

AMERICAN POWER GROUP Corp
Form 10-Q/A
June 29, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q/A

(Mark One)

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

For the quarterly period ended December 31, 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)

(Former name, former address and former fiscal year, if changed since last report)

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 (section 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

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
 Non-accelerated Filer (do not check if a smaller reporting company)

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

As of February 13, 2015 there were 51,133,556 shares of the registrant's Common Stock outstanding.

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EXPLANATORY NOTE

We are filing this Amendment No. 1 on Form 10-Q/A to amend and restate in their entirety the following items of our Quarterly Report on Form 10-Q for the quarter ended December 31, 2014 as originally filed with the Securities and Exchange Commission on February 17, 2015 (the "Original Form 10-Q"): (i) Item 1 of Part I "Financial Information," (ii) Item 2 of Part I, "Management's Discussion and Analysis of Financial Condition and Results of Operations," (iii) Item 4 of Part I, "Controls and Procedures," and (iv) Item 6 of Part II, "Exhibits", and we have also updated the signature page, the certifications of our Chief Executive Officer and Chief Financial Officer in Exhibits 31.1, 31.2, 32.1 and 32.2, and our financial statements formatted in Extensible Business Reporting Language (XBRL) in Exhibits 101. No other sections were affected, but for the convenience of the reader, this report on Form 10-Q/A restates in its entirety, as amended, our Original Form 10-Q. This report on Form 10-Q/A is presented as of the filing date of the Original Form 10-Q and does not reflect events occurring after that date, or modify or update disclosures in any way other than as required to reflect the explanation and restatement described below. Concurrently with the filing of this Form 10-Q/A, we are also filing Amendment No. 1 on Form 10-K/A to our Annual Report on Form 10-K for the year ended September 30, 2014, as originally filed with the SEC on December 22, 2014 (the "Original Form 10-K"), to provide similar updates.

In conjunction with the private placement of our 10% Convertible Preferred Stock in April 2012 and November 2014 we issued warrants which contained anti-dilution adjustment provisions that protect the holders from the dilutive effects of subsequent issuances of our Common Stock at prices below the warrants' exercise prices. These provisions, however unlikely to be triggered, could result in downward adjustments of the exercise prices of the warrants and, therefore, increases in the number of shares of our Common Stock issuable upon their exercise. In October 2012, the Financial Accounting Standards Board issued ASU 2012-04, Technical Corrections and Improvements ("ASU 2012-04"), which contained technical corrections to guidance on which we had previously relied in forming our initial conclusions regarding the accounting for warrants containing these anti-dilution protections. Based upon our extensive review of ASU 2012-04, we have now concluded that these warrants did not meet the criteria for classification as equity, as previously recorded, and must be recorded as a liability, with the value of the warrants recorded at fair value on the transition/effective date, and subsequent changes in fair value recorded in earnings on a quarterly basis. Based on transition guidance provided, we determined our effective/transition date for implementation of ASU 2012-04 to be October 1, 2013.

As a result of the foregoing, we have determined that our previously reported results for the three months ended December 31, 2014 should no longer be relied upon and need to be updated to reflect the retroactive correction of this accounting error and correctly reflect the accounting for the value of the warrants containing anti-dilution protections pursuant to the guidance provided by ASU 2012-04. The condensed consolidated balance sheets, the condensed consolidated statements of operations, the condensed consolidated statement of changes in stockholders (deficit) equity and the condensed consolidated statements of cash flows for the three months ended December 31, 2014 included in this Form 10-Q/A, have been restated to include the effects of the correction of this accounting error. In addition, we have made necessary conforming changes in "Management's Discussion and Analysis of Financial Condition and Results of Operations" resulting from the correction of this error. Our condensed consolidated financial statements (including audit reports), other financial information and related disclosures included in the Original Form 10-K and the Original Form 10-Q, as well as press releases, investor presentations or other communications issued prior to the date hereof that relate to the periods covered by the Original Form 10-K and Original Form 10-Q should not be relied upon and are superseded in their entirety by this Form 10-Q/A and the Form 10-K/A being filed concurrently herewith.

