Zacks Small-Cap Research

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XZERES Corporation (XPWR-OTC)

XPWR: Quarterly sequential revenue growth resumed last quarter. Third fiscal quarter results are expected in mid-January.

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	10/16/2012
Current Price (12/24/12)	$0.22
Six- Month Target Price	**$0.60**

OUTLOOK

XZERES is positioned to benefit from the growth of the small wind energy industry. Access to capital through three separate financings over the last eight months, at first stabilized, and then, grew the company's revenue base. Upon resumption of sequential quarterly revenue growth, we upgraded XZERES stock to Outperform in October. We look forward to the company reporting its third fiscal quarter in January to further evaluate the effect of the $1.5 million private offering that was subsequently announced. We reiterate our Outperform rating and price target of $0.60.

SUMMARY DATA

52-Week High	**$0.60**
52-Week Low	**$0.20**
One-Year Return (%)	**-48.81**
Beta	**0.01**
Average Daily Volume (shrs.)	**16,958**
Shares Outstanding (million)	**26.6**
Market Capitalization ($ mil.)	**$5.72**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**3**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/M**
P/E using 2013 Estimate	**N/M**
P/E using 2014 Estimate	**N/M**
Zacks Rank	**3**

Risk Level	**Above Average**
Type of Stock	**Small - Growth**
Industry	**Other Alt. Energy**
Zacks Rank in Industry	**5 of 14**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (May)	Q2 (Aug)	Q3 (Nov)	Q4 (Feb)	Year (Feb)
2011	0.00 A	0.36 A	0.47 A	0.65 A	1.48 A
2012	1.02 A	1.37 A	0.93 A	0.66 A	3.97 A
2013	0.65 A	1.19 A	1.54 E	1.99 E	5.36 E
2014					6.43 E

Earnings per Share
(EPS is operating earnings before non recurring items)

	Q1 (May)	Q2 (Aug)	Q3 (Nov)	Q4 (Feb)	Year (Feb)
2011	-$0.07 A	-$0.10 A	-$0.10 A	-$0.13 A	-$0.41 A
2012	-$0.11 A	-$0.09 A	-$0.11 A	-$0.12 A	-$0.43 A
2013	-$0.07 A	-$0.06 A	-$0.05 E	-$0.05 E	-$0.23 E
2014					-$0.15 E

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

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KEY POINTS

- XZERES Corporation is an engineered systems company, with a focus on clean and renewable energy. XZERES primarily designs, develops, manufactures and markets premium small wind turbine systems and related equipment for the generation of electrical power to a wide range of customers. In April 2011, the company acquired Rochester Power Saver, which offers power efficiency products.
- The company's small wind systems are competitive, and in most cases, superior in terms of performance to other wind systems. When power curves are used in conjunction with published pricing of competing wind turbines, management can demonstrate that the XZERES system has a superior return on investment based on the company's metric of modified internal rate of return.
- XZERES utilizes multiple sales channels: the traditional dealer network, direct-to-consumer and distributor channels. The company has multiple websites, each targeting a specific market.
- Through innovative marketing initiatives, such as the Buy Direct program, XZERES is stimulating sales of it small wind systems.
- **Sequential revenue growth in the second fiscal quarter increased 82.7% sequentially** with a private placement providing over $1.48 million in capital to alleviate some of the working capital needs to fulfill outstanding orders of small wind systems. The purchase order debt financing agreement, which was signed in late May, and the $1.5 million financing facility announced in early August have mitigated some of the liquidity issues that have constrained the company's ability to quickly fulfill orders. Subsequently, XZERES also received gross proceeds of $1.5 million from a private offering.
- During the past three fiscal quarters, XZERES has been unable to ship its small wind systems as quickly as management (and investors) would like. As a result, the company's backlog is over $3.8 million.
- In order to achieve profitability, operating costs are being reduced. In the second fiscal quarter, total operating expenses declined 9.2% sequentially.
- Since revenue traction has been demonstrated following the company's access to the working capital from the debt financing facilities, we are more confident that the company's sales profile should continue to experience sequential growth since additional capital has been provided by a private offering of convertible preferred stock and warrants. With management having lowered operating expenses, as demonstrated in the last reported quarter, XZERES has a better chance of achieving management's goal of reaching profitability in the near future.
- We maintain our Outperform rating and price target of $0.60. We derive the price target using normalized annual sales of $4.7 million and a price-to-sales valuation ratio of 3.2.

