

AMERICAN POWER GROUP Corp
Form 10-K
December 22, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K

(Mark One)

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

For the fiscal year ended September 30, 2014

or

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

For the transition period from _____ to _____

Commission File Number: 1-13776

American Power Group Corporation
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

71-0724248
(I.R.S. Employer
Identification No.)

7 Kimball Lane, Lynnfield MA
(Address of principal executive offices)
(781) 224-2411
(Registrant's telephone number, including area code)

01940
(Zip Code)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, \$.01 par value per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. Yes No

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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Indicate by check mark if disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form. 10-K. ý

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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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the average bid and asked price of such common equity, as of March 31, 2014, the last business day of the registrant's most recent completed second quarter, was approximately \$54,471,000.

As of December 19, 2014, there were 50,745,920 shares of the registrant’s Common Stock outstanding.

American Power Group Corporation

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INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements regarding future events and the future results of American Power Group Corporation, within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are based on current expectations, estimates, forecasts, and projections and the beliefs and assumptions of our management. Words such as “expect,” “anticipate,” “target,” “goal,” “project,” “intend,” “plan,” “believe,” “estimate,” “will,” “likely,” “may,” “designed,” “would,” “future,” “can,” “could” and other similar expressions that are predictive in nature and which do not relate to historical matters are intended to identify such forward-looking statements. These statements are based on management's current expectations and beliefs and involve a number of risks, uncertainties, and assumptions that are difficult to predict. Consequently, actual results may differ materially from those projected, anticipated, or implied.

Part I

Item 1. Business

General

The Company (together with its subsidiaries “we”, “us” or “our”) was originally founded in 1992 and has operated as a Delaware corporation since 1995.

Recent Developments

On October 27, 2014, we entered into loan agreement with Iowa State Bank in which we refinanced approximately \$2,567,000 due to the bank under an existing loan agreement, \$30,000 of transaction related fees and \$150,000 due to an officer of the Company. Under the terms of the new term loan, we will make P82M monthly payments of \$44,223, including principal and interest, commencing January 15, 2015, with the final payment of all principal and accrued interest not yet paid due on October 15, 2021. In addition, Iowa State Bank has provided a new \$500,000 working capital line of credit which has an initial expiration of January 15, 2016.

On November 28, 2014, we completed a private placement for \$2 million of 10% Series B Convertible Preferred Stock with an accredited investor.

On December 8, 2014, we were notified by the Environmental Protection Agency of our first 28 approvals under the Inside Useful Life designation (“IUL”), which is defined as vehicular engines older than two years but having less than 435,000 miles, which are principally engine family years 2010 and newer that utilize the OEM selective catalyst reduction technology. We believe that of the estimated 3.5 - 4 million Class 8 trucks operating in North America, an estimated 600,000 to 700,000 Class 8 trucks fall into the IUL designation.

Products and Services

Our patented dual fuel conversion system is a unique external fuel delivery enhancement system that converts existing diesel engines into more efficient and environmentally friendly engines that have the flexibility, depending on the circumstances, to run on:

- Diesel fuel and compressed natural gas (CNG) or liquefied natural gas (LNG);
- Diesel fuel and pipeline gas, well-head gas or approved bio-methane; or
- 100% diesel fuel.

Our proprietary technology seamlessly displaces up to 75% of normal diesel fuel consumption with various forms of natural gas with the average displacement ranging from 40% to 65%. The energized fuel balance between the two fuels is maintained with a patented control system ensuring the engines operate to Original Equipment Manufacturers' (OEM) specified temperatures and pressures with no loss of horsepower. Installation requires no engine modification, unlike the more expensive fuel injected alternative fuel systems in the market.

By displacing highly polluting and expensive diesel fuel with inexpensive, abundant and cleaner burning natural gas, a user can:

- Reduce fuel and operating costs by 10% to 30%;
- Reduce toxic emissions such as nitrogen oxide (NOX), carbon monoxide (CO) and fine particulate emissions; and
- Enhance the engine's operating life, since natural gas is a cleaner burning fuel source.

Primary end market applications include both primary and back-up diesel generators as well as heavy-duty vehicular diesel engines.

