EuroSite Power Inc. [EUSP]
First Quarter 2016 Financial Earnings Conference Call
Monday, May 16, 2016, 9:00 AM ET

Company Participants:
Bonnie Brown; CFO
Elias Samaras; CEO
Paul Hamblyn; Managing Director

Presentation:

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

The recording of this conference call will be available for playback approximately one hour after the end of the call and will remain available until Monday, May 23, 2016. Individuals may access the recording by dialing 877-344-7529 from inside the United States, and 855-669-9658 from Canada, or 412-317-0088 from outside of the United States. Enter the replay conference number 10084858 followed by the hash sign.

Now I'd like to introduce Bonnie Brown, EuroSite Power's Chief Financial Officer. Please go ahead.

Bonnie Brown: Thank you, Denise. Good day and thank you all for joining us on our first quarter 2016 earnings call. On the call with me today is Elias Samaras, our CEO and Acting Chairman of the Board; Paul Hamblyn, our Managing Director; Ariel Babcock, our Director of Investor Relations; and John [Ashbrook], our VP of Finance.

Before we begin, I'd like to read our Safe Harbor statement. Various remarks that we may make about the Company's future expectations, plans and prospects constitute forward-looking statements for the purposes of the Safe Harbor provisions under the Private Securities Litigation Reform Act of 1995.

We may make forward-looking statements about our future financial performance that involve risks and uncertainties. These risks and uncertainties could cause our results to differ materially from our current expectations. We encourage you to look at the Company's filings with the SEC to get a more complete picture of our business, including the risks and uncertainties just mentioned.

Also during this call, we'll be referring to certain financial measures not prepared in accordance with generally accepted accounting principles, or GAAP. A reconciliation of the non-GAAP financial measures used on this call to the most directly comparable GAAP measures is available in our press release and in the tables accompanying that release.

While we may elect to update forward-looking statements at some point in the future, we specifically disclaim any obligation to do so, even if our estimates change. And therefore, you should not rely on these forward-looking statements as representing our views as of any date subsequent to today.

Now I'll turn the call over to Elias for some opening remarks.

Elias Samaras: Hello, everybody, good morning and good afternoon for those joining us from [Latin] or Europe or elsewhere. First of all, I'd like to welcome everybody and thank you for the time, actually. Before I start the regular reporting about the Company, I would like to tell you, that as some of you may have already in our press release earlier today, after over a half a decade with EuroSite Power, our Board Chairman and Founder, Mr. John Hatsopoulos, has resigned this morning and as you know probably, John, alongside his brother, George Hatsopoulos, pioneered the onsite utility business model when they launched American DG Energy back in 2001. John was at the forefront of what we developed today into a robust power purchase agreement industry and well ahead of the competition in developing this type of offering.

As the Chairman of the Board, Mr. Hatsopoulos' years of experience have provided him valuable guidance, as we established the onsite infrastructure in the UK and Europe. We have to thank him, and we do thank him very much, for his many years of dedicated service and welcome him to our family of long-term shareholders. We will be very grateful to John and I hope John still remains with us and visiting us and talk with us anytime he has time.

Now, going back to the regular reporting about our Company, and during our last earnings call, we had set up, as you know probably, the four pillars and we have succeeded in meeting all four of them. That is, we have reached agreements to finance future projects with both Societe Generale and Macquarie. We have also concluded agreements with TEDOM, which is a Czech-based CHP manufacturer, so that we could expand in Europe.

We also brought in-house maintenance so that we don’t have to depend any longer to a third-party maintenance company. And we finalized agreements with Corona Energy to provide lower cost gas to our customers, not only for running our treatment but also to sell it to the customers, sell actually gas to the customers.

Now, that is what we have done the previous quarter. This time around, I'm very pleased to announce to you that we have announced a private placement about a week ago to raise about $7 million and we're very happy that this has been successfully concluded.

The Company has raised exactly $7.25 million and these funds will fully pay off the outstanding loan on the balance sheet, and of course, put EuroSite Power in an even stronger position to

execute on our expansion plan. That was very substantial for us to be able to continue running the business, execute our backlog and proceed to the future expansion.

On the other hand, the good news for this past quarter, the first quarter, is that we've improved tremendously the gross margin, exceeding the target that we set out in the previous quarter of 35%. The margin actually has improved and reached 37.2%, which is about 13% more than the first quarter of the previous year. This of course, improves very much our bottom line.

We have now overall -- this is of course, without the [precision]; with the [precision], the overall gross margin now has been increased about 13% from 7% [over] 20%. This I think is because primarily, the change of the maintenance way that we were doing before. We now are 100% using our in-house maintenance engineers instead of paying a third-party. And this also, the new contract that we signed with the gas company, so that we can provide wholesale price to customers and to run their treatment at our (inaudible) has contributed very much to some of the savings to get that we tried actually to do.