RECENT NEWS

Financing

On October 19, 2012, XZERES entered into a Subscription Agreement with a private investor, Ronald Elvidge, for a **private offering** of 1,428,571 units **for $1,500,000**. The units consist of Series A Convertible Preferred Stock and five-year warrants exercisable at $0.385 per share to purchase of 2,875,143 common shares. Each share of Series A Convertible Preferred Stock is convertible into three common shares. Mr. Elvidge also has the option to purchase up to an additional 238,091 units under the agreement.

The preferred equity offering is significant in that the company has been hampered by working capital constraints, which have delayed the shipping of orders for small wind systems. XZERES dramatically benefited from the working capital injections provided by two recent financing facilities, specifically the $510,000 purchase order debt financing agreement signed in late May and the $1.5 million financing

facility announced in early August. The recently reported results for the second fiscal quarter (for the period ending August 31st) revealed that quarterly revenues impressively increased 82.7% sequentially due to the injections of working capital.

On August 6, 2012, XZERES entered into a **$1,500,000 secured revolving credit facility** with Magna Group LLC through Hanover Holdings I, LLC. The credit facility has a one year term and carries 16% annualized interest rate on outstanding draw downs payable every 30 days. In addition, Hanover received a two-year warrant to purchase 600,000 shares of XZERES common stock with an exercise price of $0.35. Each draw down on the credit facility requires the issuance of additional warrants with a strike price of 15% above the average closing bid price for the ten days prior to the draw down. As of August 31st, the balance on the revolving credit facility was $1,500,000.

On May 25, 2012, XZERES entered into a **purchase order debt financing agreement** which provides for up to **$510,000** to fund customer orders between the time the customer is required to pay the balance (usually prior to shipment or delivery) and the customer actually pays the balance (usually after delivery). The outstanding balance of the agreement carries a 12% annual interest rate. As of August 31st, the balance on the purchase order financing was $510,026.

Results for second fiscal quarter

On October 15, 2012, XZERES filed its 10-Q quarterly report for its second fiscal quarter ending August 31, 2012. Impressively, **quarterly revenues increased 82.7% sequentially** to $1,186,101 from $649,041, dramatically breaking the streak of three negative consecutive sequential quarterly comparisons. Though **the gross profit margin was pressured** and declined 668 basis points sequentially to 15.7%, the company benefited from the working capital injections from recent financings, specifically the $510,000 purchase order debt financing agreement signed in late May and the $1.5 million financing facility announced in early August. The **company aggressively reduced expenses** reflected by the 77.2% sequential decline in sales expense and the 12.9% decline in marketing expense, although G&A expenditures increased 13.9%. Overall, **total operating expenses declined 9.1%** to $1.72 million. XZERES quarterly loss narrowed to $1.61 million or $0.06 per diluted share.

The company's backlog continues to grow, driven primarily by the UK market. As of July 12, 2012, backlog was at a record high, exceeding $3.9 million. XZERES has a strong presence in the United Kingdom and has significant potential in Asia, especially Vietnam. The company continues to receive additional orders, including more multiple system orders per customer.

Management is concentrating on lowering operating expenses and has set a goal of reaching profitability sometime during fiscal 2013. Though the company continues to be challenged by a limited working capital position, management has demonstrated its ability to execute through this liquidity event by creatively utilizing an alternative form of funding, namely collateral-based purchase order financing.