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Manufacturing/Processing

Our dual fuel conversion enhancement system is configured by our internal engineering staff based on customer engine specifications and then modeled through Computational Fluid Dynamics Analysis to scientifically determine the optimum mixture of diesel and natural gas prior to final installation. All components, including several proprietary patented components, are purchased from external sources and currently assembled into installation kits at our Algona, Iowa location and then delivered on site for installation. All installations are managed by an American Power Group lead team or certified installers that complete final testing and commissioning of the diesel engines.

Raw Materials

Our dual fuel conversion components, including several proprietary components, are purchased from well known automotive parts suppliers as off-the-shelf components. We believe these suppliers are able to support the scalability of our business. While we believe our dual fuel conversion operations have access to sufficient components for the foreseeable future, management is currently identifying multiple potential sources for critical components to reduce the likelihood that supply issues could negatively impact our business.

Customers

Our dual fuel technology upgrade is ideally suited for the large domestic and international installed base of both stationary and vehicular diesel engines. The stationary market includes primary and backup diesel power generators for oil and gas drilling rigs, shale gas recovery pumps, hospitals, cold storage warehouses, data management centers, government and manufacturing facility applications. Vehicular applications include corporate and private route fleets, long haul logistics fleets, refuse haulers, public transit and government vehicles.

The United States Environmental Agency estimates there are 20 million diesel engines operating in the U.S., with an estimated 13 million used in vehicular applications and 7 million used in stationary generator applications. Today our primary vehicular market is the Class 8 Heavy Duty vehicles operating in North America which is estimated to be 3.5 to 4 million vehicles. We believe the number of available international stationary and vehicular diesel engines is significantly higher than the U.S. market.

Sales and Marketing

Our dual fuel conversion operations address the alternative fuel market in three distinct segments: (1) North American stationary, (2) North American vehicular and (3) international. To address these markets, we have put in place a sales organization consisting of direct sales, exclusive dealers/certified installers, non-exclusive dealer/installer agreements with the WheelTime members, sales representatives, and in-country international distributors, which in most instances are large, well-known companies. We currently have twenty-eight domestic dealers/certified installers, and exclusive distributors in five countries that market and distribute our products.

In October 2014 we announced the expansion of our existing in-house and WheelTime sales and marketing resources with new direct sales representatives, additional third party dealers and co-marketing relationships with numerous national and regional CNG and LNG fuel suppliers. We believe this group of fuel suppliers encompasses a cumulative group of over 90 additional sales team members who we intend to train on selling our dual fuel solution. These additional lead generation channels will continue to be supported by WheelTime's expansion of their certified natural gas installer locations across North America.

Competition

Under certain conditions it is not cost effective or technologically feasible to convert a diesel engine to operate either entirely or partially on an alternative fuel. Emission standards sometimes dictate the use of highly sophisticated technology that sometimes cannot be easily retrofitted onto an engine and/or is cost prohibitive. In those situations, American Power Group offers customers a cost effective solution which can be used in heavy duty trucks, generators and other stationary industrial engines. As described above, our patented dual fuel conversion system is an external fuel delivery enhancement system that requires no engine modifications and can run on a combination of diesel fuel and natural gas or only diesel fuel, depending on the circumstances.

The primary natural gas alternative fuel solutions available to existing heavy-duty diesel engine operators are:

• **Dedicated Natural Gas Engines** - 100% dedicated natural gas burning engines. This is usually a more expensive solution and available in new OEM and aftermarket completely rebuilt engines.

Invasive Retrofits - an existing diesel engine can be converted to operate on a combination of diesel and an acceptable form of natural gas. The invasive solution tends to be a higher priced solution than non-invasive solutions because of the need for additional custom designed natural gas fuel injectors.

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• Non-Invasive Retrofits - are solutions, such as ours, where no major changes to the existing diesel engine are required and we do not use costly custom designed natural gas fuel injectors to operate the engine on dual fuel.

Our solution uses software to manage the introduction of natural gas under negative pressure to the engine's turbo charger air flow, thus eliminating the need for costly and maintenance-prone custom fuel injectors and therefore making our solution more cost effective than others. In addition, we believe that our solution has a more universal design than other conversion technologies and therefore is applicable to a wider range of engine models and sizes than our competitors' solutions currently are. Today, our primary focus is on addressing the installed base of existing diesel engines. We believe our dual fuel conversion technology upgrade is ideally suited for the large domestic and international installed base of both stationary and vehicular diesel engines, which is estimated to be in the millions of units.