American Power Group Corporation

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American Power Group Corporation
Condensed Consolidated Balance Sheets

	December 31, 2014 (Unaudited)	September 30, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	\$2,227,228	\$126,420
Certificates of deposit, restricted	300,000	300,000
Accounts receivable, trade, less allowance for doubtful accounts of \$3,276 and \$0 as of December 31, 2014 and September 30, 2014, respectively	643,728	1,713,639
Inventory	797,361	794,211
Prepaid expenses	160,144	145,604
Other current assets	58,058	30,971
Total current assets	4,186,519	3,110,845
Property, plant and equipment, net	760,008	831,782
Other assets:		
Seller's note, related party	797,387	797,387
Long term contracts, net	229,167	241,667
Purchased technology, net	229,167	241,667
Software development costs, net	3,140,123	3,118,798
Other	190,055	179,001
Total other assets	4,585,899	4,578,520
	\$9,532,426	\$8,521,147
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable	\$974,609	\$1,011,644
Accrued expenses	783,436	904,298
Notes payable to Bank, current	332,723	246,550
Notes payable, related parties	50,000	198,500
Obligations due under lease settlement, current	68,518	68,518
Total current liabilities	2,209,286	2,429,510
Notes payable, line of credit, non-current	380,000	—
Notes payable to Bank, non-current	2,459,301	2,364,431
Notes payable, related parties, non-current	—	200,000
Warrant liability	2,704,626	6,497,001
Obligations due under lease settlement, non-current	505,540	505,540
Total liabilities	8,258,753	11,996,482
Stockholders' equity (deficit):		
Preferred stock, \$1.00 par value, 998,654 shares authorized, 0 shares issued and outstanding	—	—
10% Convertible Preferred stock, \$1.00 par value, 1,146 shares authorized, 941 shares and 941 shares issued and outstanding at December 31, 2014 and September 30, 2014	941	941
Series B 10% Convertible Preferred stock, \$1.00 par value, 200 shares authorized, 200 shares and 0 shares issued and outstanding at December 31, 2014 and September 30, 2014	200	—
	511,337	507,351

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Common stock, \$.01 par value, 150 million shares authorized, 51,133,556 shares
and 50,735,050 shares issued and outstanding at December 31, 2014 and September
30, 2014

Additional paid-in capital	60,028,577	58,248,103
Accumulated deficit	(59,267,382)	(62,231,730)
Total stockholders' equity (deficit)	1,273,673	(3,475,335)
	\$9,532,426	\$8,521,147

See accompanying notes to unaudited condensed interim consolidated financial statements.

American Power Group Corporation
Condensed Consolidated Statements of Operations
(Unaudited)

	Three Months Ended December 31,	
	2014	2013
Net sales	\$1,055,966	\$1,842,521
Cost of sales	786,911	940,909
Gross profit	269,055	901,612
Operating expenses:		
Selling, general and administrative	1,035,105	991,617
Operating loss from continuing operations	(766,050)	(90,005)
Non operating income (expense)		
Interest and financing costs	(64,805)	(46,107)
Interest income	11,130	11,285
Revaluation of warrants	4,487,006	(324,021)
Other, net	(42,978)	(38,747)
Non operating income (expense), net	4,390,353	(397,590)
Net income (loss)	3,624,303	(487,595)
10% Convertible Preferred dividends	(265,324)	(245,039)
Series B, 10% Convertible Preferred stock beneficial conversion feature	(394,631)	—
Net income (loss) available to Common stockholders	\$2,964,348	\$(732,634)
Income (loss) from continuing operations per share – basic and diluted	\$0.07	\$(0.01)
Net loss per Common share - 10% Preferred dividend	(0.01)	(0.01)
Net loss per Common Share - Series B, 10% Convertible Preferred Stock beneficial conversion feature	(0.01)	—
Net income (loss) attributable to Common stockholders per share – basic and diluted	\$0.05	\$(0.02)
Weighted average shares outstanding:		
Basic	50,746,825	48,394,610
Diluted	51,329,409	48,394,610

See accompanying notes to unaudited condensed interim consolidated financial statements.

