

[EUSP] EuroSite Power Inc.
Third Quarter 2016 Earnings Conference Call
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Company Representatives

*Bonnie Brown; CFO
Jacques de Saussure; Chairman of the Board
Elias Samaras; CEO
Paul Hamblyn; Managing Director*

Analysts

*Michael Zuk; Oppenheimer & Co.
Thomas Orr*

Presentation

Operator: Good morning, and welcome to EuroSite Power third quarter 2016 financial earnings conference call. (Operator Instructions)

For your information, this conference is being recorded. As a reminder, a recording of this conference call will be available for playback approximately one hour after the end of the call and will remain available until Thursday, November 17, [2016]. Individuals may access the recording by dialing 877-344-7529 from inside the US, 855-669-9658 from Canada, or 412-317-0088 from outside the US. Enter the replay conference number 10094776, followed by the pound or hash sign.

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

Bonnie Brown: Thank you. Good day, and thank you all for joining our third quarter 2016 earnings call. I'm Bonnie Brown, EuroSite's Chief Financial Officer. On the call with me today are Jacques de Saussure, our Chairman of the Board; Elias Samaras, our CEO; Paul Hamblyn, our Managing Director; and Ariel Babcock, our Director of Investor Relations.

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 purposes of the Safe Harbor provision 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 will 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.

I now turn it over to Jacques for some opening remarks.

Jacques de Saussure: Thank you very much, Bonnie. And I would like to welcome all participants to this third quarter earnings call. And it is actually the first that we do as a fully independent company.

And before I hand over to Elias and Paul, who will go through the results for you, I want to share some of the key points for this quarter. And I'm sure, first, that you will agree that the most significant event is that EuroSite Power has become a fully independent company. This resulted from the decision from our former parent company, American DG Energy, to restructure its debt.

And we have now a very experienced board. We have support of some very dedicated shareholders and, therefore, think we are now in a very good position to enter a new phase of growth based also on our strong balance sheet.

So regarding the quarter, I would like to mention two main points. The first point, financially, is the continued progress towards achieving higher gross margins. You know that the summer months, third quarter, tend to be relatively weak months for our company. Because the summer months fall so that the energy output is also weaker. And we have, of course, some fixed costs. And therefore, the margin has always been lower in the third quarter.

And I'm sure that you'll be delighted to hear that this quarter saw gross margin excluding depreciation of 32.8%, which is a little under our goal of 35% but nevertheless compares very favorably to the 13.5% achieved in the same quarter last year. And for the nine months to end of September, the gross margin excluding depreciation was actually 35%, exactly on target.

The second key point I wanted to mention -- it's quite important for our company -- it is the fact of the fall of the pound. As you know, our reporting currency is the US dollar. But most of our activities are based in the United Kingdom, and therefore are transacted in sterling. After Brexit, the vote end of June, towards the end of the previous quarter, the pound is down about 20%.

So this had mixed effects for us. Of course, there are some positives. The fact that US dollar balances now are worth more in terms of pounds, and therefore give us more firepower for development in the United Kingdom. On the other hand, the amounts raised in the most recent capital increase that were already partially transferred to sterling, but also other assets that we have in sterling, do suffer from a translation loss, which we will have to report as part of the charges for the quarter. And we will have to report in our general and [listed] expenses a negative translation factor of \$109,000 to reflect the year-over-year change in forex rates. So this is quite an important factor, does not affect the operations. But it has a big impact on the reporting.

So after this introduction, I would like now to hand over to Elias, who will cover the other headlines.

Elias Samaras: Thank you, Jacques.

Welcome, everybody. Good morning, those in the US; and good afternoon, those from Europe.

As always, Paul will take us through the details. But I would like before that to say a few words and provide an update on our strategic progress.

Starting with the project finance -- now, the deals we have in place are working great. In fact, we brought the system at Doncaster Dome into operation. And as you may remember, that was the first project to be financed by Societe Generale. With the paperwork all completed and submitted, we received a check on

time from the bank, just within a few days. Also, we have started construction on our second funded project. So the financing really works excellent for us.

