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Investment Research

EuroSite Power Achieves Solid Revenue and Margin Increase in Third Quarter

November 12, 2016 - EuroSite Power (EUSP – \$0.40), which owns and operates clean, On-Site Utility systems that produce electricity, hot water, heat and cooling at facilities in the UK, recorded revenues of \$459,114 for the third quarter of 2016, versus \$421,991 in the comparable quarter of 2015, an increase of 9%.

In local currency however – the Company's operation is located in the United Kingdom – its revenues grew by an impressive 28.4% to GBP£349,615, up from GBP£272,287 in Q3 2015. The significant difference between the growth number in US dollar and British pound, is due to the sharp decline of the pound as a result of the Brexit vote in June of this year. So although the Company reports in US dollar, it's important to look at the results in British pound as well to get a true idea of its performance.

Revenues especially benefitted from a higher number of operating units and the improved utilization rate of the CHP machines. Total operational systems at September 30, 2016 was 32, compared with just 28 on September 30, 2015. At the same time, total energy production for the third quarter of 2016 reached 7,549,821 kWh, a rise of 2.07 million kWh, or 37.7%, over the third quarter of 2015.

Next to the increase in revenue, also the evolution of its gross margin indicates how well the Company is executing. Gross margin, excluding depreciation, reached 32.8%. Although a bit lower than the Company's goal of 35%, it compares very favorably with the 13.5% gross margin achieved in Q3 2015. In fact, this was the first time in EuroSite Power's history that gross margin in the third quarter was higher than 30%.

Traditionally the summer months are relatively weak for EuroSite because thermal loads fall, and as such the energy output is lower. However, as some of the Company's costs are fixed, its margins tend to be lower during the summer. This time, gross margin benefited from strong reductions in maintenance expense as well as lower fuel expense as a percent of total revenue.

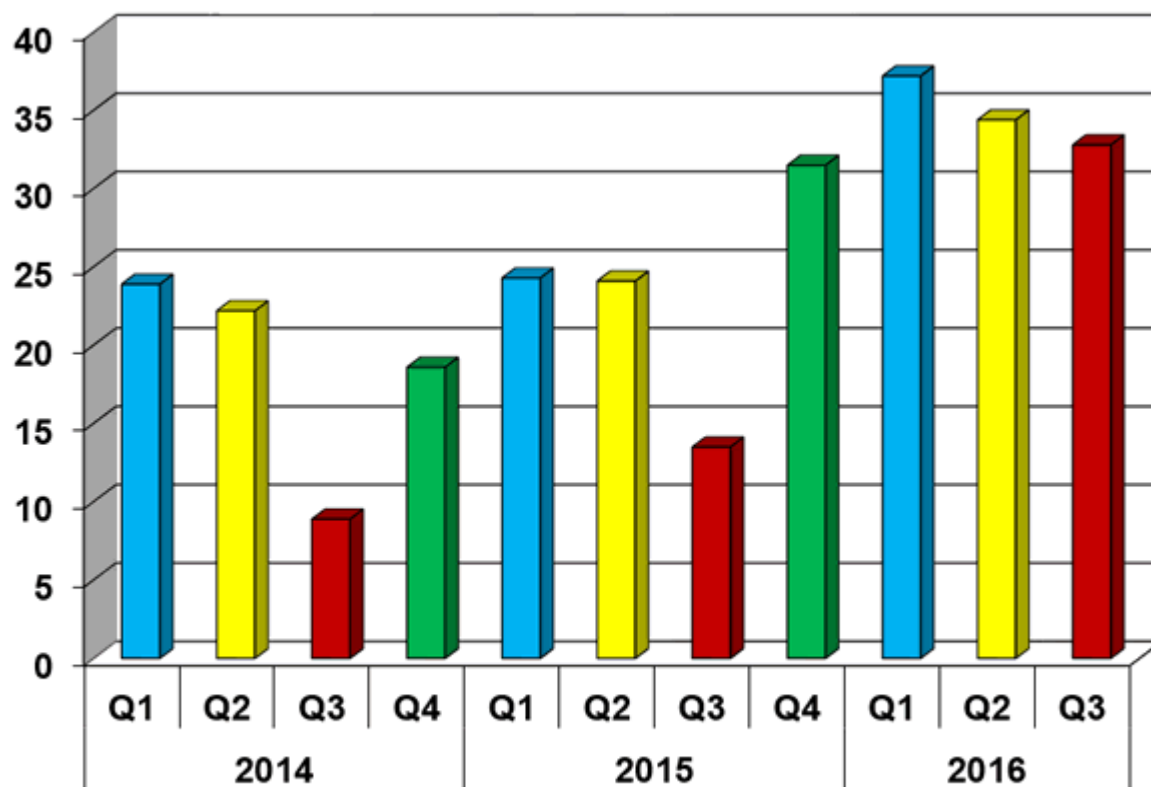
For the first nine months of 2016, gross margin, excluding depreciation, was 35%, right on target!

