

TECOGEN INC.  
Form 10-Q  
August 14, 2014

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2014

or

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  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  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

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

Title of each class

Outstanding, June 30, 2014

Common Stock, \$0.001 par value

15,809,306

TECOGEN INC.

QUARTERLY REPORT ON FORM 10-Q  
FOR THE PERIOD ENDED JUNE 30, 2014  
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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.

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## TECOGEN INC.

## PART I - FINANCIAL INFORMATION

## Item 1 - Financial Statements

## CONSOLIDATED BALANCE SHEETS

As of June 30, 2014 and December 31, 2013

|   | June 30, 2014<br>(unaudited) | December 31,<br>2013<br>(audited) |
|---|------------------------------|-----------------------------------|
| <b>ASSETS</b>   |                              |                                   |
| Current assets:   |                              |                                   |
| Cash and cash equivalents   | \$3,377,897                  | \$7,713,899                       |
| Short-term investments, restricted  | 584,375                      | —                                 |
| Accounts receivable, net  | 4,418,165                    | 3,740,885                         |
| Unbilled revenue  | 352,161                      | 646,398                           |
| Inventory, net  | 3,887,277                    | 3,343,793                         |
| Due from related party  | 148,830                      | —                                 |
| Deferred financing costs  | —                            | 140,433                           |
| Prepaid and other current assets  | 453,738                      | 340,013                           |
| Total current assets  | 13,222,443                   | 15,925,421                        |
| Property, plant and equipment, net  | 653,565                      | 638,026                           |
| Intangible assets, net  | 1,026,199                    | 953,327                           |
| Goodwill  | 40,870                       | 40,870                            |
| Deferred financing costs  | 121,970                      | —                                 |
| Other assets  | 49,355                       | 72,425                            |
| <b>TOTAL ASSETS</b>   | <b>\$15,114,402</b>          | <b>\$17,630,069</b>               |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                              |                                   |
| Current liabilities:  |                              |                                   |
| Demand notes payable and line of credit, related party  | \$—                          | \$2,950,000                       |
| Senior convertible promissory note, related party   | —                            | 3,000,000                         |
| Accounts payable  | 2,453,029                    | 2,338,046                         |
| Accrued expenses  | 1,255,978                    | 1,139,554                         |
| Deferred revenue  | 1,003,673                    | 613,915                           |
| Due to related party  | —                            | 119,667                           |
| Interest payable, related party   | —                            | 198,450                           |
| Total current liabilities   | 4,712,680                    | 10,359,632                        |
| Long-term liabilities:  |                              |                                   |
| Deferred revenue, net of current portion  | 264,503                      | 204,544                           |
| Senior convertible promissory note, related party   | 3,000,000                    | —                                 |
| Total liabilities   | 7,977,183                    | 10,564,176                        |
| Commitments and contingencies (Note 5)  |                              |                                   |
| Stockholders' equity:   |                              |                                   |
| Tecogen Inc. shareholders' equity:  |                              |                                   |
| Common stock, \$0.001 par value; 100,000,000 shares authorized; 15,809,306 and 15,155,200 issued and outstanding at June 30, 2014 and December 31, 2013, respectively | 15,809                       | 15,155                            |
| Additional paid-in capital  | 24,891,504                   | 22,463,996                        |
| Accumulated deficit   | (17,476,964)                 | (15,209,212)                      |
| Total Tecogen Inc. stockholders' equity   | 7,430,349                    | 7,269,939                         |

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|   |                     |                     |   |
|---|---------------------|---------------------|---|
| Noncontrolling interest                           | (293,130            | ) (204,046          | ) |
| Total stockholders' equity                        | 7,137,219           | 7,065,893           |   |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b> | <b>\$15,114,402</b> | <b>\$17,630,069</b> |   |

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

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## TECOGEN INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS

For the three and six months ended June 30, 2014 and 2013

(unaudited)

|   | Three months ended June 30, |                | Six months ended June 30, |                |
|---|-----------------------------|----------------|---------------------------|----------------|
|   | 2014                        | 2013           | 2014                      | 2013           |
| Revenues  |                             |                |                           |                |
| Products  | \$2,007,926                 | \$807,854      | \$3,952,702               | \$2,860,519    |
| Services  | 2,531,931                   | 1,995,606      | 4,802,912                 | 3,989,259      |
| Total revenues  | 4,539,857                   | 2,803,460      | 8,755,614                 | 6,849,778      |
| Cost of sales   |                             |                |                           |                |
| Products  | 1,587,145                   | 633,272        | 2,991,584                 | 2,221,940      |
| Services  | 1,604,039                   | 1,356,315      | 2,989,131                 | 2,702,001      |
| Total cost of sales                                     | 3,191,184                   | 1,989,587      | 5,980,715                 | 4,923,941      |
| Gross profit  | 1,348,673                   | 813,873        | 2,774,899                 | 1,925,837      |
| Operating expenses                                      |                             |                |                           |                |
| General and administrative                              | 1,911,071                   | 1,419,020      | 3,673,063                 | 2,965,580      |
| Selling   | 405,108                     | 286,101        | 826,728                   | 565,471        |
| Research and development                                | 251,582                     | 260,262        | 559,716                   | 505,405        |
| Total operating expenses                                | 2,567,761                   | 1,965,383      | 5,059,507                 | 4,036,456      |
| Loss from operations                                    | (1,219,088 )                | (1,151,510 )   | (2,284,608 )              | (2,110,619 )   |
| Other income (expense)                                  |                             |                |                           |                |
| Interest and other income                               | 15,079                      | 2,591          | 18,164                    | 6,537          |
| Interest expense  | (57,382 )                   | (36,387 )      | (92,152 )                 | (59,764 )      |
| Total other expense                                     | (42,303 )                   | (33,796 )      | (73,988 )                 | (53,227 )      |
| Loss before income taxes                                | (1,261,391 )                | (1,185,306 )   | (2,358,596 )              | (2,163,846 )   |
| Consolidated net loss                                   | (1,261,391 )                | (1,185,306 )   | (2,358,596 )              | (2,163,846 )   |
| Less: Loss attributable to the noncontrolling interest  | 31,684                      | 94,826         | 90,844                    | 212,973        |
| Net loss attributable to Tecogen Inc.                   | \$(1,229,707 )              | \$(1,090,480 ) | \$(2,267,752 )            | \$(1,950,873 ) |
| Net loss per share - basic and diluted                  | \$(0.08 )                   | \$(0.08 )      | \$(0.15 )                 | \$(0.15 )      |
| Weighted average shares outstanding - basic and diluted | 15,227,089                  | 13,205,476     | 15,013,824                | 13,209,165     |

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

TECOGEN INC.

## CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

For the six months ended June 30, 2014

(unaudited)

|                                       | Tecogen Inc.                          |                                  |                        |                            |              |
|---------------------------------------|---------------------------------------|----------------------------------|------------------------|----------------------------|--------------|
|                                       | Common<br>Stock<br>0.001<br>Par Value | Additional<br>Paid-In<br>Capital | Accumulated<br>Deficit | Noncontrolling<br>Interest | Total        |
| Balance at December 31, 2013          | \$15,155                              | \$22,463,996                     | \$(15,209,212 )        | \$(204,046 )               | \$7,065,893  |
| Sale of restricted common stock       | 2                                     | 6,298                            | —                      | —                          | 6,300        |
| Sale of common stock, net of<br>costs | 647                                   | 2,344,388                        |                        |                            | 2,345,035    |
| Exercise of stock options             | 5                                     | 5,995                            | —                      | —                          | 6,000        |
| Stock based compensation<br>expense   | —                                     | 70,827                           | —                      | 1,760                      | 72,587       |
| Net loss                              | —                                     | —                                | (2,267,752 )           | (90,844 )                  | (2,358,596 ) |
| Balance at June 30, 2014              | \$15,809                              | \$24,891,504                     | \$(17,476,964 )        | \$(293,130 )               | \$7,137,219  |