Now, on the maintenance side, our in-house maintenance has now been expanded so that it includes the out-of-warranty TEDOM units. For [this service], we started with hiring a second servicing technician, meaning now that we have engineers based both in the South and North of England.

Now, regarding sales opportunity -- we have developed the initial contacts with TEDOM. And the TEDOM Corporation has resulted in certain project inquiries from Italy and Germany. However, in our efforts to explore larger project opportunities across Europe, I would like to report to you that we have identified some large projects in the Southeast Europe area.

The first one is a totally new development. It is perhaps the largest construction project in Europe. But it is at over \$8 billion as a construction project. We are currently shortlisted [to take] the energy part of the project, which is in the order of several megawatts in size. If this materializes for us, it would be a transformational point for our company, as it is going to be a long-term project. And according to our [analysis] (inaudible) quite profitable as well. I'm sorry I cannot give you more details about it, as we are bound by a very strict confidentiality agreement.

Now, the other two large projects also have to do with two hotel resorts of [about a] megawatt [size], again in the Southeast Europe area. And I hope to be able to give you more information about the progress of these unique projects in our next earnings call.

Now, our board's decision to create a specific M&A committee, chaired by [Marcel Casard], and headed, of course, by the management, has identified a number of [initial UK] acquisition targets. While one target remains [under detailed] (inaudible) investigation, an indicative offer for another company was not successful.

Elsewhere, our research project to identify acquisition targets outside the UK is nearing completion. And the M&A committee will be focusing management time as required.

Now, on the less positive news, we failed to secure any new on-site utility agreements through this quarter. While we know that this would be disappointing to our [shareholders], and obviously it is to us. In response, however, we have invested an increased marketing effort, attending two trade exhibitions this fall. Also, our sales team is [instructed] to seek a wider range of CHP projects, including [turnkey] installations and a hybrid version of our OSU solution for larger public sector projects. And we have been [charting] this (inaudible) of course.

Well, with these highlights, I would like now to hand over to Paul to give you more details about our results. Paul?

Paul Hamblyn: Yes, thank you, Elias. And good morning or good afternoon to everybody. I'm very pleased to give you an update in more detail on the third quarter performance.

As often, I like to start by just reminding everybody what we do as a business. So we offer onsite utility solutions to our customers here in the UK. This means that we own and operate energy-generation equipment, principally combined heat and power solutions, which we then sell the electricity produced, and the heat and hot water, to our customers on long-term contracts, typically over 15 years in length.

So in addition to myself here in the UK, I'm supported by a staff of nine people, together with a consultant and a number of installation subcontractors, and also a specialist partner that provides some of the maintenance of our fleet, which I'll talk a little bit more about later on, in fact.

So turning first to look at the financial performance of the business through the quarter -- as Jacques has already alluded to, obviously we're generating revenue in pounds here in the UK. And operationally, at that UK level, our total revenue increased by 28.4% to just a little under GBP350,000. Energy revenues in the period increased 30.6% compared to the same period last year.

When expressed in dollars, revenue was around \$460,000, up some 8.8% on the third quarter in 2015. And obviously, the difference in the percentage growth that you see between the pound and US value is a result of the fall in the value of sterling year on year.

Energy production for the quarter was up over two million kilowatt hours compared to the same quarter last year. And in fact, we generated just a little over 7.5 million kilowatt hours, some 37.7% increase on the third quarter in 2015.

This increase once again reflects both the fact that we have an increasing number of operating systems within our fleet. In fact, the total number is now 32 by the end of the quarter, which is [a third] of four systems compared to the same time a year ago; and the fact that our installed capacity has grown as a result of that. In fact, it went up 756 kilowatts. And we now have a total of 3,509 kilowatts, or 3.5 megawatts, in operation.