And it doesn't stop there, as the Company continues to make progress to reach higher gross margin. For example, it will upgrade the three final Tecogen CHPs. The upgrades of the other units have had a very positive effect on their reliability and also increased the maximum output of the Tecogen fleet as engine speed is much more consistent after the

upgrade thanks to the new electronic ignition system. In addition, the Company is looking to install extended oil tanks on its Tecogen CHP units, so it can reduce the number of service intervals.

Finally, it wants to bring the lubrication servicing of the not-out-of-warranty TEDOM CHPs in-house. Normally, these units are being serviced by the TEDOM dealer in the UK during the two year warranty period. However, bringing lubrication servicing in-house would lower the costs on parts and labor. The EuroSite Power service team are receiving factory training in the TEDOM facility in the Czech Republic at the moment.

EuroSite Power's Managing Director Paul Hamblyn commented, "The significant improvement in our adjusted gross margin alongside improved overall gross margin demonstrates the value of the cost control initiatives put in place at the end of last year to drive our company toward profitability."



Gross margin excluding depreciation noticeably improved the past four quarters. Especially, in the third quarter – traditionally the softest quarter for EuroSite Power – the progress is impressive.

A final important item when looking at EuroSite Power's margins is the availability and efficiency of its operational fleet.

A CHP unit's availability, or up-time, can never reach 100%. Sometimes the equipment fails or it needs maintenance, or it might even be temporarily shut down because the electricity tariff from the grid is too low at certain times of the day, or year, to make sufficient margins. Units also switch off at times of low demand for heat such as during the warmer summer months. Overall fleet availability in the third quarter of 2016 was 74%, another strong improvement over the 69% availability in the comparable period last year. This was achieved despite exceptionally warm weather in September.

Efficiency, on the other hand, measures how much of a unit's input fuel is converted to energy which can then be sold to the customer. In the third quarter of 2016 efficiency reached 77%, identical to last year's third quarter.

Internal and External Growth Opportunities

One new installation was commissioned in the third quarter, bringing total operational systems at the end of September to 32. The total installed capacity is 3,509 kW, and long term total contract value of operational systems is approximately \$74.2 (GBP£57.2) million.

The current contracted project backlog is 7 systems for a total of 989 kW in capacity. So the total systems under contract (both operating and in backlog) at quarter end was 39; totaling 4,498 kW of capacity for a combined lifetime contract value of approximately \$91.2 (GBP£70.3) million.

Although no new orders were added in the past quarter, plenty are in the pipeline. For example, decisions are expected any day on three projects in the UK.

Next to growth in the UK market, the Company is actively seeking to grow in mainland Europe. It's doing this by collaborating with the Czech CHP manufacturer TEDOM. Through the latter's extensive dealer network across Europe, the Company has already identified several potential customers in Germany and Italy.

Moreover, the Company is targeting a number of larger projects in the UK and abroad. Dr. Elias Samaras, the CEO of EuroSite Power, mentioned during the third quarter conference call that three large projects have been identified in south-east Europe. The Company is currently shortlisted to participate in the energy part of an \$8 billion construction project. If this deal were to materialize, it goes without saying that it would be transformational for EuroSite Power. Furthermore, the Company is bidding on two hotel resort projects.

To continue filling the pipeline with new potential customers, the Company now has a "hybrid" offer, in which the customer buys the natural gas to drive the CHP, and only pays EuroSite Power for the generated electricity. This will allow the Company to compete with companies already offering this type of service. In addition, EuroSite Power has started the process of using energy consultants to promote the Company's solutions to their existing partners. Good to know is that about half of all the projects that EuroSite has completed so far, were introduced by third parties. So having more and better relationships with people and organizations that can introduce the Company to potential customers is critical.