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

## TECOGEN INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

For the six months ended June 30, 2014 and 2013

(unaudited)

|   | June 30,<br>2014 | 2013             |
|---|------------------|------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                |                  |                  |
| Consolidated net loss   | \$(2,358,596     | ) \$(2,163,846 ) |
| Adjustments to reconcile net loss to net cash used in operating activities: |                  |                  |
| Depreciation and amortization   | 171,967          | 124,847          |
| Change in provision for allowance on accounts receivable                    | 18,000           | (34,700 )        |
| Stock-based compensation  | 72,587           | (38,179 )        |
| Changes in operating assets and liabilities                                 |                  |                  |
| (Increase) decrease in:   |                  |                  |
| Accounts receivable   | (695,280         | ) 833,687        |
| Unbilled revenue  | 294,237          | (107,545 )       |
| Inventory, net  | (543,483         | ) (356,646 )     |
| Due from related party  | (148,830         | ) 55,837         |
| Prepaid expenses and other current assets                                   | (113,725         | ) (215,032 )     |
| Other assets  | 23,070           | (1,000 )         |
| Increase (decrease) in:   |                  |                  |
| Accounts payable  | 114,983          | 516,577          |
| Accrued expenses  | 116,424          | 206,573          |
| Deferred revenue  | 449,717          | (73,559 )        |
| Due to related party  | (119,667         | ) 535,729        |
| Interest payable, related party   | (198,450         | ) 41,604         |
| Net cash used in operating activities                                       | (2,917,046       | ) (675,653 )     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                |                  |                  |
| Purchases of property and equipment   | (120,773         | ) (114,767 )     |
| Purchases of intangible assets  | (113,699         | ) (196,257 )     |
| Cash paid for asset acquisition   | —                | (497,800 )       |
| Purchases of short-term investments, restricted                             | (584,375         | ) (202 )         |
| Maturities of short-term investments, restricted                            | —                | 182,061          |
| Net cash used in investing activities                                       | (818,847         | ) (626,965 )     |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                |                  |                  |
| Payments for debt issuance costs  | (7,444           | ) —              |
| Payments made on demand notes payable and line of credit to related party   | (2,950,000       | ) —              |
| Proceeds from sale of common stock and restricted common stock, net         | 2,351,335        | —                |
| Proceeds from the exercise of stock options                                 | 6,000            | —                |
| Purchase of unvested restricted stock                                       | —                | (350 )           |
| Net cash used in financing activities                                       | (600,109         | ) (350 )         |
| Net decrease in cash and cash equivalents                                   | (4,336,002       | ) (1,302,968 )   |
| Cash and cash equivalents, beginning of the period                          | 7,713,899        | 1,572,785        |
| Cash and cash equivalents, end of the period                                | \$3,377,897      | \$269,817        |
| <b>Supplemental disclosures of cash flows information:</b>                  |                  |                  |
| Cash paid for interest  | \$263,553        | \$3,836          |

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 and six months ended June 30, 2014 and 2013

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

Description of business

Tecogen Inc. (the “Company”) (a Delaware Corporation) was organized 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 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, 2013 in conjunction with our 2013 Annual Report on Form 10-K, or our Annual Report, filed with the Securities and Exchange Commission, or SEC, on March 31, 2014 and amended on April 1, 2014. This form 10-Q should be read in conjunction with our Annual Report.

The accompanying unaudited 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 June 30, 2014, and of operations and cash flows for the interim periods ended June 30, 2014 and 2013. The results of operations for the interim periods ended June 30, 2014 are not necessarily indicative of the results to be expected for the year.

The accompanying consolidated financial statements include the accounts of the Company and its 65.0% owned subsidiary Ilios, whose business focus is on advanced heating systems for commercial and industrial applications. With the inclusion of unvested restricted stock awards, the Company’s 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 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 six months ended June 30, 2014 and 2013 no revenues were

recorded as bill and hold transactions.

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TECOGEN INC.

Notes to Interim Unaudited Condensed Consolidated Financial Statements for the three and six months ended June 30, 2014 and 2013

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 six months ended June 30, 2014 and 2013, a loss of approximately \$217,000 and \$300,000 was recorded, respectively. These losses were recorded during the period ended March 31, 2014 and 2013, and have not increased during the current period reported. 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 earnings is recorded as deferred revenue.

Presentation of Sales Taxes

The Company reports revenues net of any revenue-based taxes assessed by governmental authorities that are imposed on and concurrent with specific revenue-producing transactions.

Shipping and Handling Costs

The Company classifies freight billed to customers as sales revenue and the related freight costs as cost of sales.

Advertising Costs

The Company expenses the costs of advertising as incurred. For the six months ended June 30, 2014 and 2013, advertising expense was approximately \$61,000 and \$42,000, respectively. For the three months ended June 30, 2014 and 2013, advertising expense was approximately \$13,000 for each period.

Cash and Cash Equivalents

The Company considers all highly liquid instruments with an original maturity date, at date of purchase, of three months or less to be cash and cash equivalents. The Company has cash balances in certain financial institutions in amounts which occasionally exceed current federal deposit insurance limits. The financial stability of these institutions is continually reviewed by senior management. The Company believes it is not exposed to any significant credit risk on cash and cash equivalents.

#### Concentration of Credit Risk

Financial instruments, which potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents, short-term investments and accounts receivable. The Company's cash equivalents are placed with certain financial institutions and issuers. As of June 30, 2014, the Company had a balance of \$3,684,822 in cash and cash equivalents and short-term investments that exceeded the Federal Deposit Insurance Corporation's ("FDIC") general deposit insurance limit of \$250,000.

TECOGEN INC.

Notes to Interim Unaudited Condensed Consolidated Financial Statements for the three and six months ended June 30, 2014 and 2013

Short-Term Investments, restricted

Short-term investments consist of certificates of deposit with maturities of greater than three months but less than one year. Certificates of deposits are recorded at fair value and restricted as collateral to the Company's performance bonds.

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 June 30, 2014 and December 31, 2013 the allowance for doubtful accounts was \$33,000 and \$103,800, respectively. A reduction of \$70,800 in the allowance was offset by a reduction of \$88,800 in the accounts receivable and an addition of \$18,000 to the reserve.

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 June 30, 2014 and December 31, 2013, inventory reserves were \$300,000.

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.

Intangible Assets

Intangible assets subject to amortization include costs incurred by the Company to acquire developed technology in January of 2013, product certifications and certain patent costs. These costs 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's goodwill was recorded as a result of the Company's asset acquisition in January of 2013. The Company has recorded this transaction using the acquisition method of accounting. The Company tests its recorded goodwill for impairment on an annual basis, 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. Factors that could trigger an interim impairment test include, but are not limited to, underperformance relative to historical or projected future operating results, significant changes in the manner of use of the acquired assets or the Company's overall business, significant negative industry or economic trends and a sustained period where market capitalization, plus an appropriate control premium, is less than stockholders' equity. During the first six months of 2014 the Company determined that no interim impairment test was necessary. Goodwill will be assessed for impairment at least annually or when there are indicators of potential impairment.

Common Stock

The Company's common stock was split one-for-four in a reverse stock split effective July 22, 2013. The effect of this reverse stock split has been retroactively applied to per share data and common stock information.

Impairment of long-lived assets

Long-lived assets are evaluated for impairment whenever events or changes in circumstances have indicated that an asset may not be recoverable and are grouped with other assets to the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities. If the sum of the projected

undiscounted cash flows (excluding interest charges) is less than the carrying value of the assets, the assets will be written down to the estimated fair value and such loss is recognized in income from continuing operations in the period in which the determination is made. Management determined that no impairment of long-lived assets existed as of June 30, 2014.

Off Balance Sheet Arrangements

On July 22, 2013, the Company's Chief Executive Officer personally pledged to support a bank credit facility of \$1,055,000 to support bank guarantees issued on certain construction contracts. This pledge was renewed on July 22, 2014 and will expire on July 22, 2015.

TECOGEN INC.

Notes to Interim Unaudited Condensed Consolidated Financial Statements for the three and six months ended June 30, 2014 and 2013

Financial Instruments

The Company's financial instruments that are not recorded at fair value on a recurring basis include cash and cash equivalents, accounts receivable, accounts payable, related party demand notes payable and related party convertible debentures. The recorded values of cash and cash equivalents, accounts receivable and accounts payable approximate their fair values based on short-term nature. At June 30, 2014, the carrying value on the consolidated balance sheet of notes payable and convertible debentures approximates fair value based on current market rates for instruments with similar maturities adjusted for applicable credit risk.

Research and Development Costs/Grants

Internal research and development expenditures are expensed as incurred. Proceeds from certain grants and contracts with governmental agencies and their contractors to conduct research and development for new CHP technologies or to improve or enhance existing technology is recorded as an offset to the related research and development expenses. These grants and contracts are paid on a cost reimbursement basis provided in the agreed upon budget, with 10% retainage held to the end of the contract period. For the six months ended June 30, 2013, amounts received were approximately \$67,000, which offset the Company's total research and development expenditures of \$327,262. For the six months ended June 30, 2014, no amounts were received from grants and contracts from governmental agencies to offset research and development costs.