As Jacques also explained, our gross margin in the quarter improved quite dramatically. In fact, if we look at gross margin including depreciation, we move from a loss position of 10.8% in the third quarter 2015 to a positive 8.5% this year. And when we exclude depreciation, we actually achieve 32.8% for the quarter, compared to just 13.5% in the same quarter last year. The result of this was to convert a \$46,000 gross loss into a \$39,000 gross profit in the year, a swing of some \$85,000.

So why has margin improved? Well, it's a very similar reason to that that we've seen through the first two quarters of the year. It's been through the reduction in gas prices, the fuel that we're using in our CHP units, which has improved the spark spread. And we've also seen lower operating costs as a result of bringing the maintenance operation in-house.

Jacques has also already alluded, when we're talking about the fall of sterling, to the fact that we have incurred some other expenses this quarter that specifically relate to those foreign exchange costs. In fact, it was \$109,000. In addition, we also saw another non-cash transaction within our earnings release, which is \$124,000 cost resulting from stock-based compensation. Remember, as I said a second ago, neither of these are cash transactions, so it hasn't eroded our cash reserves in any way.

Just before finishing on the financial aspect, I think it's also just worth noting that we've also recently employed a management accountant here in the UK for the first time. And it's the first time we've had dedicated financial resource based within the team in the UK. Overall, the cost of this will be neutral as we move away from our reliance on share in the financial team with our former parent of American DG. But just in the short time that our management accountant has been onboard, I can already testify to the fact that having this resource here in the UK has improved quite significantly visibility of the financials within the business. And I see that as a big advantage moving forward.

Turning now to the performance of our fleet -- at the end of the quarter, so on the 30th September, our operating fleet totaled a total number of 32 systems. This includes 16 Tecogen InVerde CHP units,

together with 12 TEDOM units, one MAN engine, two [Baxi Senertec] units, and also the Panasonic heat pump that we have installed at the Haverhill Leisure Center.

Within those 32 systems, I'm pleased to report that we now have the 331-kilowatt system at the Dome in Doncaster operating. That began its operation towards the end of September. And you may in fact remember seeing a press release about that around that time.

Important thing to remember about this particular system is it's the single largest system that we've ever installed and, at 330 kilowatts, is equivalent to bringing into operation an average of -- sorry, a further three of our average-size systems. So it's made quite a dramatic effect on our daily energy generation.

In total, our fleet capacity now stands at 3,509 kilowatts, some 756 kilowatts up on the fleet that we had in operation at the end of last September. And this all helped to boost our energy production within the quarter, as I mentioned earlier.

Overall, our fleet gross efficiency was 77% for the quarter, which is exactly the same as it was during the same quarter of last year. However, the average kilowatt output has risen to 91 kilowatts, compared to 81 kilowatts in the same quarter last year. And this reflects both the increased capacity within our fleet and the fact that we were able to improve the operational performance, particularly amongst our 16 Tecogen units.

Through the quarter, the fleet clocked up a little over 31,000 operating hours. That's 28% up on the same quarter last year. And again, this is testament to the improved reliability we've seen, particularly as a result of carrying out the maintenance in-house.

As you know, we look at fleet utilization using a metric (technical difficulty) [called] Operational Availability. This compares the number of hours actually operated in the period to the number of hours that -- theoretically, the maximum number of hours that the unit could run.

Remember, it's important to realize that this doesn't just reflect the reliability, but also the availability of the unit to operate. And particularly during the summer months, when we may have very hot summer days, just the lack of thermal demand can cause the unit to [turn] off, when otherwise it [would] go on operating.

Overall fleet availability was 74% for the quarter. This is an improvement over the 69% availability that we posted in third quarter of last year. And this was despite some record-breaking temperatures, particularly during September, here in the UK.

If I break that down a little bit further, the InVerde fleet availability was 67%, a small improvement over the 66% we recorded last year. And the TEDOM fleet availability was 84%. This is a more substantial improvement over the 78% figure that we had in third quarter of last year.

