

AMERICAN POWER GROUP Corp  
Form 10-Q  
February 13, 2014

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

(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, 2013

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

01940  
(Zip Code)

(Registrant's telephone number, including area 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

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 (do not check if a smaller reporting company)

Smaller reporting company

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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, 2014 there were 48,619,342 shares of the registrant's Common Stock outstanding.

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American Power Group Corporation

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American Power Group Corporation  
Condensed Consolidated Balance Sheets

|   | December 31,<br>2013<br>(Unaudited) | September 30,<br>2013 |
|---|-------------------------------------|-----------------------|
| <b>ASSETS</b>   |                                     |                       |
| Current assets:   |                                     |                       |
| Cash and cash equivalents   | \$ 1,295,996                        | \$ 1,684,169          |
| Certificates of deposit, restricted   | 300,000                             | 300,000               |
| Accounts receivable, trade, less allowance for doubtful accounts of \$59,750 and \$120,393 as of December 31, 2013 and September 30, 2013, respectively           | 1,443,129                           | 1,612,280             |
| Inventory   | 918,282                             | 908,059               |
| Prepaid expenses  | 139,972                             | 150,816               |
| Other current assets  | 52,113                              | 48,472                |
| Assets related to discontinued operations   | —                                   | 66,922                |
| Total current assets  | 4,149,492                           | 4,770,718             |
| Property, plant and equipment, net  | 952,446                             | 929,821               |
| Other assets:   |                                     |                       |
| Seller's note, related party, non-current   | 797,387                             | 797,387               |
| Long term contracts, net  | 279,167                             | 291,667               |
| Purchased technology, net   | 279,167                             | 291,667               |
| Software development costs, net   | 3,221,870                           | 3,180,804             |
| Other   | 145,524                             | 134,469               |
| Total other assets  | 4,723,115                           | 4,695,994             |
|   | <b>\$9,825,053</b>                  | <b>\$ 10,396,533</b>  |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                                     |                       |
| Current liabilities:  |                                     |                       |
| Accounts payable  | \$ 770,718                          | \$ 1,086,347          |
| Accrued expenses  | 873,750                             | 914,023               |
| Billings in excess of cost  | 7,533                               | 7,533                 |
| Notes payable, current  | 65,700                              | 106,972               |
| Notes payable, related parties, current   | 473,500                             | 473,500               |
| Obligations due under lease settlement, current   | 68,518                              | 68,518                |
| Total current liabilities   | 2,259,719                           | 2,656,893             |
| Notes payable, non-current  | 1,594,978                           | 1,490,160             |
| Obligations due under lease settlement, non-current   | 505,540                             | 505,540               |
| Total liabilities   | 4,360,237                           | 4,652,593             |
| Stockholders' equity:   |                                     |                       |
| Preferred stock, \$1.00 par value, 998,854 shares authorized, 0 shares issued and outstanding   | —                                   | —                     |
| 10% Convertible Preferred stock, \$1.00 par value, 1,146 shares authorized, 942 shares issued and outstanding at December 31, 2013 and September 30, 2013         | 942                                 | 942                   |
| Common stock, \$.01 par value, 150 million shares authorized, 48,619,342 shares and 48,375,316 issued and outstanding at December 31, 2013 and September 30, 2013 | 486,193                             | 483,753               |
| Additional paid-in capital  | 66,697,958                          | 66,570,909            |
| Accumulated deficit   | (61,720,277)                        | (61,311,664)          |

|                            |             |              |
|----------------------------|-------------|--------------|
| Total stockholders' equity | 5,464,816   | 5,743,940    |
|                            | \$9,825,053 | \$10,396,533 |

See accompanying notes to unaudited condensed interim consolidated financial statements.

