Nuveen Municipal Value Fund 2
Form N-CSRS
July 08, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED
MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number 811-22253

Nuveen Municipal Value Fund 2
(Exact name of registrant as specified in charter)

Nuveen Investments
333 West Wacker Drive
Chicago, IL 60606
(Address of principal executive offices) (Zip code)

Kevin J. McCarthy
Nuveen Investments
333 West Wacker Drive
Chicago, IL 60606
(Name and address of agent for service)

Registrant's telephone number, including area code: (312) 917-7700

Date of fiscal year end: October 31

Date of reporting period: April 30, 2011

Form N-CSR is to be used by management investment companies to file reports with the Commission not later than 10 days after the transmission to stockholders of any report that is required to be transmitted to stockholders under Rule 30e-1 under the Investment Company Act of 1940 (17 CFR 270.30e-1). The Commission may use the information provided on Form N-CSR in its regulatory, disclosure review, inspection, and policymaking roles.

A registrant is required to disclose the information specified by Form N-CSR, and the Commission will make this information public. A registrant is not required to respond to the collection of information contained in Form N-CSR unless the Form displays a currently valid Office of Management and Budget ("OMB") control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. ss. 3507.

ITEM 1. REPORTS TO STOCKHOLDERS.

INVESTMENT ADVISER NAME CHANGE

Effective January 1, 2011, Nuveen Asset Management, the Funds' investment adviser, changed its name to Nuveen Fund Advisors, Inc. ("Nuveen Fund Advisors"). Concurrently, Nuveen Fund Advisors formed a wholly-owned subsidiary, Nuveen Asset Management, LLC, to house its portfolio management capabilities.

NUVEEN INVESTMENTS COMPLETES STRATEGIC COMBINATION WITH FAF ADVISORS

On December 31, 2010, Nuveen Investments completed the strategic combination between Nuveen Asset Management, LLC, the largest investment affiliate of Nuveen Investments, and FAF Advisors. As part of this transaction, U.S. Bancorp – the parent of FAF Advisors – received cash consideration and a 9.5% stake in Nuveen Investments in exchange for the long-term investment business of FAF Advisors, including investment management responsibilities for the non-money market mutual funds of the First American Funds family.

The approximately $27 billion of mutual fund and institutional assets managed by FAF Advisors, along with the investment professionals managing these assets and other key personnel, have become part of Nuveen Asset Management, LLC. With these additions to Nuveen Asset Management, LLC, this affiliate now manages more than $100 billion of assets across a broad range of strategies from municipal and taxable fixed income to traditional and specialized equity investments.

This combination does not affect the investment objectives or strategies of the Funds in this report. Over time, Nuveen Investments expects that the combination will provide even more ways to meet the needs of investors who work with financial advisors and consultants by enhancing the multi-boutique model of Nuveen Investments, which also includes highly respected investment teams at HydePark, NWQ Investment Management, Santa Barbara Asset Management, Symphony Asset Management, Tradewinds Global Investors and Winslow Capital. Nuveen Investments managed approximately $206 billion of assets as of March 31, 2011.

Table of Contents

Chairman's
Letter to Shareholders

Dear Shareholders,

In 2010, the global economy recorded another year of recovery from the financial and economic crises of 2008, but many of the factors that caused the downturn still weigh on the prospects for continued improvement. In the U.S., ongoing weakness in housing values has put pressure on homeowners and mortgage lenders. Similarly, the strong earnings recovery for corporations and banks is only slowly being translated into increased hiring or more active lending. Globally, deleveraging by private and public borrowers has inhibited economic growth and that process is far from complete.

Encouragingly, constructive actions are being taken by governments around the world to deal with economic issues. In the U.S., the recent passage of a stimulatory tax bill relieved some of the pressure on the Federal Reserve to promote economic expansion through quantitative easing and offers the promise of sustained economic growth. A number of European governments are undertaking programs that could significantly reduce their budget deficits. Governments across the emerging markets are implementing various steps to deal with global capital flows without undermining international trade and investment.

The success of these government actions could determine whether 2011 brings further economic recovery and financial market progress. One risk associated with the extraordinary efforts to strengthen U.S. economic growth is that the debt of the U.S. government will continue to grow to unprecedented levels. Another risk is that over time there could be inflationary pressures on asset values in the U.S. and abroad, because what happens in the U.S. impacts the rest of the world economy. Also, these various actions are being taken in a setting of heightened global economic uncertainty, primarily about the supplies of energy and other critical commodities. In this challenging environment, your Nuveen investment team continues to seek sustainable investment opportunities and to remain alert to potential risks in a recovery still facing many headwinds. On your behalf, we monitor their activities to assure they maintain their investment disciplines.

As you will note elsewhere in this report, on December 31, 2010, Nuveen Investments completed a strategic combination with FAF Advisors, Inc., the manager of the First American Funds. The combination adds highly respected and distinct investment teams to meet the needs of investors and their advisors and is designed to benefit all fund shareholders by creating a fund organization with the potential for further economies of scale and the ability to draw from even greater talent and expertise to meet those investor needs.

As of the end of June 2011, Nuveen Investments had completed the refinancing of all of the Auction Rate Preferred Securities issued by its taxable closed-end funds and 91% of the MuniPreferred shares issued by its tax-exempt closed-end funds. Please consult the Nuveen Investments web site, www.Nuveen.com, for the current status of this important refinancing program.

As always, I encourage you to contact your financial consultant if you have any questions about your investment in a Nuveen Fund. On behalf of the other members of your Fund Board, we look forward to continuing to earn your trust in the months and years ahead.

Robert P. Bremner
Chairman of the Board
June 21, 2011

Portfolio Managers' Comments

Nuveen Municipal Value Fund, Inc. (NUV)
Nuveen Municipal Value Fund 2 (NUW)
Nuveen Municipal Income Fund, Inc. (NMI)
Nuveen Enhanced Municipal Value Fund (NEV)

Portfolio managers Tom Spalding, Chris Drahn and Steve Hlavin review key investment strategies and the six-month performance of these four national Funds. With 34 years of investment experience at Nuveen, Tom has managed NUV since its inception in 1987, adding portfolio management responsibility for NUW at its inception in 2009. Chris, who has 31 years of financial industry experience, assumed portfolio management responsibility for NMI in January 2011. An eight-year veteran of Nuveen, Steve has been involved in the management of NEV since its inception in 2009, taking on full portfolio management responsibility for this Fund in December 2010.

What key strategies were used to manage the Funds during the six-month reporting period ended April 30, 2011?

After rallying through most of 2010, municipal bond prices declined during this six-month period, impacted by investor concerns about inflation, the federal deficit and the deficit's impact on demand for U.S. Treasury securities. Adding to this market pressure was media coverage of the strained finances of many state and local governments. As a result, money began to flow out of municipal bond funds, as yields rose and valuations declined. Toward the end of this period, we saw the environment in the municipal market improve, as some buyers were attracted by municipal bond valuations and yields, resulting in declining yields and rising valuations.

The municipal bond market also was affected by a significant decline in new tax-exempt issuance during this period. One reason for this decrease was the heavy issuance of taxable municipal debt at the end of 2010 under the Build America Bond (BAB) program. During November and December 2010, taxable BABs issuance nationwide totaled $31.5 billion, accounting for 34.5% of new bonds in the municipal market. Since interest payments from BABs represent taxable income, we did not view these bonds as appropriate investment opportunities for these Funds. The BAB program expired December 31, 2010, after Congress failed to include legislation extending the program in the tax bill it passed earlier that month. In addition to the BAB program's impact on tax-exempt issuance during the November-December period, borrowers trying to take advantage of the program's favorable terms before its termination at year end accelerated issuance

Certain statements in this report are forward-looking statements. Discussions of specific investments are for illustration only and are not intended as recommendations of individual investments. The forward-looking statements and other views expressed herein are those of the portfolio managers as of the date of this report. Actual future results or occurrences may differ significantly from those anticipated in any forward-looking statements, and the views expressed herein are subject to change at any time, due to numerous market and other factors. The Funds disclaim any obligation to update publicly or revise any forward-looking statements or views expressed herein.

Any reference to credit ratings for portfolio holdings denotes the highest rating assigned by a Nationally Recognized Statistical Rating Organization (NRSRO) such as Standard & Poor's (S&P), Moody's or Fitch. AAA, AA, A and BBB ratings are investment grade; BB, B, CCC, CC, C and D ratings are below investment grade. Holdings and ratings may change over time.

that potentially would have come to market as tax-exempt bonds in 2011, choosing instead to issue taxable BABs during the last two months of 2010. Due in part to this, national municipal issuance was down 49% for the first four months of 2011 compared with the same period in 2010.

Because of the constrained tax-exempt municipal bond issuance, we continued to take a bottom-up approach to discovering undervalued sectors and individual credits with the potential to perform well over the long term. During this period, we found value in health care, transportation (specifically tollroads), higher education and tax-supported bonds. In NEV, one of the areas we favored was the "other revenue" sector, where we were actively adding redevelopment agency bonds. The proposed elimination of redevelopment district programs in California, suggested as part of efforts to close gaps in the California state budget, prompted issuers to come to market with their remaining authorizations of redevelopment district bonds. This resulted in heavier supply of these bonds and higher yields at attractive prices. Across all of the Funds, the majority of our purchases were sector-based rather than geographically focused, although we continued to keep our holdings well diversified by state.

