

XZERES Corporation (XPWR-OTCBB)

XPWR: Sequential quarterly revenues decline again. Rating lowered to Neutral.

Current Recommendation	Neutral
Prior Recommendation	Outperform
Date of Last Change	06/15/2012
Current Price (06/15/12)	\$0.30
Six- Month Target Price	\$0.50

OUTLOOK

XZERES is positioned to benefit from the growth of the small wind energy industry. Despite an impressive backlog, the company experienced an interruption in its sequential quarterly revenue growth due to the inability to source components for small wind systems. However, the recently announced purchase order debt financing agreement should provide the company the ability to fill current orders in the company's backlog. Though management expects to generate revenues of at least \$20 million during fiscal 2013, we are lowering our rating to Neutral and our price target to \$0.50 until revenue traction is demonstrated.

SUMMARY DATA

52-Week High	\$0.91
52-Week Low	\$0.30
One-Year Return (%)	-67.03
Beta	-0.09
Average Daily Volume (shrs.)	10,637

Shares Outstanding (million)	25.5
Market Capitalization (\$ mil.)	\$7.65
Short Interest Ratio (days)	N/A
Institutional Ownership (%)	N/A
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
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Risk Level	Above Average
Type of Stock	Small - Growth
Industry	Other Alt. Energy
Zacks Rank in Industry	9 of 14

ZACKS ESTIMATES**Revenue**

(in millions of \$)

	Q1	Q2	Q3	Q4	Year
	(May)	(Aug)	(Nov)	(Feb)	(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	0.75 E	0.79 E	0.90 E	1.20 E	3.62 E
2014					4.34 E

Earnings per Share

(EPS is operating earnings before non recurring items)

	Q1	Q2	Q3	Q4	Year
	(May)	(Aug)	(Nov)	(Feb)	(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	-\$0.08 E	-\$0.08 E	-\$0.07 E	-\$0.07 E	-\$0.30 E
2014					-\$0.23 E

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

KEY POINTS

- XZERES Corporation is an engineered systems company, with a focus on clean and renewable energy. Currently, 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 and now 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 three websites, each targeting a specific market.
- Through innovative marketing initiatives, such as the Buy Direct program, the availability of financing through lending partners and the Micro-Generation Utility model, XZERES is stimulating sales of its small wind systems.
- XZERES reported a disappointing fourth fiscal quarter with sequential revenue growth declining 29.2% due to the company's inability to source components for orders of small wind systems. Though the company's working capital needs were bolstered by the recent private placement announced on February 27th, the company's production capacity is being hampered by limited liquidity and insufficient working capital. A purchase order debt financing agreement signed in May should alleviate some of the financial issues.
- We reduce our rating to Neutral and lower our price target to \$0.50 due to the interruption in the company's sequential quarterly revenue growth rate profile.
- Consult the initiation report dated May 30, 2011 for additional background information.

RECENT NEWS

Results for fourth fiscal quarter and fiscal year of 2012

On June 13, 2012, XZERES reported results for the fourth fiscal quarter and fiscal year ending February 29, 2012. Quarterly revenues sequentially declined 29.2% to \$656,560 from \$927,451 due to the inability to source components for orders of small wind systems caused by insufficient working capital. On a year-over-year basis, revenues increased marginally by 0.8% versus \$651,658 in the comparable year-ago quarter. The gross profit margin sequentially declined 306 basis points to 24.0%. XZERES reported a quarterly loss of \$2.72 million or \$0.12 per diluted share. The stock declined 18.9% to \$0.30 on the news.

Revenues for fiscal 2012 were \$3.97 million, a 167% increase over the \$1.49 million generated in fiscal 2011, in which the company only had three quarters of operation. Wind turbine products accounted for 97% of revenues. The gross profit margin decreased 265 basis points to 23.5%. R&D/Engineering expenses totaled \$2.83 million for the year as the company improves current products and is developing wind turbines with higher power ratings. As revenues increased 167%, operating costs only increased 74.8% to \$9.51 million, demonstrating that some of the expenses associated with the beginning of a small wind turbine business are abating. However, R&D expenditures increased 91.2% due to investments in upgrading the 10kW turbine as well as expanding operations. For the fiscal year, XZERES reported a loss of \$8.61 million or \$0.43 per diluted share.

