability of it.

Hayden Cole: Fantastic. Yeah, no, really appreciate all the color, Bob, especially on the way that you guys are presenting the information about what's happening with these different gases in the lean drive cycle and in the fuel-rich drive cycle I think is extremely illustrative and powerful for shareholders in the market. So, I really appreciate the additional color here. And that's all from me. Thank you.

Ben Locke: Thank you.

Bob Panora: Thanks.

Operator: Our next question comes from the line of Roger Liddell with Clear Harbor Asset Management. Please proceed with your question.

Ben Locke: Hi, Roger.

Roger Liddell: Good morning. I wanted to pursue the situation in Florida where the legislation, I believe it was late fall or wintertime, but you can clarify that, the legislation mandating islanding for critical healthcare facilities. And I should think, with that change and the fact that underground natural gas distribution systems qualify--again, my understanding--qualify for robustness under these conditions, it ought to be a big opportunity. Can you clarify?

Ben Locke: Yeah, of course, Roger. And I'm quite aware of the Florida initiative. I think it was SB 7028 and HB 7099 where the legislation the Governor introduced in Florida to require assisted living facilities and the like to have a backup generation. And indeed, cogeneration would be a proxy for that. The cogeneration is our InVerde that provides the Blackstar Power. Florida is--there's many trends in Florida that are starting to be quite compelling for us.

We already have installations in Florida, Roger, I think you're aware of. We've got many of our Ilios unit down there. We have a few chillers down there. We have some cogeneration prospects coming along. In fact, Florida is very likely to be--is not definitive yet, but Florida is very likely to be our next service center location so they can handle Southeastern United States because of the population of engines that we're having in Florida and in Kentucky and around that area. But, I think even more importantly, recently, as you just alluded to, there's trends and regulations that are going to support it beyond just simple spark spread economics.

The resiliency piece was brought into stark contrast with the storms that came through. And now not just nursing homes and where a lot of press was, but hotels and generally any type of living facility wants to have that back-up piece now. Once you've experienced an outage, it's very difficult you would imagine another one. And so, in that case, the cogeneration and our chillers, as well, because as you know, electric chillers--in that nursing home example, they needed a tremendous amount of backup power to run their electric chillers whereas our natural gas chillers only need a trickle of electric power in order to maintain operation during an outage.

So, these resiliency factors I think are starting to weigh in on people and getting people to get past a little bit of a longer ROI in favor of having this resiliency piece. So, it's a great observation. Florida is absolutely very high on my list of geographies where we're going to see increased activity.

Roger Liddell: Yes, I'm particularly interested in that. As you're pointing out, the spark spread is not the only driver in Florida, and surely, there are other places, but let's just stay with Florida. And you mentioned the ancillary services that CHP equipment can provide - demand charge reduction, frequency stabilization, phase control. I mean, this is the kind of stuff that

overrides or at least allows the spark spread to be no longer the sole criterion but is simply a factor among four or five to be considered.

Ben Locke: Roger, you're exactly right. And I'm very excited about a lot of these programs that are starting to come up, really starting in California where there's a tremendous population of distributed generation, mostly solar out there. And the grid is--and while it's renewable generation which is good, it makes--it's challenging for the grid to react to power swings when you've got all that DG out there. I think the Germany example is maybe--you may be familiar with the Germany example as similar. And so, the utilities are starting to put in some policies and regulations so they can get a better grip on that as well as incentive programs - as I mentioned, the frequency control and the reactive power controls, if you're able to help them out.

And that is picture perfect for our InVerde and our microgrid controllers because that's what we developed it for is to be able to have that communication, to be able to control the CHP output, potentially control the storage also attached to our equipment, a battery storage. You could have a solar component to it.

But, all the communications and all the controls of that would be operated through the Tecogen brand in the InVerde. So, I'm pretty excited about all those developments that are

happening and the place of Tecogen, the role Tecogen can play in those. And as you've said, it chips away that ROI. Every little bit counts, and it chips away that ROI.

Roger Liddell: Yeah, thank you.

Ben Locke: Thanks, Roger.

Operator: Our next question comes from the line of Alex Blanton with Clear Harbor Asset Management. Please proceed with your question.

Alex Blanton: Hi, good morning.

Ben Locke: Hi, Alex.

Alex Blanton: How are you? I'd just like to ask, how should we think about the need for the $10 million line of credit. What do you envision there? Is that just a back up? Or, is there some specific plan for using part or all of that money?

