

### Acceleware Corp. (TSX-V: AXE) – Q4 beat expectations; Early signs of recovery in industry – FINAL REPORT

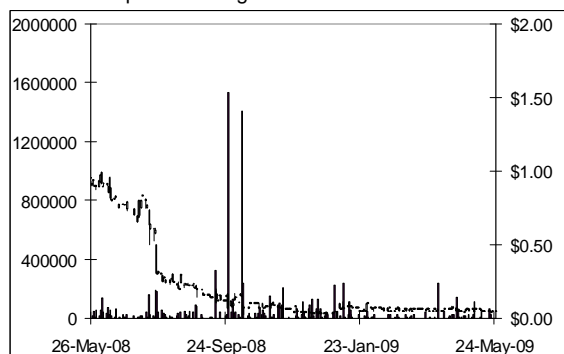
Sector/Industry: Technology

www.acceleware.com

#### Market Data (as of May 25, 2009)

Current Price	C\$0.05
Fair Value	C\$0.80 ↑
Rating*	BUY
Risk*	4 (Speculative)
52 Week Range	C\$0.02 -C\$0.99
Shares O/S	50,281,330
Market Cap	C\$2.51 mm
Current Yield	N/A
P/E (forward)	N/A
P/B	1.40
YoY Return	-94.7%
YoY TSX-V	-59.5%

\*see back of report for rating and risk definitions



#### Q4-2008 Highlights

- AXE initiated a transition to a software-only sales model in Q1-09.
- Q4 revenues beat expectations as the company reported \$0.89 million (versus our forecast of \$0.50 million) from product sales and maintenance.
- AXE was successful in significantly reducing their general and administrative (G&A) and research and development (R&D) costs from \$2.99 million in Q3-2008, to \$1.24 million in Q4-2008, a 59% decrease.
- A \$1.1 million sale of software assets announced earlier this year, and the G&A and R&D cost-cuts, have significantly reduced the company's cash requirements for this year from outside sources. Our models now estimate the company will have to raise only \$0.35 million in 2009; which can be brought down further if the company continues to cut operating expenses.
- Early signs of recovery in the industry – According to the Semiconductor Industry Association (SIA), global sales of semiconductors in March 2009 were US\$14.7 billion, up 3.3% from US\$14.2 billion in February 2009. According to some other sources, graphic chip sales in Q1-2009, although down 21% YOY, were up 3.3% QOQ.

#### Financial Summary (YE Dec 31)

(C\$)	2006 (17 mo)	2007	2008	2009E	2010E
Revenue	1,030,115	2,400,475	3,612,119	2,185,098	2,865,141
EBITDA	(2,216,812)	(6,324,586)	(9,554,876)	(2,371,740)	(1,603,365)
Net Income	(2,267,738)	(6,737,746)	(10,496,871)	(1,407,906)	(1,755,783)
EPS	(0.13)	(0.20)	(0.25)	(0.03)	(0.03)
Cash	626,996	6,196,894	1,052,724	6,128	25,935
Debt	-	-	355,587	355,587	355,587
Assets	1,817,544	12,569,293	3,097,041	1,911,657	2,108,083
ROE	-113%	-60%	-583%	-156%	-140%

Acceleware Corp. (TSXV: AXE), based in Calgary, Alberta, develops, manufactures and markets special purpose software / hardware accelerators used to reduce engineering design simulation and data processing run times. According to Acceleware, simulations that take 5 - 8 hours can be completed within just 15-30 minutes using the company's accelerators. Acceleware's solutions are deployed by several major companies worldwide, including Philips, Samsung, Eli Lilly, Nokia, Mitsubishi, Sony Ericsson, and others.

**Key Focus for 2009**

We believe AXE's key focus areas in 2009 will be the following:

1. **Transition to a software-only sales model in 2009:** The company initiated a transition to a software-only sales model in Q1-2009. As mentioned in our previous report, although this move would lead to a drop in revenues, it will result in a significant improvement in gross margins, from 35 –45%, to over 75% (as software sales have much higher gross margins), and a significant reduction in costs related to inventory management, inventory procurement, and related costs associated with hardware components. We do not believe that the change in sales model will adversely impact demand for AXE's products, as end-users can use AXE's software on off-the shelf GPUs readily available in the market.
2. **Increase focus on generating sales from inactive channel partners -** AXE currently has about eight channel partners. However, over 80% of revenues comes from only three partners. We believe it is essential for the company to focus on generating more sales from inactive partners (including Agilent Technologies: NYSE: A), as much as they focus on adding new partners.
3. **Continue to focus on core vertical markets –** AXE plans to focus efforts and strengthen their position in mature vertical markets, namely, the electromagnetic (EM) simulation and oil & gas markets, before moving on to other applications.
4. **Pursue alternative revenue streams –** AXE is also pursuing alternative revenue streams, including professional services agreements with key customers (some of which have already started). If successful, this will positively impact cash flows going forward.
5. **Continue to reduce operating expenses, and limit capital expenditures –** AXE was successful in significantly reducing their G&A and R&D costs from \$2.99 million in Q3-2008, to \$1.24 million in Q4-2008, a 59% decrease. Discussions with management indicated that the company plans to cut costs further in 2009, which will also have a positive impact on cash flows going forward.

