TECOGEN INC.
Form 10-Q
May 11, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2017
or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 001-36103
TECOGEN INC.
(Exact name of Registrant as specified in its charter)

Delaware	04-3536131
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)

45 First Avenue

Waltham, Massachusetts	02451
(Address of Principal Executive Offices)	(Zip Code)

Registrant's Telephone Number, Including Area Code: (781) 622-1120

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer o	Accelerated filer o	Non –accelerated filer o	Smaller reporting company x
			Emerging Growth company x

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).Yes ¨ No ý

Title of each class	Outstanding, April 30, 2017
Common Stock, $0.001 par value	20,043,052

TECOGEN INC.

QUARTERLY REPORT ON FORM 10-Q
FOR THE PERIOD ENDED MARCH 31, 2017
TABLE OF CONTENTS

References in this Form 10-Q to "we", "us", "our"', the "Company" and "Tecogen" refers to Tecogen Inc. and its consolidated subsidiary, unless otherwise noted.

TECOGEN INC.

PART I - FINANCIAL INFORMATION
Item 1 - Financial Statements
CONDENSED CONSOLIDATED BALANCE SHEETS
As of March 31, 2017 and December 31, 2016
(unaudited)

	March 31, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$2,148,753	$3,721,765
Accounts receivable, net	9,102,078	8,630,418
Unbilled revenue	2,347,055	2,269,645
Inventory, net	6,075,277	4,774,264
Due from related party	336,693	260,988
Prepaid and other current assets	601,437	401,876
Total current assets	20,611,293	20,058,956
Property, plant and equipment, net	548,111	517,143
Intangible assets, net	1,094,747	1,065,967
Goodwill	40,870	40,870
Other assets	2,128,300	2,058,425
TOTAL ASSETS	$24,423,321	$23,741,361
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$4,011,804	$3,367,481
Accrued expenses	1,153,864	1,378,258
Deferred revenue	907,445	876,765
Total current liabilities	6,073,113	5,622,504
Long-term liabilities:		
Deferred revenue, net of current portion	489,959	459,275
Senior convertible promissory note, related party	3,148,712	3,148,509
Total liabilities	9,711,784	9,230,288
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Tecogen Inc. stockholders' equity:		
Common stock, $0.001 par value; 100,000,000 shares authorized; 20,043,052 and 19,981,912 issued and outstanding at March 31, 2017 and December 31, 2016, respectively	20,043	19,982
Additional paid-in capital	37,490,389	37,334,773
Accumulated deficit	(22,798,895)	(22,843,682)
Total stockholders' equity	14,711,537	14,511,073
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$24,423,321	$23,741,361

The accompanying notes are an integral part of these consolidated financial statements.

1

TECOGEN INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
For the three months ended March 31, 2017 and 2016
(unaudited)

	Three months ended March 31, 2017	2016
Revenues		
Products	$2,807,347	$2,266,148
Services	4,039,420	2,809,367
Total revenues	6,846,767	5,075,515
Cost of sales		
Products	1,756,849	1,552,716
Services	2,175,245	1,803,455
Total cost of sales	3,932,094	3,356,171
Gross profit	2,914,673	1,719,344
Operating expenses		
General and administrative	2,208,905	1,892,220
Selling	447,452	515,032
Research and development	180,614	218,958
Total operating expenses	2,836,971	2,626,210
Income (loss) from operations	77,702	(906,866)
Other income (expense)		
Interest and other income (expense)	(1,213)	2,891
Interest expense	(31,702)	(42,381)
Total other expense, net	(32,915)	(39,490)
Income (loss) before income taxes	44,787	(946,356)
Consolidated net income (loss)	44,787	(946,356)
Less: Loss attributable to the noncontrolling interest	—	53,188
Net income (loss) attributable to Tecogen Inc.	$44,787	$(893,168)
Net income (loss) per share - basic	$0.00	$(0.05)
Net income (loss) per share - diluted	$0.00	$(0.05)
Weighted average shares outstanding - basic	20,037,795	18,478,990
Weighted average shares outstanding - diluted	20,317,142	18,478,990

The accompanying notes are an integral part of these consolidated financial statements.

