



Quarterly update: 2009 results

Current price: \$10.70

Rating: Outperform

April 1, 2010

Estimate changes: (new/old)

	<u>Revenue</u>	<u>EPS</u>
2009	\$311.3/\$307.4	(\$0.48)/\$0.54
2010	\$391.5/\$544	\$1.23/\$1.25

Executive Summary:

- **Fourth quarter and full-year 2009 results mixed** – A-Power Energy released financial results for Q409 and full-year 2009 that we view as mixed. Q4 revenue of \$125.9 million was slightly above our \$122 million estimate with EPS for the quarter of (\$0.68). Backing out various non-cash items, EPS on a non-GAAP basis are estimated at \$0.59, above our GAAP estimate of \$0.33. A robust gross margin of 21.3% vs. our 13.5% forecast accounted for the majority of the upside surprise. Full-year results were mixed as revenue results of \$311.3 million bested our estimate of \$307.4 million, but fell shy of company guidance of \$320 million. GAAP net income was impacted by large non-cash adjustments related to various financing items and was a negative (\$16.7) million. Excluding the charges, net income was approximately \$36.2 million resulting in estimated non-GAAP EPS for 2009 of \$1.04.
- **2010 guidance disappoints** – Management has historically overpromised and under delivered quarterly and annual results impacting confidence and reducing visibility. Newly issued guidance for 2010 of \$380 million in revenue and net income of \$45 million were revealed. This forecast is materially below our and the street's estimates for 2010. Our previous 2010 top-line forecast was \$544 million and included substantial wind turbine revenue contribution as well as a solid DG backlog conversion to bookings. We had previously believed a large jump in revenue Y/Y was attainable given the company's announced DG and wind turbine contracts and implied timelines. We surmise that management may be shifting priority and will now effort to issue attainable guidance with room for upside rather than constantly repeating the "miss vs. consensus". As a result of the reset of expectations, our 2010 revenue forecast is dramatically reduced to \$391.5 million, yet EPS is reduced only slightly to \$1.23 vs. \$1.25 previously due to better than expected margin expansion.

Conclusion:

Although the speculative nature of investing in shares of A-Power poses large risks to investors, we believe the current valuation coupled with rationalized company guidance allows for a more favorable view. We have historically valued shares on a P/E basis, yet with increasing non-cash charges, we view EV/EBITDA as more appropriate. Currently valued at 3.6 times, we believe shares of APWR are fairly valued at 5 to 6 times our 2010 EBITDA estimate of \$65.2 million on an EV basis and are upgrading our rating to Outperform (see disclosures).

Estimate Summary:

In millions (except per share data)

	Revenue		Net Income		EPS	EBITDA
2007A	\$	152,544	\$	15,214	\$ 2.23	\$ 17,286
Q1		32,337		2,865	0.24	3,267
Q2		65,739		6,227	0.19	6,529
Q3		85,371		9,406	0.29	9,711
Q4		81,418		10,017	0.30	10,286
2008A	\$	264,865	\$	28,515	1.01	\$ 29,793
Q1A		31,199		1,565	0.05	2,036
Q2A		57,518		6,252	0.14	7,133
Q3A		96,647		(623)	(0.02)	487
Q4A		125,888		(23,885)	(0.68)	(20,956)
2009A	\$	311,252	\$	(16,691)	(0.48)	\$ (11,300)
Q1E		52,000		4,683	0.10	6,108
Q2E		87,000		11,081	0.25	13,031
Q3E		115,000		17,755	0.40	20,230
Q4E		137,500		22,528	0.48	25,828
2010E	\$	391,500	\$	56,047	1.23	\$ 65,197

Source: Company and AERCA estimates

Valuation:

	P/S	P/E	EV/EBITDA
2007A	2.4	4.8	13.4
2008A	1.4	10.6	7.8
2009A	1.2	-22.4	-20.5
2010E	1.0	8.7	3.6

Recent Results:

A-Power's top-line financial results for the fourth quarter and full year 2009 were \$125.9 million and \$311.3 million respectively. EPS of (\$0.68) for the quarter and (\$0.48) for the year were dramatically impacted by the various non-cash charges related to financing activities during the year. Non-GAAP EPS for the quarter and 2009 after adjustments were \$0.59 and \$1.04. The Non-GAAP results were above our estimates primarily due to the gross margin expansion for the quarter to 21.3% vs. our 13.5% forecast. The company attributed the margin improvement to initial wind turbine sales in the quarter that carry higher gross margins than traditional DG contracts. Operating margins also improved to 18.1% from 9.7% last quarter as expense controls remained in effect. The negative net margin of (0.19%) for the quarter was impacted primarily by the aforementioned non-cash charges and the non-GAAP net margin similarly improved to 16.4% after adjustments. For the full-year, net margin of (5.4%) was impacted by the charges and improve to 11.6%, slightly better than the company guidance/goal of 10%.