During the last months of 2010, some of this investment activity resulted from opportunities created by the provisions of the BAB program. For example, tax-exempt supply was more plentiful in the health care and higher education sectors because, as 501(c)(3) (nonprofit) organizations, hospitals and private universities generally did not qualify for the BAB program and continued to issue bonds in the tax-exempt municipal market. In addition, bonds with proceeds earmarked for refundings, working capital, and private activities were not covered by the BAB program, and this resulted in attractive opportunities in other sectors of the market.

For the most part, NUV, NUW and NMI focused on purchasing longer bonds to take advantage of attractive yields at the longer end of the municipal yield curve. The purchase of longer bonds also provided some protection for the Funds' duration and yield curve positioning in the event that the BAB program was extended and continued to have an impact on tax-exempt issuance, especially at the long end of the curve. In NEV, which was invested-up during the lower rate environment of 2009, we have been working to improve the Fund's yield and reduce its duration, bringing it more in line with our targets. During this period, we actively looked for opportunities to sell some of NEV's longest holdings with lower coupons and lower embedded yields, including industrial development revenue (IDR), housing and hospital bonds. We then reinvested the proceeds from these sales into bonds with shorter durations, higher coupons and better yields. As a result of this activity, we were able to enhance NEV's yield curve positioning and maturity, average coupon and embedded yield as well as take advantage of tax losses that will enable us to offset potential capital gains tax liabilities in the future.

Some of the cash for new purchases during this period was generated by the proceeds from bond calls and maturing bonds, which we worked to redeploy to keep the Funds as fully invested as possible. NMI also took advantage of strong bids to sell a few holdings at attractive prices, mainly from the health care and IDR sectors, while NEV engaged in the selling described in the previous paragraph.

As of April 30, 2011, all four of these Funds continued to use inverse floating rate securities. We employ inverse floaters for a variety of reasons, including duration management, income enhancement, total return enhancement, and in NEV as a form of leverage. NEV also invested in additional types of derivative instruments1, such as forward interest rate swaps, designed to help shorten its duration. During this period, we gradually added to NEV's derivative positions, all of which remained in place at period end.

How did the Funds perform?

Individual results for these Funds, as well as relevant index and peer group information, are presented in the accompanying table.

Average Annual Total Returns on Net Asset Value*
For periods ended 4/30/11

Fund	6-Month	1-Year	5-Year	10-Year
NUV	-3.78%	-0.24%	3.11%	4.52%
NUW	-5.77%	-0.91%	N/A	N/A
NMI	-2.87%	1.59%	4.07%	4.82%
Standard & Poor's (S&P) National Municipal Bond Index2	-1.99%	1.98%	4.18%	4.94%
Lipper General and Insured Unleveraged Municipal				
Debt Funds Average3	-2.17%	0.76%	3.29%	4.14%
NEV4	-8.37%	-2.57%	N/A	N/A
Standard & Poor's (S&P) National Municipal Bond Index2	-1.99%	1.98%	4.18%	4.94%
Lipper General Leveraged Municipal Debt Funds Average3	-5.81%	0.10%	3.04%	5.25%

For the six months ended April 30, 2011, the cumulative returns on net asset value (NAV) for these four Funds underperformed the return for the Standard & Poor's (S&P) National Municipal Bond Index. For the same period, NUV, NUW and NMI lagged the average return for the Lipper General and Insured Unleveraged Municipal Debt Funds Average and NEV trailed the average return for the Lipper General Leveraged Municipal Debt Funds Average.

Key management factors that influenced the Funds' returns during this period included duration and yield curve positioning, credit exposure and sector allocation. In addition, the use of effective leverage had an impact on the performance of NEV. Leverage is discussed in more detail on page nine.

* Six-month returns are cumulative; all other returns are annualized.

Past performance is not predictive of future results. Current performance may be higher or lower than the data shown. Returns do not reflect the deduction of taxes that shareholders may have to pay on Fund distributions or upon the sale of Fund shares.

For additional information, see the individual Performance Overview for your Fund in this report.

1 Each Fund may invest in derivative instruments such as forwards, futures, options, and swap transactions. For additional information on the derivative instruments in which each Fund was invested during and at the end of the reporting period, see the Portfolios of Investments, Financial Statements, and Notes to Financial Statements sections of this report.

2 The Standard & Poor's (S&P) National Municipal Bond Index is an unleveraged, market value-weighted index designed to measure the performance of the tax-exempt, investment-grade U.S. municipal bond market. This index does not reflect any initial or ongoing expenses and is not available for direct investment.

3 Each of the Lipper Municipal Debt Funds Averages shown in this report is calculated using the returns of all closed-end funds in their respective categories for each period as follows: Lipper General and Insured Unleveraged Municipal Debt Funds Average: 6-month, 7 funds; 1-year, 7 funds; 5-year, 6 funds; and 10-year, 6 funds; Lipper General Leveraged Municipal Debt Funds Average: 6-month, 74 funds; 1-year, 73 funds; 5-year, 70 funds; and 10-year, 51 funds. Lipper returns account for the effects of management fees and assume reinvestment of dividends, but do not reflect any applicable sales charges. The Lipper averages are not available for direct investment.

4 NEV is a leveraged Fund through investments in inverse floating rate securities, as discussed in more detail on page nine. The remaining three Funds in this report are unleveraged and use inverse floating rate securities for duration management and both income and total return enhancement.

During this period, municipal bonds with shorter maturities generally outperformed other maturity categories, with credits at the longest end of the yield curve posting the weakest returns. The underperformance of longer bonds was due in part to the rise in municipal yields at the longer end of the curve. Among these four Funds, NMI was the most advantageously situated in terms of duration and yield curve positioning, with more exposure to the outperforming shorter end of the yield curve. NEV and NUW, on the other hand, had the longer durations typical of newer Funds that were more recently invested in long-term bonds. Their greater exposure to the underperforming long part of the curve, as well as that of NUV, detracted from the performance of all three Funds for this period. Overall, variations in duration and yield curve positioning among the Funds accounted for the majority of the differences in performance.

As previously mentioned, NEV used derivatives, such as forward interest rate swaps to reduce the duration of the Fund's portfolio. These derivatives had a positive impact on NEV's total return performance for the period.

Credit exposure also played a role in performance during these six months. During the market reversal of late 2010, as the redemption activity in high-yield funds increased and risk aversion mounted, lower-rated credits were negatively impacted. For the period as a whole, bonds rated BBB generally underperformed those rated AAA. All of these Funds tended to be overweighted in bonds rated BBB, which negatively impacted their performance. This was offset to some degree in NMI by the Fund's investment in individual securities that performed well. NEV, NMI and NUW also were hurt by their underweightings in bonds rated AAA.

Holdings that generally helped the Funds' returns included housing, resource recovery and general obligation (GOs) and other tax-supported bonds. In general, these Funds tended to have relatively light exposures to housing (with the exception of NEV) and were somewhat underweighted in GOs, which limited their participation in the performance of these sectors. During this period, pre-refunded bonds, which are often backed by U.S. Treasury securities, also were among the strongest performers, primarily due to their shorter effective maturities and higher credit quality. As of April 30, 2011, both NUV and NMI had good weightings in pre-refunded bonds, while NUW and NEV—as newer Funds—had little to no exposure to these credits.

In contrast, the health care and transportation sectors turned in relatively weaker performance. All four of these Funds, especially NUW, were overweighted in the health care sector, which was generally negative for performance. NEV, however, benefited from strong individual security selection in the health care sector, with a number of its holdings outperforming the sector as a whole. Zero coupon bonds also were among the poorer performers, due largely to their longer maturities.

IMPACT OF LEVERAGE STRATEGY ON NEV'S PERFORMANCE

One important factor impacting the return of NEV relative to the comparative indexes was the Fund's use of effective leverage through investments in inverse floating rate securities. This Fund uses leverage because its manager believes that, over time, leveraging provides opportunities for additional income and total return for shareholders. However, use of leverage also can expose shareholders to additional volatility. For example, during periods when the prices of securities held by a Fund generally are declining, the negative impact of these valuation changes on net asset value and total return is magnified by the use of leverage. This is what happened during this reporting period, as the use of leverage had an overall negative impact on the Fund's return.

Dividend and
Share Price Information

The monthly dividends of NUV, NUW, NMI and NEV remained stable throughout the six-month reporting period ended April 30, 2011.