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

|  | Three Months Ended December 31, |              |
|--|---------------------------------|--------------|
|  | 2013                            | 2012         |
| Net sales  | \$1,842,521                     | \$874,953    |
| Cost of sales  | 940,909                         | 574,404      |
| Gross profit   | 901,612                         | 300,549      |
| Operating expenses:  |                                 |              |
| Selling, general and administrative  | 991,617                         | 882,882      |
| Operating loss from continuing operations                                  | (90,005                         | ) (582,333   |
| Non operating income (expense)   |                                 |              |
| Interest and financing costs   | (46,107                         | ) (40,591    |
| Interest income  | 11,285                          | 12,061       |
| Other, net   | (38,747                         | ) (28,923    |
| Non operating expense, net   | (73,569                         | ) (57,453    |
| Net loss   | (163,574                        | ) (639,786   |
| 10% Convertible Preferred dividends  | (245,039                        | ) (212,704   |
| Net loss available to Common stockholders                                  | \$(408,613                      | ) \$(852,490 |
| Loss from continuing operations per share – basic and diluted              | \$(0.00                         | ) \$(0.01    |
| Net loss per Common share - 10% Preferred dividend                         | (0.01                           | ) (0.01      |
| Net loss attributable to Common stockholders per share – basic and diluted | \$(0.01                         | ) \$(0.02    |
| Weighted average shares outstanding - basic and diluted                    | 48,394,610                      | 45,609,928   |

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  
For the Three Months Ended December 31, 2013  
(Unaudited)

|  | Preferred Stock |        | Common Stock |           | Additional         | Accumulated    | Total       |
|--|-----------------|--------|--------------|-----------|--------------------|----------------|-------------|
|  | Shares          | Amount | Shares       | Amount    | Paid In<br>Capital | Deficit        |             |
| Balance, October 1, 2013   | 942             | \$942  | 48,375,316   | \$483,753 | \$66,570,909       | \$(61,311,664) | \$5,743,940 |
| Compensation expense<br>associated with stock options                  | —               | —      | —            | —         | 24,783             | —              | 24,783      |
| Common stock issued upon<br>warrant exercise                           | —               | —      | 107,041      | 1,070     | 4,130              | —              | 5,200       |
| Common stock issued for<br>10% Convertible Preferred<br>stock dividend | —               | —      | 136,985      | 1,370     | 98,136             | (99,506 )      | —           |
| 10% Convertible Preferred<br>stock dividend paid in cash               | —               | —      | —            | —         | —                  | (145,533 )     | (145,533 )  |
| Net loss for the three months<br>ended December 31, 2013               | —               | —      | —            | —         | —                  | (163,574 )     | (163,574 )  |
| Balance, December 31, 2013   | 942             | \$942  | 48,619,342   | \$486,193 | \$66,697,958       | \$(61,720,277) | \$5,464,816 |

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, |              |
|---|---------------------------------|--------------|
|   | 2013                            | 2012         |
| Cash flows from operating activities:                                       |                                 |              |
| Net loss  | \$(163,574                      | ) \$(639,786 |
| Adjustments to reconcile net loss to net cash used in operating activities: |                                 |              |
| Warrants issued for services rendered                                       | —                               | 31,957       |
| Depreciation expense  | 81,304                          | 49,505       |
| Amortization of deferred financing costs                                    | 8,321                           | —            |
| Stock compensation expense  | 24,783                          | 38,190       |
| Amortization of software costs  | 109,488                         | 50,538       |
| Amortization of long term contracts   | 12,500                          | 12,499       |
| Amortization of purchased technology  | 12,500                          | 12,499       |
| Decrease (increase) in assets:  |                                 |              |
| Accounts receivable   | 169,151                         | (181,120     |
| Inventory   | (10,223                         | ) (294,348   |
| Costs in excess of billings   | —                               | 29,433       |
| Prepaid and other current assets  | 8,882                           | (20,974      |
| Other assets  | (11,055                         | ) (899       |
| Assets related to discontinued operations                                   | 66,922                          | —            |
| (Decrease) increase in liabilities:   |                                 |              |
| Accounts payable  | (383,362                        | ) 286,566    |
| Accrued expenses  | (50,273                         | ) 34,725     |
| Net cash used in operating activities                                       | (124,636                        | ) (591,215   |
| Cash flows from investing activities:                                       |                                 |              |
| Purchase of property and equipment  | (83,939                         | ) (415,472   |
| Software development costs  | (102,811                        | ) (467,486   |
| Net cash used in investing activities                                       | (186,750                        | ) (882,958   |
| Cash flows from financing activities:                                       |                                 |              |
| Proceeds from notes payable   | 115,000                         | 22,050       |
| Repayment of notes payable  | (51,454                         | ) (40,889    |
| Proceeds from sale of 10% convertible preferred stock, net of fees          | —                               | 49,000       |
| Proceeds from exercise of stock options                                     | 5,200                           | 7,500        |
| Payment of cash dividend on 10% Convertible Preferred stock                 | (145,533                        | ) (52,785    |
| Net cash used in financing activities                                       | (76,787                         | ) (15,124    |
| Net decrease in cash and cash equivalents                                   | (388,173                        | ) (1,489,297 |
| Cash and cash equivalents at beginning of year                              | 1,684,169                       | 4,423,485    |
| Cash and cash equivalents at end of period                                  | \$1,295,996                     | \$2,934,188  |