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American Power Group Corporation
Condensed Consolidated Statement of Changes in Stockholders' Equity (Deficit)
For the Three Months Ended December 31, 2014
(Unaudited)

	Preferred Stock		Series B Preferred Stock		Common Stock		Additional Paid In	Accumulated	Total
	Shares	Amount	Share	Amount	Shares	Amount	Capital	Deficit	
Balance, October 1, 2014	941	\$941	—	—	50,735,050	\$507,351	\$58,248,103	\$(62,231,730)	\$(3,475,335)
Compensation expense associated with stock options	—	—	—	—	—	—	9,161	—	9,161
Common stock issued upon option and warrant exercise	—	—	—	—	10,870	109	(109)	—	—
Sale of Series B, 10% Convertible Preferred stock unit;	—	—	—	—	—	—	—	—	—
Sale of Series B Preferred stock, net of fees	—	—	200	\$200	—	—	1,253,288	—	1,253,488
Series B Preferred stock beneficial conversion feature	—	—	—	—	—	—	394,631	(394,631)	—
Common stock issued for 10% Convertible Preferred stock dividend	—	—	—	—	387,636	3,877	123,503	(127,380)	—
10% Convertible Preferred stock dividend paid in cash	—	—	—	—	—	—	—	(137,944)	(137,944)
Net income for the three months ended December 31, 2014	—	—	—	—	—	—	—	3,624,303	3,624,303
Balance, December 31, 2014	941	\$941	200	\$200	51,133,556	\$511,337	\$60,028,577	\$(59,267,382)	\$1,273,673

See accompanying notes to unaudited condensed interim consolidated financial statements.

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American Power Group Corporation
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Three Months Ended December 31,	
	2014	2013
Cash flows from operating activities:		
Net income (loss)	\$3,624,303	\$(487,595)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Revaluation of warrants	(4,487,006)	) 324,021
Depreciation expense	75,719	81,304
Amortization of deferred financing costs	4,676	8,321
Stock compensation expense	9,161	24,783
Provision for bad debts	3,276	—
Amortization of software costs	129,985	109,488
Amortization of long term contracts	12,500	12,500
Amortization of purchased technology	12,500	12,500
(Increase) decrease in assets:		
Accounts receivable	1,066,635	169,151
Inventory	(3,150)	) (10,223)
Prepaid and other current assets	35,697	8,882
Other assets	(11,054)	) (11,055)
Assets related to discontinued operations	—	66,922
(Decrease) increase in liabilities:		
Accounts payable	(72,765)	) (383,362)
Accrued expenses	(120,862)	) (50,273)
Net cash provided by (used in) operating activities	279,615	(124,636)
Cash flows from investing activities:		
Purchase of property and equipment	(3,363)	) (83,939)
Software development costs	(106,245)	) (102,811)
Net cash used in investing activities	(109,608)	) (186,750)
Cash flows from financing activities:		
Proceeds from line of credit	380,000	—
Proceeds from notes payable	—	115,000
Repayment of notes payable	(50,957)	) (51,454)
Repayment of notes payable, related party	(198,500)) —
Proceeds from sale of Series B, 10% Convertible Preferred stock, net of fees	1,948,119	—
Proceeds from exercise of stock options	—	5,200
Payment of cash dividend on 10% Convertible Preferred stock	(147,861)	) (145,533)
Net cash provided by (used in) financing activities	1,930,801	(76,787)
Net increase (decrease) in cash and cash equivalents	2,100,808	(388,173)
Cash and cash equivalents at beginning of year	126,420	1,684,169
Cash and cash equivalents at end of period	\$2,227,228	\$1,295,996

See accompanying notes to unaudited condensed interim consolidated financial statements.

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American Power Group Corporation
 Condensed Consolidated Statements of Cash Flows
 (Unaudited)

-Continued-

	Three Months Ended December 31,	
	2014	2013
Supplemental disclosure of cash flow information:		
Interest paid	\$36,684	\$41,843
Supplemental disclosure of non-cash investing and financing activities:		
Refinancing of note payable	2,567,000	—
Reclassification of the estimated fair value of warrants exercised during the period to additional paid in capital	—	126,338
Refinancing of related party note payable	150,000	—
Warrants issued	694,631	—
Beneficial conversion feature attributable to issuance of Series B, Preferred Stock	394,631	—
Shares issued for preferred stock dividend	127,380	99,506
Insurance premiums financed with short-term debt	52,000	—
Bank fees financed with long-term note	30,000	—
Software development costs included in accounts payable	45,065	47,743
Dividends included in accounts payable	9,920	—
Property and equipment included in accounts payable	582	19,990

See accompanying notes to unaudited condensed interim consolidated financial statements.