Ben Locke: Yeah, I think the most practical use of that line of credit is the most important, which is it just gives us the flexibility to go through our sales cycle and our production cycles

without worrying about cash flow. I mean, I hate that I can't preorder the raw materials needed for a chiller so I can have one on hand if a chiller fails and someone needs an order right away overnight. So, having that financial flexibility to keep inventory on hand, to keep equipment on hand for rapid orders is very important to me.

Secondly, a lot of our--or I wouldn't say a lot, but a fair amount of our installations have some type of incentive attached to it, and I'll give you the example of New York. New York gives you an incentive for installing cogeneration as well as chillers. But, that incentive doesn't come all at once. They stage. And that incentive comes directly to us. It doesn't go to the customer. The customer pays the cost of the unit and the installation net of that incentive.

And so, we have to wait for that check to arrive from the state, and that check doesn't arrive on day one, certainly not. That check arrives in three stages. And you have to have the project completely closed out, all the permits closed and every I dotted and T crossed before you see that final payment. So, it just creates a cash flow headache sometimes. So, having a line of credit just kind of alleviates the nervousness and the headache of having that--those cash flows be a little bit longer than we expected.

Alex Blanton: Okay, thank you. And I'd also like to ask about the 51% increase in selling expense that is mentioned in the press release. It says the increase in selling expenses was due

to an increase in marketing-related activity and higher sales commissions. So, could you discuss the increase in marketing-related activity and where we might expect the next burst of growth to come from?

We're kind of losing track of that because you have not put out very many releases on orders so far this year. So, in between the reports of backlog and sales, it's hard to get a sense of how the basic business--I mean, you've given us great detail on the new projects, the forklifts and Ultera. But, we also--we have the basic business to think about and what's the growth rate of that.

Ben Locke: Sure. Yeah. I mean, our--I am absolutely investing in our sales team as aggressively as our balance sheet can permit. I mentioned the actions we've been doing to attend trade shows related to our core markets, the variety of our core markets. Particularly, as I mentioned before, for the chillers, that is very much a segment that requires to be at trade shows and to meet people and to talk to people, and that's how the business gets done in the HVAC industry really is through these trade shows, these targeted trade shows. So--now, we could go to a trade show every week, and I don't want to do that.

But, prioritizing those important trade shows and getting to the right ones--I think we've shown pretty good results, again with the chillers sales being the example that we're identifying the

right sales channels, investing in the right sales staff and what they're doing to make sure we get decent sales.

On the cogen side as well as the chillers, I mean, there's commissions involved with our external sales partners. I think I've mentioned in previous calls, our sales channel is comprised kind of a three components - it is our direct sales team, of which we've added a few bodies over the past year or so to the direct Tecogen sales involved. Then there is our manufacturers representatives or reps, which typically are involved in chillers, but we've got a few cogen reps, and those are typically in areas that the spark spread or the economic viability is still good--it's not as valuable as some of our core areas like New York. But, we still want to have representation, and a manufacturers' rep as the cost-effective way to go. And then our third line of sales is we have a whole handful or maybe two handfuls of sales agents that are kind of anointed to go forward and represent the Tecogen equipment, and if they're able to close a sale, they get a commission.

As you mentioned, the commissions was mentioned in our press release as being higher. I sometimes don't like paying commissions, but on the other hand, I do like paying commissions because that means that one of these guys sold something and contributed to our revenue. So, I think our sales team right now is in a very good place in terms of who we have on board as Tecogen employees, how we're deploying them in terms of resourcing of trade shows, other

marketing events, etc., our rep network and our sales agent network. I don't see a tremendous step change in our sales expense in the next--for the rest of 2018 certainly, but success breeds success. And the more we continue to grow, the more I expect that team to grow.

Operator: Thank you. Ladies and gentlemen, we have reached the end of the question-and-answer session, and I would like to turn the call back to Mr. Benjamin Locke for closing remarks.

Ben Locke: Well, I'd like to thank all of you once again for joining this call. I think we've got lot of good results that we can build on. Certainly, in terms of the emission,, we have a lot of activity coming up this spring that we'll be happy to report on as it occurs. And of course, we'll be talking with you again, I suppose, in August for our second quarter conference call. Thank you all for joining.

Operator: This concludes today’s conference. You may disconnect your lines at this time. Thank you for your participation.