A-Power announced in December 2009 that Shenyang Power Group established an LLC with United States Renewable Energy Group Wind Partners I. The newly formed company will own, design, develop, construct, manage and operate the previously announced 600MW wind energy power plant to be located in Texas. This new company is perhaps in response to Sen. Charles Schumer's public disapproval of utilizing US ARRA stimulus funds to support a wind farm that would primarily benefit a Chinese (read: A-Power) manufacturer. Owing to the sensitive nature and high visibility of the progress of this large contract, management has, by reducing revenue expectations for 2010, extended the expected commencement of turbine deliveries for this project. Previously set to begin in March 2010, this large project may be substantially pushed into 2011 and thus our revenue forecast for 2010 is reduced accordingly.

Outlook:

A-Power management unveiled the company's 2010 outlook for revenue and net income (non-GAAP) of \$380 million and \$45 million respectively. This implies a net margin goal/guidance improvement to 11.8% from the traditional 10% level. We are assuming, despite the high probability of a delay in the Texas project, that wind turbine sales should impact margins and the bottom line in 2010. We are forecasting gross margins to increase to 18.1% in 2010 from 16.4% in 2009. Despite the solid 21.3% gross margin showing in Q4, our estimates model a modest uptick in gross margins throughout the year and provide for some upside if wind contributions are greater than expected. The relative opaqueness in DG project progress and bookings continues to decrease our confidence in actual quarter to quarter revenue estimates and thus our confidence in top-line 2010 results remains lower than usual. As the first half of 2010 unfolds, if steady margin expansion and more consistent results are displayed Q/Q, confidence in management and execution would increase. However, until visibility increases, our 2011 forecast will remain unpublished until such time that a proper estimate other than a "flat out guess" can be ascertained.

As discussed previously, our 2010 revenue forecast is lowered significantly to \$391.5 million from \$544 million previously, primarily a result of anticipated delays in wind contribution and company issued guidance. Our large reduction in revenue does not impact bottom-line results due to margin expansion and EPS moves to \$1.23 from \$1.25. The advent of various non-cash charges impacting recent financial results has lead us to focus on EBITDA as a better reflection of company performance. Thus, our new focus on a forward basis will be EBITDA not EPS. Adjusted EBITDA results will also take center stage, post results, as company released non-GAAP numbers are not our preferred method of computations. For 2010 we now have revised forecasts for GAAP net income of \$56.1 million and EBITDA of \$65.2 million.

Valuation:

A-Power's most recent quarterly revenue and margin results, by far the largest in its brief corporate history, display encouraging signs of large organic growth potential for the company. The ultimate success in establishing A-Power's position may take time and we continue to be confident and patient that the company can emerge as strong competitor.

We view shares of APWR as a speculative investment opportunity to gain exposure to the company's end-markets. We have, due to the volatile trading nature of shares of APWR, adjusted our recommendation in short order based on our perception of valuation. Our 2010 EBITDA estimate of \$65.2 million places current valuation of shares of APWR at roughly 3.6 times on an EV basis. We believe a 5 to 6 multiple fairly reflects the company's strong growth prospects with the speculative nature of investing in APWR. In our opinion shares should outperform our benchmark index (see disclosures) over the next 12 months and we are accordingly increasing our rating to **Outperform**.

Risks:

Foreign Private Issuer – A-Power has stated that the company is a foreign private issuer within the meaning of the SEC.

Due to its foreign private issuer status, the company will NOT be required to file with the SEC 10-Q nor 8-K reports. The company will be exempt from Reg FD provisions and sections of the Securities Exchange Act requiring solicitation of proxies, consents or authorizations related to registered securities, and finally exemption to the filing of public reports by insiders with respect to their ownership and trading activities.