Due to normal portfolio activity, shareholders of the following Funds received capital gains and net ordinary income distributions in December 2010 as follows:

Fund	Long-Term Capital Gains (per share)	Short-Term Capital Gains and/or Ordinary Income (per share)
NUV	$0.0210	$0.0007
NUW	$0.0193	$0.0028

All of the Funds in this report seek to pay stable dividends at rates that reflect each Fund's past results and projected future performance. During certain periods, each Fund may pay dividends at a rate that may be more or less than the amount of net investment income actually earned by the Fund during the period. If a Fund has cumulatively earned more than it has paid in dividends, it holds the excess in reserve as undistributed net investment income (UNII) as part of the Fund's NAV. Conversely, if a Fund has cumulatively paid dividends in excess of its earnings, the excess constitutes negative UNII that is likewise reflected in the Fund's NAV. Each Fund will, over time, pay all of its net investment income as dividends to shareholders. As of April 30, 2011, NUV, NMI and NEV had positive UNII balances, based upon our best estimate, for tax purposes and positive UNII balances for financial reporting purposes, while NUW had a positive UNII balance, based upon our best estimate, for tax purposes and a negative UNII balance for financial reporting purposes.

SHARE REPURCHASES AND SHARE PRICE INFORMATION

Since the inception of the Funds' repurchase program, the Funds' have not repurchased any of their outstanding shares.

SHELF EQUITY PROGRAM

On December 8, 2010, a registration statement filed by, NUV with the Securities and Exchange Commission (SEC) became effective authorizing the Fund to issue an additional 19.6 million shares through a shelf offering. Under this shelf offering program, the Fund, subject to market conditions, may raise additional equity capital from time to

786,911

Gross profit
(291,356
)

269,055

Operating expenses:

Selling, general and administrative
1,004,896

1,035,105

Operating loss from continuing operations
(1,296,252
)

(766,050
)
Non operating income (expense)

Interest and financing costs
(203,053
)

(64,805
)
Interest - discount on contingent convertible promissory notes - warrants
(906,874
)

—

Interest - discount on contingent convertible promissory notes - beneficial conversion feature
(649,813
)

—

Interest income
45,202

11,130

Revaluation of warrants
194,261

4,487,006

Other, net
(48,289
)

(42,978
)
Non operating (expense) income, net
(1,568,566
)

4,390,353

Net (loss) income
(2,864,818
)

3,624,303

10% Convertible Preferred dividends
(284,445
)

(265,324
)
Series B, 10% Convertible Preferred stock beneficial conversion feature
—

(394,631
)
Net (loss) income available to Common stockholders
$
(3,149,263
)

$
2,964,348

Net (loss) income per share – basic and diluted	$ (0.05)	$ 0.07
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 (loss) income attributable to Common stockholders per share – basic and diluted	$ (0.06)	$ 0.05
Weighted average shares outstanding:		
Basic	55,312,168	50,746,825
Diluted	55,312,168	51,329,409

See accompanying notes to unaudited condensed interim consolidated financial statements.

American Power Group Corporation
Condensed Consolidated Statement of Changes in Stockholders' Equity (Deficit)
For the Three Months Ended December 31, 2015
(Unaudited)

	Preferred Stock		Series B Preferred Stock		Series C Preferred Stock		Common Stock		Additional Paid In	Accumulated	
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Capital	Deficit	Total
Balance, October 1, 2015	938	$938	200	200	—	$—	55,287,349	$552,874	$62,497,398	$(63,277,627)	$(226,217)
Compensation expense associated with stock options	—	—	—	—	—	—	—	—	27,136	—	27,136
Warrants issued for services rendered	—	—	—	—	—	—	—	—	5,977	—	5,977
Issuance of Series C Convertible Preferred stock, net of fees	—	—	—	—	257	257	—	—	2,569,258	—	2,569,515
Interest - discount on contingent convertible promissory notes - beneficial conversion feature									649,813	—	649,813
Interest - discount on contingent convertible promissory notes - warrants									906,874	—	906,874
Common stock issued for 10% Convertible Preferred stock	—	—					2,283,307	22,834	246,597	(231,331)	38,100

dividend											
Preferred stock dividends accrued but not paid	—	—					—	—	—	(53,114)	(53,114)
Net loss for the three months ended December 31, 2015	—	—					—	—	—	(2,864,818)	(2,864,818)
Balance, December 31, 2015	938	$938	200	$200	257	$257	57,570,656	$575,708	$66,903,053	$(66,426,890)	$1,053,266

See accompanying notes to unaudited condensed interim consolidated financial statements.

5

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

	Three Months Ended December 31, 2015	2014
Cash flows from operating activities:		
Net (loss) income	$(2,864,818)	$3,624,303
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Revaluation of warrants	(194,261)	(4,487,006)
Interest - discount on contingent convertible promissory notes - warrants	906,874	—
Interest - discount on contingent convertible promissory notes - beneficial conversion feature	649,813	—
Inventory valuation allowance	5,118	—
Loss on disposal of property and equipment	5,905	—
Depreciation expense	103,676	75,719
Amortization of warrants issued for services	996	—
Amortization of deferred financing costs	12,024	4,676
Stock compensation expense	27,136	9,161
Provision for bad debts	(2,852)	3,276
Amortization of software costs	180,412	129,985
Amortization of long term contracts	20,000	12,500
Amortization of purchased technology	12,500	12,500
(Increase) decrease in assets:		
Accounts receivable	630,425	1,066,635
Inventory	(13,897)	(3,150)
Prepaid and other current assets	8,107	35,697
Other assets	(29,904)	(11,054)
(Decrease) increase in liabilities:		
Accounts payable	(510,205)	(72,765)
Accrued expenses	560,442	(120,862)
Net cash (used in) provided by operating activities	(492,509)	279,615
Cash flows from investing activities:		
Proceeds from sale of property and equipment	38,000	—
Note receivable, related party	50,000	—
Purchase of property and equipment	(20,766)	(3,363)
Software development costs	(44,139)	(106,245)
Net cash provided by (used) in investing activities	23,095	(109,608)
Cash flows from financing activities:		
Proceeds from line of credit	200,000	380,000
Repayment of notes payable	(79,870)	(50,957)
Proceeds from notes payable, related party	500,000	—
Repayment of notes payable, related party	(69)	(198,500)
Proceeds from sale of Series B, 10% Convertible Preferred stock, net of fees	—	1,948,119
Payment of cash dividend on 10% Convertible Preferred stock	—	(147,861)
Net cash provided by financing activities	620,061	1,930,801
Net increase in cash and cash equivalents	150,647	2,100,808
Cash and cash equivalents at beginning of year	67,162	126,420
Cash and cash equivalents at end of period	$217,809	$2,227,228

See accompanying notes to unaudited condensed interim consolidated financial statements.

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

-Continued-

	Three Months Ended December 31,	
	2015	2014
Supplemental disclosure of cash flow information:		
Interest paid	$159,828	$36,684
Supplemental disclosure of non-cash investing and financing activities:		
Contingent convertible promissory notes and accrued interest converted into Series C Convertible Preferred Stock	2,569,515	—
Refinancing of note payable	—	2,567,000
Beneficial conversion feature attributable to issuance of Series B Convertible Preferred stock	—	394,631
Warrants issued	5,977	694,631
Shares issued for preferred stock dividend	231,331	127,380
Equipment received in lieu of payment on note receivable	190,000	—
Refinancing of related party note	—	150,000
Construction in progress expenditures included in accounts payable	141,565	—
Insurance premiums financed with short-term debt	59,866	52,000
Dividends included in accrued expenses	53,114	9,920
Capitalized interest included in construction in progress	46,299	—
Software development costs included in accounts payable	3,457	45,065
Bank fees financed with long-term debt	—	30,000
Fixed assets included in accounts payable and accrued expenses	—	582

See accompanying notes to unaudited condensed interim consolidated financial statements.

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 21, 2015, our shareholders approved provisions to modify certain anti-dilution provisions of the 10% Convertible Preferred Stock and approved an amendment to the Restated Certificate of Incorporation to increase the number of authorized shares of Common Stock from 150,000,000 to 200,000,000. (See Note 13)

In addition on October 21, 2015, our Subordinated Contingent Convertible Promissory Notes in the aggregate principal amount $2,475,000, together with all accrued but unpaid interest thereon, automatically converted into approximately 257 shares of our Series C Convertible Preferred Stock at a conversion price of $10,000 per share. Each share of Series C Preferred Stock is convertible, at any time at the option of any holder, into 50,000 shares of Common Stock; at an initial conversion price of $0.20 per share. (See Note 10)

On January 8, 2016, we sold 22 shares of Series D Convertible Preferred Stock for gross proceeds of $2.2 million to several existing shareholders and entities affiliated with several members of our Board of Directors and issued warrants to purchase up to 44,000,000 shares of our Common Stock at an exercise price of $.10 per share. (See Note 14).

On January 15, 2016, Iowa State Bank agreed to extend the maturity of our $500,000 Revolving Line of Credit to April 15, 2016 in order to provide additional time to complete their annual renewal process.

As of January 31, 2016, we have an industry-leading 489 overall approvals from the Environmental Protection Agency ("EPA") including 33 approvals for engine families with SCR (selective catalytic reduction) technology. We believe that of the approximately 3 million Class 8 trucks operating in North America, an estimated 600,000 to 700,000 Class 8 trucks fall into the Inside Useful Life ("IUL") designation. We received State of California Air Resources Board ("CARB") Executive Order (“E.O.”) Certifications for 17 specific Volvo/Mack D-13/MP8 engine models within the 2010-2012 model years for the 12.8L heavy-duty diesel engine family ranging from 375hp to 505hp in June of 2015.

