EuroSite Power Inc. [EUSP]
Fourth-Quarter and Full-Year 2015 Financial Earnings Conference Call
Tuesday, March 29, 2015, 10:00 AM ET

Company Participants:
Bonnie Brown; CFO
John Hatsopoulos; Chairman of the Board
Dr. Elias Samaras; CEO
Paul Hamblyn; Managing Director

Presentation:

Operator: Good morning, everyone, and welcome to the EuroSite Power fourth-quarter and full-year 2015 financial earnings conference call. (Operator Instructions) For your information, today's 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 Tuesday, April 5, 2016. Individuals may access the recording by dialing 877-344-7529 from inside the US, and 855-669-9658 from Canada, or 412-317-0088 from outside the US. Enter the replay conference number of 10079917 followed by the pound sign.

At this time 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 us on our 2015 year-end earnings call. I'm Bonnie Brown, EuroSite's CFO. On the call with me today are John Hatsopoulos, 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, prospects constitute forward-looking statements for 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.

And now I'll turn it over to John Hatsopoulos for some opening remarks.

John Hatsopoulos: Ladies and gentlemen, thank you very much for participating in this call.

First, which was not part of the agenda, I had a call yesterday from one of our very good shareholders complaining that we didn't take question and answers. And since we're doing the same thing in EuroSite and after this in ADG, I thought I'd explain it. I should have explained it yesterday.

There's so many potential transactions that are going on with EuroSite and ADG, since this is the call for them -- and obviously the same thing happened to Tecogen -- that it becomes very confusing to our shareholders to answer questions when the answer is "maybe". So we decided that this is not a time to take a question-and-answer period.

Anyway, I want to make two statements and then pass it on to the CEO and Managing Director. They are the ones that are doing all the work; I'm not. We have two important events to announce and they'll give you the details.

The first one is, as you know, we are well on our way doing a study -- maybe a study is not the right word, but a test to prove whether our emissions equipment technology works for automobiles, because there is a lot of interest around the world. And we gave -- the Board of this group gave to EuroSite the rights for UK and Ireland.

And I will read you exactly the Minutes as they came in from the Board meeting, so there is again no misunderstanding. And, again, I'm reading the memo: As soon as practical the Company will grant EuroSite Power, at no cost to EuroSite, an exclusive, fully paid-up royalty-free transferrable and sub-licensable right and license to use the Company's ultra-low-emission technology as it may be improved from time to time to all automobiles and other vehicle engines manufactured in the UK and Ireland.

If we're successful, and I hope we are -- but no guarantees in these things -- this would be a major event for EuroSite. And I've been told since we started this agreement that there seem to be quite a few automobiles being manufactured in the UK.

The second one -- and, again, Dr. Samaras will give you the details -- is the biggest handicap for EuroSite is the need of capital. There is a tremendous amount of interest throughout Europe for the EuroSite principle. Unfortunately, we didn't have enough capital to execute it. We have now [one] and another bank in the process of competing, that they will loan us all the money that we need to expand EuroSite.

And, again, with that I'd like to ask Dr. Samaras, who's the CEO and member of the Board that is doing all this work, to give you the details. Elias?

Elias Samaras: Thank you, John. Good morning, everybody in the US and Canada. Good afternoon for those in the UK and Europe. This is Elias Samaras, CEO of EuroSite.

After joining EuroSite as CEO in June last year, I set out clear targets based on four pillars I have described previously. As of today, less than nine months later, I'm very pleased to announce that all four pillars have been successfully completed.

As John said, most importantly the finance for future projects is now in place and both Societe Generale and Macquarie are on board. We have already seen the fruits of this, having signed the [working] agreement for a 330 kilowatt project at the Doncaster Dome, which will be financed 100% by Societe Generale. I can also disclose to you that we have signed a tentative agreement for another 400 kilowatt project which, if closed, will also be financed by Societe Generale. That was the number one pillar.

Number two: In terms of growing the business into Europe, I can announce to you today that we have reached an agreement with a company called Tedom, a Czech-based CHP manufacturer to offer On-Site Utility solutions through their 31 dealers across the EU and Turkey.

The third pillar: We have succeeded in bringing maintenance of our Tecogen fleet in house, a move that resulted in gross margin improvement from 18.6% to 31.5% in the last quarter of 2015.