Government Regulation

Our dual fuel conversion business and operations are affected by various federal, regional, state, local and foreign laws, rules, regulations and authorities. The primary domestic governing body is the EPA, which is responsible for monitoring and enforcing emissions standards and safety requirements. All domestic dual fuel conversion systems are subject to the regulations of the EPA, the primary requirement of which is that being that addition of a dual fuel conversion system to an existing diesel engine does not negatively impact the current emission profile of the engine or the engine's original emission profile.

In April 2011, the EPA announced it had amended its alternative fuel conversion regulations for light, medium and heavy-duty vehicles. The new regulations introduced new flexibilities for all clean alternative fuel converters and expanded compliance options for certain categories of conversions, building upon the concept that it is appropriate to treat conversions differently based on the age of the vehicle or engine being converted. EPA regulations had previously required vehicle and engine conversion systems to be installed after receiving a certificate of conformity which provided a regulatory exemption from potential tampering charges. Under the new heavy-duty vehicle regulations, testing and compliance procedures differ based on the age category of the vehicle or engine that is being converted: 1) full certification for new or relatively new, which is defined as engines less than two years old; 2) intermediate age ("IUL"), which is defined as engines older than two years but having fewer than 435,000 miles, and 3) outside useful life ("OUL") which is defined as engines with more than 435,000 miles or 10 years old. All conversion manufacturers seeking exemption must demonstrate compliance, but the requirements differ among age categories. Our initial focus was on obtaining approval for a large number of engine families within the OUL category, as we believe they represent over seventy five percent of the Class 8 trucks in operation and the testing requirements are less stringent than those for the IUL category.

As of September 30, 2014, we had an industry leading 456 OUL vehicular engine family approvals covering what we believe are six of the top seven OUL engine families on the road in the U.S. On December 8, 2014, we were notified by the EPA of 28 approvals for our first Volvo/Mac IUL engines, which included 25 approvals covering engine families for which we already have OUL approval. As a result, we have expanded our ability to convert engines within these families having fewer than 435,000 miles. In addition, we received approval on three SCR technology families covering model years 2010-2012, bringing our overall total to 459 engine families.

Failure to comply with applicable regulatory requirements can result in, among other things, fines, suspensions of approvals, seizure or recall of products, operating restrictions and criminal prosecutions. Furthermore, changes in existing regulations or adoption of new regulations could impose costly new procedures for compliance, or prevent us from obtaining, or affect the timing of, regulatory approvals. We use our best efforts to keep abreast of changing or new regulations for timely implementation.

Protection of Intellectual Property Rights and Proprietary Rights

Our American Power Group subsidiary has an exclusive, worldwide license under one U.S. patent for dual fuel conversion technology owned by M&R Development, Inc.

We use the name American Power Group in interstate commerce and assert a common law right in and to that name. Employees

As of September 30, 2014, we had 21 full time employees and no part-time employees. We are not a party to any collective bargaining agreements and consider the relationship with our employees to be satisfactory.

Item 1A. Risk Factors

An investment in our Common Stock involves a high degree of risk. Investors should carefully consider the following risk factors, in addition to the risks described elsewhere in this Annual Report, in evaluating our Company and our business. If any of these risks, or other risks not presently known to us or that we currently believe are not significant, develops into an actual event, then our business, financial condition and results of operations could be adversely affected. If that happens, the market price of our Common Stock could decline.

Risks Related to our Business

Our dual fuel conversion business has lost money in the last six consecutive fiscal years and we may need additional working capital if we do not obtain sustained profitability. If additional capital is not received, it may force us to adjust operations accordingly.

Since the July 2009 acquisition of American Power Group's dual fuel conversion operations, we have invested over \$14 million to obtain regulatory approvals of our dual fuel products and support dual fuel sales and marketing initiatives intended to promote American Power Group's dual fuel conversion technology and establish a broader market presence worldwide. Despite these efforts and increasing quarterly revenue, American Power Group's business has incurred significant operating losses and experienced negative cash flow from operations.

Our continued existence is dependent on our ability to generate positive operating cash flow, achieve profitability on a sustained basis and generate improved performance. If American Power Group is unable to achieve sustained profitability, our ability to maintain our current level of operations could be materially and adversely affected. There is no guarantee we will be able to achieve profitability.