Nature of Operations, Risks, and Uncertainties

Dual Fuel Technology Subsidiary - American Power Group, Inc.

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.

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 5% to 15%;
- 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.

Wellhead Gas Flare Capture and Recovery Services Division - Trident NGL Services a division of American Power Group, Inc.

When oil is extracted from shale, a mixture of hydrocarbon gases (methane, ethane, propane, butane, pentane and other heavy gases) reach the surface at each well site. These gases are either gathered in low-pressure pipelines for downstream NGL and methane extraction by large mid-stream processing companies or flared into the atmosphere when the gas-gathering infrastructure is too far away (remote well sites) or the pipeline is insufficient to accommodate the volumes of associated gas (stranded well sites). Many areas in North America are facing significant state imposed penalties and restrictions associated with the elimination of flared well head gas by oil and gas production companies.

In August 2015, we entered the flare gas capture and recovery business through a relationship with Trident Resources, LLC whereby they exclusively licensed to us their proprietary next generation natural gas liquids ("NGL") compression/refrigeration process. The proprietary Trident NGL capture and recovery process captures and converts a higher percent of the gases at these remote and stranded well sites, with its mobile and modular design when compared to other competitive capture technologies. NGL's can be sold to a variety of end markets for heating, emulsifiers, or as a combined NGL liquid called Y Grade that can be sold to midstream companies who separate the liquids into their final commodities.

The majority of the remaining associated gas is comprised of methane which is currently not sold but, if further processed, can produce pipeline grade natural gas for use in stationary and vehicular engines utilizing APG's Fueled By Flare™ dual fuel solution. This process is designed to capture and separate the methane flare in order to produce a premium quality natural gas capable of being compressed and used for many natural gas applications including both stationary and vehicular APG dual fuel conversions.

During the three months ended December 31, 2015, operations from our Natural Gas Liquids Division were not significant.

Liquidity and Management's Plans

As of December 31, 2015, we had $527,793 in cash, cash equivalents and restricted certificates of deposit and a working capital deficit of $1,982,684. The accompanying financial statements have been prepared on a basis that assumes we will continue as a going concern and that contemplates the continuity of operations, realization of assets and the satisfaction of liabilities and commitments in the normal course of business. We continue to incur recurring losses from operations, which raises substantial doubt about our ability to continue as a going concern unless we secure additional capital to fund our operations as well as implement initiatives to reduce our cash burn in light of lower diesel/natural gas price spreads and the impact it has had on our business as well as the slower than anticipated ramp of our flare capture and recovery business. The accompanying financial statements do not include any adjustments that might result from the outcome of the uncertainty.

Management understands that our continued existence is dependent on our ability to generate positive operating cash flow, achieve profitability on a sustained basis and generate improved performance. Based on the information discussed below, our fiscal 2016 operating plan, the recent $2.2 million Series D Convertible Preferred Stock private placement closed January 8, 2016, the cash saving initiatives that have been implemented below and anticipated cash flows from operations, we believe we will have sufficient resources to satisfy our cash requirements into the first quarter of 2017.

In order to ensure the future viability of American Power Group, management has implemented or is in the process of implementing the following actions:

A.Series D Convertible Preferred Stock Private Placement

On January 8, 2016, we completed a $2.2 million private placement of Series D Convertible Preferred Stock with accredited investors affiliated with several members of our Board of Directors and shareholders. In addition, we issued warrants to purchase 44 million shares of Common Stock at $.10 which do not contain a cashless exercise provision. Pursuant to the terms of the offering, the investors are required to exercise all Series D warrants before exercising any other warrants they or their affiliates own (all containing cashless provisions). In addition, all minority Series D investors are required to match on a pro-rata basis the exercise of any warrants by the majority investor or lose those warrants to the majority investor.

B. Deferment of WPU Leasing Payments and Cash Dividend Payments

In January 2016, we reached an agreement with WPU Leasing whereby they agreed to defer cash payments on approximately 70% of the $1.9 million of debt outstanding through December 1, 2016 which reduces our cash outflow commitments by approximately $500,000 during fiscal 2016. WPU Leasing also has the option of taking these payments in shares of our Common Stock which will again positively impact our cash flow position going forward. Our Board of Directors has determined that our cash resources are not currently sufficient to permit the payment of cash dividends in respect of the 10% Convertible Preferred Stock and the Series B 10% Convertible Preferred Stock.

The Board of Directors has therefore determined to suspend the payment of cash dividends, commencing with the dividend payable on September 30, 2015, until such time as the Board of Directors determines that we possess funds legally available for the payment of dividends. Holders of approximately 69% of the 10% Convertible Preferred Stock and 100% of the Series B 10% Convertible Preferred Stock have agreed to defer cash payments indefinitely. We will continue to offer the option for holders to take shares of our Common Stock in lieu of cash.

C. Amendment of Trident Promissory Note

In December 2015, we amended the terms of the $1.716 million of secured notes payable to Trident Resources whereby we consolidated the two notes into one and are not required to make any payments under the note until such time as the two purchased NGL processing systems are producing a minimum of 200,000 gallons of saleable product on a monthly basis. The original notes would have required cumulative payments through September 2016 of approximately $900,000 which based on our fiscal 2016 operating plan has been reduced to $240,000.

D. Iowa State Bank Working Capital Line of Credit

Iowa State Bank has agreed to extend our working capital line of credit which was scheduled to mature January 15, 2016 to April 15, 2016 in order to provide additional time to complete their formal renewal process. In addition, we have had preliminary discussions regarding the increase of our $500,000 limits later in fiscal 2016 as collateral levels and performance dictate. However, there can be no assurance that the Bank will renew or increase the line of credit.

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, 2015 are unaudited and should be read in conjunction with the financial statements and notes thereto for the fiscal year ended September 30, 2015 included in our Annual Report on Form 10-K. The balance sheet at September 30, 2015 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, 2015 and the operating results for the interim periods ended December 31, 2015 and 2014 have been included.

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, 2015 and September 30, 2015, we have pledged a $309,984 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.

Note Receivable, Related Party

On June 30, 2015, we entered into a Loan and Security Agreement with Trident Resources LLC (“Trident”), pursuant to which we loaned Trident $737,190 under the terms of a 6% senior secured demand promissory note due September 30,2015. The note is secured by a first priority security interest in all of Trident’s assets and has been guaranteed on a secured basis by Trident’s sole owner.

On December 1, 2015, we amended and restated the note to extend the maturity until December 31, 2015 and provide for certain additional penalties in the event of any default under such note, including a 5% penalty for late payment. During the three months ended December 31,2015 Trident repaid $240,000, of the outstanding principal balance including $50,000 in cash and equipment valued at $190,000. As of December 31, 2015, Trident did not pay the outstanding principal and accrued interest balance when due and as a result we recorded a late payment penalty of approximately $25,800. As of December 31, 2015, the outstanding principal balance was $497,190 and accrued but unpaid interest and late fees were approximately $45,000.

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, 2015. 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, 2015 and September 30, 2015, we recorded an inventory valuation allowance of $198,755 and $193,637.

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, 2015	September 30, 2015
Raw materials	$433,610	$514,041
Work in progress	56,989	25,784
Finished goods	59,174	1,169
Total inventory	$549,773	$540,994

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 exclusive license agreement from Trident, we recognized $300,000 associated with the execution of the agreement. The value is being amortized on a straight line basis over an estimated useful life of 120 months. Amortization expense associated with the long term technology license agreement is $7,500 and $0 for the three months ended December 31, 2015 and 2014, respectively. Accumulated amortization was $12,500 and $5,000 at December 31, 2015 and September 30, 2015, respectively.

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, 2015 and 2014, respectively. Accumulated amortization was $641,667 at December 31, 2015 and $616,667 at September 30, 2015.

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, 2015 and 2014, 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, 2015, we have capitalized $4,422,844 of software development costs associated with our OUL ($1,801,506) and IUL ($2,621,338) 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, 2015 and 2014 were $180,412 and $129,985, respectively. Accumulated amortization was $1,557,584 and $1,377,172 at December 31, 2015 and September 30, 2015, respectively.

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

Twelve months ending December 31:	NGL Services Contracts	Dual Fuel Contracts	Technology	Software Development	Total
2016	$30,000	$50,000	$50,000	$732,589	$862,589
2017	30,000	50,000	50,000	684,302	814,302
2018	30,000	50,000	50,000	471,294	601,294
2019	30,000	29,167	29,167	337,414	425,748
2020	30,000	—	—	294,803	324,803
2021 and thereafter	137,500	—	—	344,858	482,358
	$287,500	$179,167	$179,167	$2,865,260	$3,511,094

7. Property, Plant and Equipment

Property, plant and equipment consist of the following:

	December 31, 2015	September 30, 2015	Estimated Useful Lives
Leasehold improvements	$127,087	$127,087	5 years
Machinery and equipment	3,268,599	3,342,202	3 - 10 years
Construction in progress	1,832,546	1,436,908	
Less accumulated depreciation	(1,238,130)	(1,167,144)	
	$3,990,102	$3,739,053	

8. 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 remained approximately the same during the three months ended December 31, 2015. 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, 2015	Twelve Months Ended September 30, 2014
Warranty accrual at the beginning of the period	$167,180	$221,562
Charged to costs and expenses relating to new sales	10,503	70,426
Costs of product warranty claims	(10,469)	(124,808)
Warranty accrual at the end of period	$167,214	$167,180

12

9. Notes Payable/Credit Facilities

The following summarizes our notes payable as of December 31, 2015 and September 30, 2015.

