TECOGEN INC.
Form 10-Q
May 11, 2016

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, 2016
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, or a smaller reporting company. See the definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act:

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

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, March 31, 2016
Common Stock, $0.001 par value	18,478,990

TECOGEN INC.

QUARTERLY REPORT ON FORM 10-Q
FOR THE PERIOD ENDED MARCH 31, 2016
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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, 2016 and December 31, 2015
(unaudited)

	March 31, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$4,253,931	$5,486,526
Short-term investments	294,875	294,802
Accounts receivable, net	5,888,310	5,286,863
Unbilled revenue	859,270	1,072,391
Inventory, net	5,301,532	5,683,043
Due from related party	594,599	1,177,261
Prepaid and other current assets	354,891	353,105
Total current assets	17,547,408	19,353,991
Property, plant and equipment, net	549,319	543,754
Intangible assets, net	1,048,280	1,044,611
Goodwill	40,870	40,870
Other assets	58,425	58,425
TOTAL ASSETS	$19,244,302	$21,041,651
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$2,377,211	$3,311,809
Accrued expenses	1,079,969	1,066,860
Deferred revenue	984,239	996,941
Total current liabilities	4,441,419	5,375,610
Long-term liabilities:		
Deferred revenue, net of current portion	322,885	273,162
Senior convertible promissory note, related party	2,963,393	2,951,011
Total liabilities	7,727,697	8,599,783
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Tecogen Inc. stockholders' equity:		
Common stock, $0.001 par value; 100,000,000 shares authorized; 18,478,990 issued and outstanding at March 31, 2016 and December 31, 2015	18,479	18,479
Additional paid-in capital	34,522,237	34,501,640
Accumulated deficit	(22,575,605)	(21,682,437)
Total Tecogen Inc. stockholders' equity	11,965,111	12,837,682
Noncontrolling interest	(448,506)	(395,814)
Total stockholders' equity	11,516,605	12,441,868
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$19,244,302	$21,041,651

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

TECOGEN INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
For the three months ended March 31, 2016 and 2015
(unaudited)

	Three months ended March 31, 2016	2015
Revenues		
Products	$2,266,148	$3,537,875
Services	2,809,367	2,565,559
Total revenues	5,075,515	6,103,434
Cost of sales		
Products	1,552,716	2,553,638
Services	1,803,455	1,324,821
Total cost of sales	3,356,171	3,878,459
Gross profit	1,719,344	2,224,975
Operating expenses		
General and administrative	1,892,220	2,174,747
Selling	515,032	493,674
Research and development	218,958	176,163
Total operating expenses	2,626,210	2,844,584
Loss from operations	(906,866)	(619,609)
Other income (expense)		
Interest and other income	2,891	9,103
Interest expense	(42,381)	(42,441)
Total other expense, net	(39,490)	(33,338)
Loss before income taxes	(946,356)	(652,947)
Consolidated net loss	(946,356)	(652,947)
Less: Loss attributable to the noncontrolling interest	53,188	35,483
Net loss attributable to Tecogen Inc.	$(893,168)	$(617,464)
Net loss per share - basic and diluted	$(0.05)	$(0.04)
Weighted average shares outstanding - basic and diluted	18,478,990	16,224,642

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

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TECOGEN INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the three months ended March 31, 2016 and 2015
(unaudited)

	March 31, 2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Consolidated net loss	$(946,356)	$(652,947)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	65,456	67,239
Provision for inventory reserve	14,000	(40,000)
Stock-based compensation	27,243	93,254
Non-cash interest expense	12,382	12,383
Gain (loss) on sale of assets	640	(5,569)
Provision for losses on accounts receivable	(6,154)	—
Changes in operating assets and liabilities		
(Increase) decrease in:		
Short term investments	(73)	(353)
Accounts receivable	(595,293)	(659,607)
Unbilled revenue	213,121	(153,905)
Inventory, net	367,511	374,069
Due from related party	582,662	327,843
Prepaid expenses and other current assets	(1,786)	(53,163)
Increase (decrease) in:		
Accounts payable	(934,598)	681,160
Accrued expenses	13,109	270,174
Deferred revenue	37,021	(765,124)
Net cash used in operating activities	(1,151,115)	(504,546)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(47,371)	(12,935)
Proceeds from sale of assets	—	5,569
Purchases of intangible assets	(27,959)	(47,237)
Net cash used in investing activities	(75,330)	(54,603)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment of stock issuance costs	(6,150)	—
Proceeds from sale of restricted common stock, net	—	996,874
Proceeds from the exercise of stock options	—	360,225
Net cash provided by (used in) financing activities	(6,150)	1,357,099
Net increase (decrease) in cash and cash equivalents	(1,232,595)	797,950
Cash and cash equivalents, beginning of the period	5,486,526	1,186,033
Cash and cash equivalents, end of the period	$4,253,931	$1,983,983
Supplemental disclosures of cash flows information:		
Cash paid for interest	$29,999	$30,059