Now, with this strong gas position, and in fact, a new group of investors, the Company is in a position to accelerate its growth and we had several meetings. And in our last Board meeting, we decided that one way to expand and accelerate the growth of the Company actually is to go after larger customers now that we have the banks to back up all the finances and installation costs; and also through an acquisition strategy. The fact that the Company has now enough cash on the balance sheet as well as the two banks, but most importantly, the new investors that joined EuroSite during the private placement brings us in a very good position to expanding through an acquisition strategy.

And we're now trying in the next few months to identify potential probably installations, existing installations, co-generation, which we'll acquire and then apply our proven model of onsite utility. And hopefully having this, we can speed up the growth. This is our plan for the next few months and so we hope during our next -- after this earnings call to be able to have some good news for you.

Regarding the operations, I'll ask Paul Hamblyn, who is the Director of the Company, to give you more detailed information. And Paul, I'd appreciate it if you could please provide some information about the operations in the last quarter. Are you ready?

Paul Hamblyn: Yes, indeed, Elias. Thank you very much. So welcome, everybody. I'm very pleased to give you an overview of the operations within the business over the past quarter.

I think it's always useful to start, just for the benefit of those investors that may be joining us more recently, just with a brief summary of what we do as a business. So we offer On-Site Utility solutions to customers here in the UK. What that means is that we own and operate combined heat and power solutions, and we sell electricity, heat, and hot water on long-term contracts to our customers. Typically, those contracts are 15 years in length.

In addition to myself, I'm supported by a staff of seven, plus one additional consultant, a number of installation subcontractors and one specialist partner that helps us with maintenance on some of our TEDOM fleet during the warranty period of that equipment.

So to begin with, I'd just like to cover some of the financial highlights for the quarter that's just closed. As you've seen from the press release, total revenue in the period rose by some 25% to just over $687,000. The growth reflects both the increase in the number of operating systems within our fleet. In fact, that number rose from 25 for Q1 in 2015 to 30 units operating by the end of the quarter this year.

It also reflects the fact that many of the systems we've added over the past 12 months are actually larger units using the TEDOM equipment and typically range between 125 and 200 kilowatts in output capacity.

What's interesting is if you compare the revenue growth to that of the increase that we've seen in energy production, there's a slight difference. So as I said, energy revenue grew by 25% but in fact, energy production in the same period grew by 40%. What this illustrates is the change we've seen in the underlying utility tariffs through the difference between the quarter just closed and the same quarter last year.

The major improvement we've seen this quarter has been, as Elias has said, the rising gross margin and just to be clear, the margin we're here comparing is excluding depreciation. And in fact, in Q1 of 2015, we saw that rise from 24.3% to 37.2% in the quarter that just closed. If we now include depreciation, we've actually seen that rise from 7.8% to 20.8% this year. In both cases, that exceeds the targets that we set ourselves and we're very pleased to see those results happen so early in 2016.

So why has it happened? In truth, the single-biggest contributor to the improved margin is the fact that we've seen underlying gas prices fall somewhat faster than electricity prices year-on-year.

In addition, the work we began earlier last year is quite clearly delivering results. So for example, the switch to in-house maintenance for our Tecogen fleet, ensuring that we sell our projects with a better margin locked in from day one, and the work that we've been doing to optimize the fleet operating hours and higher seasonal or time of day electricity tariffs, and lock those in, and just basically get more out of our fleet.

The other thing we've been working hard on is enhancing the efficiency and the unit availability while at the same time, maximizing the kilowatt output from the fleet.

Elsewhere we've worked hard to contain the operational expenses within the business and we've seen costs rise 2.7% compared to the same period last year. Principally this is due to adding a new salesperson to our team toward the back end of the quarter.

Non-GAAP EBITDA cash flow for the quarter was positive at $123,850 (inaudible) 2015. This was the result of receiving the enhanced capital allowance monies from the UK government during the first quarter of this year.

Moving on to look at some of the metrics we consider and look carefully at in terms of fleet performance, I'd say that at the end of March 2016, our operating fleet numbered 30 systems, 16 of which were Tecogen units; 10 were TEDOM units. We had one MAN engine-based unit and a couple of other smaller units at some sites. This number includes the system that was brought into operation during the quarter at the [Little Down] Center in the south of England.

Fleet capacity now totals 3,078 kilowatts; some 722 kilowatts higher than the fleet we had in operation at the end of the same quarter last year.

This all helped to push up our total energy production for the quarter and in fact, we delivered 9,940,000 kilowatt hours, a rise of some 40% compared to the same period last year.

In addition, we've worked hard to complete the number of upgrades to a couple of our sites which has further enhanced the output and helped them to push our daily electrical generation up to a record of 48,000 kilowatt hours per day shortly after the quarter ended.

Through the quarter, the fleet [cropped] up some 35,500 operating hours, also a rise of 40% compared to the same period last [year].

Overall fleet efficiency was 79% and this is actually down 1 percentage point to the same period last year, but the reason for this is that we now have more TEDOM units operating in the fleet and the gross efficiency of those units is very slightly less than that of the Tecogen unit. So therefore, the drop is entirely consistent with what we'd expect now that we have 10 compared to 4 TEDOM units operating within the fleet.