Finally, our fourth pillar: We made arrangements with Corona Energy to provide lower cost gas on a [side-by-side] basis as customers sign our new gas (inaudible) agreements throughout 2016.

With these four pillars now in place, 2016 will focus on growing the business, taking advantage of both the finance that is now in place and the available [freedom] to access markets outside the UK. Importantly, we are now focusing on larger projects both in terms of kilowatt capacity and size as we move forward. This is important as larger capacity systems deliver for us both a better margin and return on investment.

With this, I'd like to pass it on to Paul Hamblyn, our Managing Director, to explain about our company's operations in more detail. Thank you. Paul?

Paul Hamblyn: Thank you, Elias, and welcome, everybody.

My name's Paul Hamblyn. I'm the Managing Director of EuroSite Power here in the UK. And I'm very pleased to give you a little bit more detail about 2015 and put some color on the picture that's already been painted.

Just before starting, I think it's always useful to remind investors what we do. So, we offer On-Site Utility solutions to customers here in the UK. What this means is that we own and operate

combined heat and power solutions, selling the electricity, heat, and hot water on long-term contracts to our customers.

Currently I'm supported by a staff of six, plus a service consultant and a team of installation subcontractors and specialist partners that provide plan maintenance services to our fleet and installation services.

So to begin with, I'd like to just focus on some of the financial numbers that have been announced today. So, as you will see, revenues increased by some 39% to just over $2.1 million for the year. And, in fact, energy revenues have increased some 44% compared to 2014. We saw particularly strong growth in the last quarter of the year, with revenue achieving $685,000 compared to some $378,000 in the same quarter of 2014.

This growth really reflects the increase in the number of operating systems that we now have in our fleet. We actually through the year increased from 21 systems at the end of 2014 to 29 at the close of 2015. It also reflects the fact that many of the systems added through the year were larger, typically 125 to 200 kilowatts, whereas previously in our history the systems have been much smaller, at around 100 kilowatts. This had the effect of slightly accelerating our revenue growth compared to previous years.

What's interesting, though, is that our revenue growth could have actually been slightly higher, had the underlying utility rates not fallen through 2015. As many of you, particularly those residents in Europe, will know, we've seen various reductions in electricity and gas costs. And of course the price that we charge for our electricity and our heat is tied to those underlying utility tariffs. This is best demonstrated by actually having a look at what energy production did through the year. We actually saw a 59% increase in energy generation through 2015.

If we look at revenue in a little bit more detail, I can tell you that 54% of our revenue came from electricity, 35% from heat, and 11% from our share of carbon savings. These numbers are slightly different from those of 2014, and really just demonstrate the shift within our fleet from the Tecogen product to an increasing number of Tedom products, which have a higher electrical efficiency and therefore greater electrical output.

Looking at the sectors in which we operate, we have an almost equal split between revenue coming from sports and motor facilities and that from hospitality, with about 5% coming from health care, in hospitals in particular.

As we've explained in previous earnings calls, gross margin has and continues to be a key focus of the business. And as Elias has already mentioned, margin excluding depreciation and site impairments, was up to 24.4% for the year and, in fact, 31.5% for the last quarter of the year. This compares very favorably with the 18.9% we achieved in 2014 and 18.6% in the last quarter of 2014.

However, we do recognize that the negative gross margin, or loss, achieved once you add in depreciation and site impairment isn't good enough. And therefore we continue to work hard to improve that situation. And that's really being done in really four ways.

Firstly, it's about selling our projects with better margins locked in from day one. Secondly, it's about optimizing the operating performance of our fleet, both in terms of maximizing the run hours, particularly during the seasonal and time-of-day tariffs when electricity prices are at their highest. Making sure that we focus on the build cost of our projects. And also then enhancing the efficiency and availability of the fleet to maximize the amount of kilowatt hours that we can generate.

As we've already said, it is particularly worth noting the improvement that we see in the underlying margin through the fourth quarter. We saw a figure of 31.5%, which in itself is not that far away from the target we set ourselves of 35% and really reflects the impact of two key things.

The first is the cost of gas. As you know, we have the arrangements in place with Corona Energy although, to be honest, this has yet to take full effect. We would expect to see the benefits of that come through towards the end of 2016. But it perhaps better demonstrates the fall in gas prices that we've seen in the UK market.