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, |          |
|--|---------------------------------|----------|
|  | 2013                            | 2012     |
| Supplemental disclosure of cash flow information:                            |                                 |          |
| Interest paid  | \$41,843                        | \$46,246 |
| Taxes paid   | —                               | 6,032    |
| Supplemental disclosure of non-cash financing activities:                    |                                 |          |
| Shares issued for preferred stock dividend                                   | 99,506                          | 159,920  |
| Software development costs included in accounts payable and accrued expenses | 47,743                          | —        |
| Property and equipment included in accounts payable                          | 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

Effective August 1, 2012, GreenMan Technologies, Inc. (the "Company") changed its name to American Power Group Corporation ("APG"). In connection with the corporate name change, the Company's stock trading symbol on the OTCQB has changed from "GMTI" to "APGI". APG (together with its subsidiaries "we", "us" or "our") was originally founded in 1992 and has operated as a Delaware corporation since 1995.

Recent Developments

In December 2013, Iowa State Bank agreed to extend the maturity of our \$2.25 million credit facility from December 31, 2013 to April 1, 2015, increase our borrowing limit to \$2.5 million and expand our collateral base to include certain fixed assets which will provide more working capital availability under the credit facility.

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, well-head gas or approved bio-methane; or

• 100% diesel fuel.

Our proprietary technology seamlessly displaces up to 75% (average displacement ranges from 40% to 65%) of the normal diesel fuel consumption with various forms of natural gas. 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 15% 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 mid- to heavy-duty vehicular diesel engines.

As of December 31, 2013, we had \$1,595,996 cash, cash equivalents and restricted certificates of deposit and working capital of \$1,889,773. Based on our fiscal 2014 operating budget, cash on hand at December 31, 2013 and anticipated availability under our bank working capital line, we believe we will be able to satisfy our cash requirements through at least the end of calendar 2014 without the need to materially modify our operating plan. 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 achieve profitability.

2. Basis of Presentation

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

The accompanying interim financial statements at December 31, 2013 are unaudited and should be read in conjunction with the financial statements and notes thereto for the year ended September 30, 2013 included in our Annual Report on Form 10-K. The balance sheet at September 30, 2013 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, 2013 and the operating results for the interim periods ended December 31, 2013 and 2012 have been included.

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### 3. 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, 2013 and September 30, 2013, we have pledged a \$300,000 certificate of deposit as collateral for outstanding loans with Iowa State Bank.

### 4. 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 the 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 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 then, 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, 2013. 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.

### 5. 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, 2013 and September 30, 2013, we recorded an inventory valuation allowance of \$44,073, respectively.