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. Use of a valuation model requires management to make certain assumptions with respect to selected model inputs. The determination of the fair value of share-based payment awards is affected by the Company's stock price. Prior to May 22, the Company had considered the sale price of common stock in the private placements to unrelated third parties as a measure of the fair value of its common stock. Effective May 22, the Company's common stock is traded on the NASDAQ Exchange, which is now considered the fair value of the Company's common stock. The average expected life is estimated using the simplified method for "plain vanilla" options. The simplified method determines the expected life in years based on the vesting period and contractual terms as set forth when the award is made. 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. The risk-free interest rate is based on U.S. Treasury zero-coupon issues with a remaining term which approximates the expected life assumed at the date of grant. When options are exercised the Company normally issues new shares (see "Note 4 – Stock-based compensation".)

Loss per Common Share

The Company computes basic loss per share by dividing net loss for the period by the weighted-average number of shares of Common Stock outstanding during the period. The Company computes its diluted earnings per common share using the treasury stock method. For purposes of calculating diluted earnings per share, the Company considers its shares issuable in connection with the convertible debentures, stock options and warrants to be dilutive Common Stock equivalents when the exercise/conversion price is less than the average market price of our Common Stock for the period. (See Note 2 - Loss per common share)

Other Comprehensive Net Loss

The comprehensive net loss for the three and six month periods ended June 30, 2014 and 2013 does not differ from the reported loss.

Segment Information

The Company reports segment data based on the management approach. The management approach designates the internal reporting that is used by management for making operating and investment decisions and evaluating performance as the source of the Company's reportable segments. The Company uses one measurement of

profitability and does not disaggregate its business for internal reporting. The Company has determined that it operates in one business segment which manufactures and supports highly efficient CHP products based on engines fueled by natural gas.

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## TECOGEN INC.

Notes to Interim Unaudited Condensed Consolidated Financial Statements for the three and six months ended June 30, 2014 and 2013

The following table summarizes net revenue by product line and services for the three months ended and six months ended June 30, 2014 and 2013:

|                       | Three months ended June 30, |              | Six months ended June 30, |              |
|-----------------------|-----------------------------|--------------|---------------------------|--------------|
|                       | 2014                        | 2013         | 2014                      | 2013         |
| <b>Products</b>       |                             |              |                           |              |
| Cogeneration          | \$ 1,419,581                | \$ 457,486   | \$ 2,573,850              | \$ 1,735,642 |
| Chiller               | 588,345                     | 350,368      | 1,378,852                 | 1,124,877    |
| Total Product Revenue | 2,007,926                   | 807,854      | 3,952,702                 | 2,860,519    |
| <b>Services</b>       |                             |              |                           |              |
| Service contracts     | 1,921,875                   | 1,848,675    | 3,694,856                 | 3,596,621    |
| Installations         | 610,056                     | 146,931      | 1,108,056                 | 392,638      |
| Total Service Revenue | 2,531,931                   | 1,995,606    | 4,802,912                 | 3,989,259    |
| Total Revenue         | \$ 4,539,857                | \$ 2,803,460 | \$ 8,755,614              | \$ 6,849,778 |

**Income Taxes**

The Company uses the asset and liability method of accounting for income taxes. The current or deferred tax consequences of transactions are measured by applying the provisions of enacted tax laws to determine the amount of taxes payable currently or in future years. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities and expected future tax consequences of events that have been included in the financial statements or tax returns using enacted tax rates in effect for the years in which the differences are expected to reverse. Under this method, a valuation allowance is used to offset deferred taxes if, based upon the available evidence, it is more likely than not that some or all of the deferred tax assets may not be realized. Management evaluates the recoverability of deferred taxes and the adequacy of the valuation allowance annually.

The Company follows the provisions of the accounting standards relative to accounting for uncertainties in tax positions. These provisions provide guidance on the recognition, de-recognition and measurement of potential tax benefits associated with tax positions. The Company elected to recognize interest and penalties related to income tax matters as a component of income tax expense in the statements of operations. There was no impact on the financial statements as a result of this guidance.

**Reclassification**

Certain prior period balances have been reclassified to conform with current period presentation. As a result, installation revenue is broken out in the schedule of net revenue by product line and services above; in the prior period this revenue was included in services. Research and development expense is separated from general and administrative expense in this and prior periods.

**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 six months ended June 30, 2014 and 2013, respectively, were as follows:

|   | Three months ended June 30, |                | Six months ended June 30, |                |
|---|-----------------------------|----------------|---------------------------|----------------|
|   | 2014                        | 2013           | 2014                      | 2013           |
| Loss available to stockholders                            | \$(1,229,707 )              | \$(1,090,480 ) | \$(2,267,752 )            | \$(1,950,873 ) |
| Weighted average shares outstanding - Basic and diluted   | 15,227,089                  | 13,205,476     | 15,013,824                | 13,209,165     |
| Basic and diluted loss per share                          | \$(0.08 )                   | \$(0.08 )      | \$(0.15 )                 | \$(0.15 )      |
| Anti-dilutive shares underlying stock options outstanding | 1,233,125                   | 1,095,250      | 1,233,125                 | 1,095,250      |

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|                                      |         |        |         |        |
|--------------------------------------|---------|--------|---------|--------|
| Anti-dilutive convertible debentures | 555,556 | 75,806 | 555,556 | 75,806 |
|--------------------------------------|---------|--------|---------|--------|

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## TECOGEN INC.

Notes to Interim Unaudited Condensed Consolidated Financial Statements for the three and six months ended June 30, 2014 and 2013

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

At December 31, 2013, demand notes payable and line of credit to related parties consisted of various demand notes outstanding to stockholders totaling \$2,950,000. As of December 31, 2013, John N. Hatsopoulos, the company's Chief Executive Officer, held all of the demand notes. The demand notes accrued interest annually at rates ranging from 5% to 6%. Unpaid principal and interest on the demand notes was due upon demand. The outstanding principal balance of these notes, together with accrued interest was paid during the three month period ended March 31, 2014.

On September 24, 2001, the Company entered into subscription agreements with three investors for the sale of convertible debentures in the aggregate principal amount of \$330,000. The primary investors were George N. Hatsopoulos, a member of the board of directors, who subscribed for \$200,000 of the debentures and John N. Hatsopoulos, the Company's Chief Executive Officer, who subscribed for \$100,000 of the debentures. The debentures accrue interest at a rate of 6% per annum and were initially due six years from issuance date, and then amended to extend maturity to 2011. The debentures are convertible, at the option of the holder, into a number of shares of Common Stock as determined by dividing the original principal amount plus accrued and unpaid interest by a conversion price of \$1.20. On September 24, 2011 the remaining holders of the Company's convertible debentures agreed to amend the terms of the debentures and extend the due date from September 24, 2011 to September 24, 2013. On May 11, 2009 the Company sold 1,400,000 shares in Ilios at \$0.50 per share to George Hatsopoulos and John Hatsopoulos in exchange for the extinguishment of \$427,432 in demand notes payable, \$109,033 in convertible debentures and \$163,535 in accrued interest. The difference between the Company's purchase price of the Ilios shares and the amount of debt forgiveness was recorded as additional paid-in capital.

On September 30, 2009, Joseph J. Ritchie elected to convert \$30,000 of the outstanding principal amount of the debenture, plus accrued interest of \$14,433, into 37,028 shares of Common Stock at a conversion price of \$1.20 per share.

On September 30, 2012, certain holders of the debentures converted the principal amount of \$100,000 and accrued interest in the amount of \$6,100 into 85,242 shares of the Company's Common Stock. At December 31, 2012 there were 75,806 shares of common stock issuable upon conversion of the Company's outstanding convertible debentures. At December 31, 2012, the principal amount of the Company's convertible debentures was \$90,967 which was due on September 24, 2013.

On October 18, 2013, the remaining holder of the debentures, George N. Hatsopoulos, converted the principal balance of \$90,967 into 75,806 shares of the Company's common stock at a conversion price of \$1.20 per share. In addition, Mr. Hatsopoulos requested that the accrued interest earned in 2012 in the amount of \$6,913 be converted into 2,161 shares of the Company's common stock at a conversion price of \$3.20 per share and that the accrued interest earned on or after January 1, 2013 in the amount of \$4,367 be converted into 970 shares of the Company's common stock at a conversion price of \$4.50 per share.