The second, and perhaps more significant, aspect is the switch to in-house maintenance for the Tecogen units within our fleet. The cost savings have proven to be significant and we've also seen a marked improvement in the liability of that fleet, both of which have fed through to improve margin performance in the last quarter of the year. And I can say at this stage that the early signs, early in 2016, show that that improvement is continuing.

I think it's also worth just mentioning about some site impairments, which you have noticed in the accounts. 2015 saw us having to apply a $246,000 charge against two sites. These two sites -- in fact some 70% of that charge, came from one site in particular, which was actually the very first site that we installed.

The project really, and the costs involved in that project, really represented the learning curve that we had to go up in that first construction. And although we tried our best to maximize the revenue and margin from that site, I think we all felt it was better to take that impairment charge at the end of the year in order to be able to move on in a favorable way through 2016.

We'll prevent these type of issues occurring in the future by improving the project assessment that we do, and also through better project management now that we've brought the management of our construction in house from June of last year.

I think it's also worth considering margin in the context of a liability. Those of you with a keen memory will remember that we suffered particular liability problems in the early part of last year and again in quarter three of the year, which did depress our margin performance. But, as I go on to explain a little bit, our improvements that we've seen through quarter four illustrate really that these liability problems are now largely behind us.

So I'm going to turn now to have a look in a little bit more detail about performance within the fleet. Energy production for the year 2015 was up some 59% from the previous year, with us generating just under 29 million kilowatt hours of total energy.

In quarter four of the year our production almost doubled compared to the same quarter last year. And this really reflects the improved liability that we've seen and better operation and the increased size of the eight systems that we brought on through the year.

In fact, for the first time, monthly electricity generation in the last quarter of the year exceeded 1 million kilowatt hours, or 1 gigawatt hour in each of the last three months. That sets us up fairly soundly for the coming year and years ahead.

Overall the fleet clocked up some 114,000 run hours. That's equivalent to running one machine 13 years continuously. So you can definitely see that with our 29 units now running the operation is now quite considerable.

Within our operational fleet as of the end of the year we have 29 units, 16 of which were Tecogen units and 9 from Tedom, the Czech manufacturer that we've now signed our European partnership with. We also have a handful of other equipment within the fleet as well.

Maintenance of the Tecogen units, together with a single MAN-engined machine, is now managed entirely in house, while the Tedom units continue to be maintained by the UK dealer. Just to explain that in a little more detail, the Tedom units come with a two-year warranty. And in order to maintain that warranty, we need to have the maintenance undertaken by the UK dealer.

However, the first units installed will begin to come to the end of their first two-year period as of July this year, and we anticipate extending our in-house maintenance program to incorporate the servicing of the Tedom units from that period onwards. We would expect that to improve our margins yet further.

We have seen and worked hard on improving the liability, and the upgrade program that we agreed with Tecogen in the early part of last year is now fully complete.

In addition, the electronic ignition trial that we undertook at one of our sites proved very successful and orders have now been placed to [load] this new electronic ignition system out across the entire Tecogen fleet by the end of the second quarter of this year.

With these new ignition systems in place we hope to be able to increase the service intervals of the Tecogen units. But, of course, we're going to try all this first and foremost to make sure that we can achieve that. And the primary aim within that is to make sure that we can improve our margin yet further.

We'll now have a look at fleet efficiency. Overall the gross efficiency of the fleet was 78% for 2015 compared to 76% in 2014. The average kilowatt output for the year rose to 91 kilowatts compared to 82 kilowatts for the previous year. And within the last quarter, we actually achieved

a 95.4 kilowatts average output compared to just over 90 kilowatts in the same period of last year.

Our measure of reliability, which we call availability, which is really the number of hours a machine can run based upon the hours that are set within the unit, also increased. Overall fleet availability was 85% in the fourth quarter. And if you break that down into the Tecogen fleet, that achieved 81%, and then the Tedom fleet, of which there are nine units, actually achieved 90%.

Turning a little bit into a bit more detail on the operational side, as I said, we now have 29 units installed. The total capacity of those units is 2,878 kilowatts, with a total contract value of some $81 million worth of revenue.

A further 200 kilowatt system was also brought into operation in January of this year. And with the sale of the 330 kilowatt units at Doncaster Dome, which Elias mentioned earlier, our current backlog as of today is 7 systems totaling 1,020 kilowatts. Those 7 systems have a total additional contract value of $21.17 million.