Finally, the Company has hired a strategic advisor to source and research potential acquisition targets. Acquisition candidates with existing portfolios of distributed generation assets, service networks, and those operating in new geographies are all attractive potential targets. So far, the initial phase of research has identified a number of potential candidates for acquisition both in the UK and mainland Europe.

Dr. Samaras noted, "These are exciting times at EuroSite Power. We have the in-house maintenance, gas purchase arrangement, and project financing agreements as well as an improved balance sheet. This has positioned the Company to actively pursue larger projects as well as acquisitions alongside geographic expansion."

Third Quarter 2016 Financials and Balance Sheet

Total revenue for the third quarter of 2016 was \$459,114, compared to \$421,991 for the same period in 2015, an increase of 8.8%. GAAP diluted loss per share (EPS) was \$0.01 for the third quarter of 2016, in line with prior year results.

Operating expenses were higher as the Company continued to invest in additional personnel and marketing activities. General and Administrative expense included an approximately \$109,000 exceptional translation loss due to the decline of the pound versus the US dollar. Also, included in the G&A expense is a stock compensation amount of \$124,000. These are both non-cash transactions, so they don't influence the balance sheet, but they do have quite an impact on the net result.

While operating strength is important for a small growth company, financial strength is paramount. Securing the project financing partners Macquarie and Societe Generale was just the first step in establishing a solid, sustainable financial position for EuroSite Power. Via a series of transactions that began in May 2016, management and the Board have demonstrated their commitment to improving the financial profile of EuroSite Power. This summer the Company raised over \$7 million via a private placement, eliminated an outstanding \$2 million related party loan, and converted nearly the entirety of its outstanding 4% Senior Convertible Debt. An impressive achievement!

	Three Months Ended September 30		Nine Months Ended September 30	
	2016	2015	2016	2015
Net Sales	459,114	421,991	1,786,583	1,513,018
Cost of Sales	420,272	467,582	1,501,756	1,481,897
Gross Profit (Loss)	38,842	(45,591)	284,827	31,121
Operating Expenses	617,796	404,732	1,721,886	1,149,104
(Loss) From Operations	(578,954)	(450,323)	(1,437,059)	(1,117,983)
Debt Conversion Expense	-	-	(224,782)	-
Net (Loss)	(582,826)	(457,957)	(1,682,576)	(1,145,331)
Earnings (Loss) Per Share	(0.01)	(0.01)	(0.02)	(0.02)
Shares Out. - Diluted	82,265,056	65,747,100	73,605,329	65,747,100
Most important income statement data for the quarters and nine months ending September 30, 2016 and September 30, 2015. Source: Company Press Release				

The result of management's diligence is evident in the newly strengthened balance sheet. EuroSite Power today has more cash on hand than at any other point in the Company's history and is burdened by negligible debt - just \$300,000 remains of its Senior Convertible note.

	September 30, 2016	September 30, 2015
Cash and Cash Equivalents	4,597,780	587,819
Accounts Receivable	216,845	303,782
Inventories	192,133	137,093
Total Current Assets	5,115,519	1,450,034
Property and Equipment	7,992,328	7,516,262
Total Assets	13,117,730	8,977,300
Accounts Payable	206,618	313,293
Accrued Expenses	226,906	286,814
Total Current Liabilities	561,445	699,086

Convertible Debentures	-	1,585,264
Convertible Debentures - Related Party	308,026	951,158
Note Payable - Related Party	-	2,000,000
Total Liabilities	1,149,203	5,235,508
Total Stockholder Equity	11,968,527	3,741,792
Most important balance sheet data for the periods ending September 30, 2016 and September 30, 2015.		
Source: Company Filings		

Conclusion

Both energy production and gross margin were up considerably in the third quarter of 2016, compared with the same period in 2015. And if it hadn't been for the sharp decline of the British pound, which obviously is out of the Company's control, sales growth would have been even more impressive.

On the other hand, the devaluation of the pound can also be favorable, as the cash that the Company still holds in US dollars, is more valuable if they want to acquire a UK company.

In addition, the Company is working hard to secure more and bigger projects. Customers with multiple sites, like the National Health Service (NHS) and private health care operators, have been targeted in particular. Winning these types of customers will bring larger and more profitable projects. Also in mainland Europe several projects have been identified that could result in contract wins in the coming months.

Its strong balance sheet, strategic partnerships, and improved operational efficiencies should drive EuroSite Power towards profitability even faster. Buy recommendation.

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