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, 2016 and 2015

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, 2015 in conjunction with our 2015 Annual Report on Form 10-K, or our Annual Report, filed with the Securities and Exchange Commission, or SEC, on March 30, 2016. 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, 2016, and of operations and cash flows for the interim periods ended March 31, 2016 and 2015. The results of operations for the interim periods ended March 31, 2016 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 65.0% owned subsidiary Ilios Inc. or Ilios, whose business focus is on advanced heating systems for commercial and industrial applications. With the inclusion of unvested restricted stock awards, the Company owns 63.7% of Ilios. Non controlling interest in the accompanying consolidated balance sheets represents the ownership of minority investors of Ilios.

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.

Infrequently, 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 three months ended March 31, 2016, revenues of $140,600 were recorded as bill and hold transactions. For the same period in 2015, no 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 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, 2016 and 2015, a loss of approximately $155,200 and $0 was recorded, respectively. 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 year. Bad debts are written off against the allowance when identified. At March 31, 2016 and December 31, 2015 the allowance for doubtful accounts was approximately $44,000 and $50,000, respectively.

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, 2016 and December 31, 2015, inventory reserves were $307,000 and $293,000, 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, 2016 and 2015, depreciation expense was $41,166 and $43,956, respectively.

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 2016, 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, 2016 and 2015

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, 2016 and 2015:

	Three months ended March 31,	
	2016	2015
Products		
Cogeneration	$1,417,972	$2,571,928
Chiller & Heat Pump	848,176	965,947
Total Product Revenue	2,266,148	3,537,875
Services		
Service contracts	2,188,322	1,872,366
Installations	621,045	693,193
Total Service Revenue	2,809,367	2,565,559
Total Revenue	$5,075,515	$6,103,434

Reclassification

Certain prior period balances have been reclassified to conform with current period presentation. The interest expense includes the amortization of the deferred financing costs, and this has been adjusted in the comparable periods. The balance of deferred financing cost on the balance sheet under ASU 2015-03 is netted with the associated debt and is retrospectively shown for prior period balances.

Note 2 – Loss per common share

All shares issuable for both periods were anti-dilutive because of the reported net loss. Basic and diluted loss per share for the three months ended March 31, 2016 and 2015, respectively, were as follows:

	Three months ended March 31,	
	2016	2015
Net loss attributable to stockholders	$(893,168)	$(617,464)
Weighted average shares outstanding - Basic and diluted	18,478,990	16,224,642
Basic and diluted loss per share	$(0.05)	$(0.04)
Anti-dilutive shares underlying stock options outstanding	1,123,200	1,254,325
Anti-dilutive convertible debentures	890,207	555,556

TECOGEN INC.
Notes to Interim Unaudited Condensed Consolidated Financial Statements for the three months ended March 31, 2016 and 2015

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 is being 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 is evaluating the impact, if any, resulting from this modification.

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

On April 11, 2016 and April 13, 2016, the Company entered into numerous private placement share exchange agreements ("Share Exchange Agreements") with shareholders of Ilios Inc. ("Exchanging Shareholders"), a majority owned subsidiary of the Company ("Ilios"). 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. On April 11, 2016 and April 13, 2016, the Company issued 559,783 and 16,538 shares of its common stock, respectively, in exchange for Ilios shares of common stock. Pursuant to the Registration Rights Agreement, the Company shall as soon as practicable file with the U.S. Securities And Exchange Commission a registration statement on an appropriate form (the “Registration Statement”) covering the resale of the shares and shall use its commercially reasonable best efforts to cause the Registration Statement to be declared effective as soon as practicable. The Company is determining the accounting impact of these transactions.