	December 31, 2015	September 30, 2015	Due Date	Interest Rate
Iowa State Bank, line of credit	$700,000	$500,000	April 15, 2016	8%
Iowa State Bank, notes payable	2,497,721	2,541,414	October 15, 2021	8%
Other unsecured term notes payable	68,004	44,315	February 27, 2016 and June 12, 2016	3.35% - 3.85%
	3,265,725	3,085,729		
Less current portion	(1,136,033)	(880,698)		
Notes payable, non-current portion	$2,129,692	$2,205,031		

Credit Facilities

On October 27, 2014, we entered into a loan agreement and new working capital line of credit with Iowa State Bank in which we refinanced approximately $2,567,000 due to the bank under an existing loan agreement, $30,000 for transaction fees and $150,000 due one of our officers. Under the terms of the new term loan, we are required to 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. The credit facility requires us to meet certain monthly loan covenants. As of December 31, 2015, we were not in compliance with our working capital covenant but Iowa State Bank agreed to waive the default.

Iowa State Bank has provided a $500,000 working capital line of credit which had an initial expiration of January 15, 2016 and was extended to April 15, 2016 in order to provide additional time to complete their formal renewal process. On December 14, 2015, Iowa State Bank provided us with an additional $200,000 of availability under the terms of the working capital line under the condition it was repaid by January 31, 2016, which it was.

All borrowings under the term loan and the line of credit bear interest at a rate equal to the base rate on corporate loans posted by at least 70% of the 10 largest U.S. banks (known as The Wall Street Journal U.S. Prime Rate) plus 4.0%, with a minimum interest rate of 8.0% per annum. Our obligations due Iowa State Bank continue to be secured by the grant of a first priority security interest in all of our assets including a $309,984 certificate of deposit. In addition, under the terms of a stock transfer agreement, should we fail to make any payment when due, we have agreed to issue Iowa State Bank that number of shares of common stock which is equal in value to the past due amount. For purposes of determining the number of shares of common stock to be issued under the stock transfer agreement, the value of our common stock will be deemed to be the closing price of the common stock on the date of such default. In no event, however, will we be obligated to issue more than 2,000,000 shares of the common stock under the stock transfer agreement. In addition, one director and two officers have each pledged 500,000 shares of our common stock owned by them in the aggregate, as additional collateral to Iowa State Bank.

10. Notes Payable, Related Parties

	December 31, 2015	September 30, 2015	Due Date	Interest Rate
Term Note Payable, Trident Resources, LLC	$1,716,500	$1,716,500	Varying maturity dates	6%
Term Note Payable, WPU Leasing, LLC	1,885,774	1,385,843	Varying maturity dates	22.2%
Officer's Promissory Note	50,000	50,000	May 31, 2016	8%
	3,652,274	3,152,343		
Less current portion	(707,344)	(386,083)		
Notes payable, non-current portion	$2,944,930	$2,766,260		

Notes Payable-Related Party-Trident Resources, LLC

On August 12, 2015, we purchased two processing systems from Trident for $1,716,500 and in return we issued Trident a promissory note for $832,000, which was payable in 12 equal monthly installments of principal and interest at 6.75% commencing September 20, 2015 and a second secured promissory note for $884,500, which was payable in 36 equal monthly installments of principal and interest at 6% commencing September 20, 2016. These notes are secured by liens on the purchased equipment.

As of December 1, 2015, we amended and restated these two secured promissory notes and combined the obligations of the original notes into a new note for $1,716,500 which bears interest at 6% per year with 48 monthly payments of principal and interest estimated to initially begin on February 29, 2016 assuming the Trident NGL Services division meets specified production goals in the preceding month. If these productions goals are not met, the new note provides that we may defer payments otherwise due in any month following a month in which the production goals are not met to the maturity date, without incurring any additional interest. The amended and restated note also permits us to offset against amounts otherwise due under such note in the event of any default by Trident under their promissory note to the Company.

Financing Agreement -WPU Leasing, LLC

On August 24, 2015, we entered into a Secured Financing Agreement with WPU Leasing LLC, an accredited institutional investor, the members of which are affiliated with certain members of our Board of Directors. Pursuant to this agreement, WPU Leasing committed to loan us up to $3,250,000 to fund our purchase of two additional wellhead gas processing systems. Our initial note of $1,400,000 under the financing agreement was issued on August 24, 2015 and the second note of $500,000 was issued on October 9, 2015. The notes bear interest at the rate of 22.2% per annum, and are secured by a security interest in the purchased equipment and are guaranteed by the Company.

In January 2016, we reached an agreement with WPU Leasing whereby they agreed to defer cash payments on approximately 70% of the $1.9 million of debt outstanding. The deferral of payments reduces our cash outflow commitments by approximately $500,000 during fiscal 2016. WPU Leasing also has the option of taking these payments in shares of our Common Stock which will again positively impact our cash flow position going forward.

In consideration of WPU Leasing's commitment under the financing agreement, we issued to WPU Leasing's members warrants to purchase up to the lesser of (i) an aggregate of 3,250,000 shares of our Common Stock or (ii) one share of Common Stock for each dollar borrowed by the us under the related Loan Agreement. The initial exercise price of the warrants is $0.20 per share and are exercisable for a period of four years from the date of issue and may be exercised on a cashless basis. We determined the value of these warrants using the Black Scholes option pricing model and recorded deferred financing costs of $86,293, which will be amortized over the term of the finance agreement.

Note Payable-Related Party- Other

On December 12, 2015, we amended, as of September 30, 2015, an unsecured promissory note dated as of September 17, 2010 issued to an Officer in the original principal amount of $50,000. As of the date of the amendment, the outstanding principal balance of the note was $50,000. The amendment extends the maturity date of the promissory note and amortizes principal payments, together with accrued interest, over a 5 month period commencing on January 15, 2016.

Contingent Convertible Promissory Notes - Related Parties

On June 2, 2015, we completed a private placement of $2.475 million of Contingent Convertible Promissory Notes with several existing shareholders and investors affiliated with members of our Board of Directors.

The unsecured Notes bear simple interest at the rate of 10% per annum and were automatically converted into shares of Series C Convertible Preferred Stock at a conversion price of $10,000 per share on October 21, 2015 upon the effectiveness of the filing of a Certificate of Designation of Preferences, Rights and Limitations of Series C Convertible Preferred Stock with the Secretary of State of Delaware. The outstanding principal amount $2,475,000, together with approximately $96,000 of accrued but unpaid interest automatically was converted into approximately 257 shares of our Series C Convertible Preferred Stock . In addition, we issued the investors five year warrants to purchase up to 12,853,053 shares of Common Stock at an exercise price of $0.20 per share.

Each share of Series C Convertible Preferred Stock is convertible into shares of our common stock at a conversion price of $0.20 per share. Upon the conversion of the Notes into shares of Series C Convertible Preferred Stock, we issued to each investor a five year warrant to purchase a number of shares of common stock equal to the number of shares issuable upon conversion of the Series C Convertible Preferred Stock, exercisable at $0.20 per share. In addition, one of the investors, Arrow LLC, was granted the right under certain conditions to designate two members of our Board of Directors.

We determined the discount on the contingent convertible promissory note to be $1,556,687 of which $906,874 was allocable to warrants and $649,813 was allocable to the intrinsic value of the conversion feature. The discount was recorded as paid-in-capital and as non-cash financing expense on the date of the conversion and is included in the results for the three months ended December 31, 2015.

In connection with this private placement, our securities purchase agreements dated April 30, 2012 and November 26, 2014 were amended to provide that the issuance of the Series C Convertible Preferred Stock would not trigger adjustments to the exercise price of the warrants issued in connection with those agreements (the "Prior Warrants"). We also amended the Prior Warrants to extend the term of any Prior Warrant held by the purchasers of the Notes (and their affiliates, members of their families and certain related trusts) as of the issuance of the Notes or subsequently acquired by such persons. The maximum period by which any Prior Warrant was extended is the difference between 60 months and the remaining term of the respective Prior Warrant as of the initial issuance of the Notes. The fair value of the warrants before and after the modification was determined using Black-Scholes and recorded on the balance sheet, and the difference between fair value of the extended terms and of the existing terms of $454,253 was recognized in the income statement as non-cash warrant extension expense during the third quarter of the fiscal year ended September 30, 2015.

Each share of Series C Preferred Stock is convertible, at any time at the option of any holder, into 50,000 shares of the Company's Common Stock, at a conversion price of $0.20 per share. The conversion ratio of the Series C Preferred Stock is subject to adjustment in the event that, with certain exceptions, we issue shares of Common Stock or other securities convertible into or exchangeable for Common Stock at a price per share that is less than the then applicable conversion price of the Series C Preferred Stock. The Series C Preferred Stock does not bear dividends.