On March 25, 2013, the Company entered into a Revolving Line of Credit Agreement, or the Credit Agreement, with John N. Hatsopoulos, our Chief Executive Officer. Under the terms of the Credit Agreement, as amended on August 13, 2013, Mr. Hatsopoulos has agreed to lend the Company up to an aggregate of \$1,500,000, from time to time, at the written request of the Company. Any amounts borrowed by the Company pursuant to the Credit Agreement will bear interest at the Bank Prime Rate as quoted from time to time in the Wall Street Journal plus 1.5% per year. Repayment of the principal amount borrowed pursuant to the Credit Agreement was due on March 1, 2014. In addition, the company may prepay accrued interest, provided that prepayment may not be made prior to January 1, 2014. During the quarter ending March 31, 2014, the outstanding principal balance was fully paid.

On December 23, 2013, the company entered into a Senior Convertible Promissory Note (the "Note") with Michaelson Capital Special Finance Fund LP, ("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. The principal amount, if not converted, is due on the third anniversary of the Note, December 31, 2016. 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 185.19 shares of the Company's common stock per \$1,000 principal amount of Note (equivalent to a conversion price of \$5.40 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 the 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 \$5.40 per share.

## TECOGEN INC.

Notes to Interim Unaudited Condensed Consolidated Financial Statements for the three and six months ended June 30, 2014 and 2013

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 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 financial statements.

Debt issuance costs of \$147,577 are being amortized to interest expense over the term of the Note using the effective interest method. At December 31, 2013 and June 30, 2014, there were 555,556 shares of common stock issuable upon conversion of the Company's outstanding convertible debentures.

Michaelson has the option to call the Note upon an event of default at the optional 120% prepayment amount discussed above. One event of default is defined as the Company's failure to issue a registration statement covering the resale of the Company's Common Stock that is declared effective within one year of the funding date of the Note. The Company has reclassified this Note as long term on the accompanying consolidated balance sheet as the event of default related to the registration statement, originally filed on February 6, 2014, became effective on July 2, 2014 and is no longer a risk for event of default.

While, prior to this transaction, Michaelson was an unrelated party, due to their beneficial ownership percentage of 6.4% after this transaction, Michaelson is now considered a related party.

On March 26, 2014, the Company secured a working capital line of credit with John Hatsopoulos, the Company's Chief Executive Officer, in the amount of \$3,500,000 which may be used in the occurrence of an event of default as described in the Note.

#### Note 4 - Stock-based compensation

##### Stock-Based Compensation

In 2006, the Company adopted the 2006 Stock Option and Incentive Plan (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 most recently amended by the Board of Directors on January 24, 2014, and approved by written consent of majority of shareholders on June 30, 2014 to increase the reserved shares of common stock issuable under the Plan to 3,838,750 (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 June 30, 2014 was 1,968,558.

Stock option activity for the six months ended June 30, 2014 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, 2013 | 1,148,000         | \$1.20-\$4.50            | \$2.13                          | 5.80 years                      | \$2,721,100               |
| Granted                        | 93,325            | 4.50                     | 4.50                            | —                               | —                         |
| Exercised                      | (5,000)           | ) 1.20                   | 1.20                            | —                               | —                         |
| Canceled and forfeited         | (3,200)           | ) \$1.20-\$4.50          | 1.92                            | —                               | —                         |
| Expired                        | —                 | —                        | —                               | —                               | —                         |
| Outstanding, June 30, 2014     | 1,233,125         | \$1.20-\$4.50            | \$2.31                          | 5.67 years                      | \$6,999,956               |

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|  |           |        |             |
|--|-----------|--------|-------------|
| Exercisable, June 30, 2014                 | 926,125   | \$1.92 | \$5,623,189 |
| Vested and expected to vest, June 30, 2014 | 1,233,125 | \$2.31 | \$6,999,956 |

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## TECOGEN INC.

Notes to Interim Unaudited Condensed Consolidated Financial Statements for the three and six months ended June 30, 2014 and 2013

Restricted stock activity for the six months ended June 30, 2014 as follows:

|                             | Number of<br>Restricted<br>Stock | Weighted<br>Average<br>Grant Date<br>Fair Value |
|-----------------------------|----------------------------------|---|
| Unvested, December 31, 2013 | 361,570                          | \$ 1.31   |
| Granted                     | —                                | —   |
| Vested                      | —                                | —   |
| Forfeited                   | —                                | —   |
| Unvested, June 30, 2014     | 361,570                          | \$ 1.31   |

## Stock Based Compensation - Ilios

In 2009, Ilios adopted the 2009 Stock Incentive Plan (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. 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. The options are not transferable except by will or domestic relations order. The option price per share under the 2009 Plan cannot be less than the fair market value of the underlying shares on the date of the grant.

Stock option activity relating to Ilios for the six months ended June 30, 2014 was as follows:

| Common Stock Options                       | Number of<br>Options | Exercise<br>Price<br>Per<br>Share | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Life | Aggregate<br>Intrinsic<br>Value |
|--|----------------------|-----------------------------------|--|--|---------------------------------|
| Outstanding, December 31, 2013             | 575,000              | \$0.10-\$0.50                     | \$0.29                                   | 6.44 years                               | \$ 120,000                      |
| Granted                                    | 50,000               | 0.50                              | 0.50                                     |  |                                 |
| Exercised                                  | —                    | —                                 | —  |  |                                 |
| Canceled and forfeited                     | —                    | —                                 | —  |  |                                 |
| Expired                                    | —                    | —                                 | —  |  |                                 |
| Outstanding, June 30, 2014                 | 625,000              | \$0.10-\$0.50                     | \$0.31                                   | 6.25 years                               | \$ 120,000                      |
| Exercisable, June 30, 2014                 | 181,250              |                                   | \$0.50                                   |  | \$—                             |
| Vested and expected to vest, June 30, 2014 | 625,000              |                                   | \$0.31                                   |  | \$ 120,000                      |

Restricted stock activity for the Ilios awards, for the six months ended June 30, 2014 was as follows:

|                             | Number of<br>Restricted<br>Stock | Weighted<br>Average<br>Grant Date<br>Fair Value |
|-----------------------------|----------------------------------|---|
| Unvested, December 31, 2013 | 310,000                          | \$0.10  |
| Granted                     | —                                | —   |
| Vested                      | —                                | —   |
| Forfeited                   | —                                | —   |
| Unvested, June 30, 2014     | 310,000                          | \$0.10  |

Consolidated stock-based compensation expense for the six months ended June 30, 2014 and 2013 was \$72,587 and \$(38,131), respectively. At June 30, 2014, the total compensation cost related to unvested restricted stock awards and stock option awards not yet recognized is \$242,435. This amount will be recognized over a weighted average period of 1.24 years. No tax benefit was recognized related to the stock-based compensation recorded during the periods.





## TECOGEN INC.

Notes to Interim Unaudited Condensed Consolidated Financial Statements for the three and six months ended June 30, 2014 and 2013

## Note 5 – Commitments and contingencies

Future minimum lease payments under all non-cancelable operating leases as of June 30, 2014 consist of the following:

| Years Ending December 31, | Amount      |
|---------------------------|-------------|
| 2014                      | \$286,868   |
| 2015                      | 535,349     |
| 2016                      | 485,040     |
| 2017                      | 491,920     |
| 2018                      | 499,122     |
| 2019 and thereafter       | 2,742,217   |
| Total                     | \$5,040,516 |

For the three months ended June 30, 2014 and 2013 rent expense was \$106,178 and \$127,994, respectively. The Company records rent expense on a straight line basis over the term of the lease. For the six months ended June 30, 2014 and 2013 rent expense was \$204,638 and \$244,153, respectively.

## Letters of Credit

A letter of credit of \$583,073, the original value of the short term investment prior to an increase from interest income of \$1,302, was outstanding under a revolving bank credit facility needed to collateralize a performance bond on a certain installation project. This revolving bank credit facility expired June 14, 2014. In addition, approximately \$1,055,000 in a letter of credit was required to collateralize performance bonds on several installation projects. This letter of credit is collateralized by an account owned by John N. Hatsopoulos and expires July 22, 2015. In each case, a performance bond has been furnished on projects, and would be drawn upon only in the event that Tecogen fails to complete the project in accordance with the contract.

## Note 6 – Related party transactions

The Company has two affiliated companies, namely American DG Energy Inc., or American DG Energy, and EuroSite Power Inc. These companies are affiliates because several of the major stockholders of those companies, have a significant ownership position in the Company. Neither of American DG Energy or EuroSite Power own any shares of the Company, and the Company does not own any shares of American DG Energy or EuroSite Power. American DG Energy and EuroSite Power are affiliated companies by virtue of common ownership. The common stockholders include:

John N. Hatsopoulos, the Company's Chief Executive Officer, who is also: (a) the Chief Executive Officer and a director of American DG Energy and holds 19.8% of American DG Energy's common stock; (b) the Chairman of EuroSite Power; (c) a director of Ilios and holds 6.8% of Ilios's common stock.