**Major developments since our previous report**

**Announces New Software Sales Contract -** In January 2009, the company announced it has entered into an agreement with one of its leading channel partners to sell:

- certain application-specific software assets (specific to the vendor)
- provide a non-exclusive license for additional software components and
- provide services for the software assets

The agreement, valued at \$1.11 million, consists of an up-front cash payment of approximately \$0.85 million upon signing, plus an additional payment of approximately \$0.18 million upon final delivery. The agreement also includes an ongoing services relationship that has a minimum value of approximately \$79,000 in 2009.

The software applications being sold are specific to the vendor; therefore, the agreement does not affect sales of other solutions provided by AXE to the vendor or other clients. Upon

completion of this sale, there will be no further product revenues (which we estimate are less than \$0.10 million per annum) to AXE from the particular application from the vendor.

**We believe the signing of this sales agreement is very timely for AXE as it provides two main advantages for the company – (1) provides immediate cash flows; (2) reiterates the efficiency and recognition of AXE’s products in the market today**

**Seismic data processing company chooses AXE’s solutions** - In February 2009, the company announced that Key Seismic Solutions Ltd., a Calgary based seismic data processing company, has chosen AXE’s seismic acceleration solution to speed-up processing using Kirchhoff Pre-Stack Time Migration (KTM) algorithms (for the oil and gas industry) and lower costs in their data center. AXE’s solution integrates seamlessly with Key Seismic’s existing processing software, enabling it to run faster and more economically on GPUs.

**Appoints new CFO** - In February 2009, the company announced the appointment of Geoff Clark as its new Chief Financial Officer. A brief biography of Mr. Clark, as provided by the company, follows:

*Mr. Clark has held several executive and managerial positions in a number of service and technology companies, including Pan Terra Industries, Revolve Magnetic Bearings, Nova Corporation, and most recently as CFO of TSX listed Guest-Tek Interactive Entertainment Ltd. Mr. Clark holds an MBA from the University of Western Ontario as well as a B.Sc. in Electrical and Computer Engineering from the University of Calgary.*

**Q4 revenues  
beat  
expectations**

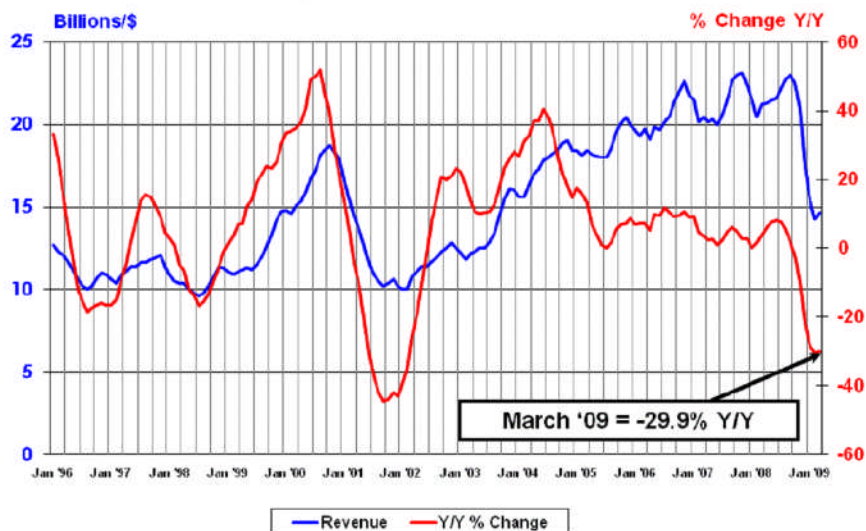
Q4 revenues beat expectations as the company reported \$0.89 million (versus our forecast of \$0.50 million) from product sales and maintenance. Q4 revenues were down 6% YOY. However, we were pleased to see a 101% QOQ increase after a disappointing Q3, when revenues were down 23% YOY. Strong growth in sales and a strong US\$ (with respect to the C\$) were the primary revenue drivers in Q4. For the 12 month period in FY2008, the company reported \$3.61 million in revenues versus \$2.40 million in 2007. Our forecast for FY2008 was \$3.22 million.

In FY2008, 91% of the company’s revenues, and 77% of the cost of goods sold were in US\$. Although we expect the company to receive most of their revenues (over 90%+) in US\$ going forward, cost of goods sold in US\$ as a percentage of total costs will significantly drop as a result of the transition to a software-only sales model (this is because of the significant reduction in inventory costs associated with the hardware components). Although we expect the US\$ (with respect to the C\$) to drop from current levels, we expect it to stay well above 2008 levels, and therefore, positively benefit AXE in 2009.