The holders of the Series C Preferred Stock will vote with the holders of the Common Stock and the holders of the Company's 10% Convertible Preferred Stock (the "Series A Preferred Stock") and Series B 10% Convertible Preferred Stock on all matters presented to the holders of the Preferred Stock, on a Common Stock-equivalent basis. In addition to certain approval rights of the holders of the Series A Preferred Stock and/or the Series B Preferred Stock, the approval of the holders of at least 67% of the outstanding shares of Series C Preferred Stock will be required before we may take certain actions as described in the Certificate of Designation.

The holders of the Series C Preferred Stock have priority in the event of a liquidation of the Company over the outstanding shares of Common Stock. Upon liquidation, dissolution or winding up of the Company, whether voluntary or involuntary, before any distribution or payment is made to the holders of the Common Stock, the holders of the Preferred Stock will be entitled to be paid out of the assets of the Company an amount equal to the stated value of the Preferred Stock, which is initially $10,000 per share, plus (in the case of the Series A Preferred Stock and the Series B Preferred Stock) any accrued, but unpaid, dividends.

The Preferred Stock may be required to convert into shares of Common Stock at our election if the trading price of the Common Stock meets certain thresholds as set forth in the Certificate of Designation. If we fail to meet certain obligations affecting the Preferred Stock, the holders of Preferred Stock may require the Company to redeem the Preferred Stock.

11. Warrants to Purchase Common Stock

In conjunction with the private placement of our 10% Convertible Preferred stock in April 2012 and November 2014, we issued warrants which contained a "down-round" provision that provides for a reduction in the warrant exercise price if there are subsequent issuances of additional shares of common stock for consideration per share less than the per share warrant exercise prices. 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. Pursuant to this guidance and effective commencing October 1, 2013, we have recognized the fair value of these warrants as a liability and have re-measured the fair value of these warrants on a quarterly basis with any increase or decrease in the estimated fair value being recorded in

15

other income or expense for the respective quarterly reporting period.

We have historically used the Black-Scholes option pricing model to determine the fair value of options and warrants. We have considered the facts and circumstances in choosing the Black-Scholes model to calculate the fair value of the warrants with a down-round price protection feature as well as the likelihood of triggering the down-round price protection feature, which, as described below, we have concluded is remote.

In determining the initial fair value of the warrants associated with the April 2012 Convertible Preferred Stock private placement as of October 1, 2013, we prepared a valuation simulation using the Black Scholes option pricing model as well as additional models using a modified Black Scholes option pricing model and a Binomial Tree option pricing model. We determined the initial fair value of the warrants associated with the November 2014 Convertible Preferred Stock private placement to be $694,631 based on a valuation simulation using the Black Scholes option pricing model. Both additional simulations included various reset scenarios, different exercise prices, and other assumptions, such as price volatility and interest rates, that were kept consistent with our original Black-Scholes model. The resulting warrant values as determined under the modified Black-Scholes model and the Binomial Tree option model were not materially different from the values generated using the Black-Scholes model. We have therefore determined to use the Black-Scholes model as we believe it provides a reasonable basis for valuation and takes into consideration the relevant factors of the warrants, including the down round provision.

During the three months ended December 31, 2015 and December 31, 2014, we recorded warrant valuation income of $194,261 and $4,487,006 associated with the change in the estimated fair value of all warrants containing the down round provision outstanding. Our warrant liability was $29,347 and $223,608 as of December 31, 2015 and September 30, 2015, respectively.

The warrant liabilities were valued at December 31, 2015, using the Black-Scholes option-pricing model with the following assumptions.

	10% Convertible Preferred Stock Financing					
Warrants	Private Placement 1		Private Placement 2		Private Placement 3	
	December 31, 2015	September 30, 2015	December 31, 2015	September 30, 2015	December 31, 2015	September 30, 2015
Closing price per share of common stock	$0.12	$0.29	$0.12	$0.29	$0.12	$0.29
Exercise price per share	0.50	0.50	0.50	$0.50	0.50	0.50
Expected volatility	70.0 %	64.0 %	70.0 %	64.0 %	70.0 %	64.0 %
Risk-free interest rate	1.1 %	0.6 %	1.3 %	— %	1.5 %	1.6 %
Dividend yield	—	—	—	—	—	—
Remaining expected term of underlying securities (years)	1.8	2.0	2.8	3.0	4.4	4.6
Warrants outstanding	17,623,387	17,623,387	6,032,787	6,032,787	5,000,000	5,000,000
Warrants outstanding with down-round provision	2,742,763	2,742,763	905,917	905,917	—	—

Private Placement 1 - April 30, 2012, sale of 821.6 units of 10% Convertible Preferred Stock

Private Placement 2 - March 31, 2013, additional investment right from Private Placement 1, sale of approximately 274 units of 10% Convertible Preferred Stock.

Private Placement 3 - November 28, 2014, sale of 200 shares of Series B 10% Convertible Preferred Stock

12. Fair Value Measurements

The carrying amount of our receivables and payables approximate their fair value due to their short maturities. Accounting principles provide guidance for using fair value to measure assets and liabilities. The guidance includes a three level hierarchy of valuation techniques used to measure fair value, defined as follows:

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Level 1 - Unadjusted Quoted Prices. The fair value of an asset or liability is based on unadjusted quoted prices in active markets for identical assets or liabilities.

- Level 2 - Pricing Models with Significant Observable Inputs. The fair value of an asset or liability is based on information derived from either an active market quoted price, which may require further adjustment based on the attributes of the financial asset or liability being measured, or an inactive market transaction.
- Level 3 - Pricing Models with Significant Unobservable Inputs. The fair value of an asset or liability is primarily based on internally derived assumptions surrounding the timing and amount of expected cash flows for the financial instrument. Therefore, these assumptions are unobservable in either an active or inactive market.

We consider an active market as one in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. Conversely, we view an inactive market as one in which there are few transactions of the asset or liability, the prices are not current, or price quotations vary substantially either over time or amount market makers. When appropriate, non-performance risk, or that of a counterparty, is considered in determining the fair values of liabilities and assets, respectively.

We have classified certain warrants related to the 10% Convertible Preferred Stock private placements noted in Note 11 as a Level 3 Liability. Assumptions used in the calculation require significant judgment. The unobservable inputs in our valuation model includes the probability of additional equity financing and whether the additional equity financing would trigger a reset on the down-round protection.

The following table summarizes the financial liabilities measured a fair value on a recurring basis as of September 30, 2015 and December 31, 2015.

	Total	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2015				
Warrant liability	$223,608	$—	$—	$223,608
December 31, 2015				
Warrant liability	$29,347	$—	$—	$29,347

Level 3 Valuation

The following table provides a summary of the changes in fair value of our financial liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the three month period ended December 31, 2015.

	Warrant Liability
Level 3	
Balance at September 30, 2015	$223,608
Revaluation of warrants recognized in earnings	(194,261)
Balance at December 31, 2015	$29,347

13. Stockholders' Equity

Authorized Shares

On October 21, 2015, our shareholders approved an amendment to our Restated Certificate of Incorporation to increase the number of authorized shares of Common Stock from 150 million to 200 million shares.

10% Convertible Preferred Stock Dividends

Our Board of Directors has determined that our cash resources are not currently sufficient to permit the payment of cash dividends in respect of the 10% Convertible Preferred Stock and the Series B 10% Convertible Preferred Stock. The Board of Directors has therefore determined to suspend the payment of cash dividends, commencing with the dividend payable on September 30, 2015, until such time as the Board of Directors determines that the Company possesses funds legally available for the payment of dividends. Holders of approximately 69% of the 10% Convertible Preferred Stock and 100% of the Series B 10% Convertible Preferred Stock have agreed to defer cash payments indefinitely.