We may require additional funding to grow our business, such funding may not be available to us on favorable terms or at all. If we do not obtain funding when we need it, our business will be adversely affected. In addition, if we have to sell securities in order to obtain financing, the rights of our current holders may be adversely affected.

Substantial expenditures have been required and may be required in the future to enable us to obtain the necessary additional vehicular engine family approvals from the EPA to accelerate our ability to sell our vehicular dual fuel solution in the United States. In addition, we may need additional capital to continue operations. There can be no assurance that we will generate revenues from operations or obtain sufficient capital on acceptable terms, if at all. Failure to generate such operating revenues or obtain such capital, if needed, would have an adverse impact on our financial position, our results of operations and our ability to continue as a going concern. We may also seek funding for the manufacturing and marketing of our products through strategic partnerships and other arrangements with corporate partners. There can be no assurance that such collaborative arrangements or additional funds will be available when needed, or on terms acceptable to us if at all. Operating and capital requirements during the next fiscal year and thereafter will vary based on a number of factors, including the level of sales and marketing activities for services and products. There can be no assurance that additional private or public finances, including debt or equity financing, will be available as needed, or, if available, on terms favorable to us. Any additional equity financing may be dilutive to stockholders and such additional equity securities may have rights, preferences or privileges that are senior to those of our existing Common Stock and/or Preferred Stock.

Improvement in our business depends on our ability to increase demand for our products and services.

We must substantially increase revenues by increasing demand for our dual fuel products and services. Factors that could limit demand for our products and services include changes in the price spread between diesel fuel and natural gas and potential additional changes in the regulatory environment. Other possible adverse circumstances may include changes in economic conditions affecting markets for our products and services, potential delays in product development, product and service flaws which could result in material warranty claims, changes in technology and the availability of competitive products and services could also delay or limit demand for our products and services. There can be no assurance that our efforts will be successful, that all of our products will prove to meet the anticipated levels of approval or effectiveness, or that we will be able to obtain and sustain customers as well as distribution approval.

We rely on significant customers and relationships. The loss of one or more of which could adversely affect our operating results, financial condition and business prospects.

During the fiscal years ended September 30, 2014 and 2013, approximately 69% and 80% of our sales were derived from our dual fuel stationary solution for oil and gas applications, with the balance derived from our dual fuel vehicular applications. Three oil and gas stationary customers accounted for 39%, 16% and 9% of consolidated revenue for the fiscal year ended September 30, 2014 and 34%, 21% and 12% of consolidated net sales in the fiscal year ended September 30, 2013. The loss of any one of these customers could have a material adverse effect on our operating results, financial condition and business prospects. Revenue in fiscal 2013 from the other two customers related to specific one-time conversions of multiple oil and gas high pressure fracturing engines as the result of new

engine family approvals received during fiscal 2013. Approximately \$1.4 million of fiscal 2013 revenue associated with these two customers was derived from us providing a full turnkey solution in lieu of the more traditional sale of us providing the dual fuel conversion kit with a third party providing installation and additional equipment. We do not anticipate providing similar full turnkey dual fuel solutions in the future. Our operating plans assume significant growth in North American vehicular revenues, based in part on our new relationships with the leading national and regional natural gas fuel suppliers as well as our existing relationship with WheelTime. The loss of our relationship with the WheelTime member companies could have a material adverse effect on our operating results, financial condition and business prospects.

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We are exposed to risks related to technological obsolescence and competition.

We operate in competitive and evolving markets locally, nationally and globally. These markets are subject to technological changes and changes in demand. In seeking market acceptance, we encounter competition from many sources, including other well-established and larger dominant original equipment providers such as CAT, Cummings, Detroit Diesel, Volvo and Mercedes as well as several other companies that offer dual fuel conversion solutions on both an invasive as well as non-invasive basis. Many of these competitors have substantially greater financial resources as well as substantially greater experience in conducting testing, manufacturing and marketing of products than we do. As a result, they may be able to adapt more quickly to new or emerging technologies, changes in customer requirements, or devote greater resources to the promotion and sale of their products and services. In addition, our competitors might succeed in developing or purchasing technologies and products that are more effective than those that we are developing or that would render our technology and products obsolete or noncompetitive. Competition could increase if new companies enter the markets in which we operate or our existing competitors expand their service lines.