If I look at those 7 in a bit more detail, I have 1 of those units we are anticipating commissioning this week, and another unit which is currently under construction and due to be commissioned early next quarter. The 5 remaining systems are at various stages of consent, design, or preconstruction, but we do anticipate that those will come online through the rest of this year.

As some of you remember from last year, we were able to get a grant -- well, a tax refund, really, called an enhanced capital allowance, from the UK government. We received a refund for 2014 in the first few months of last year, 2015. That was just shy of $650,000. We also made a further claim for $358,000 during 2015 and received payment of that during the first quarter of this year.

Just a reminder, the enhanced capital allowance is a cash energy tax incentive that specifically rewards investments in energy-saving plants and machinery, particularly combined heat and power systems.

Whilst we're talking tax and regulation, for those of you based in the UK, you may be aware during the recent budget that the government announced some changes to some of the carbon taxes that we enjoy partly [with] some revenue.

These changes don't come into effect until April 2019. Because of that, the exact details are still to be announced. But from what we've already been able to establish, we anticipate these changes will have a neutral effect on our revenue at worst, but more than likely a positive impact moving forward.

I think one other point just quickly to note is that we have also as of the beginning of January this year, we now have a fully staffed office whereas previously we had a virtual office. Our office is based just south of Manchester in the Midlands of the UK. As such, it's centrally located, enjoys far cheaper rents than we would be paying, for example, in London and benefits from good communication links, both to London and elsewhere around the UK.

Turning now to have a look at sales, 2015 saw four new On-Site Utility contracts being signed with a total capacity of 554 kilowatts. To be honest, this was down on our target, but the pipeline continues to grow and, as such, we expect, with the project finance solutions now in place, to see an upsurge in new contracts through 2016.

At the end of 2015 our contract book stood at 36 systems totaling 3,760 kilowatts and approximately $101.1 million worth of revenue. With the announcement of the Doncaster Dome project early this month, obviously we now have 37 systems on contract, bringing the revenue value of that to $105.95 million.

Within our immediate pipeline we have a 400 kilowatt system for a major hotel in [South Wales]. As Elias mentioned, we've already signed a term sheet with this client and we are moving towards closing that deal. But the good news is that the credit has already been approved by Societe Generale, so we're confident that we'll be able to build that contract should we close it. In addition, there are three service systems from a range of different customers that we feel pretty confident about at this stage.

Elsewhere, we continue to pursue a major private health care provider with both a range of private hospitals and health club sites across the country, a number of inside-UK hotel groups, and we're continuing to press hard on the National Health Service estate, which numbers over 300 potential properties here in the UK alone.

To help in this process we employed a third sales person as of March 1st of this year. And we've been continuing to invest in a small way in marketing. So, through 2015, for example, we held an [open] day at our site in the Wentworth Club in September of the year. We sponsored and spoke at an ESTA Energy Summit in October. And we also attended a specialist NHS project and seminar earlier in the year.

You may also remember that we were shortlisted as a finalist for the ADE Innovation Award for our project at Clifton Hospital. Although unfortunately we weren't successful enough to win that, it was good to get the national press coverage that came with that nomination.

And for the eagle-eyed amongst you, you'll also notice we now have an updated website. It's more [light] and has been specially designed to optimize search engine rankings and also to be viewable on smartphones and tablets.

In summary then, 2015 saw both a solid rise in revenue and energy production. We saw improvement across all the measures that we use to look at fleet performance. And we successfully brought in house the maintenance operation for our Tecogen fleet, and established a way of lowering our gas prices moving forward.

As a result, the gross margin, excluding depreciation and site impairment, improved compared to 2014. And we saw particular improvement through the last quarter of the year.

We have also, as has been mentioned, agreed terms for future project finance with both Societe Generale and Macquarie. And we have reached agreement with Tedom to enable us to access their 31 dealers across Europe to sell On-Site Utility solutions into territories outside of the UK.

And just to close, I look forward to continuing to grow the business through 2016 and beyond.

And with that, I'd just like to hand back to the Operator. Thank you.

Operator: Ladies and gentlemen, at this time I'd like to thank everyone for participating. This concludes today's event. You may now disconnect your lines.