17

During the three months ended December 31, 2015, we recorded a dividend on our 10% Convertible Preferred Stock and Series B 10% Convertible Preferred Stock of $284,444, of which $53,114 remains in accrued dividends. Certain stockholders agreed to accept 2,283,307 shares of Common Stock (valued at $269,431) in lieu of cash dividend payments of $231,331 due for the current quarter and $38,100 due for previous quarters.
During the three months ended December 31, 2014, we recorded a dividend on our 10% Convertible Preferred Stock of $265,324, of which $137,944 was paid in cash. Certain stockholders agreed to accept 387,636 shares of Common Stock (valued at $127,380) in lieu of cash dividend payments.
Stock Options
In October 2015, we granted options to a new director to purchase 250,000 shares of our Common Stock at an exercise price of $0.25 per share, which represented the closing price of our stock on the date of the grant. The options were granted under the 2005 Stock Option Plan, have a five-year term and vest equally over a period of fifteen months from date of grant. The fair value of the options at the date of grant in aggregate was $35,394, which was determined on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions; dividend yield of 0%; risk-free interest rates of approximately 1.4%; expected volatility based on historical trading information of 68% and expected term of 5 years.
Amortization of stock compensation expense was $27,136 and $9,161 for the three months ended December 31, 2015 and 2014, respectively. Our Board of Directors agreed to extend the exercise period from 3 months to 18 months on options to purchase 340,000 shares of our Common Stock owned by a former director who resigned on October 1, 2015. The fair value of the options before and after the modification was determined using Black-Scholes and the difference between fair value of the extended terms and of the existing terms of $15,793 is included in the stock compensation expense for the three months ended December 31, 2015.
The unamortized compensation expense at December 31, 2015 was $64,815 and will be amortized over a weighted average remaining life of approximately 1.62 years.
14. Segment Information
We have two reportable operating segments: (1) dual fuel conversion operations and (2) natural gas liquids operations. Each operating segment has its respective management team.
Our Chief Executive Officer has been identified as the chief operating decision maker (CODM) as he is responsible for assessing the performance of the segments and decides how to allocate resources to the segments. Income (loss) from operations is the measure of profit and loss that our CODM uses to assess performance and make decisions. Assets are a measure used to assess the performance of the company by the CODM; therefore we will report assets by segment in our disclosures. Income (loss) from operations represents the net sales less the cost of sales and direct operating expenses incurred within the operating segments as well as the allocation of some but not all corporate operating expenses. These unallocated costs include certain corporate functions (certain legal, accounting, wage, public relations and interest expense) and are included in the results below under Corporate in the reconciliation of operating results. Management does not consider unallocated Corporate in its management of segment reporting.
There were no sales between segments for the three months ending December 31, 2015 and December 31, 2014.

	Dual Fuel Conversions	NGL Services	Corporate	Consolidated
Three Months Ended December 31, 2015				
Net sales	$464,668	$29,982	$—	$494,650
Amortization	205,412	7,500	28,132	241,044
Depreciation	60,351	43,325	—	103,676
Operating loss from continuing operations	(662,481)	(235,916)	(397,855)	(1,296,252)
Interest and financing costs	81,272	114,245	7,536	203,053
Total assets	5,844,019	3,691,897	1,036,586	10,572,502
Capital expenditures	2,993	395,638	—	398,631
Software development	47,596	—	—	47,596

	Dual Fuel Conversions	NGL Services	Corporate	Consolidated
Three Months Ended December 31, 2014				
Net sales	$1,055,966	$—	$—	$1,055,966
Amortization	154,985	—	9,161	164,146
Depreciation	75,719	—	—	75,719
Operating loss from continuing operations	(403,237)	—	(362,813)	(766,050)
Interest and financing costs	70,711	—	(5,906)	64,805
Total assets	7,559,063	—	1,973,363	9,532,426
Capital expenditures	7,160	—	—	7,160
Software development	151,310	—	—	151,310

15. Subsequent Event

Issuance of Series D 10% Convertible Preferred Stock

On January 8, 2016, we sold 22 shares of Series D Convertible Preferred Stock for gross proceeds of $2.2 million to several existing shareholders and entities affiliated with several members of our Board of Directors and issued warrants to purchase up to 44,000,000 shares of our Common Stock at an exercise price of $.10 per share. Each share of the Series D 10% Convertible Preferred Stock which has a stated value of $100,000, is convertible, at any time at the option of the holder, into 1 million shares of Common Stock at a conversion price of $0.10 per share. The warrants are subject to certain exercise restrictions, do not contain cashless exercise provisions and do not contain anti-dilution protections. All of the warrants previously issued to each investor in this financing were amended to provide that the investor may not exercise those warrants until the investor exercises the new warrants for cash. The Series D Preferred Stock has a 10% annual dividend, payable quarterly in cash or in shares of Common Stock at our Board of Director’s discretion.

The holders of the Series D Preferred Stock will receive certain liquidation preferences over the holders of our other convertible preferred stock and common stock, and have been provided similar preferential treatment with respect to all other shares of convertible preferred stock held by them.

In connection with this private placement, our securities purchase agreements dated April 30, 2012, November 26, 2014 and June 2, 2015 were amended to reduce the exercise price on approximately 23 million warrants previously issued to the Purchasers (and their affiliates, members of their families and certain related trusts) in conjunction with these agreements to the Series D Preferred Stock conversion price noted above. Management is evaluating the potential recognition of additional expense in conjunction with the implementation of this provision.

The terms of the April 30, 2014, Voting Agreement between us and the 10% Convertible Preferred Stock holders was amended to allow the holders of a majority of the Series D Convertible Preferred Stock to designate (i) three persons to be appointed or elected to our Board of Directors and (ii) nominate three candidates for election to the Board of Directors by the holders of Common Stock voting together as a single class.

Further details of the financing are set forth in a current report on Form 8-K, which we filed with the Securities and Exchange Commission on January 12, 2016 and in certain exhibits to our Annual Report on Form 10-K for the fiscal year ended September 30, 2015.

Extension of Iowa State Bank Revolving Line of Credit

On January 15, 2016, Iowa State Bank agreed to extend the maturity of our $500,000 Revolving line of credit from January 15, 2016 to April 15, 2016 in order to complete their formal renewal process. On December 14, 2015, Iowa State Bank provided us with an additional $200,000 of availability under the terms of the working capital line under the condition it was repaid by January 31, 2016 which it was.

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, 2015 and in Item 1A of this Quarterly Report. 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, 2015.
Results of Operations
Three Months ended December 31, 2015 Compared to the Three Months ended December 31, 2014
Net sales for the three months ended December 31, 2015 decreased $561,316 or 53% to $494,650 as compared to net sales of $1,055,966 for the three months ended December 31, 2014. Due to increased oil reserves and a decrease in the growth rate of demand throughout certain parts of the world the price of oil in the U.S. has dropped to the $30 per barrel range which has resulted in a steady decrease in diesel prices during the three months ended December 31, 2015. While natural gas prices at the pump have remained stable, the price spread between lower diesel prices and natural gas have tightened. Because our dual fuel technology displaces higher cost diesel fuel with lower cost and cleaner burning natural gas, the recent decrease in oil/diesel pricing has impacted the timing of dealer restocking orders and the implementation schedules of existing and prospective customers in the near term due to the current tighter price spread between diesel and natural gas.
North American stationary revenues for the three months ended December 31, 2015 were approximately $282,892 which was $697,999 or 71% lower as compared to revenue of $980,891 for the three months ended December 31, 2014. The decrease was primarily due to the decline in active drilling rigs in the oil and gas industry.
Domestic vehicular revenues for the three months ended December 31, 2015 increased $16,817 or 22% to $91,892 as compared to revenues of $75,075 for the three months ended December 31, 2014. International vehicular revenues for the three months ended December 31, 2015 increased $89,883 as compared to no revenues for the three months ended December 31, 2014. The increase was attributable to an increase in fleet sales for the quarter.
Revenues from the Trident NGL Services division were $29,982 for the three months ended December 31, 2015. There were no sales for the three months ended December 31, 2014.

During the three months ended December 31, 2015 our gross loss was $291,356 or 59% of net sales as compared to a gross profit of $269,055 or 25% of net sales for the three months ended December 31, 2014. The decrease in gross profit was primarily due to decreased revenues and fixed overhead costs.
Selling, general and administrative expenses for the three months ended December 31, 2015 decreased $30,209 or 3% to $1,004,896 as compared to $1,035,105 for the three months ended December 31 2014.

During the three months ended December 31, 2015 the revaluation of our warrant liability to fair value resulted in non-cash revaluation income of $194,261 as compared to a non-cash revaluation income of $4,487,006 during the three months ended December 31, 2014.

During the three months ended December 31, 2015, interest and financing expense increased $138,248 or 213% to $203,053 as compared to $64,805 for the three months ended December 31, 2014 due to increased borrowings and interest rates for our Trident NGL Services division. In addition, during the three months ended December 31, 2015, we recorded additional non-cash financing expense of $1,556,687 resulting from the recognition of the discount upon conversion of the contingent convertible promissory notes.

Our net loss for the three months ended December 31, 2015 increased $6,489,121 or 179% to a net loss of $2,864,818 or $(0.05) per basic share as compared to a net income of $3,624,303 or $0.07 per basic share for the three months ended December 31, 2014. The calculation of net loss per share available to Common shareholders for the three months ended December 31, 2015 reflects the inclusion of Convertible Preferred Stock quarterly dividends of $284,445. The calculation of net income per share available for Common shareholders for the three months ended December 31, 2014 reflects the inclusion of quarterly Convertible Preferred Stock dividends of $265,324 and a beneficial conversion feature of $394,631.

Liquidity and Capital Resources

As of December 31, 2015, we had $527,793 in cash, cash equivalents and restricted certificates of deposit and working capital deficit of $1,982,684. We continue to incur recurring losses from operations, which raises substantial doubt about our ability to continue as a going concern unless we secure additional capital to fund our operations as well as implement initiatives to reduce our cash burn in light of lower diesel/natural gas price spreads and the impact it has had on our business as well as the slower than anticipated ramp of our flare capture and recovery business. The accompanying financial statements do not include any adjustments that might result from the outcome of the uncertainty.