We may not be able to protect our intellectual property rights adequately.

Our ability to compete is affected by our ability to protect our intellectual property rights. We rely on a single licensed patent, as well as on trademarks, copyrights, trade secrets, confidentiality procedures and licensing arrangements to protect our intellectual property rights. Despite these efforts, we cannot be certain that the steps we take to protect our proprietary information will be adequate to prevent misappropriation of our technology or protect that proprietary information. Companies in our industry often own large numbers of patents, copyrights, trademarks and trade secrets and frequently enter into litigation based on allegations of infringement or other violations of intellectual property rights. As we gain increasing market share, the possibility of intellectual property rights claims against our licensed dual fuel technology could grow. Although the owner of our licensed patent is responsible for defending all claims against the licensed dual fuel technology, it may not have the resources to defend such claims adequately. Such claims, whether having merit or otherwise, could be time consuming and expensive to litigate or settle and could divert management resources and attention. No assurance can be given that, if challenged, our licensed patent or any other patents we may obtain will be found to be valid or enforceable, or that the patents of others will not have an adverse effect on our ability to do business.

Although our dual fuel technology is licensed from a related party, M&R Development, Inc., if we should default on the payment of royalties or other material terms of that license, the license can be terminated. Such termination would have a material adverse effect on our business and on our results of operations.

Many of our distribution agreements require us to indemnify the distributor for third-party intellectual property infringement claims and may require that we pay the damages if there were an adverse ruling in any such claims and the licensor was unable to adequately indemnify us. If litigation is successfully brought by a third party against us and/or our licensor in respect to intellectual property, we may be required to cease distributing or marketing certain products or obtain licenses from the holders of the intellectual property at material cost, redesign affected products in such a way as to avoid infringing intellectual property rights, either of which could materially adversely affect our business, financial condition and results of operations. If those intellectual property rights are held by a competitor, we or the licensor may be unable to obtain the intellectual property at any price, which could also adversely affect our competitive position.

There is uncertainty relating to our ability to enforce our rights under international distribution agreements.

Several of our exclusive distribution agreements are with foreign entities and are governed by the laws of foreign jurisdictions. If a distributor breaches such agreement, then we may incur the additional costs of determining our rights and obligations under the agreement and under applicable foreign laws, and enforcing the agreement in a foreign jurisdiction. In addition, some of the exclusive distribution agreements contain arbitration provisions that govern disputes and there is uncertainty with respect to the enforceability of these arbitration provisions under the laws of certain foreign jurisdictions. If a dispute were to arise under an exclusive distribution agreement and the related arbitration provision was not effective, then we would be exposed to the additional costs of resolving the dispute through traditional legal avenues rather than through an arbitration process.

The creditworthiness of our distributors may be an ongoing concern.

We may not always be able to collect all funds owed to us by our distributors. Some distributors may experience financial difficulties that may adversely impact our collection of accounts receivable. We regularly review the collectability and creditworthiness of our distributors to determine an appropriate allowance for credit to such distributors. If our uncollectible accounts exceed our expectations, this would adversely impact our operating results. We attempt to minimize this concern with international customers by selling most of our products by way of advanced deposits and letters of credit or similar payment methods.

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We depend on the manufacture and installation capabilities of third parties.

An important element of our strategy for the marketing and release of our products is to enter into arrangements with multiple distribution and installation entities, such as our relationships with WheelTime and its member companies.

The success and commercialization of our dual fuel products will be dependent, in part, upon our ability to enter into additional similar arrangements and upon the ability of these third parties to perform their responsibilities. Although we believe that parties to any such arrangements would have an economic motivation to succeed in performing their contractual responsibilities, the amount and timing of resources to be devoted to these activities may not be within our control. There can be no assurance that any such arrangements will be available on terms acceptable to us, or at all, that the parties to any such agreements will perform their obligations as expected, or that any revenue will be derived from such arrangements. If we are not able to enter into such arrangements, we could encounter delays in introducing our products into the market.