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,<br>2013 | September 30,<br>2013 |
|------------------|----------------------|-----------------------|
| Raw materials    | \$897,817            | \$895,905             |
| Work in progress | 19,465               | 11,423                |
| Finished goods   | 1,000                | 731                   |
| Total inventory  | \$918,282            | \$908,059             |

### 6. 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, 2013 and 2012, respectively. Accumulated amortization was \$441,667 at December 31, 2013 and \$416,666 at September 30, 2013.

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 the provisions of 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 and 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, 2013 and 2012, 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's 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, 2013, we have capitalized \$3,648,242 of software development costs associated with our OUL (\$1,801,506) and IUL (\$1,846,736) 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, 2013 and 2012 were \$109,488 and \$50,538, respectively.

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

| Twelve months ending December 31: | Contracts | Technology | Software Development | Total       |
|-----------------------------------|-----------|------------|----------------------|-------------|
| 2014                              | \$50,000  | \$50,000   | \$577,579            | \$677,579   |
| 2015                              | 50,000    | 50,000     | 624,121              | 724,121     |
| 2016                              | 50,000    | 50,000     | 624,121              | 724,121     |
| 2017                              | 50,000    | 50,000     | 573,644              | 673,644     |
| 2018                              | 50,000    | 50,000     | 364,962              | 464,962     |
| 2019 and thereafter               | 29,167    | 29,167     | 457,443              | 515,777     |
|                                   | \$279,167 | \$279,167  | \$3,221,870          | \$3,780,204 |

#### 7. Contracts in Progress

Contracts in progress consist of the following:

|  | December 31,<br>2013 | September 30,<br>2013 |
|--|----------------------|-----------------------|
| Costs incurred on uncompleted contracts            | \$14,572             | \$14,572              |
| Estimated earnings on contracts in progress        | 25,387               | 25,387                |
|  | 39,959               | 39,959                |
| Less billings on contracts in progress             | 47,492               | 47,492                |
|  | \$(7,533)            | \$(7,533)             |
| Costs and estimated earnings in excess of billings | \$—                  | \$—                   |
| Billings in excess of costs and estimated earnings | 7,533                | 7,533                 |
|  | \$(7,533)            | \$(7,533)             |

#### 8. Property, Plant and Equipment

Property, plant and equipment consist of the following:

|                               | December 31,<br>2013 | September 30,<br>2012 | Estimated<br>Useful Lives |
|-------------------------------|----------------------|-----------------------|---------------------------|
| Leasehold improvements        | \$127,087            | \$127,087             | 5 years                   |
| Machinery and equipment       | 1,535,800            | 1,431,871             | 3 - 7 years               |
| Less accumulated depreciation | (710,441)            | (629,137)             |                           |
|                               | \$952,446            | \$929,821             |                           |

#### 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. The increase in warranty reserve at December 31, 2013 is attributable to the increase in revenue for the quarter ended December 31, 2013.

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

|   | Quarter Ended<br>December 31, 2013 | Year Ended<br>September 30, 2013 |
|---|------------------------------------|----------------------------------|
| Warranty accrual at the beginning of the period     | \$ 118,591                         | \$ 18,306                        |
| Charged to costs and expenses relating to new sales | 34,467                             | 146,594                          |
| Costs of product warranty claims                    | (2,226                             | ) (46,309                        |
| Warranty accrual at the end of period               | \$ 150,832                         | \$ 118,591                       |

#### 10. Notes Payable/Credit Facilities

##### Credit Facilities

We have a \$2,500,000 credit facility with Iowa State Bank under which we may borrow up to 50% of the value of eligible inventory, 75% of eligible accounts receivable, 100% of our certificate of deposit and 50% of eligible machinery and equipment. This note is due April 1, 2015 and bears interest of 7%. We have collateralized the obligation by: (i) granting to the lender a security interest in our \$300,000 certificate of deposit and certain additional collateral and (ii) pledging to the lender, as additional collateral, 2,000,000 shares of our Common Stock. In addition, two directors and two members of management have each pledged 125,000 shares of our Common Stock owned by them as additional collateral.