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

TECOGEN INC.
Notes to Interim Unaudited Condensed Consolidated Financial Statements for the three months ended March 31, 2016 and 2015

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, 2016, 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, 2016 was 1,759,533.
Stock option activity for the three months ended March 31, 2016 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, 2015	1,268,200	$1.20-$5.39	$ 3.06	6.01 years	$985,578
Granted	5,000	3.93	3.93		
Exercised	—	—	—		
Canceled and forfeited	(150,000)	3.39	3.39		
Expired	—	—	—		
Outstanding, March 31, 2016	1,123,200	$1.20-$5.39	$ 3.02	5.46 years	$1,300,361
Exercisable, March 31, 2016	849,558		$ 2.50		$1,286,161
Vested and expected to vest, March 31, 2016	1,123,200		$ 3.02		$1,300,361

Stock-Based Compensation - Ilios
In 2009, Ilios adopted the 2009 Stock Incentive Plan, or the 2009 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 maximum number of shares allowable for issuance under the 2009 Plan is 2,000,000 shares of common stock. The 2009 Plan has 1,325,000 available for grant as of March 31, 2016. There were 5,000 option grants during the first quarter of 2016. 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 Plan.
Consolidated stock-based compensation expense for the three months ended March 31, 2016 and 2015 was $27,243 and $93,254, respectively. No tax benefit was recognized related to the stock-based compensation recorded during the periods.
Note 6 – Commitments and contingencies
Letters of Credit
On January 28, 2016, the letter of credit from Enterprise Bank and Trust Company required for collateral with an outstanding performance bond was closed as the Company had met the performance obligations of the bond.
Note 7 – Related party transactions
The Company has two affiliated companies, namely American DG Energy Inc., or American DG Energy, and EuroSite Power Inc. or EuroSite Power. These companies are affiliates because several of the major stockholders of those companies, have a significant ownership position in the Company. Neither American DG Energy nor EuroSite Power own any shares of the Company, and the Company does not own any shares of American DG Energy or EuroSite Power.
On December 23, 2013, the Company entered into a Senior Convertible Promissory Note with Michaelson Capital Special Finance Fund LP (see Note 3). This agreement came with board observation rights causing the related party status.
On June 15, 2015, the Company entered into a Non-Revolving Line of Credit Agreement with John N. Hatsopoulos, the Company's Co-Chief Executive Officer and a Company Director (see Note 3).

The Company provides office space and certain utilities to American DG Energy based on a monthly rate set at the beginning of each year. This sublease was signed on July 1, 2014 and subsequently amended. The lease will expire on July 1, 2017. The agreement contains an automatic monthly renewal at expiration. In addition, the Company pays certain operating expenses, including benefits and insurance, on behalf of American DG Energy. The Company is reimbursed for these costs.

TECOGEN INC.
Notes to Interim Unaudited Condensed Consolidated Financial Statements for the three months ended March 31, 2016 and 2015

Note 8 - Intangible assets other than goodwill

As of December 31, 2015 and March 31, 2016 the Company has the following amounts related to intangible assets:

	Product Certifications	Patents	Developed Technology	Trademarks	Total
Balance at December 31, 2015					
Intangible assets	$ 514,616	$ 603,915	$ 240,000	$ 4,775	$ 1,363,306
Less - accumulated amortization	(182,931)	(91,764)	(44,000)	—	(318,695)
	$ 331,685	$ 512,151	$ 196,000	$ 4,775	$ 1,044,611
Balance at March 31, 2016					
Intangible assets	$ 514,616	$ 631,024	240,000	$ 5,625	$ 1,391,265
Less - accumulated amortization	(195,681)	(99,304)	(48,000)	—	(342,985)
	$ 318,935	$ 531,720	$ 192,000	$ 5,625	$ 1,048,280

The aggregate amortization expense of the Company's intangible assets for the three months ended March 31, 2016 and 2015 was $24,290 and $23,283, respectively.

Note 9 - Joint Venture

On December 28, 2015, Tecogen entered into a joint venture agreement relating to the formation of a joint venture company (the “JV”) organized to develop and commercialize Tecogen’s patented technology (“Ultera® Technology”) designed to reduce harmful emissions generated by engines using fossil fuels. The joint venture company, called Ultra Emissions Technologies Ltd., was organized under the laws of the Island of Jersey, Channel Islands.