We've also previously talked about a number of the upgrades that we've been doing particularly to the Tecogen units. And I'm pleased to say that the (technical difficulty) [electronic ignition] upgrade, which had stalled when we last spoke, is now very much back on track. And in fact, we just have three units left to upgrade. And I expect those to be done within the next few weeks. So a little head of the time scale that I referred to during our last earnings call.

What's been interesting about this upgrade is not only has it improved reliability but we've also been able to increase the maximum output of the Tecogen fleet as we found that engine speeds are much more

consistent than they were with the original mechanical ignition system. And this in turn will result in higher production from these units, not just in this quarter but in all future quarters as well.

One of the other upgrades we were looking at implementing is an extended oil tank, the design of which is intended to increase the service schedule, so that we're not having to visit sites as frequently as we are currently. That trial is still very much underway. We have had some positive results, but there is further work to be done to make sure that we get that right before implementing it across the rest of the fleet.

As Elias has already said, we took on our second service technician in September. And with Patrick's arrival, we've now been able to split the UK on a north-south basis, so reducing our response times to issues and also lowering some of our travel costs. It also, of course, gives us improved cover during things like staff holiday or periods of illness.

We did that principally because we are going to be taking in-house the maintenance of the TEDOM units as they complete their warranty. So far, three TEDOM units have completed their warranty period. And that now means that we're maintaining -- a total of 20 of our 32 systems are actually being maintained by our in-house team. And obviously, that will increase month by month as more of the TEDOM units come to the end of their two-year warranty period.

In addition to that, we're also looking at taking over the lubrication servicing of all the new TEDOM units, including those that are actually within their warranty period. And in fact, I'm pleased to report that my team is out receiving factory training to enable that to take place. And they're out in the Czech Republic undergoing that training as we speak.

If I now move on to have a look a little bit more at the operations within the business -- so at the end of the quarter, at 30th September, as I said, we had 3,509 kilowatts of installed capacity. These systems between them have a contract value of some GBP57.2 million or \$74.2 million at today's exchange rate.

In total, the backlog on our books at the end of that period was seven systems, totaling a further 989 kilowatts. And that 989 kilowatts has a total contract value forecast to be around GBP13 million or some \$17 million.

Construction of the 400-kilowatt system at Celtic Manor in South Wales, begun during -- we started that during September, and we're making very good progress indeed. And I fully expect those two units at the site to be operating by the year end.

In addition, there's a 125-kilowatt system being installed at the Basingstoke Sports Centre. And this project is nearing completion. And again, I would fully expect that unit to be operational before year end as well. The remaining systems in backlog are in various phases of implementation. But I expect those to come on-stream as time moves forward.

Operationally within the business, we've also begun a couple of further changes, which may sound minor but in fact, I think, are quite significant. The first is a change to our IT system that will move us more to a cloud-based solution, which will provide us with faster and much greater reliable access to the shared data, and also improve data security and safety. The second is development of a [bespoke] billing platform that undoubtedly will speed up our billing process while reducing the man hours involved in what has become an increasingly complex and sizeable billing run each month as our business has grown.

Like to now move on to sales. And as Elias has said, we did not secure any new projects during the third quarter. And while I expect there are some imminent decisions on particularly three projects, totaling a

further 265 kilowatts of solutions, I too am very disappointed by the fact that our sales performance in the quarter -- and in fact, really, for the whole of 2016 -- is not what I had hoped it would be.

To address this issue, we've taken a number of steps. And I'd just like to quickly walk you through those. Firstly, I've agreed with the Board that in fact I need to spend more of my time not just managing the sales activity within the business but also actively participating in developing new business.

Secondly, as Elias mentioned, we've invested in marketing and, in particular, in attending a couple of significant events, exhibitions here in the UK -- one in September, and the second earlier last month. We've also secured some additional trade press coverage and are working with existing customers to develop a number of case studies that we plan to use in a range of marketing activity over the coming months.