We assemble our dual fuel installation kits in-house after receiving components from outside vendors. The assembled kits are then installed by independent certified installers. Therefore, we may be dependent on contract manufacturers for the production of certain critical components for products as well as their installation. In the event that we are unable to obtain or retain the necessary components and services on acceptable terms, we may not be able to continue to commercialize and market our products as planned. There can be no assurance that we will be able to obtain adequate supplies of our products in a timely fashion at acceptable quality and prices, enter into arrangements for the manufacturing of our products with manufacturers whose facilities and procedures comply with our requirements. There can be no assurance that such manufacturers will be able to adequately supply us with our product needs. Our dependence upon others for the manufacturing of certain critical components may adversely affect our ability to develop and deliver products on a timely and competitive basis.

We are subject to federal, regional, state, local and foreign regulations that may impair our ability to sell our products in

different jurisdictions, and more stringent regulations in the future may impair our ability to market our products.

Our dual fuel conversion business and operations are affected by various federal, regional, state, local and foreign laws, rules, regulations and authorities. The primary domestic governing body is the EPA, which is responsible for monitoring and enforcing emissions standards and safety requirements. All domestic dual fuel conversion systems are subject to the requirements of the EPA, the primary environmental requirement of which is that the addition of our dual fuel conversion system to an existing diesel engine does not negatively impact the current emission profile of the engine or the engine's original emission profile.

All vehicles and components on vehicles that operate on public highways must comply with the Federal Clean Air Act and meet specific EPA emission and safety guidelines or face anti-tampering infractions. Because our vehicular dual fuel system has not been previously EPA certified as a new system, due to our primary focus being aftermarket diesel engines, we must demonstrate to the EPA that our technology has sound engineering design and does not degrade the emissions level of the model year that would be requested for commercialization.

In addition to our operations in the United States, we currently have distributors in Australia, Canada and Latin America. We intend to market our products and technologies in other international markets, including both industrialized and developing countries. Prior to marketing our dual fuel solution in countries outside the United States, we must ensure our technology is compliant with the appropriate in-country rules and regulations and there is no assurance our technology will comply with such rules and regulations.

Any new or revised government regulation that affects our dual fuel conversion business, whether at the foreign, federal, state, or local level, may increase our costs and the price of our products. As a result, these regulations could have a significant negative impact on our business, financial condition and results of operations.

Our success depends on the retention of our senior management and other key personnel.

Our success depends largely on the skills, experience and performance of our senior management. Our senior management consists of two officers, our President/Chief Executive Officer, who has held that position for eight years, and our Chief Financial Officer, who has held that position for sixteen years. The loss of either member of our senior management could have a material adverse effect on our business. We maintain a key man insurance policy on our President/Chief Executive Officer. In addition, in the event that either our President or Chief Financial Officer is

terminated by us without cause, the officer will be entitled to receive severance payments equal to twelve months' salary and certain benefits. In the event we are required to make these severance payments to our officers, it could have a material adverse effect on our results of operations for the fiscal period in which such payments are made. In addition, to increase revenues, we will be required to hire additional sales and marketing officers and to develop a larger and more effective sales force. There can be no assurance that we will be able to hire, motivate and retain skilled marketing and sales personnel.

Seasonal factors may affect our quarterly operating results.

Seasonality may cause our total revenues to fluctuate. We may experience some seasonality in the winter months in the oil and gas industry and in the Hurricane Belt located in the Southeastern U.S., where critical care installations are usually not scheduled during the July-October time frame.

Inflation and changing prices may hurt our business.

We are generally exposed to the effects of inflation and changing prices. Because our dual fuel conversion technology replaces a certain percentage of diesel fuel with natural gas, we would be impacted by any material change in the net fuel savings between the two fuels (such as a decrease in diesel fuel prices and an increase in natural gas prices).

If we acquire other companies or businesses we will be subject to risks that could hurt our business.

A part of our business strategy may be based on future acquisitions or significant investments in businesses that offer complementary products and services. Promising acquisitions are difficult to identify and complete for a number of reasons. Any acquisitions we may complete may be made at a premium over the fair value of the net assets of the acquired companies and competition may cause us to pay more for an acquired business than its long-term fair market value. There can be no assurance that we will be able to complete future acquisitions on terms favorable to us or at all. In addition, we may not be able to integrate any future acquired businesses at all or without significant distraction of management into our ongoing business. In order to finance acquisitions, it may be necessary for us to issue shares of our capital stock to the sellers of the acquired businesses and/or to seek additional funds through public or private financings. Any equity or debt financing, if available at all, may be on terms which are not favorable to us and, in the case of an equity financing or the use of our stock to pay for an acquisition, may result in dilution to our existing stockholders.