2

TECOGEN INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the three months ended March 31, 2017 and 2016
(unaudited)

	March 31, 2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Consolidated net income (loss)	$44,787	$(946,356)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	64,281	65,456
Recovery of inventory reserve	(36,000)	14,000
Stock-based compensation	48,842	27,243
Non-cash interest expense	203	12,382
Loss on sale of assets	2,909	640
Provision for losses on accounts receivable	—	(6,154)
Changes in operating assets and liabilities		
(Increase) decrease in:		
Short term investments	—	(73)
Accounts receivable	(471,660)	(595,293)
Unbilled revenue	(77,410)	213,121
Inventory, net	(1,265,013)	367,511
Due from related party	(75,705)	582,662
Prepaid expenses and other current assets	(199,561)	(1,786)
Other non-current assets	(69,875)	—
Increase (decrease) in:		
Accounts payable	644,323	(934,598)
Accrued expenses	(224,394)	13,109
Deferred revenue	61,364	37,021
Net cash used in operating activities	(1,552,909)	(1,151,115)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(73,330)	(47,371)
Purchases of intangible assets	(53,608)	(27,959)
Net cash used in investing activities	(126,938)	(75,330)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment of stock issuance costs	—	(6,150)
Proceeds from the exercise of stock options	106,835	—
Net cash provided by financing activities	106,835	(6,150)
Net increase (decrease) in cash and cash equivalents	(1,573,012)	(1,232,595)
Cash and cash equivalents, beginning of the period	3,721,765	5,486,526
Cash and cash equivalents, end of the period	$2,148,753	$4,253,931
Supplemental disclosures of cash flows information:		
Cash paid for interest	$31,150	$29,999

The accompanying notes are an integral part of these consolidated financial statements.

TECOGEN INC.
Notes to Interim Unaudited Condensed Consolidated Financial Statements for the three months ended March 31, 2017 and 2016

Note 1 – Description of business and summary of significant accounting policies

Description of business

Tecogen Inc., or the Company, was organized as a Delaware Corporation on November 15, 2000, and acquired the assets and liabilities of the Tecogen Products division of Thermo Power Corporation. The Company produces commercial and industrial, natural-gas-fueled engine-driven, combined heat and power (CHP) products that reduce energy costs, decrease greenhouse gas emissions and alleviate congestion on the national power grid. The Company's products supply electric power or mechanical power for cooling, while heat from the engine is recovered and purposefully used at a facility. The majority of the Company's customers are located in regions with the highest utility rates, typically California, the Midwest and the Northeast. The Company's common stock is listed on the NASDAQ under the ticker symbol TGEN.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions for Form 10-Q and therefore do not include all information and notes necessary for a complete presentation of our financial position, results of operations and cash flows, in conformity with generally accepted accounting principles. We filed audited financial statements which included all information and notes necessary for such presentation for the two years ended December 31, 2016 in conjunction with our 2016 Annual Report on Form 10-K, or our Annual Report, filed with the Securities and Exchange Commission, or SEC, on March 23, 2017. This form 10-Q should be read in conjunction with our Annual Report.

The accompanying unaudited condensed consolidated balance sheets, statements of operations and statements of cash flows reflect all adjustments (consisting only of normal recurring items) which are, in the opinion of management, necessary for a fair presentation of financial position at March 31, 2017, and of operations and cash flows for the interim periods ended March 31, 2017 and 2016. The results of operations for the interim period ended March 31, 2017 are not necessarily indicative of the results to be expected for the year.

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiary Ilios Inc. or Ilios, whose business focus is on advanced heating systems for commercial and industrial applications. In May 2016, the Company completed an exchange of common stock with the shareholders of Ilios and effected a statutory merger. Ilios is no longer a separate subsidiary.

The Company's operations are comprised of one business segment. Our business is to manufacture and support highly efficient CHP products based on engines fueled by natural gas.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition

Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is fixed or determinable and collectability is reasonably assured. Generally, sales of cogeneration and chiller units and parts are recognized when shipped and services are recognized over the term of the service period. Payments received in advance of services being performed or as a deposit on equipment are recorded as deferred revenue.