Financing

On February 27, 2012, XZERES completed a private placement, in which 3,714,050 restricted units were issued at \$0.40 per unit providing gross proceeds of \$1,485,620. Each unit consists of one share of

common stock and one half of a warrant exercisable at \$.80 per share for a period of three years. The proceeds will be utilized to purchase essential components needed to fill current orders.

During the fiscal 2012, the company raised \$6,414,081 through the issuance of common shares through five private placements. However, the company does not have sufficient working capital to be able to satisfy the current order backlog (last reported as over \$3.5 million at the end of the third fiscal quarter of 2012). In addition, the company has insufficient working capital to meet all its current obligations. As a result, payments have been delayed to most vendors, three of which have filed suit against XZERES.

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.

Expectations for fiscal 2013

Management expects to generate revenues of at least \$20 million and achieve profitability during fiscal 2013. 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 now 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.

OVERVIEW

Based in Wilsonville, Oregon¹, XZERES Corporation (XPWR: OTCBB) 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. Originally incorporated as an oil & gas production company in 1984², the company began to focus on renewable energy in late 2008 and was renamed Cascade Wind Corp., Inc. After a developmental period, the company acquired the wind energy assets of Abundant Renewable Energy, LLC on March 25, 2010, and subsequently was renamed XZERES Wind Corp. After the acquisition of Rochester Power Saver, the company was renamed XZERES Corp.

The **Wind Power Division** focuses on the small wind market, which encompasses wind-powered turbines that are capable of producing up to 100 kilowatts³ (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

¹ Though based in Oregon, XZERES Wind Corporation is incorporated in Nevada.

² XZERES Wind was originally incorporated in New Mexico as Intermountain Refining Company.

³ 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 to the formula: $W = V \times A$ (watts = volts x amperes).

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.

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, but with a sales profile that should experience rapid growth through management's ramp up of multiple distribution channels for both the company's small wind systems and power efficiency products, along with potentially further acquisitions. Ultimately, the growing revenue stream should manifest itself into positive earnings. Based on historical norms for similar emerging growth companies, we expect a price-to-sales valuation range between 2.8 and 5.2; however, the sales base of XZERES has declined sequentially for two quarters due to limited working capital. Therefore, we are reverting to a valuation based on a price-to-sales valuation range for a small-capitalization 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 sales base being used is an average of 12-month trailing sales and normalized sales (approximately \$925,000 per quarter). **At a 3.2 price-to-sales ratio, our price target is \$0.50.**

RISKS

- As of February 29, 2012, XZERES had negative working capital of \$603,353, which is impeding the generation of revenues. Operations continue to consume cash, the largest item being General and Administrative expenses, which have risen to a level over \$1.4 million per quarter. The auditor's modified unqualified opinion 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 successfully raise capital and thereby increase revenues. In addition, at the company's request, the auditor, Silberstein Ungar, PLLC, did not perform an audit of the company's internal control over financial reporting.

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	3,617,000	4,340,400
Cost of sales	0	0	0	1,099,456	3,035,943	2,606,910	2,474,028
Gross Profit	0	0	0	389,605	933,186	1,010,090	1,866,372
General & administrative	0	209,274	70,607	3,157,018	4,838,054	6,104,339	6,195,904
Marketing	0	0	0	172,158	321,868	160,546	162,954
Sales expense	0	0	0	629,580	1,523,001	1,454,072	1,468,613
Engineering/R&D expense	0	0	0	1,480,585	2,825,688	2,000,000	2,020,000
Total Expenses	0	209,274	70,607	5,439,341	9,508,611	9,718,957	9,847,471
Pre-tax profit from operations	0	(209,274)	(70,607)	(5,049,736)	(8,575,425)	(8,708,867)	(7,981,099)
Interest income (expense)	0	0	0	0	0	0	0
Other Income	0	0	0	(47,904)	(28,951)	3,700	5,000
Income (loss) Continuing Operations	0	(209,274)	(70,607)	(5,097,640)	(8,604,376)	(8,705,167)	(7,976,099)
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)	(8,705,167)	(7,976,099)
Net income per common share (diluted)	0.04	(0.19)	(0.01)	(0.41)	(0.43)	(0.30)	(0.23)
Net inc. per common share continuing ops.	0.00	(0.08)	(0.02)	(0.41)	(0.43)	(0.30)	(0.23)
Weighted average common shares outstanding - diluted	1,155,609	2,529,933	4,652,643	12,447,305	19,845,813	28,921,070	34,705,284
Gross Margin	N/M	N/M	N/M	26.2%	23.5%	27.9%	43.0%