Expectations for fiscal 2013

Management maintains its objective to generate revenues of at least $20 million and to reach profitability during the current fiscal year. Key assumptions include the company's ability to meet the financial challenges of limited liquidity and insufficient working capital, the ability of end-customers to prepare their sites for installation on a timely basis and the continuation of incentives for renewable energy, specifically for wind energy. Concerning the Power Management Division, XZERES has 35 dealers representing its products; however, customer education about the benefits of power efficiency products is the key to the potential growth of this business.

Chairman of the Board Resigns

David N. Baker resigned as Director effective December 13, 2012.

OVERVIEW

Based in Wilsonville, Oregon[1], XZERES Corporation (XPWR: OTC Markets) designs, develops, manufactures and markets premium small wind turbine systems and related equipment for the generation of electrical power to a wide range of customers: residential, commercial, municipal, rural, agricultural, etc. In April 2011, the company acquired the assets of Rochester Power Saver, a manufacturer and distributor of power savers. The acquisition broadens the company's small wind systems product lines (the Wind Power Division) with the addition of power efficiency products (Power Management Division) that are designed to improve the power factor for both business and residential customers. Power saver products also act as surge suppression devices. The power management devices are offered both separately and in tandem with wind turbine systems. Management's goal is to become a global, diversified engineered systems company, with a focus on clean and renewable energy, and primarily through acquisitions.

The **Wind Power Division** focuses on the small wind market, which encompasses wind-powered turbines that are capable of producing up to 100 kilowatts[2] (kW). XZERES manufactures and assembles wind turbine systems, towers and various wind power system components, including controllers, inverters and lightning protection equipment. The company currently offers two power ratings of small wind turbines: the **XZERES 110** (2.5 kW) and the **XZERES 442SR** (10 kW). Approximately 150 wind turbines have been deployed.

In August 2010, Frank Greco, former CEO of Southwest Windpower, was appointed Chief Executive Officer. Within a few months, XZERES rapidly developed with the implementation of a **Direct Buy** program, the initiation of a consumer **financing** option, the launch of **WindRx**™ site assessment tool both in the UK and US, and the creation of the **Micro-Generation Utility** business model, all between November 2010 and January 2011. The addition of Frank Greco to the team of co-founders of David Baker and Steve Shum synergistically accelerated the company's progress with the creation and implementation of non-typical industry sales and business models, including the expansion into multiple sales channels in the United States and opening a European subsidiary, XZERES Wind Europe Ltd., in January 2011.

The **Power Management Division** was formed with the acquisition of Rochester Power Saver in April 2011. The Division manufactures and markets power efficiency products, which are designed to improve the power factor for commercial and light-industrial customers, who should benefit from a 10% to 20% reduction in electricity costs. The products can also be used by residential customers as power conditioners (by smoothing voltage spikes) and as central surge suppressors. The power management devices are marketed both separately and in tandem with the company's wind turbine systems.

XZERES acquired Rochester Power Saver on April 25, 2011 for $450,000 worth of common stock and $50,000 in cash, along with a 5% royalty on gross profits over the next 24 months, up to a maximum of $150,000. The acquisition broadened the company's small wind systems product lines with the addition of power saver products. The Rochester Power Saver product line consists of several models with different capacity ratings with price points between $500 and $2,900. Payback periods range between 6 and 24 months.

The small wind industry is an emerging growth industry with industry sales expected to increase at least 20% per year. As market penetration increases, market participants with proven, established and certified products, like XZERES, should experience sales growth and achieve profitability.

[1] Though based in Oregon, XZERES Wind Corporation is incorporated in Nevada.
[2] A kilowatt is a unit of energy equal to 1,000 watt s. A watt is defined as one joule per second and defines the rate at which work is done according the formula: W = V x A (watts = volts x amperes).