The Company recognizes revenue in certain circumstances before delivery has occurred (commonly referred to as bill and hold transactions). In such circumstances, among other things, risk of ownership has passed to the buyer, the buyer has made a written fixed commitment to purchase the finished goods, the buyer has requested the finished goods be held for future delivery as scheduled and designated by them, and no additional performance obligations exist by the Company. For these transactions, the finished goods are segregated from inventory and normal billing and

credit terms are granted. For the period ended March 31, 2017, revenues of $1,140,699 were recorded as bill and hold transactions. For the same period in 2016, $140,600 revenues were recorded as bill and hold transactions.
For those arrangements that include multiple deliverables, the Company first determines whether each service or deliverable meets the separation criteria of FASB ASC 605-25, Revenue Recognition—Multiple-Element Arrangements. In general, a deliverable (or a group of deliverables) meets the separation criteria if the deliverable has stand-alone value to the customer and if the arrangement includes a general right of return related to the delivered item and delivery or performance of the undelivered item(s) is considered probable and substantially in control of the Company. Each deliverable that meets the separation criteria is considered a separate ‘‘unit of accounting”. The Company allocates the total arrangement consideration to each unit of accounting

using the relative fair value method. The amount of arrangement consideration that is allocated to a delivered unit of accounting is limited to the amount that is not contingent upon the delivery of another unit of accounting.

When vendor-specific objective evidence or third-party evidence is not available, adopting the relative fair value method of allocation permits the Company to recognize revenue on specific elements as completed based on the estimated selling price. The Company generally uses internal pricing lists that determine sales prices to external customers in determining its best estimate of the selling price of the various deliverables in multiple-element arrangements. Changes in judgments made in estimating the selling price of the various deliverables could significantly affect the timing or amount of revenue recognition. The Company enters into sales arrangements with customers to sell its cogeneration and chiller units and related service contracts and occasionally installation services. Based on the fact that the Company sells each deliverable to other customers on a stand-alone basis, the Company has determined that each deliverable has a stand-alone value. Additionally, there are no rights of return relative to the delivered items; therefore, each deliverable is considered a separate unit of accounting.

After the arrangement consideration has been allocated to each unit of accounting, the Company applies the appropriate revenue recognition method for each unit of accounting based on the nature of the arrangement and the services included in each unit of accounting. Cogeneration and chiller units are recognized when shipped and services are recognized over the term of the applicable agreement, or as provided when on a time and materials basis.

In some cases, our customers may choose to have the Company design, engineer and install the system for them rather than simply purchase the cogeneration and/or chiller units. In this case, the Company accounts for revenue, or turnkey revenue, and costs using the percentage-of-completion method of accounting. Under the percentage-of-completion method of accounting, revenues are recognized by applying percentages of completion to the total estimated revenues for the respective contracts. Costs are recognized as incurred. The percentages of completion are determined by relating the actual cost of work performed to date to the current estimated total cost at completion of the respective contracts. When the estimate on a contract indicates a loss, the Company’s policy is to record the entire expected loss, regardless of the percentage of completion. During the three months ended March 31, 2017 and 2016, a loss of approximately $35,000 and $155,200, respectively was recorded. The excess of contract costs and profit recognized to date on the percentage-of-completion accounting method in excess of billings is recorded as unbilled revenue. Billings in excess of related costs and estimated profit is recorded as deferred revenue.

Accounts Receivable

Accounts receivable are stated at the amount management expects to collect from outstanding balances. An allowance for doubtful accounts is provided for those accounts receivable considered to be uncollectible based upon historical experience and management’s evaluation of outstanding accounts receivable at the end of the period. Bad debts are written off against the allowance when identified. At March 31, 2017 and December 31, 2016, the allowance for doubtful accounts was approximately $30,000.

Inventory

Raw materials, work in process, and finished goods inventories are stated at the lower of cost, as determined by the average cost method, or net realizable value. The Company periodically reviews inventory quantities on hand for excess and/or obsolete inventory based primarily on historical usage, as well as based on estimated forecast of product demand. Any reserves that result from this review are charged to cost of sales. At March 31, 2017 and December 31, 2016, inventory reserves were $230,000 and $266,000, respectively.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost. Depreciation is provided using the straight-line method over the estimated useful lives of the asset, which range from three to fifteen years. Leasehold improvements are amortized using the straight-line method over the lesser of the estimated useful lives of the assets or the term of the related leases. Expenditures for maintenance and repairs are expensed currently, while renewals and betterments that materially extend the life of an asset are capitalized. For the three months ended March 31, 2017 and 2016, depreciation expense was $39,453 and $41,166.