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 E 2013 (May 31)	2Q E 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	725,000	792,000	900,000	1,200,000	3,617,000
Cost of sales	765,781	1,046,669	676,509	546,984	3,035,943	543,750	578,160	639,000	846,000	2,606,910
Gross Profit	251,436	321,232	250,942	109,576	933,186	181,250	213,840	261,000	354,000	1,010,090
General & administrative	1,177,879	1,025,478	1,164,575	1,470,122	4,838,054	1,492,174	1,514,556	1,537,275	1,560,334	6,104,339
Marketing	92,668	103,224	87,120	38,856	321,868	39,245	39,833	40,431	41,037	160,546
Sales expense	325,817	370,974	562,266	263,944	1,523,001	291,458	318,392	361,809	482,413	1,454,072
Engineering/R&D expense	639,583	571,051	554,556	1,060,498	2,825,688	500,000	500,000	500,000	500,000	2,000,000
Total Expenses	2,235,947	2,070,727	2,368,517	2,833,420	9,508,611	2,322,876	2,372,782	2,439,515	2,583,784	9,718,957
Pre-tax profit from operations	(1,984,511)	(1,749,495)	(2,117,575)	(2,723,844)	(8,575,425)	(2,141,626)	(2,158,942)	(2,178,515)	(2,229,784)	(8,708,867)
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)	0	0	0	0	0
Income (loss) Continuing Operations	(1,998,698)	(1,762,940)	(2,130,515)	(2,712,223)	(8,604,376)	(2,141,626)	(2,158,942)	(2,178,515)	(2,229,784)	(8,708,867)
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)	0	0	0	0	0
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)	(2,141,626)	(2,158,942)	(2,178,515)	(2,229,784)	(8,708,867)
Net income per common share (diluted)	(0.11)	(0.09)	(0.11)	(0.12)	(0.43)	(0.08)	(0.08)	(0.07)	(0.07)	(0.30)
Weighted average common shares outstanding - diluted	18,031,530	19,302,825	19,502,825	22,546,070	19,845,813	25,546,070	28,546,070	30,546,070	31,046,070	28,921,070
Gross Margin	24.7%	23.5%	27.1%	24.0%	23.5%	25.0%	27.0%	29.0%	29.5%	27.9%