Dr. George N. Hatsopoulos, who is John N. Hatsopoulos' brother, and is also: (a) a director of American DG Energy and holds 13.5% of American DG Energy's common stock; (b) an investor in Ilios and holds 2.7% of Ilios' common stock.

Additionally, the following related persons had or may have a direct or indirect material interest in our transactions with our affiliated companies:

Barry J. Sanders, who is: (a) the President and Chief Operating Officer of American DG Energy, (b) the Chief Executive Officer and a director of EuroSite Power and (c) the Chairman of the Board of Directors of Ilios.

Anthony S. Loumidis, the Company's former Vice President and Treasurer, who is: (a) the former Chief Financial Officer Secretary and Treasurer of American DG Energy, (b) the former Chief Financial Officer Secretary and Treasurer of EuroSite Power, and (c) the former Treasurer of Ilios.

On October 20, 2009, American DG Energy, in the ordinary course of its business, signed a Sales Representative Agreement with Ilios to promote, sell and service the Ilios high-efficiency heating products, such as the high efficiency water heater, in the marketing territory of the New England States and all of the nations in the European Union. The initial term of this Agreement is for five years, after which it may be renewed for successive one-year

terms upon mutual written agreement.

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## TECOGEN INC.

Notes to Interim Unaudited Condensed Consolidated Financial Statements for the three and six months ended June 30, 2014 and 2013

On September 24, 2001, the Company entered into subscription agreements with investors for the sale of convertible debentures. The primary investors were George N. Hatsopoulos, who subscribed for debentures having an initial principal amount of \$200,000; the John N. Hatsopoulos 1989 Family Trust for the benefit of Nia Marie Hatsopoulos, or the Nia Hatsopoulos Trust, which subscribed for debentures having an initial principal amount of \$50,000; and John N. Hatsopoulos 1989 Family Trust for the benefit of Alexander John Hatsopoulos, or the Alexander Hatsopoulos Trust, which subscribed for debentures having an initial principal amount of \$50,000. Nia Hatsopoulos and Alexander Hatsopoulos are John N. Hatsopoulos's adult children. John N. Hatsopoulos disclaims beneficial ownership of any shares held by these trusts. The debentures accrue interest at a rate of 6% per annum and were due on September 24, 2007. The debentures are convertible, at the option of the holder, into shares of common stock at a conversion price of \$1.20 per share.

On September 24, 2007, George N. Hatsopoulos, the Nia Hatsopoulos Trust and the Alexander Hatsopoulos Trust, holding debentures representing a majority of the then-outstanding principal amount of the debentures, agreed to extend the debenture term to September 24, 2011. On May 11, 2009, George N. Hatsopoulos converted \$109,033 of the principal amount under the debentures held by him, together with accrued interest in the amount of \$90,967 into 400,000 shares of common stock of Ilios, the Company's then newly-formed subsidiary, at a conversion price of \$0.50 per share. The difference between the Company's purchase price of the Ilios shares and the amount of debt forgiveness was recorded as additional paid-in capital.

On September 30, 2009, Joseph J. Ritchie elected to convert the outstanding principal amount under the debenture held by him, \$30,000, together with accrued interest of \$14,433, into \$37,028 shares of the Company's common stock at a conversion price of \$1.20 per share.

On September 24, 2011, George N. Hatsopoulos, the Nia Hatsopoulos Trust and the Alexander Hatsopoulos Trust, holding debentures representing a majority of the then-outstanding principal amount of the debentures, agreed to extend the term of the debentures to September 24, 2013 and requested that accrued interest in the aggregate amount of approximately \$72,960 be converted into the Company's common stock at \$2.00 per share (which was the average price of the Company's stock between September 24, 2001 and September 24, 2011).

On September 30, 2012, the debentures, including accrued interest, were converted into 170,480 shares of Common Stock held in the JNH 1989 Family Trust for the benefit of Nia Marie Hatsopoulos and 170,480 shares of Common Stock held in the JNH 1989 Family Trust for the benefit of Alexander J. Hatsopoulos for whom Mr. and Mrs. Paris Nicolaidis are the trustees. Mr. John N. Hatsopoulos disclaims beneficial ownership of the shares held by this trust.

On October 18, 2013, the remaining holder of the debentures, George N. Hatsopoulos, converted the principal balance of \$90,967 into 75,806 shares of the Company's common stock at a conversion price of \$1.20 per share. In addition, Mr. Hatsopoulos requested that the accrued interest earned in 2012 in the amount of \$6,913 be converted into 2,161 shares of the Company's common stock at a conversion price of \$3.20 per share and that the accrued interest earned on or after January 1, 2013 in the amount of \$4,367 be converted into 970 shares of the Company's common stock at a conversion price of \$4.50 per share.

On September 10, 2008 the Company entered into a demand note agreement with John N. Hatsopoulos, in the principal amount of \$250,000 at an annual interest rate of 5%. On September 7, 2011 the Company entered in to an additional demand note agreement with John N. Hatsopoulos, in the principal amount of \$750,000 at an annual interest rate of 6%. On November 30, 2012 the Company entered into an additional demand note agreement with John N. Hatsopoulos, in the principal amount of \$300,000 at an annual interest rate of 6%. Unpaid principal and interest on the demand notes are due upon demand. On October 3, 2013 the Company entered into an additional demand note agreement with John N. Hatsopoulos, in the principal amount of \$450,000 at an annual interest rate of 6%. On January 6, 2014, the Company repaid the then outstanding principal balance of \$1,750,000 together with accrued interest of \$175,311.

On March 25, 2013, the Company entered into a Revolving Line of Credit Agreement, or the Credit Agreement, with John N. Hatsopoulos, our Chief Executive Officer. Under the terms of the Credit Agreement, as amended on August

13, 2013, Mr. Hatsopoulos has agreed to lend the Company up to an aggregate of \$1,500,000 from time to time, at the written request of the Company. Any amounts borrowed by the Company pursuant to the Credit Agreement will bear interest at the Bank Prime Rate as quoted from time to time in the Wall Street Journal plus 1.5% per year. Repayment of the principal amount borrowed pursuant to the Credit Agreement will be due on March 1, 2014. In addition, the company may prepay accrued interest, provided that prepayment may not be made prior to January 1, 2014. The Credit Agreement terminates on March 1, 2014. As of December 31, 2013 the Company has borrowed \$1,200,000 pursuant to the Credit Agreement. On January 6, 2014, the Company repaid the then outstanding principal balance of \$1,200,000 together with accrued interest of \$25,347.

## TECOGEN INC.

Notes to Interim Unaudited Condensed Consolidated Financial Statements for the three and six months ended June 30, 2014 and 2013

On December 23, 2013, the company entered into a Senior Convertible Promissory Note (the "Note") with Michaelson Capital Special Finance Fund LP, ("Michaelson"), for the principal amount of \$3,000,000 with interest at 4% per annum for a term of three years. 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. The principal amount, if not converted, is due on the third anniversary of the date of the Note. The Note is senior in right of payment to any unsecured indebtedness that is expressly subordinated in right of payment to the Note. The Note is convertible into shares of the Company's common stock at 185.19 shares of our common stock per \$1,000 principal amount of Note (equivalent to a conversion price of \$5.40 per share). Debt issuance costs of \$147,577 are being amortized to expense over the term of the Note using the effective interest method. At December 31, 2013, there were 555,556 shares of common stock issuable upon conversion of the Company's outstanding convertible debentures.

In addition, on December 23, 2013, Michaelson participated in our private placement, investing \$2,000,000 to purchase 444,445 shares of common stock at \$4.50 per share. As of the purchase date and December 31, 2013, Michaelson, on a fully diluted basis, owns 6.4% of the Company. As Michaelson's beneficial ownership is 6.4% after this transaction, it is now considered a related party.

John N. Hatsopoulos' salary is \$1.00 per year. On average, Mr. Hatsopoulos spends approximately 50% of his business time on the affairs of the Company; however such amount varies widely depending on the needs of the business and is expected to increase as the business of the Company develops.