Tecogen received a 50% equity interest in the JV in exchange for a fully paid-up worldwide license to use Tecogen’s Ultera emissions control technology in the field of mobile vehicles burning fossil fuels. The other half of the joint venture equity interests were purchased for $3,000,000 by a small group of offshore investors. Warrants to purchase additional equity securities in the JV were granted to all parties pro rata. If the venture is not successful, all licensed intellectual property rights will revert to Tecogen.

The JV is expected to have losses as it performs the necessary research and development with the Ultera technology. Using equity method accounting, these losses will not be included in Tecogen's financial statements since Tecogen does not guarantee obligations of the JV and is not otherwise obligated to provide further financial support of the JV, although it may choose to in the future.

Expenses incurred by Ultra Emissions Technologies Ltd. for three months ended March 31, 2016 were $368,500, leaving a funds available for future expenditures of $2,631,500.

Note 10 - Subsequent Events

On April 1, 2016, the senior convertible note was amended including modification of conversion price 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. The Company is evaluating the impact, if any, resulting from this modification (See Note 3).

On April 11, 2016 and April 13, 2016, the Company entered into numerous private placement share exchange agreements with shareholders of Ilios Inc., a majority owned subsidiary of the Company. These transactions are detailed in Note 4. Effective May 3, 2016, Tecogen, Inc. (the "Company") entered into an Agreement and Plan of Merger (the "Agreement"), with its majority owned private subsidiary, Ilios Inc. ("Ilios"). Pursuant to the Agreement, Ilios will merge with and into Tecogen with Tecogen as the surviving Company. Tecogen will assume ownership of all of Ilios' assets, debts, contracts, liabilities, obligations, and duties. Pursuant to the Agreement, any stockholders or options holders of Ilios may turn in their stock or options for stock or options of Tecogen at the agreed upon exchange rate. Pursuant to the agreement, Ilios will merged with and into Tecogen in short-form merger under Delaware General Corporate Law Section 253.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-looking statements are made throughout this Management’s Discussion and Analysis of Financial Condition and Results of Operations. Any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words “believes,” “anticipates,” “plans,” “expects,” “seeks,” “estimates” and similar expressions are intended to identify forward-looking statements. Such forward-looking statements include, among other things, statements regarding our current and future cash requirements, our expectations regarding suppliers of cogeneration units, and statements regarding potential financing activities in the future. While the Company may elect to update forward-looking statements in the future, it specifically disclaims any obligation to do so, even if the Company’s estimates change, and readers should not rely on those forward-looking statements as representing the Company’s views as of any date subsequent to the date of the filing of this Quarterly Report. There are a number of important factors that could cause the actual results of the Company to differ materially from those indicated by such forward-looking statements, including those detailed under the heading “Risk Factors” in this Quarterly Report.

Overview

Tecogen Inc., or the Company, or Tecogen, designs, manufactures and sells industrial and commercial cogeneration systems that produce combinations of electricity, hot water and air conditioning using automotive engines that have been specially adapted to run on natural gas. In some cases, our customers may choose to have the Company engineer and install the system for them rather than simply purchase the cogeneration and/or chiller units, which we refer to as "turnkey" projects. Cogeneration systems are efficient because in addition to supplying mechanical energy to power electric generators or compressors – displacing utility supplied electricity – they provide opportunity for the facility to incorporate the engine’s waste heat into onsite processes such as space and portable water heating. We produce standardized, modular, small-scale products, with a limited number of product configurations that are adaptable to multiple applications. We refer to these combined heat and power products as CHP (electricity plus heat) and MCHP (mechanical power plus heat).

In addition to being a smaller reporting company, Tecogen is an emerging growth company as that term is defined in the Jumpstart Our Business Startups Act of 2012 (JOBS Act).

Results of Operations

Revenues

Revenues in the first quarter of 2016 were $5,075,515 compared to $6,103,434 for the same period in 2015, a decrease of $1,027,919 or 16.8%. Product revenues in the first quarter of 2016 were $2,266,148 compared to $3,537,875 for the same period in 2015, a decrease of $1,271,727 or 35.9%. This decrease was the aggregate of a decrease in cogeneration sales of $1,153,956 and a decrease in chiller and heat pump sales, which include the Ilios products, of $117,771. Service revenues in the first quarter of 2016 were $2,809,367 compared to $2,565,559 for the same period in 2015, an increase of $243,808 or 9.5%. This increase in the first quarter is the due to a decrease in installation activity of $72,148 and an increase of $315,956 in service contracts.