As we grow, we are subject to growth related risks.

We are subject to growth-related risks, including capacity constraints and pressure on our internal systems and personnel. In order to manage current operations and any future growth effectively, we will need to continue to implement and improve our operational, financial and management information systems and to hire, train, motivate, manage and retain employees. We may be unable to manage such growth effectively. Our management, personnel or systems may be inadequate to support our operations, and we may be unable to achieve the increased levels of revenue commensurate with the increased levels of operating expenses associated with this growth. Any such failure could have a material adverse impact on our business, operations and prospects. In addition, the cost of opening new facilities and the hiring of new personnel for those facilities could significantly decrease our profitability, if the new facilities do not generate sufficient additional revenue.

We incur substantial costs to operate as a public reporting company.

We incur substantial legal, financial, accounting and other costs and expenses to operate as a public reporting company. We believe that these costs are a disproportionately larger percentage of our revenues than they are for many larger companies, and they contribute significantly to our operating losses. In addition, the rules and regulations of the Securities and Exchange Commission impose significant requirements on public companies, including ongoing disclosure obligations and mandatory corporate governance practices. Our limited senior management and other personnel need to devote a substantial amount of time to ensure ongoing compliance with these requirements. Our Common Stock is currently quoted on the OTC Markets Group's OTCQB tier. OTC Markets Group imposes no specific quotation requirements for its OTCQB tier other than that issuers must be current in their reporting to the Securities and Exchange Commission. If we are successful in listing our stock for trading on a national securities exchange or having our stock quoted on the Nasdaq Stock Market, we will be subject to additional disclosure and governance obligations. There can be no assurance that we will continue to meet all of the public company requirements to which we are subject on a timely basis, or at all, or that our compliance costs will not continue to be material.

We are required to pay substantial cash dividends on our 10% Convertible Preferred Stock.

During the fiscal years ended September 30, 2014 and 2013, we paid cash dividends on our 10% Convertible Preferred Stock of \$569,368 and \$434,211, respectively. We expect to continue to pay a significant portion of the dividends on our 10% Convertible Preferred Stock and on our newly issued Series B 10% Convertible Preferred Stock in cash rather than in shares of Common Stock. Although these dividends do not directly affect our net income, they

significantly reduce the amount of cash we have available to fund operations and invest in our business. There can be no assurance that the requirement to pay dividends in cash, rather than in shares of Common Stock, will not increase in the future, further reducing the cash available to us.

Risks Related to the Securities Market and our Common Stock

Our stock price may be volatile, which could result in substantial losses for our shareholders.

Our Common Stock is thinly traded and an active public market for our stock may not develop. Consequently, the market price of our Common Stock may be highly volatile. Additionally, the market price of our Common Stock could fluctuate significantly in response to the following factors, some of which are beyond our control:

- we are traded on the OTC Market's Group's OTCQB tier;
- changes in market valuations of similar companies;
- announcements by us or by our competitors of new or enhanced products, technologies or services or significant contracts, acquisitions, strategic relationships, joint ventures or capital commitments;
- regulatory developments;
- additions or departures of senior management and other key personnel;
- deviations in our results of operations from the estimates of securities analysts; and
- future issuances of our Common Stock or other securities.

We have options, warrants and convertible preferred stock currently outstanding. Their exercise and/or conversion will cause dilution to existing and new shareholders.

As of September 30, 2014, we had options and warrants outstanding to purchase 30,199,294 additional shares of Common Stock. These reserved shares included the following: 3,806,000 shares for issuance upon exercise of awards granted under our 1996 Non-Employee Director Stock Option Plan and 2005 Stock Option Plan, and 26,393,294 shares for issuance upon exercise of other stock options and stock purchase warrants. In addition, at that date, we had convertible preferred stock which is convertible into 23,536,120 shares of our Common Stock. On November 28, 2014, we issued 200 shares of our Series B 10% Convertible Preferred Stock and an additional warrant which are convertible into, or exercisable for, a total of 10,000,000 additional shares of Common Stock.

The exercise