Intangible Assets

Intangible assets are amortized on a straight-line basis over the estimated economic life of the intangible asset. The Company reviews intangible assets for impairment when the circumstances warrant.

Goodwill

The Company tests its recorded goodwill for impairment in the fourth quarter, or more often if indicators of potential impairment exist, by determining if the carrying value of the Company's single reporting unit exceeds its estimated fair value. During the first three months of 2017, the Company determined that no interim impairment test was necessary.

TECOGEN INC.
Notes to Interim Unaudited Condensed Consolidated Financial Statements for the three months ended March 31, 2017 and 2016

Stock-Based Compensation

Stock-based compensation cost is measured at the grant date based on the estimated fair value of the award and is recognized as an expense in the consolidated statements of operations over the requisite service period. The fair value of stock options granted is estimated using the Black-Scholes option pricing valuation model. The Company recognizes compensation on a straight-line basis for each separately vesting portion of the option award. The determination of the fair value of share-based payment awards is affected by the Company's stock price. The Company uses the simplified method for awards of stock-based compensation since it does not have the necessary historical exercise and forfeiture data to determine an expected life for stock options (see Note 5).

Revenues by Product

The following table summarizes net revenue by product line and services for the three months ended March 31, 2017 and 2016:

	Three months ended March 31,	
	2017	2016
Products		
Cogeneration	$2,296,637	$1,417,972
Chiller & Heat Pump	510,710	848,176
Total Product Revenue	2,807,347	2,266,148
Services		
Service contracts	2,361,582	2,188,322
Installations	1,677,838	621,045
Total Service Revenue	4,039,420	2,809,367
Total Revenue	$6,846,767	$5,075,515

Note 2 – Income (Loss) per common share

Basic and diluted income (loss) per share for the three months ended March 31, 2017 and 2016, respectively, were as follows:

	Three months ended March 31,	
	2017	2016
Net income (loss) attributable to stockholders	$44,787	$(893,168)
Weighted average shares outstanding - Basic	20,037,795	18,478,990
Basic income (loss) per share	$0.00	$(0.05)
Weighted average shares outstanding - Diluted	20,317,142	18,478,990
Diluted income (loss) per share	$0.00	$(0.05)
Anti-dilutive shares underlying stock options outstanding	—	1,123,200
Anti-dilutive convertible debentures	889,830	890,207
Anti-dilutive warrants outstanding	—	—

TECOGEN INC.
Notes to Interim Unaudited Condensed Consolidated Financial Statements for the three months ended March 31, 2017 and 2016

Note 3 – Demand notes payable, convertible debentures and line of credit agreement to related parties

On December 23, 2013, the Company entered into a Senior Convertible Promissory Note or the Note, with Michaelson Capital Special Finance Fund LP or Michaelson, for the principal amount of $3,000,000 with interest at 4% per annum for a term of three years. In the event of default such interest rate shall accrue at 8% after the occurrence of the event of default and during continuance plus 2% after the occurrence and during the continuance of any other event of default. The Note is a senior unsecured obligation which pays interest only on a monthly basis in arrears at a rate of 4% per annum, unless earlier converted in accordance with the terms of the agreement prior to such date. Effective April 1, 2016, the Note was amended increasing the principal amount by $150,000 for a total of $3,150,000 and extending the maturity date. The principal amount, if not converted, is now due on the fifth anniversary of the Note, December 28, 2018. The Note is senior in right of payment to any unsecured indebtedness that is expressly subordinated in right of payment to the Note.

The principal balance of the Note, together with any unpaid interest, is convertible into shares of the Company's common stock at 282.49 shares of the Company's common stock per $1,000 principal amount of Note (equivalent to a conversion price of $3.54 per share) at the option of Michaelson. If at any time the common stock of the Company is (1) trading on a national securities exchange, (2) qualifies for unrestricted resale under federal securities laws and (3) the arithmetic average of the volume weighted average price of the Common Stock for twenty consecutive trading days preceding the Company's notice of mandatory conversion exceeds $150,000, the Company shall have the right to require conversion of all of the then outstanding principal balance together with unpaid interest of this Note into the Company's common stock based on the conversion price of $3.54 per share. The Company may prepay all of the outstanding principal and interest due and payable under this Note in full, at any time prior to the maturity date for an amount equal to 120% of the then outstanding principal and interest due and payable as of the date of such prepayment.