VALUATION

The appropriate valuation methodology for XZERES is based on price-to-sales (P/S) due the character of the company's enterprise, namely a small-capitalization company with current negative profitability. Furthermore, we are utilizing a valuation range based on a small-cap company with a stable or moderately growing sales profile, namely, **a P/S range between 1.1 and 3.2**. Since XZERES has the potential and is expected to resume double-digit sequential sales growth, our price target is based on a 3.2 price-to-sales ratio valuation (the high-end of the range). The annual sales base being used is a normalized value determined by the latest reported fiscal quarter (approximately $1.186 million per quarter). **At a 3.2 price-to-sales ratio, our price target is $0.60.**

As revenue continued traction is demonstrated, the company's sales profile is expected to experience rapid sequential growth through management's successful execution in the development of multiple distribution channels for both the company's small wind systems and power efficiency products. Ultimately, the growing revenue stream should manifest itself into positive earnings. Once significant sequential revenue growth is once again indicated, we expect a price-to-sales valuation range to migrate upwards to between 2.8 and 5.2, which is based on historical norms for similar emerging growth companies.

RISKS

- As of August 31, 2012, XZERES had negative working capital of $3,481,114, which is impeding the generation of revenues. Operations continue to consume cash, the largest item being General and Administrative expenses, though management reduced total operating expenses by 9.1% sequentially to $1.72 million from $1.89 million in the prior quarter. The auditor's modified unqualified opinion of the annual financial statements includes the "going concern" disclaimer, citing the company's losses from operations, negative working capital and need for additional capital. Management believes that the company can successful raise capital and thereby increase revenues.

PROJECTED INCOME STATEMENT & BALANCE SHEET

XZERES Corporation

Annual Earnings Analysis For the years ending February 28 (in $ US)	**FY 2008**	**FY 2009**	**FY 2010**	**FY 2011**	**FY 2012**	**FY 2013 E**	**FY 2014 E**
Revenue:	**0**	**0**	**0**	**1,489,061**	**3,969,129**	**5,357,344**	**6,428,813**
Cost of sales	0	0	0	1,099,456	3,035,943	4,378,221	4,178,728
Gross Profit	**0**	**0**	**0**	**389,605**	**933,186**	**979,123**	**2,250,084**
General & administrative	0	209,274	70,607	3,157,018	4,838,054	5,766,732	5,853,233
Marketing	0	0	0	172,158	321,868	202,788	205,830
Sales expense	0	0	0	629,580	1,523,001	766,918	774,587
Engineering/R&D expense	0	0	0	1,480,585	2,825,688	458,691	463,278
Total Expenses	**0**	**209,274**	**70,607**	**5,439,341**	**9,508,611**	**7,195,129**	**7,296,927**
Pre-tax profit from operations	**0**	**(209,274)**	**(70,607)**	**(5,049,736)**	**(8,575,425)**	**(6,216,006)**	**(5,046,843)**
Interest income (expense)	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Other Income	**0**	**0**	**0**	**(47,904)**	**(28,951)**	**(157,290)**	**(78,048)**
Income (loss) Continuing Operations	**0**	**(209,274)**	**(70,607)**	**(5,097,640)**	**(8,604,376)**	**(6,373,296)**	**(5,124,891)**
Income (loss) from Discontinued Operations	42,771	(237,495)	2,229	0	0	0	0
Other comprehensive income	6,019	(40,425)	0	0	(8,477)	0	0
Provision for income taxes	0	0	0	0	0	0	0
Net income for the year	**48,790**	**(487,194)**	**(68,378)**	**(5,097,640)**	**(8,612,853)**	**(6,373,296)**	**(5,124,891)**
Net income per common share (diluted)	**0.04**	**(0.19)**	**(0.01)**	**(0.41)**	**(0.43)**	**(0.23)**	**(0.15)**
Net inc. per common share continuing ops.	**0.00**	**(0.08)**	**(0.02)**	**(0.41)**	**(0.43)**	**(0.23)**	**(0.15)**
Weighted average common shares outstanding - diluted	1,155,609	2,529,933	4,652,643	12,447,305	19,845,813	27,638,236	33,165,883
Gross Margin	**N/M**	**N/M**	**N/M**	**26.2%**	**23.5%**	**18.3%**	**35.0%**