On January 1, 2006, the Company entered into a Facilities and Support Services Agreement with American DG Energy for a period of one year, renewable annually, on January 1st, by mutual agreement. That agreement was replaced by the Facilities, Support Services and Business Agreement between the Company and American DG Energy, effective July 1, 2013. On July 1, 2013 the Company entered into an Amendment to the Facilities, Support Services and Business Agreement, or the Amendment, with American DG Energy. Under this agreement, the Company provides American DG Energy with certain office and business support services and also provides pricing based on a volume discount depending on the level of American DG Energy purchases of cogeneration and chiller products. For certain sites, American DG Energy hires the Company to service its chiller and cogeneration products. The Company also provides office space and certain utilities to American DG Energy based on a monthly rate set at the beginning of each year. Also, under this agreement, American DG Energy has sales representation rights to the Company's products and services in New England.

On August 8, 2014 the Company entered into a new agreement with American DG Energy. The agreement is similar to the previous Facilities, Support Services and Business Agreement between the Company and American DG Energy. It was signed for a one year period, beginning on July 1, 2014.

The Company subleases portions of its corporate offices and manufacturing facility to sub-tenants under annual sublease agreements. For the six months ended June 30, 2014 and 2013, the Company received \$104,938 and \$107,276, respectively, from American DG Energy and other sub-tenants.

The Company's headquarters are located in Waltham, Massachusetts and consist of approximately 43,000 square feet of office and storage space that are shared with American DG Energy and other tenants. The lease expires on March 31, 2024. We believe that our facilities are appropriate and adequate for our current needs.

Revenue from sales of cogeneration and chiller systems, parts and service to American DG Energy during the six months ended June 30, 2014 and 2013 amounted to \$637,059 and \$384,415, respectively. In addition, Tecogen pays certain operating expenses, including benefits and insurance, on behalf of American DG Energy. Tecogen was reimbursed for these costs. As of June 30, 2014 the total amount due from American DG Energy was \$148,830, which is included in due from related party on the accompanying condensed consolidated balance sheet. As of December 31, 2013 the total amount due to American DG Energy was \$119,667.

On March 14, 2013 the Company received a prepayment for purchases of modules, parts and service to be made by American DG Energy in the amount of \$827,747. The Company will provide a discount on these prepaid purchases

equal to 6% per annum on deposit balances. As of June 30, 2014 the principal balance on this prepayment had a balance of \$0.

Note 7 - Asset acquisition

On January 9, 2013 the Company purchased certain assets, both tangible and intangible, required to manufacture the generator used in its InVerde product from Danotek Motion Technologies. The aggregate consideration paid by the Company was \$497,800, of which \$17,400 represents the fair value of inventory and \$199,530 represents the estimated fair value of property, plant and equipment which is depreciated over useful lives ranging from 5 to 8.5 years. The fair value of the property, plant and equipment was estimated utilizing a replacement cost method. In addition, \$240,000 of the purchase consideration represents the fair value of identified intangible assets using a relief from royalty method with a useful life of fifteen years. The balance of

## TECOGEN INC.

\$40,870 is included in goodwill in the accompanying condensed consolidated balance sheet, which consists largely of economies of scale expected from combining the manufacturing of the generator into Tecogen's operations.

Acquisition related costs were not material to the financial statements and were expensed as incurred to general and administrative expenses.

This transaction was accounted for under the purchase method of accounting in accordance with FASB ASC Topic 805, Business Combinations. Under the purchase method of accounting, the total purchase price has been allocated to the net tangible and intangible assets acquired based on estimates of their values by the Company's management.

There is one reporting unit within the Company.

Under the purchase method of accounting, an acquisition is recorded as of the closing date, reflecting the purchased assets, at their acquisition date fair values. Intangible assets that are identifiable are recognized separately from goodwill which is measured and recognized as the excess of the fair value, as a whole, over the net amount of the recognized identifiable assets acquired.

The purchase price has been allocated as follows:

|                         |           |
|-------------------------|-----------|
| Inventory               | \$17,400  |
| Machinery and equipment | 171,910   |
| Computer equipment      | 22,070    |
| Tooling                 | 5,550     |
| Developed technology    | 240,000   |
| Goodwill                | 40,870    |
|                         | \$497,800 |

## Note 8 - Intangible assets other than goodwill

As of June 30, 2014 the Company has the following amounts related to intangible assets:

|                                 | Product<br>Certifications | Patents   | Developed<br>Technology | Total        |
|---------------------------------|---------------------------|-----------|-------------------------|--------------|
| Balance at December 31, 2013    |                           |           |                         |              |
| Intangible assets               | \$406,705                 | \$441,610 | 240,000                 | \$1,088,315  |
| Less - accumulated amortization | (83,405 )                 | (39,583 ) | (12,000 )               | (134,988 )   |
|                                 | \$323,300                 | \$402,027 | \$228,000               | \$953,327    |
| Balance at June 30, 2014        |                           |           |                         |              |
| Intangible assets               | \$469,343                 | \$492,669 | 240,000                 | \$1,202,012  |
| Less - accumulated amortization | (103,785 )                | (52,028 ) | (20,000 )               | \$(175,813 ) |
|                                 | \$365,558                 | \$440,641 | \$220,000               | \$1,026,199  |

The aggregate amortization expense of the Company's intangible assets for the three months ended June 30, 2014 and 2013 was \$20,853 and \$14,487, respectively. The aggregate amortization expense of the Company's intangible assets for the six months ended June 30, 2014 and 2013 was \$40,825 and \$24,247, respectively.

Estimated future annual amortization expense related to the intangible assets is as follows:

|                            |             |
|----------------------------|-------------|
| 2014                       | \$43,055    |
| 2015                       | 133,744     |
| 2016                       | 133,744     |
| 2017                       | 133,744     |
| 2018                       | 127,547     |
| Thereafter                 | 454,365     |
| Total amortization expense | \$1,026,199 |

The Company expects to receive foreign patents for the patents granted in the United States by year end. The expense in the estimated future amortization schedule is based on this assumption.





Note 9 – Subsequent events

On August 8, 2014, the Company entered into a new agreement with American DG Energy. The agreement is similar to the previous Facilities, Support Services and Business Agreement between the Company and American DG Energy. It was signed for a one year period, beginning on July 1, 2014.

On August 12, 2014, the Company entered into a three year lease with Kavenor Big & Tall King of Valley Stream LLC for the Company's new service center in Valley Stream, New York to better serve the growing installation base in Brooklyn, Queens, and Long Island, New York.

The Company has evaluated subsequent events through the date of this report and determined that no additional subsequent events occurred that would require recognition in the consolidated financial statements or disclosure in the notes thereto.

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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 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 potable 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).

Results of Operations

Revenues

Revenues in the second quarter of 2014 were \$4,539,857 compared to \$2,803,460 for the same period in 2013, an increase of \$1,736,397 or 61.9%. Product revenues in the second quarter of 2014 were \$2,007,926 compared to \$807,854 for the same period in 2013, an increase of \$1,200,072 or 149%. This increase was the aggregate of an increase in cogeneration sales of \$962,095 and an increase in chiller sales of \$237,977. Service revenues in the second quarter of 2014 were \$2,531,931 compared to \$1,995,606 for the same period in 2013, an increase of \$536,325 or 27%. This increase is due to an increase in installation activity of \$463,125 and an increase of \$73,200 by the service group.

Revenues in the first six months of 2014 were \$8,755,614 compared to \$6,849,778 for the same period in 2013, an increase of \$1,905,836 or 27.8%. Product revenues in the first six months of 2014 were \$3,952,702 compared to \$2,860,519 for the same period in 2013, an increase of \$1,092,183 or 38.2%. This increase was the aggregate of an increase in cogeneration sales of \$838,208 and an increase in chiller sales of \$253,975. Service revenues in the first six months of 2014 were \$4,802,912 compared to \$3,989,259 for the same period in 2013, an increase of \$813,653 or 20.4%. This increase is due to an increase in installation activity of \$715,418 and an increase of \$98,235 by the service group.

Cost of Sales

Cost of sales in the second quarter of 2014 was \$3,191,184 compared to \$1,989,587 for the same period in 2013 an increase of \$1,201,597, or 60.4%. During the second quarter of 2014 our overall gross profit margin was 29.7% compared to 29.0% for the same period in 2013, an increase of 0.7%. The growth in sales volume and the increasing number of turnkey projects have continued to improve gross margins.

Cost of sales in the first six months of 2014 was \$5,980,715 compared to \$4,923,941 for the same period in 2013 an increase of \$1,056,774, or 21.5%. During the first six months of 2014 our overall gross profit margin was 31.7% compared to 28.1% for the same period in 2013, an increase of 3.6%. The growth in sales volume and the increasing

number of turnkey projects have continued to improve gross margins.