Cost of Sales

Cost of sales in the first quarter of 2016 was $3,356,171 compared to $3,878,459 for the same period in 2015 a decrease of $522,288, or 13.5%. During the first quarter of 2016 our overall gross profit margin was 33.9% compared to 36.5% for the same period in 2015, a decrease of 2.6%. This decrease in margin is isolated to this quarter and a single installation project. Margin improvements realized in previous quarters is expected to return in the following periods. Management expects growth in sales volume to improve gross margins going forward.

Operating Expenses

General and administrative expenses consist of executive staff, accounting and legal expenses, office space, general insurance and other administrative expenses. General and administrative expenses in the first quarter ending March 31, 2016 were $1,892,220 compared to $2,174,747 for the same period in 2015, a decrease of $282,527 or 13.0%. The majority of the decrease, including routine fluctuations in the timing of expenses, was the result of management's efforts to lower overhead costs.

Selling expenses consist of sales staff, commissions, marketing, travel and other selling related expenses. Selling expenses for the first quarter of 2016 were $515,032 compared to $493,674 for the same period in 2015, an increase of $21,358 or 4.3%. The majority of the increase in expense was due to increased sales personnel when compared to the previous year.

Research and development expenses consist of engineering and technical staff, materials, outside consulting and other related expenses. Research and development expenses in the first quarter ending March 31, 2016 were $218,958 compared to $176,163 for the same period in 2015, an increase of $42,795 or 24.3%. This increase was due to the beginning of new engineering programs for the next product improvement cycle.

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Loss from Operations

Loss from operations for the first quarter of 2016 was $906,866 compared to $619,609 for the same period in 2015, an increase of $287,257. The increase in the loss was due to a reduction in gross profit resulting from lower revenues and decreased margins.

Other Income (Expense), net

Other expense, net for the three months ended March 31, 2016 was $39,490 compared to $33,338 for the same period in 2015. Other income (expense) includes interest income and other income of $2,891, net of interest expense on notes payable of $42,381 for the first quarter of 2016. For the same period in 2015, interest and other income was $9,103 and interest expense was $42,441.

Provision for Income Taxes

The Company did not record any benefit or provision for income taxes for the three months ended March 31, 2016 and 2015, respectively. As of March 31, 2016 and 2015, the income tax benefits generated from the Company's net losses have been fully reserved.

Noncontrolling Interest

The noncontrolling interest share in the loss of Ilios was $53,188 for the three months ended March 31, 2016 compared to losses of $35,483 for the same period in 2015, an increase of $17,705 or 49.9%. The increase was due to increased selling expenses for Ilios in the first quarter of 2016 as compared to the same period in 2015. Noncontrolling interest ownership percentage as of March 31, 2016 and 2015 was unchanged at 35.0% for both periods.

Net loss

Net loss attributable to Tecogen for the three months ended March 31, 2016 was $893,168 compared to $617,464 for the same period in 2015, an increase of $275,704. The increase in net loss was the result of the decrease in gross profit combined with the decrease in revenues as described above.

Liquidity and Capital Resources

Consolidated working capital at March 31, 2016 was $13,105,989 compared to $13,978,381 at December 31, 2015, a decrease of $872,392. Included in working capital were cash and cash equivalents of $4,253,931 and $294,875 in short-term investments at March 31, 2016, compared to $5,486,526 in cash and cash equivalents and $294,802 in short-term investments at December 31, 2015, a decrease of $1,232,522. The decrease in working capital and cash was mainly due to the loss in the quarter net of non-cash items.

Cash used in operating activities for the three months ended March 31, 2016 was $1,151,115 compared to $504,546 for the same period in 2015. Our accounts receivable balance increased to $5,888,310 at March 31, 2016 compared to $5,286,863 at December 31, 2015, using $601,447 of cash due to timing of billing, shipments, and collections. In addition, amounts due from related parties decreased by $582,662 providing cash due to timing of billing, shipments and collections. Our inventory decreased to $5,301,532 as of March 31, 2016 compared to $5,683,043 as of December 31, 2015, a decrease of $381,511. Although lowering inventory is a goal, management expects inventory not to vary significantly from the level at year end.