Clearly, exemption from required financial information and reporting, when combined with the exemptions for Reg FD and insider reporting, is the largest risk for investors.

A-Power, for its part, continues to address the financial reporting exemption. A-power issues regular quarterly financial reports and information and conducts quarterly conference calls with interested investors. The company anticipates filing quarterly financial reports on time and “according to SEC filing requirements”, but has, in some instances, released limited financial data and information later than the usual required filing date.

Concerns regarding Reg FD and insider trading activities will pose continuing risks to investors as the company is not required to meet usual SEC and traditional Western investor standards. The company will endeavor to disclose information in a fair and timely manner to all investors equally, yet no assurances can be given as to the symmetrical dissemination of material information to all global investors.

Financial Control – The company stated that as a privately held company, GaoKe historically did not focus on Western style financial reporting and internal control systems. A lack of management, legal and financial controls that meet Western standards may be difficult to achieve as A-Power focuses on near-term growth opportunities. We view the relative opaqueness into GaoKe’s operations as another large risk for investors seeking information about the company and its financial progress.

Reliance on Top-Level Management – A-Power relies heavily on the services of its engineering talent, especially the talent and expertise of Mr. Jinxiang Lu. A suitable replacement for Mr. Lu would be extremely difficult to find and the company would likely be severely impaired if Mr. Lu no longer was available to lead the company. Mr. Lu also owns a majority of the company, further highlighting his importance and ability to direct the fortunes of the company at the possible expense of minority shareholders.

Chinese Regulations and Incentives – A-Power’s primary market, the PRC, could alter, change or eliminate various regulations and rules regarding the development of power, distributed or grid related, that could materially alter the competitive position of the company. PRC tariff policy, economic reform packages, foreign currency regulations and other policies beyond the control of A-Power could materially affect the company’s prospects substantially, especially incentive policies relating to the emerging wind power market in China. Substantial changes could cause our outlook to be changed dramatically.

British Virgin Islands Incorporation – A-Power is incorporated in the British Virgin Islands and does not afford investors the same legal protections for minority shareholders. Various fiduciary and liability rights properly established and enforced in the U.S. may not be available to holders of A-Power, resulting in a diminished degree of protection from management wrongdoing or other actions.

A-Power Energy Generation and Subsidiaries - Income Statement

(in 000s except per share data)