**Contract Research and Development**

There was no contract research and development income for the three months ended and six months ended June 30, 2014 and three months ended June 30, 2013. For the six months ended June 30, 2013 there was \$67,000, which is classified as an offset to applicable expenses.

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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 second quarter ending June 30, 2014 were \$1,911,071 compared to \$1,419,020 for the same period in 2013, an increase of \$492,051 or 34.7%. This increase was due to an overall increase in costs attributable to expenses related to the transition to becoming a public company. These items include larger administrative staff, listing fees, higher insurance expense and technology. General and administrative expenses in the first six months of 2014 were \$3,673,063 compared to \$2,965,580 for the same period in 2013, an increase of \$707,483 or 23.9%. This increase was due to an overall increase in costs attributable to expenses related to the transition to becoming a public company. These items include larger administrative staff, listing fees, higher insurance expense and technology.

Selling expenses consist of sales staff, commissions, marketing, travel and other selling related expenses. Selling expenses for the second quarter of 2014 were \$405,108 compared to \$286,101 for the same period in 2013, an increase of \$119,007 or 41.6%. A large portion of this increase is due to higher commissions in this period due to the higher sales. Selling expenses for the first six months of 2014 were \$826,728 compared to \$565,471 for the same period in 2013, an increase of \$261,257 or 46.2%. The largest portion of this increase is due to higher commissions in this period due to higher sales.

Research and development expenses consist of engineering and technical staff, materials, outside consulting and other related expenses. Research and development expenses in the second quarter ending June 30, 2014 were \$251,582 compared to \$260,262 for the same period in 2013, a decrease of \$8,680 or 3.3%. This decrease was due to completion of the heat pump development project as the program migrated to production. Current projects include the emissions control retrofits utilizing the Company's patents and an InVerde product improvement programs. Research and development expenses for the first six months of 2014 were \$559,716 compared to \$505,405 for the same period in 2013, an increase of \$54,311 or 3.3%. This increase was due to the timing of the beginning and completion of projects. Current projects include development projects in emissions controls and the InVerde product line.

Loss from Operations

Loss from operations for the second quarter of 2014 was \$1,219,088 compared to \$1,151,510 for the same period in 2013, an increase of \$67,578. The increase in the loss was due to the growth in operating expenses offset by the increase in revenue and gross profit discussed above.

Loss from operations for the first six months of 2014 was \$2,284,608 compared to \$2,110,619 for the same period in 2013, an increase of \$173,989. The increase in the loss was due to the growth in operating expenses offset by the increase in revenue and gross profit discussed above.

Other Income (Expense), net

Other expense, net for the three months ended June 30, 2014 was \$42,303 compared to \$33,796 for the same period in 2013. Other income (expense) includes interest income and other income of \$15,079, net of interest expense on notes payable of \$57,382 for the second quarter of 2014. For the same period in 2013, interest and other income was \$2,591 and interest expense was \$36,387. The increase in interest income of \$12,488 is the result of short-term investments held during the second quarter of 2014 that were not held during the second quarter of 2013. The increase in interest expense of \$20,995 was mainly due to the increase in note payable balances carried during the three months ended June 30, 2014 as compared to the same period in 2013.

Other expense, net for the six months ended June 30, 2014 was \$73,988 compared to \$53,227 for the same period in 2013. Other income (expense) includes interest income and other income of \$18,164, net of interest expense on notes payable of \$92,152 for the first six months of 2014. For the same period in 2013, interest and other income was \$6,537 and interest expense was \$59,764. The increase in interest income of \$11,627 is the result of short-term investments held during the first six months of 2014 that were not held during the first six months of 2014. The increase in interest expense of \$32,388 was mainly due to the increase in note payable balances carried during the first six months of 2014 as compared to the first six months of 2013.

Provision for Income Taxes

The Company did not record any benefit or provision for income taxes for the three or six months ended June 30, 2014 and 2013, respectively. As of June 30, 2014 and 2013, the income tax benefits generated from the Company's net losses have been fully reserved.

Noncontrolling Interest

The noncontrolling interest share in the losses of Ilios was \$31,684 for the three months ended June 30, 2014 compared to \$94,826 for the same period in 2013, a decrease of \$63,142 or 66.6%. The decrease was due to a decrease in the Ilios loss in the second quarter of 2014 as compared to the same period in 2013. Noncontrolling interest ownership percentage as of June 30, 2014 and 2013 was unchanged at 35.0% for both periods.

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## TECOGEN INC.

The noncontrolling interest share in the losses of Ilios was \$90,844 for the six months ended June 30, 2014 compared to \$212,973 for the same period in 2013, a decrease of \$122,129 or 57.3%. The decrease was due to a decrease in the Ilios loss in the first six months of 2014 as compared to the same period in 2013. Noncontrolling interest ownership percentage as of June 30, 2014 and 2013 was unchanged at 35.0% for both periods.

## Net loss

Net loss attributable to Tecogen for the three months ended June 30, 2014 was \$1,229,707 compared to \$1,090,480 for the same period in 2013, an increase of \$139,227. The increase in net loss was the result of the increase in gross profit not offsetting the increase in operating expenses as described above.

Net loss attributable to Tecogen for the six months ended June 30, 2014 was \$2,267,752 compared to \$1,950,873 for the same period in 2013, an increase of \$316,879. The increase in net loss was the result of the increase in gross profit not offsetting the increase in operating expenses as described above.

## Liquidity and Capital Resources

Consolidated working capital at June 30, 2014 was \$8,509,763 compared to \$5,565,789 at December 31, 2013, an increase of \$2,943,974. Included in working capital were cash and cash equivalents of \$3,377,897 and \$584,375 in short-term investments at June 30, 2014, compared to \$7,713,899 in cash and cash equivalents at December 31, 2013, a decrease of \$3,751,627. The decrease in working capital is due to the lower cash resulting from operating losses, increases in inventory and unbilled revenue from turnkey projects.

Cash used in operating activities for the six months ended June 30, 2014 was \$2,917,046 compared to \$675,653 for the same period in 2013. Our accounts receivable balance increased to \$4,418,165 at June 30, 2014 compared to \$3,740,885 at December 31, 2013, using \$677,280 of cash due to timing of billing, shipments, collections and changes in allowance. In addition, amounts due from related parties increased by \$148,830 using cash due to timing of billing, shipments and collections. Our inventory increased to \$3,887,277 as of June 30, 2014 compared to \$3,343,793 as of December 31, 2013, using \$543,484 of cash to purchase inventory to build modules in backlog and to support ongoing turnkey projects.

As of June 30, 2014, the Company's backlog of product and installation projects (and excluding service contracts) was \$11.7 million, consisting of \$6 million of purchase orders actually received by us and \$5.7 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. Our inventory balances have increased to support production demands, tightening available working capital.

Accounts payable increased to \$2,453,029 as of June 30, 2014 from \$2,338,046 at December 31, 2013, providing \$114,983 in cash flow for operations. Accrued expenses increased to \$1,255,978 as of June 30, 2014 from \$1,139,554 as of December 31, 2013, providing \$116,424 of cash for operations. The Company expects accounts payable and accrued expenses to increase into the foreseeable future as operations continue to expand.

During the first six months of 2014 our investing activities used \$818,847 of cash and included purchases of short-term investments of \$584,375 to support performance bonds, purchases of property and equipment of \$120,773 and expenditures related to intangible assets of \$113,699.

During the first six months of 2014 our financing activities included the payment of principal balances on demand notes payable to our Chief Executive Officer aggregating \$2,950,000. In addition we received proceeds from sales of our common stock of \$2,351,335 and proceeds from the exercise of stock options of \$6,000. The proceeds were used for general corporate purposes, including research and development.

At June 30, 2014 our commitments included various leases for office and warehouse facilities of \$4,753,648 to be paid over several years through 2024. The source of funds to fulfill these commitments will be provided from cash balances, operations or through debt or equity financing.

On March 14, 2013 the Company received a prepayment for purchases of modules, parts and service to be made by American DG Energy in the amount of \$827,747. The Company provides a discount on these prepaid purchases equal to 6% per annum on deposit balances. The 6% discount is recorded as interest expense in the accompanying

statements of operations. As of June 30, 2014 the outstanding balance on this prepayment was \$0 and is included in due from related party, net of amounts receivable but not yet due from American DG Energy, in the accompanying condensed consolidated balance sheet.

During 2013, the Company entered into multiple demand notes, with John N. Hatsopoulos, our Chief Executive Officer. These agreements totaled a principal balance of \$2,950,000 and had interest rates as quoted from time to time in the Wall Street Journal plus 1.5% per year and 6%. On January 6, 2014, the Company repaid all demand note owed to its Chief Executive Officer, including accrued interest of \$200,658.