As of March 31, 2016, the Company's backlog of product and installation projects, excluding service contracts, was $10.73 million, consisting of $3.98 million of purchase orders received by us and $6.75 million of projects in which the customer's internal approval process is complete, financial resources have been allocated and the customer has made a firm verbal commitment that the order is in the process of execution. Backlog at the beginning of any period is not necessarily indicative of future performance. Our presentation of backlog may differ from other companies in our industry.

Accounts payable decreased to $2,377,211 as of March 31, 2016 from $3,311,809 at December 31, 2015, using $934,598 in cash flow from operations. Accrued expenses increased to $1,079,969 as of March 31, 2016 from $1,066,860 as of December 31, 2015, providing $13,109 of cash from operations. The Company expects accounts payable and accrued expenses to only increase as operations expand.

During the first three months of 2016 our investing activities used $75,330 of cash and included purchases of property and equipment of $47,371 and expenditures related to intangible assets of $27,959.

During the first three months of 2016 our financing activities included the payment of expenses from the issuance of our common stock of $6,150. The proceeds were used for general corporate purposes, including research and development.

Significant Accounting Policies and Critical Estimates

The Company’s significant accounting policies are discussed in the Notes to the Condensed Consolidated Financial Statements above and in our Annual Report. The accounting policies and estimates that can have a significant impact upon the operating results, financial position and footnote disclosures of the Company are described in the above notes and in our Annual Report.

Seasonality

We expect that the majority of our heating systems sales will be in the winter and the majority of our chilling systems sales will be in the summer. Our cogeneration and chiller system sales are not generally affected by the seasons, although customer goals will be to have chillers installed and running in the spring. Our service team does experience higher demand in the warmer months when cooling is required. These units are generally shut down in the winter and started up again in the spring. This “busy season” for the service team generally runs from May through the end of September.

Off-Balance Sheet Arrangements

Currently, we do not have any off-balance sheet arrangements, including any outstanding derivative financial instruments, off-balance sheet guarantees, interest rate swap transactions or foreign currency contracts. We do not engage in trading activities involving non-exchange traded contracts.

Subsequent Events

On April 1, 2016, the senior convertible note was amended including modification of conversion price 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. The Company is evaluating the impact, if any, resulting from this modification (See Note 3).

On April 11, 2016 and April 13, 2016, the Company entered into numerous private placement share exchange agreements with shareholders of Ilios Inc., a majority owned subsidiary of the Company. These transactions are detailed in Note 4. Effective May 3, 2016, Tecogen, Inc. (the "Company") entered into an Agreement and Plan of Merger (the "Agreement"), with its majority owned private subsidiary, Ilios Inc. ("Ilios"). Pursuant to the Agreement, Ilios will merge with and into Tecogen with Tecogen as the surviving Company. Tecogen will assume ownership of all of Ilios' assets, debts, contracts, liabilities, obligations, and duties. Pursuant to the Agreement, any stockholders or options holders of Ilios may turn in their stock or options for stock or options of Tecogen at the agreed upon exchange rate. Pursuant to the agreement, Ilios will merged with and into Tecogen in short-form merger under Delaware General Corporate Law Section 253.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Not applicable.

Item 4. Controls and Procedures.

Management’s Evaluation of Disclosure Controls and Procedures:

The Company maintains "disclosure controls and procedures,” as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act, that are designed to provide reasonable assurance that information required to be disclosed by the Company in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to the Company's management, including our principal executive officers and principal financial and accounting officer, as appropriate, to allow timely decisions regarding required disclosure.

Our disclosure controls and procedures are designed to provide reasonable assurance that the control system’s objectives will be met. Our management, including our Co-Chief Executive Officers and Chief Financial Officer, after evaluating the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report, have concluded that our disclosure controls and procedures were not effective due to material weaknesses in financial reporting relating to lack of personnel with a sufficient level of accounting knowledge and a small number of employees dealing with general controls over information technology. Management will continue to evaluate the above weaknesses, and as the Company grows and resources become available, the Company plans to take the necessary steps in the future to remediate the weaknesses.

Changes in Internal Control over Financial Reporting:
The Company currently does not have personnel with a sufficient level of accounting experience and training in the selection, application and implementation of generally accepted accounting principles as it relates to complex transactions and financial reporting requirements. The Company also has a small number of employees dealing with general controls over information technology security and user access. This constitutes a material weakness in financial reporting.