Upon change of control, as defined by the Note, at Michaelson's option, the obligations may be assumed, on the terms and conditions in this Note, through an assignment and assumption agreement, or the Company may prepay all of the then outstanding principal and unpaid interest under this Note in full at the optional 120% prepayment amount. This provision creates an embedded derivative in accordance with FASB ASC 815, Derivatives and Hedging. As such it is required to be bifurcated and accounted for separately from the Note. However, the Company has determined that the fair value of the embedded derivative is immaterial to the consolidated financial statements. Debt issuance costs are netted against the principal balance of the debt.

As per an amendment to the Note dated April 1, 2016, the conversion price was increased from $3.37 to $3.54 and the number of shares issuable upon conversion decreased from 890,207 at December 31, 2015 to 889,830 at April 1, 2016. The Company has determined that changes resulting from this modification were immaterial to the consolidated financial statements.

On June 15, 2015, the Company entered into a Non-Revolving Line of Credit Agreement, or the Agreement, with John N. Hatsopoulos, the Company's Co-Chief Executive Officer and a Company Director. Under the terms of the Agreement, Mr. Hatsopoulos has agreed to lend the Company up to an aggregate of $2,000,000, with a withdrawal limit of $250,000 per financial calendar quarter, at the written request of the Company. Any amounts borrowed by the Company pursuant to the Agreement will bear interest at 6% per year. Interest is due and payable quarterly in arrears. The term of the Agreement is from July 1, 2015 to July 1, 2017. Repayment of the principal amount borrowed pursuant to the Agreement will be due on July 1, 2017, or the Maturity Date. Prepayment of any amounts due under the Agreement may be made at any time without penalty. The Agreement terminates on the Maturity Date. The Company has not yet borrowed any amounts pursuant to the Agreement.

Note 4 - Stockholders' Equity and Ilios subsidiary

Beginning on April 11, 2016 through its conclusion on May 3, 2016, the Company entered into numerous private placement share exchange agreements ("Share Exchange Agreements") with shareholders of Ilios ("Exchanging Shareholders"), a majority owned subsidiary of the Company. Pursuant to the Share Exchange Agreements, the

Exchanging Shareholders agreed to exchange every 7.86 of their restricted Ilios shares of common stock for 1 share of the Company's restricted common stock. In addition, the Company granted each Exchanging Shareholder registration rights of the Company's common stock they received in exchange for their Ilios shares. The Company issued a total of 670,464 shares of its common stock in exchange for Ilios shares of common stock. Pursuant to the Registration Rights Agreement, the Company filed a registration statement covering the resale of the shares.
Upon execution of the exchange agreements for 100% of the shares of Ilios, the Company no longer had a non-controlling interest in its subsidiary. On April 30, 2016, Ilios was merged into the Company, and accounting for the noncontrolling interest in the subsidiary ended.

TECOGEN INC.
Notes to Interim Unaudited Condensed Consolidated Financial Statements for the three months ended March 31, 2017 and 2016

Note 5 - Stock-based compensation
Stock-Based Compensation
In 2006, the Company adopted the 2006 Stock Option and Incentive Plan or the Plan, under which the Board of Directors may grant incentive or non-qualified stock options and stock grants to key employees, directors, advisors and consultants of the Company. The Plan was amended at various dates by the Board of Directors to increase the reserved shares of common stock issuable under the Plan to 3,838,750 as of March 31, 2017, or the Amended Plan. Stock options vest based upon the terms within the individual option grants, with an acceleration of the unvested portion of such options upon a change in control event, as defined in the Amended Plan. The options are not transferable except by will or domestic relations order. The option price per share under the Amended Plan cannot be less than the fair market value of the underlying shares on the date of the grant. The number of shares remaining available for future issuance under the Amended Plan as of March 31, 2017 was 2,186,424.
Stock option activity for the three months ended March 31, 2017 was as follows:

Common Stock Options	Number of Options	Exercise Price Per Share	Weighted Average Exercise Price	Weighted Average Remaining Life	Aggregate Intrinsic Value
Outstanding, December 31, 2016	1,117,918	$0.79-$5.39	$ 3.10	5.00 years	$1,415,150
Granted	3,000	$3.72	3.72		