Thirdly, we've started to develop a partner program that will use energy consultants and others to promote our onsite utility solutions to their existing customers. And then, next, we've created a new account management role by actually re-tasking our presales engineer within the team. The aim of this is both to provide a better customer experience but also to enable us to upsell and then cross-sell by way of cross-customer references and introductions.

And then finally, we've also introduced a couple of new propositions to our offer. The first is a new hybrid form of the onsite utility agreement that sells electricity only, while allowing our customers to buy the gas. And then, they effectively receive the heat at no charge. This actually allows us to compete on a much more level playing field for public works and to take our competitors on on a much more like-for-like basis, but still retaining a lot of the unique features at are onsite utility solution. And then finally, we've also begun bidding turnkey projects where we feel that is appropriate.

Although new orders have been hard to come by, we have had a number of other successes within the sales and marketing arena. Just like to share three of those with you. The first is that we have successfully passed prequalification and been awarded admission onto the Yorkshire Purchasing organization's dynamic system for low-carbon heat and combined heat and power solutions. This really means -- what it means practically is that we're now able to bid as a prequalified bidder for a wide range of public works throughout the UK, albeit primarily in Yorkshire in the Northeast of England.

We've also been shortlisted for two categories within the 2016 AD Awards. And recently, we also learned that we've shortlisted for the Sustainable Project of the Year at the 2016 Builder and Engineer Awards. So we have three chances to win an award. And I think that's testament to the work that my team has been doing over the past year. Winners will be announced before the end of this month. So I'm quite sure we'll share any news of success with you when we know for certain what's happened.

Finally, turning to some more strategic items -- while we have had a number of initial meetings with TEDOM's agents both in Germany and Italy, the feedback to date is that our approach is likely to be well received particularly in Italy. And in fact, we've seen a couple of projects put forward.

So far, I think where we're at here is that need to spend more time educating and informing the dealers to make sure that they're putting forward the right type of projects for us. Because if I look at the projects that were actually submitted, one was a little bit too small, and the other was really to help us aid a competitor, something, obviously, we're not keen to do. But there are definitely project opportunities in both countries, and that's something we'll be seeking to exploit over the coming weeks.

Elsewhere, the research being undertaken in identifying European acquisition targets has resulted in some further useful intelligence, and also the possibility of pursuing a number of other projects. And Elias alluded to that earlier in his statement.

In terms of acquisitions, yes, as Elias said, we made an indicative bid for one particular business that did prove to be unsuccessful. But in the process of completing that transaction and running through that, we learned an awful lot about the market and the market in which the companies and similar companies are operating. And I think that gives us a great potential to look for other targets. And in fact, we've already begun that process here in the UK.

And with that, I'd very much like to hand back to Jacques. Thank you very much.

Jacques de Saussure: And before we come to the end of this earnings call, the formal part, I would like to summarize briefly the key points. This last quarter saw us become a fully independent company and prepare for our future growth. We've seen a continued improvement in our gross margin. We've posted a solid rise in both revenues and energy production for the quarter and continue to improve fleet availability and efficiency.

We also started our largest system to date, which was fully funded by Societe Generale. And we've put in place steps to improve our sales performance. And finally, we continued our move into Europe and completed our first bid to acquire a company to add to EuroSite Power. And that search continues.

So I look forward to continuing to reporting yet more success as the year progresses.

And with that, we'll hand back to the operator so we can take any questions.

Questions and Answers

Operator: (Operator Instructions) Michael Zuk, Oppenheimer.

Michael Zuk: I have a question regarding the status of incentive payments from the UK government. Is that program continuing, or is it being modified? Or what's the status going forward?

Paul Hamblyn: Yes. Yes, I'll take this question, shall I, Elias?

Elias Samaras: Yes, Paul.

Paul Hamblyn: Okay. So yes, Michael, thank you for the question.

So the simple answer to your question is yes, the program does still exist. And we will be submitting our return for the last year within the next few weeks. And we fully expect to get very similar amounts of money, Michael, to that that we saw in the previous year.