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TECOGEN INC.

On March 26, 2014, the Company secured a working capital line of credit with John Hatsopoulos, the Company's Chief Executive Officer, in the amount of \$3,500,000 which may be used in the occurrence of certain events. On July 2, 2014, the date of effectiveness of the registration statement, along with the May 20, 2014 sale of common stock with gross proceeds in excess of \$2,000,000, the line of credit triggers were fulfilled, and the working capital line of credit will not be drawn upon before its expiration without a separate event of default as described in the Michaelson Note.

On May 20, 2014, the Company sold 647,706 shares at \$4.75 in a public offering while simultaneously listing on the NASDAQ under the ticker symbol TGEN. Total gross proceeds from the offering were approximately \$3.0 million, before the placement agent's fees \$207,670 and certain offering expenses of \$523,898. The net proceeds of the offering will be used for working capital and general corporate purposes, including expanding Tecogen's turnkey business, constructing a dedicated manufacturing facility for Tecogen's majority owned subsidiary, Ilios Inc., expanding Tecogen's low emissions technology to other markets and continuing product development.

Based on our current operating plan, we believe existing resources, including our line of credit and cash and cash flows from operations, will be sufficient to meet our working capital requirements in the short term. As we continue to grow our business, our cash requirements are expected increase. As a result, we will need to raise additional capital through an equity offering to meet our operating and capital needs for future growth.

Our ability to continue to access capital could be impacted by various factors, including general market conditions and the continuing slowdown in the economy, interest rates, the perception of our potential future earnings and cash distributions, any unwillingness on the part of lenders to make loans to us and any deterioration in the financial position of lenders that might make them unable to meet their obligations to us. If these conditions continue and we cannot raise funds through a public or private debt financing, or an equity offering, our ability to grow our business may be negatively affected and we may need to suspend and significantly reduce our operating costs until market conditions improve.

#### 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 2013 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

On July 22, 2013, the Company's Chief Executive Officer personally pledged to support a bank credit facility of \$1,055,000 to support bank guarantees issued on certain construction contracts. We do not have any other 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.

#### Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Not applicable.



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Item 4. Controls and Procedures.

Management's Evaluation of Disclosure Controls and Procedures:

Our disclosure controls and procedures are designed to provide reasonable assurance that the control system's objectives will be met. Our management, including our Chief Executive Officer 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, or the Evaluation Date, have concluded that as of the Evaluation Date, 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. At the present time, our management has decided that, considering the employees involved and the control procedures in place, there are risks associated with the above, but the potential benefits of adding additional employees to mitigate these weaknesses do not justify the expenses associated with such increases. 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.

For these purposes, the term disclosure controls and procedures of an issuer means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Report of Management on Internal Control over Financial Reporting:

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting in accordance with the Exchange Act. Management, including our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of our internal control over financial reporting based on the framework and criteria established in Internal Control—Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission. This evaluation included review of the documentation of controls, evaluation of the design effectiveness of controls, testing of the operating effectiveness of controls and a conclusion of this evaluation. Based on this evaluation, management concluded that the Company's internal control over financial reporting was not effective as of June 30, 2014.

The Company currently does not have personnel with a sufficient level of accounting knowledge, 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. At this time, management has decided that considering the employees involved and the control procedures in place, there are risks associated with the above, but the potential benefits of adding additional employees to mitigate these weaknesses, does not justify the expenses associated with such increases. Management will continue to evaluate the above weaknesses.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our Disclosure Controls or our internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of a simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any

system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. In connection with the evaluation referred to in the foregoing paragraph, we will make changes in our internal controls over financial reporting as soon as the resources become available. As of June 30, 2014, no changes have been made to the Company's process.

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PART II - OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

As previously disclosed, from October 16, 2013 to January 17, 2014, the Company raised an aggregate of \$6,651,844 in a private placement of 1,478,189 shares of Common Stock at a price of \$4.50 per share. The private placement was exempt from registration under Section 4(a)(2) of the Securities Act and/or under Rule 506 of Regulation D. The proceeds were used for general corporate purposes.

Item 5. Other Information

On August 8, 2014, the Company entered into a new Facilities, Support Services and Business Agreement (the "Agreement") with Tecogen Inc. ("Tecogen"). The Agreement between the Company and Tecogen provides the Company with, among other things; (1) certain office space; (2) certain business support services; (3) certain rights to purchase Cogeneration products directly from Tecogen at a discounted price; (4) certain rights to purchase Tecogen services at a discounted price; (5) certain rights that allow the Company to purchase Tecogen products from Tecogen's sales representatives; and (6) the right to certain royalty fees. The Agreement was effective July 1, 2014 and shall expire on July 1, 2015. It is renewable upon mutual written consent.

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TECOGEN INC.

Item 6. Exhibits

| Exhibit No. | Description of Exhibit  |
|-------------|---|
| 3.1         | Amended and Restated Certificate of Incorporation <sup>(a)</sup>  |
| 3.2         | Amended and Restated Bylaws <sup>(a)</sup>  |
| 4.1         | Specimen Stock Certificate of Tecogen, Inc. <sup>(a)</sup>  |
| 4.2         | Form of Restricted Stock Purchase Agreement <sup>(b)</sup>  |
| 4.3         | Form of Stock Option Agreement <sup>(a)</sup>   |
| 4.4         | Indenture and Form of 6% Convertible Debenture Due 2004, dated September 24, 2001 <sup>(b)</sup>  |
| 10.1***     | 2006 Stock Incentive Plan, as amended and restated on June 30, 2014   |
| 10.3        | Facilities and Support Services Agreement between American DG Energy Inc. and Tecogen Inc., dated July 1, 2012 <sup>(a)</sup>   |
| 10.4        | First Amendment to the Facilities, Support Services, and Business Agreement between American DG Energy Inc. and Tecogen Inc., dated July 1, 2013 <sup>(a)</sup>       |
| 10.5        | Second Amendment to the Facilities, Support Services, and Business Agreement between American DG Energy Inc. and Tecogen Inc., dated November 12, 2013 <sup>(a)</sup> |
| 10.7        | Lease Agreement between Atlantic-Waltham Investment II, LLC, and Tecogen Inc., dated May 18, 2008 <sup>(a)</sup>  |
| 10.8        | Second Amendment to Lease between Atlantic-Waltham Investment II, LLC, and Tecogen Inc., dated Jan 16, 2013 <sup>(a)</sup>  |
| 10.12       | Asset Purchase Agreement with Danotek, LLC, dated January 8, 2013 <sup>(a)</sup>  |
| 10.13       | Exclusive License Agreement with the Wisconsin Alumni Research Foundation, dated February 5, 2007 <sup>(a)</sup>  |
| 10.21       | Senior Convertible Promissory Note, dated December 23, 2013, by Tecogen Inc. in favor of Michaelson Capital Special Finance Fund LP. <sup>(a)</sup>                   |
| 10.22       | Collective Bargaining Agreement, dated February 25, 2014, between Tecogen Inc. and International Union of Operating Engineers, Local 68, 68A, 68B <sup>(a)</sup>      |
| 10.23       | Revolving Line of Credit Agreement between Tecogen Inc. and John N. Hatsopoulos, dated March 26, 2014. <sup>(a)</sup>   |
| 10.24*      | Facilities and Support Services Agreement between American DG Energy Inc. and Tecogen Inc., dated August 8, 2014.   |
| 21.1        | List of subsidiaries <sup>(a)</sup>   |
| 31.1*       | Rule 13a-14(a) Certification of Chief Executive Officer   |
| 31.2*       | Rule 13a-14(a) Certification of Chief Financial Officer   |
| 32.1*       | Section 1350 Certifications of Chief Executive Officer 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

incorporated by reference from the Company's Registration Statement on Form S-1, as amended, originally filed  
<sup>(a)</sup> with the SEC on February 6, 2014 (Registration No. 333-193791), amendment No. 3 was filed on June 27, 2014 and went effective July 2, 2014.

<sup>(b)</sup>

incorporated by reference from the Company's Registration Statement on Form S-1, as amended, originally filed with the SEC on December 22, 2011 (Registration No. 333-178697).

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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 August 14, 2014.

TECOGEN INC.

(Registrant)

By: /s/ John N. Hatsopoulos

Chief Executive Officer

(Principal Executive Officer)

By: /s/ Bonnie J. Brown

Chief Financial Officer, Treasurer and Secretary

(Principal Financial and Accounting Officer)