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In connection with the material weaknesses referred to in the foregoing paragraph, we will make changes in our internal controls over financial reporting as soon as the resources become available. During the period ended March 31, 2016, no changes have been made to the Company's process.

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PART II - OTHER INFORMATION
Item 6. Exhibits

Exhibit No.	Description of Exhibit
3.1	Amended and Restated Certificate of Incorporation [(a)]
3.2	Amended and Restated Bylaws [(a)]
4.1	Specimen Stock Certificate of Tecogen, Inc. [(a)]
4.2	Form of Restricted Stock Purchase Agreement [(b)]
4.3	Form of Stock Option Agreement [(a)]
10.8	Second Amendment to Lease between Atlantic-Waltham Investment II, LLC, and Tecogen Inc., dated Jan 16, 2013[(a)]
10.19	Form of Common Stock Purchase Agreement. [(a)]
10.21	Senior Convertible Promissory Note, dated December 23, 2013, by Tecogen Inc. in favor of Michaelson Capital Special Finance Fund LP. [(a)]
10.24	Facilities and Support Services Agreement between American DG Energy Inc. and Tecogen Inc., dated Aug 8, 2014.[(c)]
10.26+	Tecogen Inc. 2006 Stock Incentive Plan, as amended on January 24, 2014 with stockholder approval on July 15, 2014. [(e)]
10.27	Non-Revolving Line of Credit Agreement between the Company and John N. Hatsopoulos, dated June 15, 2015. [(e)]
10.28	Form of Common Stock Purchase Agreement dated August 3, 2015.[(d)]
10.29	Registration Rights Agreement dated August 3, 2015.[(d)]
10.30	First amendment to the Facilities and Support Services Agreement between American DG Energy Inc. and Tecogen Inc., dated Aug 7, 2015. [(f)]
10.35	Share Exchange Agreement for the Ilios private placements dated April 11, 2016 and April 13, 2016.[(g)]
10.36	Amendment No. 1 to the Senior Convertible Promissiory Note effective April 1, 2016.[(g)]
21.1	List of subsidiaries [(a)]
31.1*	Rule 13a-14(a) Certification of Co-Chief Executive Officer
31.2*	Rule 13a-14(a) Certification of Co-Chief Executive Officer
31.3*	Rule 13a-14(a) Certification of Chief Financial Officer
32.1*	Section 1350 Certifications of Co-Chief Executive Officers and Chief Financial Officer

101.INS** XBRL Instance Document
101.SCH** XBRL Taxonomy Extension Schema
100.CAL** XBRL Taxonomy Extension Calculation Linkbase
100.DEF** XBRL Taxonomy Extension Definition Linkbase
101.LAB** XBRL Taxonomy Extension Label Linkbase
101.PRE** XBRL Taxonomy Extension Presentation Linkbase

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*Filed herewith
**Furnished herewith
+Compensatory plan or arrangement
(a) incorporated by reference from the Company's Registration Statement on Form S-1/A (Registration No. 333-193791), filed with the SEC on June 27, 2014.
(b) incorporated by reference from the Company's Registration Statement on Form S-1 (Registration No. 333-178697), originally filed with the SEC on December 22, 2011.
(c) incorporated by reference from the Company's 10-Q Report for the period ending June 30, 2014, originally filed with the SEC on August 14, 2014.

(d) incorporated by reference from the Company's form 8-K Report originally filed with the SEC on August 6, 2015.

(e) incorporated by reference from the Company's 10-Q Report for the period ending June 30, 2015, originally filed with the SEC on August 6, 2015.

(f) incorporated by reference from the Company's form 8-K Report originally filed with the SEC on August 13, 2015.

(g) incorporated by reference from the Company's form 8-K Reports originally filed with the SEC on April 15, 2016.

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TECOGEN INC.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, on May 11, 2016.

TECOGEN INC.
(Registrant)

By: /s/ John N. Hatsopoulos
Co-Chief Executive Officer
(Principal Executive Officer)

By: /s/ Benjamin M. Locke
Co-Chief Executive Officer
(Principal Executive Officer)

By: /s/ David A. Garrison
Chief Financial Officer, Treasurer and Secretary
(Principal Financial and Accounting Officer)