As of December 31, 2013, we have \$1,560,110 outstanding under the credit facility and had sufficient collateral to borrow an additional \$545,419 under the terms of our working capital line.

##### Notes Payable, Related Party

In September and October 2010, an officer and former director loaned us a total of \$323,500 in connection with a private placement of 12% six-month promissory notes. In October 2011, an officer loaned us \$150,000 pursuant to the terms of a 10% promissory note due November 27, 2011. In conjunction with the 10% Convertible Preferred Stock financing in April 2012, these officers and former director agreed to extend the maturity of their notes until April 30, 2014 and reduce their interest rate to 8%. These notes have been classified as short term as of December 31, 2013.

#### 11. Stockholders' Equity

##### Common Stock

During the three months ended December 31, 2013, holders exercised warrants to purchase an aggregate of 301,024 shares of Common Stock at an exercise price of \$0.50 utilizing a cashless exercise feature resulting in the net issuance of 99,041 shares of Common Stock. In addition, another holder exercised warrants to purchase 8,000 shares of Common Stock at an exercise price of \$0.65.

##### 10% Convertible Preferred Stock

During the three months ended December 31, 2013, we recorded a dividend on our 10% Convertible Preferred Stock of \$245,039, of which \$145,533 was paid in cash. Certain stockholders agreed to accept 136,985 shares of Common Stock (valued at \$99,506) in lieu of cash dividend payments. During the three months ended December 31, 2012, we recorded a dividend on our 10% Convertible Preferred Stock of \$212,704, of which \$52,785 was paid in cash. Certain stockholders agreed to accept 245,575 shares of Common Stock (valued at \$159,920) in lieu of cash dividend payments.

##### Stock Options

Amortization of stock compensation expense was \$24,783 and \$38,190 for the three months ended December 31, 2013 and 2012, respectively. The unamortized compensation expense at December 31, 2013 was \$113,045 and will be amortized over a weighted average remaining life of approximately 2.38 years.

#### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Quarterly Report on Form 10-Q contains certain statements that are "forward-looking." These forward-looking statements and other information are based on our beliefs as well as assumptions made by us using information

currently available. The words “anticipate,” “believe,” “estimate,” “expect,” “intend,” “will,” “should” and similar expressions they relate to us, are intended to identify forward-looking statements. Such statements reflect our current views with respect to future events, are subject to certain risks, uncertainties and assumptions, and are not guaranties of future performance. Should one or more of these

risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated, expected, intended or using other similar expressions. In accordance with the provisions of the Private Securities Litigation Reform Act of 2005, we are making investors aware that such forward-looking statements, because they relate to future events, are by their very nature subject to many important factors that could cause actual results to differ materially from those contemplated by the forward-looking statements contained in this Quarterly Report on Form 10-Q. Important factors that could cause actual results to differ from our predictions include those discussed in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2013. Although we have sought to identify the most significant risks to our business, we cannot predict whether, or to what extent, any of such risks may be realized, nor can there be any assurance that we have identified all possible issues which we might face. In addition, assumptions relating to budgeting, marketing, product development and other management decisions are subjective in many respects and thus susceptible to interpretations and periodic revisions based on actual experience and business developments, the impact of which may cause us to alter our marketing, capital expenditure or other budgets, which may in turn affect our financial position and results of operations. For all of these reasons, the reader is cautioned not to place undue reliance on forward-looking statements contained herein, which speak only as of the date hereof. We assume no responsibility to update any forward-looking statements as a result of new information, future events, or otherwise except as required by law.

The following information should be read in conjunction with the unaudited consolidated financial statements and the notes thereto included in Item 1 of this Quarterly Report, and the audited consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K filed for the fiscal year ended September 30, 2013.