XZERES Corporation

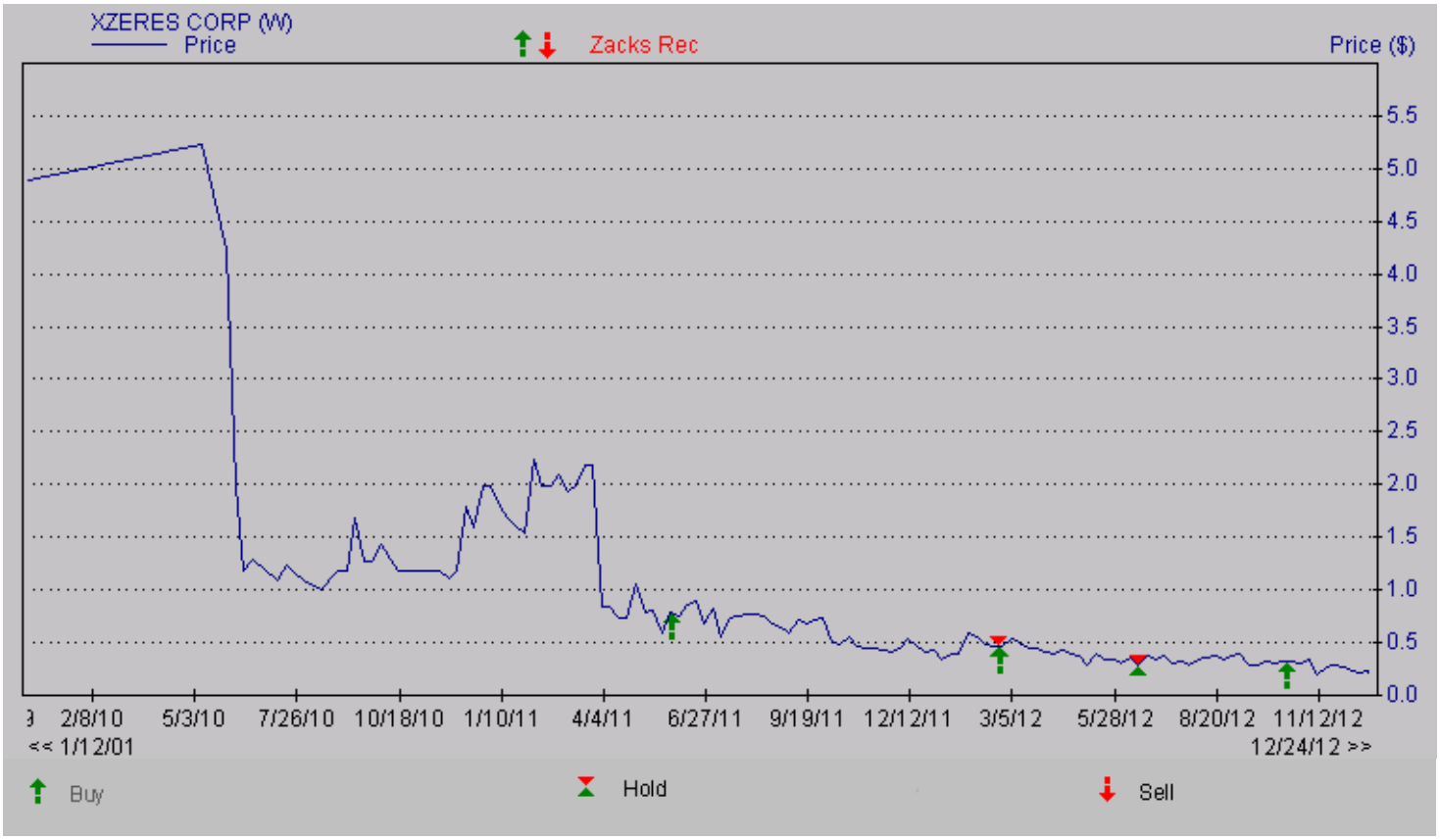
Quarterly Earnings Analysis	1Q 2012 (May 31)	2Q 2012 (Aug 31)	3Q 2012 (Nov 30)	4Q 2012 (Feb 29)	**FY 2012** (Feb 29)	1Q 2013 (May 31)	2Q 2013 (Aug 31)	3Q E 2013 (Nov 30)	4Q E 2013 (Feb 28)	**FY E 2013** (Feb 28)
Revenue:	**1,017,217**	**1,367,901**	**927,451**	**656,560**	**3,969,129**	**649,041**	**1,186,101**	**1,536,101**	**1,986,101**	**5,357,344**
Cost of sales	765,781	1,046,669	676,509	546,984	**3,035,943**	503,817	999,915	1,265,747	1,608,742	**4,378,221**
Gross Profit	**251,436**	**321,232**	**250,942**	**109,576**	**933,186**	**145,224**	**186,186**	**270,354**	**377,359**	**979,123**
General & administrative	1,177,879	1,025,478	1,164,575	1,470,122	**4,838,054**	1,290,720	1,469,846	1,491,894	1,514,272	**5,766,732**
Marketing	92,668	103,224	87,120	38,856	**321,868**	55,545	48,352	49,077	49,813	**202,788**
Sales expense	325,817	370,974	562,266	263,944	**1,523,001**	420,939	95,979	100,000	150,000	**766,918**
Engineering/R&D expense	639,583	571,051	554,556	1,060,498	**2,825,688**	124,310	104,381	110,000	120,000	**458,691**
Total Expenses	**2,235,947**	**2,070,727**	**2,368,517**	**2,833,420**	**9,508,611**	**1,891,514**	**1,718,558**	**1,750,971**	**1,834,086**	**7,195,129**