The average kilowatt output for the quarter was 103 kilowatts compared to 100 kilowatts during the same period last year.

As you know, we've been working very hard on reliability, and to measure our reliability, we use a metric called operational availability, which basically compares the number of hours the machines have actually operated to the number of hours that technically, they could have operated, given the time settings that have been entered into each machine.

What I'm pleased to report this time is that fleet availability was 88% for the quarter. This is the best we've ever achieved, and a dramatic improvement over the 72% availability posted in the first quarter of last year.

We've obviously been doing a lot of work to improve reliability, as that number indicates. We've also been rolling out a number of upgrades to try and improve the reliability yet further and also to reduce our maintenance costs in the long term.

Just quickly to talk about two of those, the first was that our process of trialing electric ignition on the Tecogen units has proven very successful and we're now in the middle of a program to roll that out to all of these 16 units in the fleet and 5 have already been completed, and we remain on target to have that work fully executed by the end of the current quarter.

The other thing that we've been trialing is an extended oil tank for the Tecogen units. The aim here is to increase oil capacity, further improve reliability and then also to extend the service intervals so that we have an opportunity to improve the margin yet further. Although this trial is fairly early-stage, the results so far have been successful, although we haven't yet taken a decision to roll this out across the fleet. That decision will be taken a little bit later this month.

As I said, at the end of March of this year, the operating system totaled 3,078 kilowatts. The contract value of that fleet using the measures that we assess to look at value, totaled $85 million. And in the quarter, we also sold our largest system to date, a 331 kilowatt solution for the Dome in Doncaster. This project will actually be funded by SocGen or Societe Generale, and that order is currently within our current backlog.

That backlog number is a total of 7 systems totaling 1,021 kilowatts with a contract value of $20.9 million. Of those 7 systems, 2 of them are actually (inaudible) commissioning this quarter, and installation work on the Dome project is due to commence within a few weeks and it's planned for completion during the third quarter of this year. The other 4 systems are at various stages of consent, design or pre-construction process.

Just turning now to sales, as I said, we successfully secured the On-Site Utility agreement for the Dome earlier in the quarter, but I'm also pleased to report that we have now -- during the quarter, we signed our first gas resale agreement with the arrangement we have in place with Corona Energy. This covers three sites and produces a saving for the customer of some £83,000 a year.

Importantly though, it delivers us an additional £30,000 additional revenue for the year and also improves our margins on the sites covered by this agreement by up to a third, giving us an additional £20,000 of cash into the business through the year.

Now that this work has been proven, we're now rolling out the gas contract to most of our other customers and we've already identified two key customers with a total of six sites that we intend to bring within that contract within the next few weeks.

Our immediate sales pipeline for new On-Site Utility contracts continues to grow. We have a 400 kilowatt system for a major hotel where we signed a term sheet and gained credit approval from one of the banks. In addition, there's two further systems for a local authority and a third, a small system, for an existing customer again where credit approval is already in place.

Then finally, in the immediate term, we have another 330 kilowatt system for a leading university that we believe is moving quite quickly towards a decision.

Elsewhere, we continue to pursue a number of major opportunities, including a private healthcare provider. We're actually -- we're now working in cooperation with Macquarie as they

have a good relationship with the corporate finance team within this business, and we feel together we can work much more closely to bring that to fruition.

There's also a number of midsize UK hotel groups and of course, we're continuing to work on the NHS Estate, which numbers over some 300 properties that are suitable for our solution.

Strategically, as Elias mentioned at the beginning, we signed our agreement with TEDOM to make use of their European dealer network and we've been working over the past few weeks to actually begin that process by marketing to those dealers. And already, we started engagement with a couple of the dealers to actually look at some specific projects. Our aim is to secure our first project outside the UK later this year and I hope to have a report on that over the coming earnings calls.

Operationally, we're busy assessing the viability of bringing the TEDOM, maintenance of the TEDOM units in-house as the warranty periods begin to expire on those units approaching their second birthday. This won't actually begin until July this year, but we're making good progress toward that decision and I'd expect to be able to update you in the next earnings call.

So to sum up, the quarter has seen us deliver significant improved gross margin and to post a solid rise in both revenue and energy production. We've seen a dramatic improvement in fleet availability and then on the sales side, we've been able to sign our largest On-Site Utility to date and also sign up our first customer under the new gas sale resale agreement.

As Elias said, we've also completed a significant private placement, raising some $7.25 million and allowing us to eliminate the loan note that was outstanding on our balance sheet. And that, together with the agreements that we now have in place with Macquarie and Societe Generale, provide us with the project funding and the cash required to be able to move the business forward rapidly over the coming months.

I look forward to continuing to report yet more success as the year progresses. And with that, I'd like to hand it back to our operator for questions, please.

Operator: Thank you, sir. We will now begin the question-and-answer session. (Operator Instructions).

And in showing no questions at this time, we will conclude the question-and-answer session. The EuroSite Power first quarter 2016 earnings conference call has now concluded. Thank you for attending today's presentation. You may now disconnect your lines.