Michael Zuk: Do you think that program will be extended into 2017 and 2018?

Paul Hamblyn: Yes. We know that it's on the statutes until April 2018. After that, the government haven't said. I think it's fair to say their priorities lie elsewhere at the moment. And this is a minor detail for them, I suspect, although it's important for us. But certainly through until April 2018, we do expect to be able to continue that benefit.

Michael Zuk: Thank you, I appreciate that.

Operator: [Thomas Orr], a private investor.

Thomas Orr: Hey, I just have a question, I just want to make sure I understand the full adverse currency swing and how it's embedded in the G&A. So I look at, under operating expenses, G&A for the third quarter was \$379,000 and change. Is it as simplistic as the \$109,000 is baked into that? Does that mean it would've been \$270,000 without that adverse currency swing, or is that number put somewhere else or allocated on another expense [finally]? I just want to make sure I understand it fully.

Paul Hamblyn: Yes. So it is embedded in that \$379,000. Bonnie, just confirm that's correct?

Bonnie Brown: That's correct.

Thomas Orr: Okay. So on that basis, Q2 G&A was \$332,000, so it actually would've been down very nicely. Selling was down quarter over quarter, G&A was down quarter over quarter. So your expense control ex that odd item was very, very good. Is that pretty accurate?

Paul Hamblyn: Well, that's how I feel about it, Thomas. I think the other thing to remember in that \$379,000, there's also the stock compensation amount, which again is a non-cash element. And I think that was \$124,000. So we're trying very hard to keep on top of those overhead costs. So yes, it is important to realize that that \$379,000 does include those two elements.

Thomas Orr: I'm surprised, though, the sales cycle has been not that robust, given all the different irons you guys have in the fire now -- the relationships, I mean, a couple years in the field, financing, everything else. I'm just -- is it more of a lack of your time, Paul, and maybe we just need to beef up selling a little more? Or is that we just weren't as successful, or we just didn't have maybe the ability to get in front of as many deals as we'd like?

Paul Hamblyn: I think in (inaudible) sense it's a combination of all those things. I think your observation that my time -- yes, I think you can sort of take from the fact that the Board have acknowledged the fact that I need to spend a bit more time in that area, meaning that has had an effect.

I think elsewhere, what we've seen is that traditionally we've sold smaller systems. Our average system is around 100 kilowatts. We have seen in the UK quite significant drops in utility tariffs. What that's meant is that those smaller systems are not generating as large a saving for the customer. And that perhaps means that the deals are not as exciting to them.

As a consequence of that, and also the fact that have the funding now in place, we've also retargeted our approach to much larger and multiple-site opportunities. And I think we've just suffered from the fact that, if you like, the timing of swinging around to that approach and where we are today has meant that the sales cycle is such that we just haven't closed those deals through the quarter.

The pipeline remains strong. The key is we just got to convert those, Thomas.

Thomas Orr: Got it.

And one last question -- I'm assuming we're probably still buying most of our equipment in US dollars stateside. Is there a way, or over time, if we could buy in local currency, mainland Europe or UK, that would help mitigate the currency fluctuations? Is that doable? Is most of our equipment still purchased in dollars, or is some of it purchased euros and pounds?

Paul Hamblin: No, actually, we have the CHP units, which are the primary expenditure actually bought in pounds. And although they're built in the Czech Republic -- which is within the EU but not actually in the eurozone -- we're paying the UK dealer in pounds. And they're taking the currency risk. So in many respects, the foreign exchange piece is not such an issue there, although we may see some price changes come, I guess, through 2017. The foreign exchange piece is purely to do with the difference between our operating currency and reporting currency.

Thomas Orr: Okay. Thank you very much, appreciate your time. Thank you.

Paul Hamblin: You're welcome. Thank you, Thomas.

Operator: Thank you.

And there are no more questions. So I would like to thank everyone for participating. This concludes today's event.

Jacques de Saussure: Thank you very much.

Paul Hamblin: Thank you.