	2006A*	2007A*	2008A	1Q09A	2Q09A	3Q09A	4Q09A	2009A	1Q10E	2Q10E	3Q10E	4Q10E	2010E
Net Revenues	\$ 98,705	\$ 152,544	\$ 264,865	\$ 31,199	\$ 57,518	\$ 96,647	\$ 125,888	\$ 311,252	\$ 52,000	\$ 87,000	\$ 115,000	\$ 137,500	\$ 391,500
Cost of Revenues	(85,915)	(131,987)	(227,988)	(27,266)	(49,838)	(84,029)	(99,034)	(260,167)	(44,252)	(72,384)	(93,265)	(110,688)	(320,589)
Gross Profit	12,790	20,557	36,877	3,933	7,680	12,618	26,854	51,085	7,748	14,616	21,735	26,813	70,912
Operating expenses													
Selling expenses	-	-	-	-	-	-	-	-	-	-	-	-	-
General and administrative	(1,900)	(3,482)	(8,700)	(2,564)	(2,990)	(3,254)	(4,036)	(12,844)	(3,110)	(3,545)	(3,955)	(4,225)	(14,835)
Research and development	-	-	-	-	-	-	-	-	-	-	-	-	-
Total operating expenses	(1,900)	(3,482)	(8,700)	(2,564)	(2,990)	(3,254)	(4,036)	(12,844)	(3,110)	(3,545)	(3,955)	(4,225)	(14,835)
Operating income	10,890	17,075	28,177	1,369	4,690	9,364	22,818	38,241	4,638	11,071	17,780	22,588	56,077
Interest income (expense)	(237)	(1,882)	13	-	68	89	(526)	(369)	(25)	(50)	(75)	(100)	(250)
Financing expense	-	-	(134)	-	(20)	(177)	(75)	(272)	(30)	(40)	(50)	(60)	(180)
Interest income	72	-	8	-	-	-	-	-	-	-	-	-	-
Other income (expenses)	-	250	924	139	78	127	93	437	100	100	100	100	400
Accretion on convertible debt	-	-	-	-	(133)	(1,034)	(1,113)	(2,280)	-	-	-	-	-
Change in fair value - warrants	-	-	-	-	624	(2,958)	(9,262)	(11,596)	-	-	-	-	-
Change in fair value - embedded derivative convertible notes	-	-	-	-	1,270	(6,028)	(20,853)	(25,611)	-	-	-	-	-
Make-whole amount paid on conversion	-	-	-	-	-	-	(9,886)	(9,886)	-	-	-	-	-
Fair value of inducement	-	-	-	-	-	-	(3,394)	(3,394)	-	-	-	-	-
Income from continuing operations before income taxes	10,725	15,443	28,988	1,508	6,577	(617)	(22,198)	(14,730)	4,683	11,081	17,755	22,528	56,047
Income tax expenses	(3,218)	(190)	(71)	(10)	(138)	(31)	(1,613)	(1,792)	-	-	-	-	-
Minority Interest	3	(39)	(402)	67	(187)	25	(74)	(169)	-	-	-	-	-
Net income	7,507	15,214	28,515	1,565	6,252	(623)	(23,885)	(16,691)	4,683	11,081	17,755	22,528	56,047
Foreign currency adjustment	-	-	4,767	(211)	(11)	103	-	(119)	-	-	-	-	-
Comprehensive income	7,507	15,214	33,282	1,354	6,241	(520)	(23,885)	(16,810)	4,683	11,081	17,755	22,528	56,047
Basic	\$ 37.54	\$ 2.33	\$ 1.02	\$ 0.05	\$ 0.19	\$ (0.02)	\$ (0.69)	\$ (0.49)	\$ 0.13	\$ 0.30	\$ 0.47	\$ 0.60	\$ 1.51
Diluted	\$ 37.54	\$ 2.23	\$ 1.01	\$ 0.05	\$ 0.14	\$ (0.02)	\$ (0.68)	\$ (0.48)	\$ 0.10	\$ 0.25	\$ 0.40	\$ 0.48	\$ 1.23
Weighted average number of shares out													
Basic	200	6,530	27,995	33,707	33,707	34,555	34,825	34,199	36,750	36,750	37,500	37,500	37,125
Diluted	200	6,834	28,248	34,707	35,310	34,925	34,925	34,967	44,925	44,925	44,925	46,925	45,425
Gross Margin	13.0%	13.5%	13.9%	12.6%	13.4%	13.1%	21.3%	16.4%	14.9%	16.8%	18.9%	19.5%	18.1%
SG&A/Sales	1.9%	2.3%	3.3%	8.2%	5.2%	3.4%	3.2%	4.1%	6.0%	4.1%	3.4%	3.1%	3.8%
Operating Margin	11.0%	11.2%	10.6%	4.4%	8.2%	9.7%	18.1%	12.3%	8.9%	12.7%	15.5%	16.4%	14.3%
Net Income/sales	7.6%	10.0%	10.8%	4.3%	10.9%	-0.5%	-19.0%	-5.4%	9.0%	12.7%	15.4%	16.4%	14.3%
Year over Year Growth													
Sales	N/A	55%	74%	-4%	-13%	13%	55%	18%	67%	51%	19%	9%	26%

* Based on Head Dragon and subs.

Source: Company and AERCA estimates

A-Power Energy Generation and Subsidiaries - Balance Sheet

(in 000's except per share data)