Management understands that our continued existence is dependent on our ability to generate positive operating cash flow, achieve profitability on a sustained basis and generate improved performance. Based on the information discussed below, our fiscal 2016 operating plan, the recent $2.2 million Series D Convertible Preferred Stock private placement closed January 8, 2016, the cash saving initiatives that have been implemented below and anticipated cash flows from operations, we believe we will have sufficient resources to satisfy our cash requirements into the first quarter of 2017.

In order to ensure the future viability of American Power Group, management has implemented or is in the process of implementing the following actions:

A.Series D Convertible Preferred Stock Private Placement:

On January 8, 2016, we completed a $2.2 million private placement of Series D Convertible Preferred Stock with accredited investors affiliated with several members of our Board of Directors and shareholders. In addition, we issued warrants to purchase 44 million shares of Common Stock at $.10 which do not contain a cashless exercise provision. Pursuant to the terms of the offering, the investors are required to exercise all Series D warrants before exercising any other warrants they or their affiliates own (all containing cashless provisions). In addition, all minority Series D investors are required to match on a pro-rata basis the exercise of any warrants by the majority investor or lose those warrants to the majority investor.

B. Deferment of WPU Leasing Payments and Cash Dividend Payments

In January 2016, we reached an agreement with WPU Leasing whereby they agreed to defer cash payments on approximately 70% of the $1.9 million of debt outstanding through December 1, 2016 which reduces our cash outflow commitments by approximately $500,000 during fiscal 2016. WPU Leasing also has the option of taking these payments in shares of our Common Stock which will again positively impact our cash flow position going forward.

Our Board of Directors has determined that our cash resources are not currently sufficient to permit the payment of cash dividends in respect of the 10% Convertible Preferred Stock and the Series B 10% Convertible Preferred Stock. The Board of Directors has therefore determined to suspend the payment of cash dividends, commencing with the dividend payable on September 30, 2015, until such time as the Board of Directors determines that the Company possesses funds legally available for the payment of dividends. Holders of approximately 69% of the 10% Convertible

Preferred Stock and 100% of the Series B 10% Convertible Preferred Stock have agreed to defer cash payments indefinitely. We will continue to offer the option for holders to take shares of our Common Stock in lieu of cash.

C. Amendment of Trident Promissory Note

In December 2015, we amended the terms of the $1.716 million of secured notes payable to Trident Resources whereby we consolidated the two notes into one and are not required to make any payments under the note until such time as the two purchased NGL processing systems are producing a minimum of 200,000 gallons of saleable product on a monthly basis. The original notes would have required cumulative payments through September 2016 of approximately $900,000 which based on our fiscal 2016 operating plan has been reduced to $240,000.

D. Iowa State Bank Working Capital Line of Credit

Iowa State Bank has agreed to extend our working capital line of credit which was scheduled to mature January 15, 2016 to April 15, 2016 in order to provide additional time to complete their formal renewal process. In addition, we have had preliminary discussions regarding the increase of our $500,000 limits later in fiscal 2016 as collateral levels and performance dictate. However, there can be no assurance that the Bank will renew or increase the line of credit.

The Condensed Consolidated Statement of Cash Flows reflect events for the three months ended December 31, 2015 and 2014 as they affect our liquidity.

During the three months ended December 31, 2015, net cash used in operating activities was $492,509. Our net loss for the three months ended December 31, 2015 was $2,864,818, inclusive of $194,261 of non-cash warrant revaluation income, and additional non-cash financing expense of $1,556,687 related to the discount on the contingent convertible promissory notes. Our cash flow was positively impacted by the following non-cash expenses and changes to our working capital: the collection of $630,425 of accounts receivable and $364,915 of depreciation, amortization, bad debt provision, inventory valuation allowance and compensation expense associated with stock options. During the three months ended December 31, 2014, net cash provided by operating activities was $279,615. Our net income for the three months ended December 31, 2014 was $3,624,303, inclusive of $4,487,006 of non-cash warrant revaluation income. Our cash flow was positively impacted by non-cash expenses and changes to our working capital of $247,817 consisting of depreciation, amortization, warrants, bad debt provision and compensation expense associated with stock options and was offset by a decrease of $193,627 in accounts payable and accrued expenses.

Net cash used in investing activities was $23,095 for the three months ended December 31, 2015, reflecting primarily the capitalization of $44,139 of costs associated with our dual fuel electronic control unit engine family software applications and equipment purchases of $20,766 for property, plant and equipment. Net cash used in investing activities was $109,608 for the three months ended December 31, 2014, reflecting the capitalization of $106,245 of costs associated with our dual fuel electronic control unit engine family software applications and the purchase of $3,363 of property, plant and equipment.

Net cash provided by financing activities was $620,061 during the three months ended December 31, 2015, reflecting the net proceeds of $200,000 from our working capital line of credit with Iowa State Bank and $500,000 in proceeds from WPU Leasing, LLC for our construction in progress costs. Payments made on notes payable totaled $79,939. Net cash provided by financing activities was $1,930,801 during the three months ended December 31, 2014, reflecting the net proceeds of $1,948,119 from the sale of our Series B Preferred Stock and warrant and $380,000 advanced under our working capital line. Payments made on notes payable totaled $249,457 and we paid dividends to holders of our preferred stock of $147,861.

Effects of Inflation and Changing Prices

We are generally 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 have been negatively impacted by any material change in the net fuel savings between the two fuels (such as a decrease in diesel fuel prices and an increase in natural gas prices). We were unaffected by interest rate changes during the three months ended December 31, 2015, because our only floating rate debt is with Iowa State Bank and at WSJ prime plus 4% (7.25%), which was below the stated minimum rate of 8%.

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, 2015. 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, 2015, 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, 2015 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

Item 1A. Risk Factors

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

During the three months ended December 31, 2015, we issued approximately 257 shares of Series C Convertible Preferred Stock and warrants to purchase 12,853,053 shares of Common Stock to a group of investors upon the conversion of $2.57 million of notes payable and accrued interest. The issuance of these securities is exempt from registration under the Securities Act pursuant to Sections 3(a)(9) and/or 4(2) of the Securities Act.

During the three months ended December 31, 2015, we issued 2,283,307 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
3.1 (1)	—	Restated Certificate of Incorporation of American Power Group Corporation, as amended
10.1 (2)	—	Amended and Restated Secured Promissory Note dated December 1, 2015, in the principal amount of $1,716,500.00, issued by American Power Group Corporation in favor of Trident Resources LLC
10.2 (2)	—	Amended and Restated Senior Secured Demand Promissory Note dated as of December 1, 2015, in the principal amount of $497,190.00, issued by Trident Resources LLC in favor of American Power Group Corporation
10.3 (1)	—	Secured Term Note #2, dated October 9, 2015, in the principal amount of $500,000.00, issued by American Power Group Corporation in favor of WPU Leasing, LLC
10.4 (1)	—	Forbearance and Waiver Agreement dated January 8, 2016 among WPU Leasing, LLC, American Power Group Corporation and American power Group, Inc.
10.5 (1)	—	Securities Purchase Agreement dated as of January 8, 2016, among American Power Group Corporation and the purchasers named therein
10.6 (1)	—	Form of Warrant issued to investors named in the Securities Purchase Agreement dated January 8, 2016
10.7 (1)	—	Amended and Restated Voting Agreement dated January 8, 2016, among American Power Group Corporation and the investors named therein
10.8 (1)	—	Form of Amendment to Warrants dated as of January 8, 2016, between American Power Group Corporation and the holders of certain previously issued warrants who are also parties to the Securities Purchase Agreement dated as of January 8, 2016
10.9 (1)	—	Form of Amendment to Warrants dated as of January 8, 2016, between American Power Group Corporation and the holders of certain previously issued warrants
10.10 (1)	—	Amendment No. 2, dated January 8, 2016, to Registration Rights Agreement dated as of June 2, 2015, among American Power Group Corporation and the other parties named therein
10.11 (1)	—	Stockholder Consent, Amendment to Securities Purchase Agreements and Waiver, amending the Securities Purchase Agreements dated April 30, 2012 and November 26, 2014
10.12 (3)	—	Change in Terms Agreement, between American Power Group, Inc. and Iowa State Bank, dated as of January 15, 2016
31.1 (4)	—	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a)
31.2 (4)	—	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a)
32.1 (5)	—	Certification of Chief Executive Officer under 18 U.S.C. Section 1350
32.2 (5)	—	Certification of Chief Financial Officer under 18 U.S.C. Section 1350
101.SCH (6)	—	XBRL Taxonomy Extension Schema Document
101.CAL (6)	—	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF (6)	—	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB (6)	—	XBRL Taxonomy Extension Label Linkbase Document
101.PRE (6)	—	XBRL Taxonomy Extension Presentation Linkbase Document

(1) Filed as an Exhibit to American Power Group Corporation's Annual Report on Form 10-K for the fiscal year ended September 30, 2015, and incorporated herein by reference.

(2) Filed as an Exhibit to American Power Group Corporation's Form 8-K dated December 12, 2015 and filed December 16, 2015, and incorporated herein by reference.

(3) Filed as an Exhibit to American Power Group Corporation's Form 8-K dated January 15, 2016 and filed January 25, 2016, and incorporated herein by reference.

(4) Filed herewith.

(5) 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 “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.

(6) 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 11, 2016

26