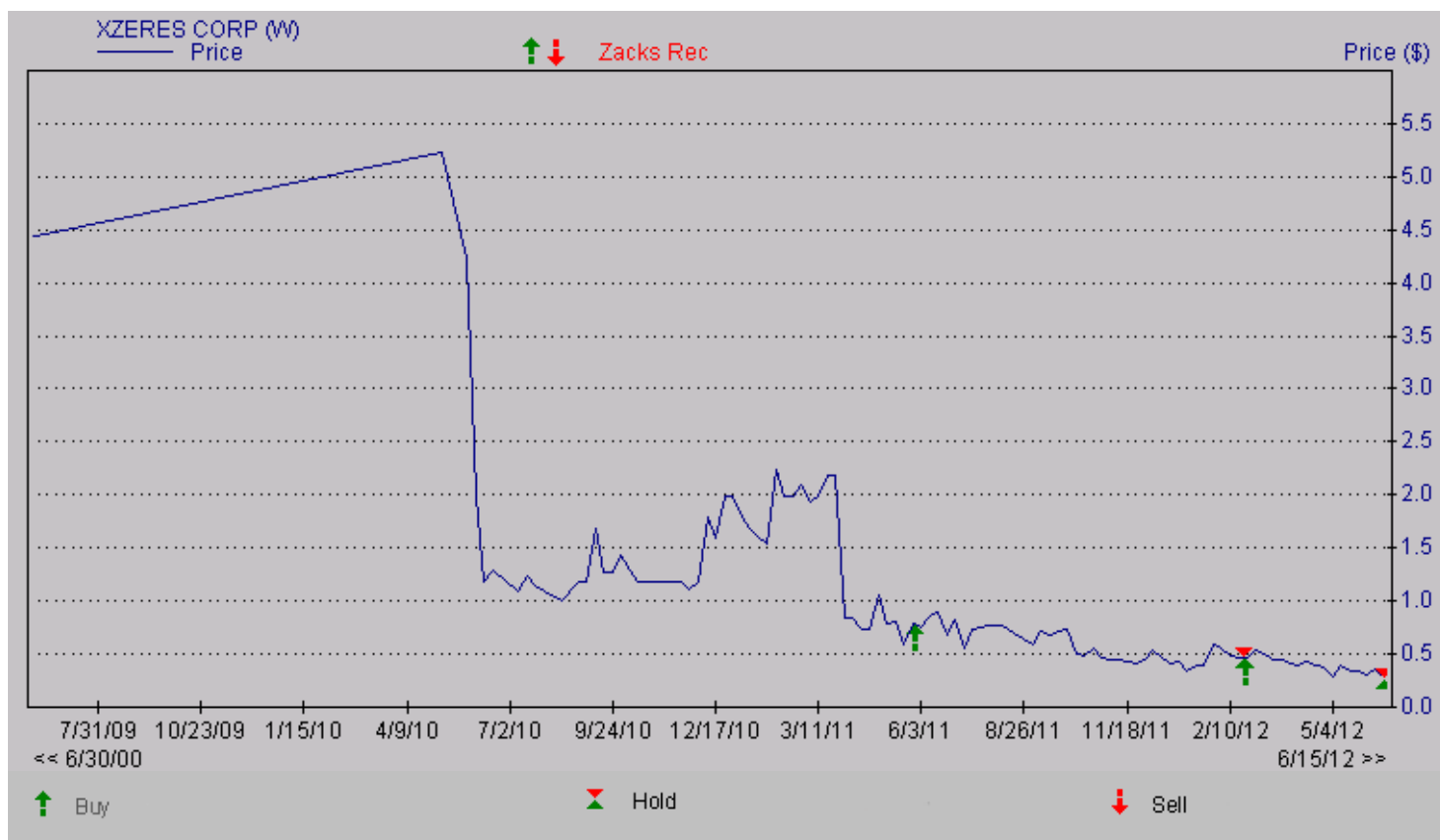
XZERES Corporation

Consolidated Balance Sheets (in \$ US)

For the years ending February 28

	2008	2009	2010	2011	2012
ASSETS					
Cash and cash equivalents	0	1,978	195,990	364,068	236,682
Accounts receivable (net)	-	-	-	633,669	1,036,778
Subscription receivable	-	-	-	-	80,000
Notes receivable - current portion	-	-	-	-	45,552
Inventories	-	-	-	502,548	828,188
Inventory deposit	-	-	-	40,066	70,092
Prepaid expenses	-	-	-	110,281	334,361
Current Assets	0	1,978	195,990	1,650,632	2,631,653
Property, plant & equipment (net)	-	-	-	375,115	347,007
Notes receivable - net of current portion	-	-	-	0	43,309
Intellectual property	-	-	-	1,320,226	1,802,210
Website development costs (net)	-	-	-	18,234	11,176
Deposits	-	-	-	18,198	18,198
Net assets of discontinued operations	2,847,226	0	0	0	0
Total Assets	2,847,226	1,978	195,990	3,382,405	4,853,553
LIABILITIES					
Accounts payable	-	-	-	600,451	2,177,351
Due to factor - related party	-	-	-	-	303,806
Accrued expenses	-	161,093	337,578	107,277	113,551
Customer deposits	-	-	-	48,228	520,458
Warranty reserve	-	-	-	16,601	87,018
VAT & sales tax payable	-	-	-	-	32,822
Notes payable to related party	-	5,140	0	97,500	0
Notes payable	-	-	90,740	100,000	0
Net liabilities of discontinued operations	35,674	0	0	0	0
Current Liabilities	35,674	166,233	428,318	970,057	3,235,006
Preferred stock	0	0	0	0	0
Common stock	-	4,652	4,683	15,383	25,501
Stock warrants	-	-	-	1,565,054	3,791,031
Additional paid in capital	1,455,314	40,367	40,641	6,207,203	11,790,160
Retained earnings (deficit)	1,315,813	(209,274)	(277,652)	(5,375,292)	(13,979,668)
Accumulated other comprehensive income	40,425	0	0	0	(8,477)
SHAREHOLDERS' EQUITY	2,811,552	(164,255)	(232,328)	2,412,348	1,618,547
Total Liabilities and Equity	2,847,226	1,978	195,990	3,382,405	4,853,553
Common shares outstanding	1,155,609	4,651,978	4,682,602	15,382,816	25,500,414

HISTORICAL ZACKS RECOMMENDATIONS



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