Pre-tax profit from operations	**(1,984,511)**	**(1,749,495)**	**(2,117,575)**	**(2,723,844)**	**(8,575,425)**	**(1,746,290)**	**(1,532,372)**	**(1,480,617)**	**(1,456,726)**	**(6,216,006)**
Interest income (expense)	0	0	0	0	**0**	0	0	0	0	**0**
Other Income	(14,187)	(13,445)	(12,940)	11,621	**(28,951)**	(39,069)	(78,221)	(20,000)	(20,000)	**(157,290)**
Income (loss) Continuing Operations	**(1,998,698)**	**(1,762,940)**	**(2,130,515)**	**(2,712,223)**	**(8,604,376)**	**(1,785,359)**	**(1,610,593)**	**(1,500,617)**	**(1,476,726)**	**(6,373,296)**
Income (loss) from Discontinued Operations	0	0	0	0	**0**	0	0	0	0	**0**
Other comprehensive income	0	0	0	(8,477)	**(8,477)**	(36,314)	0	0	0	**(36,314)**
Provision for income taxes	0	0	0	0	**0**	0	0	0	0	**0**
Net income	**(1,998,698)**	**(1,762,940)**	**(2,130,515)**	**(2,720,700)**	**(8,612,853)**	**(1,821,673)**	**(1,610,593)**	**(1,500,617)**	**(1,476,726)**	**(6,409,610)**
Net income per common share (diluted)	**(0.11)**	**(0.09)**	**(0.11)**	**(0.12)**	**(0.43)**	**(0.07)**	**(0.06)**	**(0.05)**	**(0.05)**	**(0.23)**
Weighted average common shares outstanding - diluted	18,031,530	19,302,825	19,502,825	22,546,070	**19,845,813**	26,221,781	26,610,387	28,610,387	29,110,387	**27,638,236**
Gross Margin	24.7%	23.5%	27.1%	16.7%	**23.5%**	22.4%	15.7%	17.6%	19.0%	**18.3%**