#### Results of Operations

Three Months ended December 31, 2013 Compared to the Three Months ended December 31, 2012

Net sales from continuing operations for the three months ended December 31, 2013 increased \$967,568 or 111% to \$1,842,521 as compared to net sales of \$874,953 for the three months ended December 31, 2012. The increase is attributable to stronger domestic stationary revenues especially in the area of oil and gas which increased approximately \$945,000 or almost four-fold. Domestic vehicular revenues for the three months ended December 31, 2013 increased approximately \$45,000 or 10% to a record \$520,000. The increase was attributable to the ability to actively solicit customer orders due to the increased number of EPA approvals received to date.

During the three months ended December 31, 2013, our gross profit was \$901,612 or 49% of net sales as compared to a gross profit of \$300,549 or 34% of net sales for the three months ended December 31, 2012. The increase was attributable to higher oil and gas stationary revenue and relative lower overhead costs.

Selling, general and administrative expenses for the three months ended December 31, 2013 increased \$108,735 or 12% to \$991,617 as compared to \$882,882 for the three months ended December 31, 2012. The increase was primarily attributable to increased sales and marketing costs as well as an increased number of employees.

During the three months ended December 31, 2013, interest and financing expense increased \$5,516 or 14% to \$46,107 as compared to \$40,591 for the three months ended December 31, 2012.

Our net loss for the three months ended December 31, 2013 decreased \$476,212 or 74% to \$163,574 or (\$0.00) per basic share as compared to a net loss of \$639,786 or (\$0.01) per basic share for the three months ended December 31, 2012. The calculation of net loss per share available for Common shareholders for the three months ended December 31, 2013 reflects the inclusion of 10% Convertible Preferred Stock quarterly dividends of \$245,039 and \$212,704 associated with the issuance of the 10% Convertible Preferred as of December 31, 2013 and December 31, 2012, respectively.

#### Liquidity and Capital Resources

As of December 31, 2013, we had \$1,595,996 in cash, cash equivalents and restricted certificates of deposit and working capital of \$1,889,773. As of December 31, 2013, under the terms of our working capital line, we had sufficient collateral to borrow an additional \$545,419 above the then outstanding balance.

Based on our fiscal 2014 operating budget, cash on hand at December 31, 2013 and anticipated availability under our bank working capital line, we believe we will be able to satisfy our cash requirements through at least the end of

calendar 2014 without the need to materially modify our operating plan. 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 achieve profitability.



The Consolidated Statement of Cash Flows reflect events for the three months ended December 31, 2013 and 2012 as they affect our liquidity. During the three months ended December 31, 2013, net cash used in operating activities was \$124,636. Our net loss for the three months ended December 31, 2013 was \$163,574. Our cash flow was positively impacted by the following non-cash expenses and changes to our working capital: \$240,575 of depreciation, amortization and stock options. However, a decrease of \$454,913 related to accounts payable, accrued expenses, inventory and other assets was offset by decreases in accounts receivable, prepaids, other current assets and assets related to discontinued operations.

Our net loss for the three months ended December 31, 2012 was \$639,786, while our cash flow was positively impacted by the following non-cash expenses and changes to our working capital: \$195,188 of depreciation, amortization, stock options we also realized an increase of \$321,291 in accounts payable and accrued expenses offset by an increased investments in inventory and accounts receivables. The result of which was net cash used in operating activities of \$591,215 for the three months ended December 31, 2012.

Net cash used in investing activities was \$186,750 for the three months ended December 31, 2013, reflecting the capitalization of \$102,811 of costs associated with our dual fuel electronic control unit engine family software applications and the purchase of \$83,939 of property, plant and equipment. Net cash used in investing activities was \$882,958 for the three months ended December 31, 2012, reflecting the capitalization of \$467,486 of costs associated with our dual fuel electronic control unit engine family software applications and the purchase of \$415,472 of property, plant and equipment.

Net cash used in financing activities was \$76,787 during the three months ended December 31, 2013, reflecting the proceeds of \$115,000 from the credit facility plus \$5,200 of proceeds from exercised warrants. Payments made on notes payable totaled \$51,454 and we paid our 10% Preferred Stockholders \$145,533 of 10% preferred dividends. Net cash used in financing activities was \$15,124 during the three months ended December 31, 2012, reflecting the payment of cash dividends on the 10% Convertible Preferred Stock and normal debt payments.