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American Power Group Corporation
Notes to Condensed Interim Consolidated Financial Statements
(Unaudited)

1. Nature of Operations, Risks, and Uncertainties

American Power Group Corporation (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 fees and \$150,000 due one of our officers. Under the terms of the new term loan, we will make 82 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. (See Note 9)

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

On December 8, 2014, we were notified by the Environmental Protection Agency (“EPA”) of our first 28 approvals under the Inside Useful Life (“IUL”) designation which is defined as vehicular engines older than 2 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 approximately 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.

Nature of Operations, Risks, and Uncertainties

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, conditioned well-head gas or approved bio-methane; or
- 100% diesel fuel.

Our proprietary technology seamlessly displaces up to 75% of the normal diesel fuel consumption with various forms of natural gas with average displacement ranges from 40% to 65%. 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 35%;
- 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.

As of December 31, 2014, we had \$2,527,228 in cash, cash equivalents and restricted certificates of deposit and working capital of \$1,977,233. As of December 31, 2014, under the terms of our working capital line we had sufficient collateral to borrow and additional \$120,000 above the then outstanding balance.

Based on our fiscal 2015 operating budget, cash on hand at December 31, 2014 and anticipated availability under our bank working capital line, we believe we will be able to satisfy our cash requirements through at least the first quarter of calendar 2016 without the need to materially modify our operating plan. We continue to evaluate multiple financing alternatives should we determine the need to supplement existing cash flows from operations in order to fund operations or accelerate certain revenue related initiatives. We understand 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 we are unable to achieve and sustain profitability and we are unable to obtain additional financing to supplement our cash position, our ability to maintain our current level of operations could be materially and adversely

affected. There is no guarantee we will be able to obtain additional financing or achieve profitability.

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2. Basis of Presentation

The consolidated financial statements include the accounts of American Power Group Corporation and our wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

The accompanying interim financial statements at December 31, 2014 are unaudited and should be read in conjunction with the financial statements and notes thereto for the fiscal year ended September 30, 2014 included in our Annual Report on Form 10-K. The balance sheet at September 30, 2014 has been derived from the audited financial statements as of that date; certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the Securities and Exchange Commission rules and regulations, although we believe the disclosures which have been made herein are adequate to ensure that the information presented is not misleading. The results of operations for the interim periods reported are not necessarily indicative of those that may be reported for a full year. In our opinion, all adjustments which are necessary for a fair statement of our financial position as of December 31, 2014 and the operating results for the interim periods ended December 31, 2014 and 2013 have been included.

3. Correction of an Accounting Error

The warrants issued in connection with our 10% Convertible Preferred Stock contain anti-dilution protection provisions including certain reset features (down-round protection) which protects the holders from future issuances of our Common Stock at prices below such warrants' then-in-effect respective exercise prices (See Note 11). This provision, however unlikely to occur, could result in modification of the warrants then-in-effect. In October 2012, the Financial Accounting Standards Board (FASB), issued ASU 2012-04 Technical Corrections and Improvement ("ASU 2012-04") which contained technical corrections to guidance on which we had previously relied upon in forming our initial conclusions regarding the accounting for warrants containing these reset provisions relating to the April 2012 and November 2014 private placements of our 10% Convertible Preferred Stock. Based upon our extensive review of ASU 2012-04, we have concluded these warrants no longer meet the criteria for classification as equity as previously recorded and must be recorded as a liability with the value of the warrants recorded at fair value on the transition/effective date, with subsequent changes in fair value recorded in earnings on a quarterly basis. Based on transition guidance provided, we determined our effective/transition date for implementation of ASU 2012-04 to be October 1, 2013 and the consolidated condensed financial statements contained herein reflect the retroactive impact of this correction of this accounting error as of this date. The restated historical information is as follows:

Condensed Consolidated Statements of Operations

	Three Months Ended December 31, 2014		
	Originally Reported	Adjustments	Adjusted
Non operating income (expense):			
Revaluation of warrants	\$—	\$4,487,006	\$4,487,006
Non operating income (expense), net	(96,653	) 4,487,006	4,390,353
Net income (loss)	(862,703	) 4,487,006	3,624,303
Series B, 10% Convertible Preferred stock beneficial conversion feature	(255,193	) (139,438	) \$(394,631
Net income (loss) available to Common Stockholders	\$(1,383,220	) \$4,347,568	\$2,964,348
Income (loss) income from continuing operations per share - basic and diluted	\$(0.02	) \$0.09	\$0.07
Net income (loss) attributable to Common stockholders per share - basic and diluted	\$(0.02	) \$0.07	\$0.05