XZERES Corporation

Consolidated Balance Sheets (in $ US)

For the years ending February 28	2008	2009	2010	2011	2012	1Q 2013	2Q 2013
ASSETS							
Cash and cash equivalents	0	1,978	195,990	364,068	236,682	3,561	104,645
Accounts receivable (net)	-	-	-	633,669	1,036,778	629,059	468,858
Subscription receivable	-	-	-	-	80,000	0	0
Notes receivable - current portion	-	-	-	-	45,552	120,281	66,330
Inventories	-	-	-	502,548	828,188	781,533	838,169
Inventory deposit	-	-	-	40,066	70,092	70,092	70,092
Deferred financing costs (net)	-	-	-	-	-	-	71,041
Prepaid expenses	-	-	-	110,281	334,361	580,844	499,127
Current Assets	**0**	**1,978**	**195,990**	**1,650,632**	**2,631,653**	**2,185,370**	**2,118,262**
Property, plant & equipment (net)	-	-	-	375,115	347,007	332,797	324,346
Notes receivable - net of current portion	-	-	-	0	43,309	115,565	115,565
Intellectual property	-	-	-	1,320,226	1,802,210	1,802,210	1,802,210
Website development costs (net)	-	-	-	18,234	11,176	9,411	7,647
Deposits	-	-	-	18,198	18,198	18,198	18,198
Net assets of discontinued operations	2,847,226	0	0	0	0	0	0
Total Assets	**2,847,226**	**1,978**	**195,990**	**3,382,405**	**4,853,553**	**4,463,551**	**4,386,228**
LIABILITIES							
Accounts payable	-	-	-	600,451	2,177,351	2,133,213	1,881,023
Due to factor - related party	-	-	-	-	303,806	309,876	322,012
Accrued expenses	-	161,093	337,578	107,277	113,551	155,302	428,446
Accrued interest	-	-	-	-	-	-	27,644
Customer deposits	-	-	-	48,228	520,458	901,540	729,562
Warranty reserve	-	-	-	16,601	87,018	80,160	100,136
VAT & sales tax payable	-	-	-	-	32,822	59,651	527
Notes payable to related party	-	5,140	0	97,500	0	0	0
Notes payable	-	-	90,740	100,000	0	488,778	2,010,026
Convertible notes payable	-	-	-	-	-	-	100,000
Net liabilities of discontinued operations	35,674	0	0	0	0	0	0
Current Liabilities	**35,674**	**166,233**	**428,318**	**970,057**	**3,235,006**	**4,128,520**	**5,599,376**
Preferred stock	0	0	0	0	0	0	0
Common stock	-	4,652	4,683	15,383	25,501	26,610	26,611
Stock warrants	-	-	-	1,565,054	3,791,031	3,800,275	3,876,235
Additional paid in capital	1,455,314	40,367	40,641	6,207,203	11,790,160	12,317,964	12,315,187
Retained earnings (deficit)	1,315,813	(209,274)	(277,652)	(5,375,292)	(13,979,668)	(15,765,027)	(17,375,620)
Accumulated other comprehensive income	40,425	0	0	0	(8,477)	(44,791)	(55,561)
SHAREHOLDERS' EQUITY	**2,811,552**	**(164,255)**	**(232,328)**	**2,412,348**	**1,618,547**	**335,031**	**(1,213,148)**
Total Liabilities and Equity	**2,847,226**	**1,978**	**195,990**	**3,382,405**	**4,853,553**	**4,463,551**	**4,386,228**
Common shares outstanding	1,155,609	4,651,978	4,682,602	15,382,816	25,500,414	26,610,387	26,610,387

HISTORICAL ZACKS RECOMMENDATIONS



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