	12/31/2007	12/31/2008	3/31/2009	6/30/2009	9/30/2009	12/31/2009
Assets						
Current Assets						
Cash and cash equivalents	\$ 35,832	\$ 43,518	\$ 60,560	\$ 128,746	\$ 90,755	\$ 166,476
Restricted bank balance	-	3,608	1,607	1,608	6,835	13,399
Accounts receivable, net	20,980	8,036	8,320	10,170	5,882	12,463
Costs and estimated earnings in excess of billings on uncompleted contracts	-	-	2,016	2,189	6,154	2,967
Prepayments, deposits and other receivables	3,119	79,845	80,366	78,873	67,057	52,452
Inventory	-	8,722	9,494	11,042	26,197	10,327
Due from related parties	32	105	105	105	114	105
Total current assets	59,963	143,834	162,468	232,733	202,994	258,189
Accounts receivable	1,843	3,646	6,825	4,929	9,885	5,738
Construction in progress	411	18,006	20,705	20,752	18,014	-
Property, plant and equipment, net	2,502	14,312	14,363	14,274	38,034	58,617
Intangible assets	-	12,564	12,545	12,555	21,113	22,412
Deposits on intangible assets	3,729	10,322	10,307	14,213	5,657	5,657
Deferred income tax asset	-	364	364	364	364	2,321
Deferred financing costs	-	-	-	2,289	2,174	-
Long-term investment	-	-	-	-	2,509	2,423.00
Total Assets	\$ 68,448	\$ 203,048	\$ 227,577	\$ 302,109	\$ 300,744	\$ 355,357
Liabilities and Stockholder's Equity						
Current Liabilities						
Bank loans	\$ 960	\$ -	\$ -	\$ -	\$ -	\$ 20,368
Accounts payable	18,047	30,136	17,310	18,767	15,814	15,415
Other payable and accrued liabilities	-	-	17,057	17,258	20,844	24,619
Customer deposits	2,480	16,076	26,853	45,085	18,238	9,993
Billings in excess of costs and estimated earnings on uncompleted projects	-	-	4,240	9,315	10,098	4,887
Due to shareholder	376	-	-	-	-	-
Due to related party	-	128	3,123	4,143	4,140	4,158
Income and business taxes payable	51	741	1,534	1,771	2,334	4,078
Unearned revenue	-	-	-	-	-	1,419
Deferred income tax liability	-	-	-	-	-	31
Notes payable	15,000	-	-	-	-	-
Short-term loans	-	-	-	-	13,249	-
Total current liabilities	36,914	47,081	70,117	96,339	84,717	84,968
Warrant liability	-	-	-	5,530	8,487	17,750
Fair value of embedded derivatives-convertible note	-	-	-	18,511	24,540	-
Convertible note	-	-	-	13,598	14,632	-
Minority interest	256	658	-	-	-	-
Total liabilities	37,170	47,739	70,117	133,978	132,376	102,718
Shareholders' Equity						
Common stock	1,667	3	3	3	3	4
Preferred shares	54	-	-	-	-	-
Additional paid-in-capital	1,671	94,137	111,448	111,791	112,133	203,491
Accumulated other comprehensive income	2,016	6,783	6,367	6,356	6,459	6,459
Statutory reserves	3,307	3,307	4,155	4,155	4,155	4,155
Retained earnings	22,563	51,079	34,896	41,148	40,525	(1,651)
Noncontrolling interest	-	-	591	4,678	5,093	40,180
Total shareholders' equity	31,278	155,309	157,460	168,131	168,368	252,638
Total Liabilities and Stockholders' Equity	\$ 68,448	\$ 203,048	\$ 227,577	\$ 302,109	\$ 300,744	\$ 355,356
Book value/share	\$ 3.66	\$ 4.63	\$ 4.54	\$ 4.76	\$ 4.82	\$ 7.22
Net Cash/share	\$ 4.19	\$ 1.30	\$ 1.75	\$ 3.65	\$ 2.60	\$ 4.75
Debt/Capital	34%	0%	0%	8%	15%	9%

Source: Company and AERCA estimates

Stock Data:

3 year stock chart:



Source: Bigcharts.com

Companies mentioned in this report:

- None

Data Table:

Average volume (mill. shares)	1.83
52 week range	\$3.92 - \$21.04
Short interest (mill. shares)	5.59
Shares outstanding (mill. shares)	34.9
Market Capitalization (\$ millions)	373.7
Enterprise value (\$ millions)	231.7

Analyst Disclosures:

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Outperform: Our Outperform rating is based on our belief that the subject company is anticipated to produce a total return greater than our benchmark index, The Wilderhill Clean Energy Index (ECO), over the coming 12 months.

Marketperform: Our Marketperform rating is based on our belief that the subject company is anticipated to produce a return equal to our benchmark index, The Wilderhill Clean Energy Index (ECO), over the coming 12 months.

Underperform: Our Underperform rating is based on our belief that the subject company is anticipated to produce a return less than our benchmark index, The Wilderhill Clean Energy Index (ECO), over the coming 12 months.

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