Condensed Consolidated Balance Sheets

	As of December 31, 2014		
	Originally Reported	Adjustments	Adjusted
Liabilities:			
Warrant liability	\$—	\$2,704,626	\$2,704,626
Total liabilities	5,554,127	2,704,626	8,258,753
Stockholders' equity (deficit):			
Additional paid-in capital	69,410,819	(9,382,242)	60,028,577
Accumulated deficit	(65,944,998)	6,677,616	(59,267,382)
Total stockholders' equity (deficit)	3,978,299	(2,704,626)	1,273,673
	\$9,532,426	\$—	\$9,532,426

Condensed Consolidated Statement of Stockholders' Equity (Deficit)

	Preferred Stock		Series B Preferred Stock		Common Stock		Additional Paid In Capital	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount	Shares	Amount			
Originally Reported:									
Balance, December 31, 2014	941	\$941	200	\$200	51,133,556	\$511,337	\$69,410,819	\$(65,944,998)	\$3,978,299
Adjustments Adjusted:									
Balance, December 31, 2014	941	\$941	200	\$200	51,133,556	\$511,337	\$60,028,577	\$(59,267,382)	\$1,273,673

Condensed Consolidated Statements of Cash Flows

	Three Months Ended December 31, 2014		
	Originally Reported	Adjustments	Adjusted
Cash flows from operating activities:			
Net income (loss)	\$(862,703)	\$4,487,006	\$3,624,303
Revaluation of warrants	—	(4,487,006)	(4,487,006)
Net cash provided by operating activities	279,615	—	279,615

4. Certificates of Deposit

All certificate of deposit investments have an original maturity of more than three months but less than three years and are stated at original purchase price which approximates fair value. As of December 31, 2014 and September 30, 2014, we have pledged a \$300,000 certificate of deposit as collateral for outstanding loans with Iowa State Bank.

5. Receivables

Accounts Receivable

Accounts receivable are carried at original invoice amount less an estimate made for doubtful accounts. Management determines the allowance for doubtful accounts by regularly evaluating past due individual customer receivables and considering a customer's financial condition, credit history, and the current economic conditions. Individual accounts

receivable are written off when deemed uncollectible, with any future recoveries recorded as income when received.

Seller's Note Receivable, Related Party

In conjunction with the July 2009 acquisition of substantially all the American Power Group operating assets, including the name American Power Group (excluding its dual fuel patent), we acquired a promissory note from the previous owners of American Power Group (renamed M&R Development, Inc.), payable to us, in the principal amount of \$797,387. The note bears interest at the rate of 5.5% per annum and was based on the difference between the assets acquired and the consideration given.

In conjunction with our 10% Convertible Preferred Stock financing in April 2012, we amended the note to increase the amount of royalties payable under a technology license (see Note 6) that can be applied to the outstanding principal and interest payments to 50% and to defer all interest and principal payments due under the note during calendar 2012 and 2013. Thereafter, the aggregate principal amount due under the note was to be paid in eight equal quarterly payments plus interest. In addition, M&R will not be required to make any payments under the note until such time as we begin to make royalty payments and at that time, those payments will be limited to a maximum of 50% of any royalty payment due M&R on a quarterly basis. No payments have been made under the amended note as of December 31, 2014. We have classified 100% of the balance as long term. We consider this a related party note as one of the former owners of American Power Group is now an employee of ours.

6. Inventory

Raw material inventory primarily consists of dual fuel conversion components. Work in progress includes materials, labor and direct overhead associated with incomplete dual fuel conversion projects. As of December 31, 2014 and September 30, 2014, we recorded an inventory valuation allowance of \$69,761 and \$71,629.

All inventory is valued at the lower of cost or market on the first-in first-out (FIFO) method. Inventory consists of the following:

	December 31, 2014	September 30, 2014
Raw materials	\$673,691	\$694,479
Work in progress	68,597	30,913
Finished goods	55,073	68,819
Total inventory	\$797,361	\$794,211

7. Intangible Assets

We review intangibles for impairment annually, or more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of our intangible assets below their carrying value.