#### Effects of Inflation and Changing Prices

Generally, we are exposed to the effects of inflation and changing prices. Given that 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 (for example, if diesel fuel prices decrease and natural gas prices increase). We have generally been unaffected by interest rate changes in the three months ended December 31, 2013 and 2012, because we no longer maintain any floating-rate debt.

#### Environmental Liability

There are no known material environmental violations or assessments.

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

Not required pursuant to Item 305(e) of Regulation S-K.

#### Item 4. Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of December 31, 2013. In designing and evaluating our disclosure controls and procedures, we recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management applies judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on this evaluation, our chief executive officer and chief financial officer concluded that as of December 31, 2013, our disclosure controls and procedures were (1) designed to ensure that material information relating to the company, including our consolidated subsidiaries, is made known to our chief executive officer and chief financial officer by others within those entities, particularly during the period in which this report was being prepared and (2) effective.

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended December 31, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

None

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Item 1A. Risk Factors

There have not been any material changes from the risk factors previously disclosed under Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2013.

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

During the three months ended December 31, 2013, we issued 107,041 shares of our unregistered Common Stock to certain third parties as a result of warrants that were exercised. The issuance of these shares is exempt from registration under the Securities Act pursuant to Section 4(2) of the Securities Act.

During the three months ended June 30, 2012, we issued shares of Common Stock to certain holders of our 10% Convertible Preferred Stock in lieu of payment of cash dividends. The issuance of these shares is exempt from registration under the Securities Act pursuant to Section 4(2) of the Securities Act.

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

The following exhibits are filed with this document:

| Exhibit No. | Description   |
|-------------|---|
| 10.1 (1)    | - Business Loan Agreement, dated December 19, 2013 between American Power Group, Inc. and Iowa State Bank with regard to a \$2,500,000 line of credit |
| 10.2 (1)    | - Promissory Note dated as of December 19, 2013, issued by American Power Group, Inc. in favor of Iowa State Bank                                     |
| 31.1 (2)    | - Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a)   |
| 31.2 (2)    | - Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a)   |
| 32.1 (3)    | - Certification of Chief Executive Officer under 18 U.S.C. Section 1350   |
| 32.2 (3)    | - Certification of Chief Financial Officer under 18 U.S.C. Section 1350   |
| 101.SCH (4) | XBRL Taxonomy Extension Schema Document   |
| 101.CAL (4) | XBRL Taxonomy Extension Calculation Linkbase Document   |
| 101.DEF (4) | XBRL Taxonomy Extension Definition Linkbase Document  |
| 101.LAB (4) | XBRL Taxonomy Extension Label Linkbase Document   |
| 101.PRE (4) | XBRL Taxonomy Extension Presentation Linkbase Document  |

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(1) Filed as an Exhibit to American Power Group Corporation's Annual Report on Form 10-K for the fiscal year ended September

30, 2013, and incorporated herein by reference.

(2) Filed herewith.

(3) In accordance with Item 601(b)(32)(ii) of Regulation S-K, the certifications furnished in Exhibits 32.1 and 32.2 hereto are deemed to accompany this Form 10-Q and will not be deemed to be “filed” for purposes of Section 18 of the Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filings under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

(4) In accordance with Rule 406T of Regulation S-T, the information in these exhibits shall not be deemed to be “filed” or part of a registration statement for purposes of Sections 11 and 12 of the Securities Act, shall not be deemed “filed” for purposes of Section 18 of the Exchange Act and is not otherwise subject to liability under these sections, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act except as expressly set forth by specific reference in such filing.

#### SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

American Power Group Corporation

By: /s/ Lyle Jensen

Lyle Jensen

President & Chief Executive Officer

(Principal Executive Officer)

By: /s/ Charles E. Coppa

Charles E. Coppa

Chief Financial Officer

(Principal Accounting and Financial Officer)

Dated: February 13, 2014