In conjunction with the American Power Group acquisition and license agreement, we recorded intangible assets of \$500,000 associated with the execution of a long term technology license agreement and \$500,000 associated with the purchase of the dual fuel conversion technology. Both values are being amortized on a straight line basis over an estimated useful life of 120 months. Amortization expenses associated with the long term technology license agreement and the purchased dual fuel conversion technology amounted to \$25,000 and \$25,000 for the three months ended December 31, 2014 and 2013, respectively. Accumulated amortization was \$541,667 at December 31, 2014 and \$516,666 at September 30, 2014.

In conjunction with the 10% Convertible Preferred Stock financing in April 2012, we amended the M&R technology license agreement to modify the calculation and the timing of the royalty payments. Under this amendment, effective April 27, 2012, the monthly royalty due is the lesser of 10% of net sales or 30% of pre-royalty EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization). No royalties will be earned or due until such time as our cumulative EBITDA commencing April 1, 2012 is positive on a cumulative basis. During the three months ended December 31, 2014 and 2013, we incurred \$0 royalties to M&R.

A critical component of our dual fuel aftermarket conversion solution is the internally developed software component of our electronic control unit. The software allows us to seamlessly and constantly monitor and control the various gaseous fuels to maximize performance and emission reduction while remaining within all original OEM diesel engine performance parameters. We have developed a base software application and EPA testing protocol for both our Outside Useful Life ("OUL") and Intermediate Useful Life ("IUL") engine applications, which will be customized for

each engine family approved in order to maximize the performance of the respective engine family. As of December 31, 2014, we have capitalized \$4,039,339 of software development costs associated with our OUL (\$1,801,506) and IUL (\$2,237,833) applications, which will be amortized on a straight line basis over an estimated useful life of 60 months for OUL applications and 84 months for IUL applications. Amortization costs for the three months ended December 31, 2014 and 2013 were \$129,985 and \$109,488, respectively.

Amortization expense associated with intangibles during the next five years is anticipated to be:

Twelve months ending December 31:	Contracts	Technology	Software Development	Total
2015	\$50,000	\$50,000	\$670,443	\$770,443
2016	50,000	50,000	679,992	779,992
2017	50,000	50,000	629,515	729,515
2018	50,000	50,000	416,507	516,507
2019	29,167	29,167	282,628	340,962
2020 and thereafter	—	—	461,038	461,038
	\$229,167	\$229,167	\$3,140,123	\$3,598,457

8. Property, Plant and Equipment

Property, plant and equipment consist of the following:

	December 31, 2014	September 30, 2014	Estimated Useful Lives
Leasehold improvements	\$127,087	\$127,087	5 years
Machinery and equipment	1,657,071	1,653,127	3 - 7 years
Less accumulated depreciation	(1,024,150	) (948,432)
	\$760,008	\$831,782	

9. Product Warranty Costs

We provide for the estimated cost of product warranties for our dual fuel products at the time product revenue is recognized. Factors that affect our warranty reserves include the number of units sold, historical and anticipated rates of warranty repairs, and the cost per repair. We assess the adequacy of the warranty provision and we may adjust this provision if necessary. Our warranty reserve decreased during the three months ended December 31, 2014, as a result of an increase in claims primarily related to our efforts in Canada to expand the number of stationary engine families we can convert, in response to market demand. Warranty accrual is included in accrued expenses.

The following table provides the detail of the change in our product warranty accrual relating to dual fuel products as of:

	Three Months Ended December 31, 2014	Year Ended September 30, 2014
Warranty accrual at the beginning of the period	\$221,562	\$118,591
Charged to costs and expenses relating to new sales	15,648	212,033
Costs of product warranty claims	(51,112	) (109,062
Warranty accrual at the end of period	\$186,098	\$221,562

10. Notes Payable/Credit Facilities

The following summarizes our notes payable as of December 31, 2014 and September 30, 2014.

	December 31, 2014	September 30, 2014	Due Date	Interest Rate
Iowa State Bank, line of credit	\$380,000	\$2,500,000	January 15, 2016	8%
Iowa State Bank, notes payable	2,746,752	70,050	October 15, 2021	8%
Other unsecured term notes payable	45,272	40,931	February 27, 2015 and July 01, 2015	5.9% - 6.65%