**Early signs of recovery in the industry** – According to the Semiconductor Industry Association (SIA), global sales of semiconductors in March 2009 were US\$14.7 billion, up 3.3% from US\$14.2 billion in February 2009. Q1 sales were US\$44 billion, down 29.9% YOY and 15.7% QOQ. The following chart shows global semiconductor revenues since 1996.

## Worldwide Semiconductor Revenues

Year-to-Year Percent Change



Source: WSTS

The SIA stated that sales in all geographic regions except Japan showed month-to-month gains in March. We believe this could be an early sign of recovery in this space.

According to some sources, graphic chip sales in Q1-2009, although down 21% YOY, were up 3.3% QOQ. We believe this is another sign indicating that demand for graphic chip sales might be recovering. We expect the sector to start recovery by the end of this year along with the recovery of global economic growth.

**AXE Revenue Forecasts** - Although we believe the current economic slowdown will soften demand for AXE's products in 2009, we continue to believe in AXE's technology and believe there is a lot of room for growth as the company adds new channel partners and generates more sales from their inactive partners. A positive Q4 has prompted us to raise our revenue forecasts for FY2009 from \$1.97 million to \$2.19 million. We have introduced our forecasts for FY2010 in this report. Our revenue forecast for FY2010 is \$2.87 million.

### **Gross margins improve**

The company recorded a \$0.61 million inventory write-down associated with slow moving and obsolete inventories in Q4. Excluding the write-down, AXE reported gross margins of 40% in Q4, versus our forecast of 35%. For the 12 month period, gross margins (excluding inventory write downs) were 36% versus 42% in FY2007. We continue to expect a significant improvement in gross margins in FY2009, as the company moves to a software-only sales model. We have maintained our gross margin forecast for FY2009, and FY2010, at 55%, and 75%, respectively. Margins are expected to improve in 2010, as the company completes its transition to the new model.

### **Lowers G&A and R&D costs by 59% QOQ**

The company reported a 59% QOQ decrease in G&A and R&D costs combined, as they dropped from \$2.99 million in Q3, to \$1.24 million in Q4. This is a very good achievement considering our estimate for Q4 was \$2.46 million. Cost reduction was primarily done by

reducing the number of personnel from approximately 90 to 39 as at December 31, 2008. About \$0.4 million of restructuring charges were incurred in Q4. AXE expects to incur \$0.10 million in additional restructuring charges in Q1-2009, and the overall restructuring should be completed by now.

EBITDA was (\$1.49million) in Q4-2008, versus (\$1.91 million) in Q4-2007, and (\$2.97 million) in Q3-2008. Excluding inventory write-downs and restructuring charges, AXE would have recorded EBITDA of (\$0.47 million) in Q4-2008. For FY2008, EBITDA was (\$9.55 million) versus (\$6.32 million) in FY2007. Excluding inventory write downs and restructuring charges, EBITDA would have been (\$7.58 million) in FY2008.

The company wrote down \$0.78 million of property and equipment (\$0.27 million), ABCP investments (\$0.32 million) and from loss on disposal of surplus property and equipment (\$0.20 million) in Q4. AXE reported a net loss of \$2.32 million in Q4, versus \$2.12 in Q4-2007. Our forecast for net loss in Q4 was \$2.32 million. For FY2008, the company reported a net loss of \$10.50 million (EPS: -\$0.25) versus \$6.74 million (EPS: -\$0.20) in FY2007.

**Revised EPS**

A significant drop in our cost estimates led us to raise our EPS forecasts for FY2009. Our revised EPS forecast for FY2009 is a net loss of \$1.41 million (EPS: -\$0.03), up from our previous forecast of \$4.90 million (EPS: -\$0.10). Our EPS forecast also includes a \$1.1 million gain on disposal of assets from the recently announced sales agreement. Our forecast for FY2010 is a net loss of \$1.76 million (EPS: -\$0.03).

**Improved balance sheet**

The company spent \$0.35 million on operating and investing activities in Q4. These costs were funded by equity issuances totaling \$0.4 million in the quarter. During the year, the cash cycle dropped from 122 to 42 days, primarily because of the significant inventory write off in Q4. It is worth noting that the company also reduced its days receivables and days payables outstanding accordingly.

<b>Liquidity Analysis</b>	<b>2007</b>	<b>2008</b>
Current Ratio	7.20	1.26
Working Capital (in \$)	8,698,740	334,670
Debt / Equity	-	19.7%
Interest Coverage Ratio	-	-
<b>Activity Analysis</b>	<b>2007</b>	<b>2008</b>
Days Accounts Receivable	129	76
Inventory Days	185	78
Days Accounts Payable	192	112
<b>Cash Conversion Cycle</b>	<b>122</b>	<b>42</b>

At the end of FY2008, the company had \$1.05 mm in cash. Working capital and the current ratio were \$0.33 million and 1.3x, which were better than our forecasts of (\$0.39 million) and 0.8x, respectively.

The company continues to hold debt of \$0.36 million (line of credit with no set maturity date). Debt to equity was 20% at the end of FY2008.

The \$1.1 million sale of software assets announced earlier this year, and the G&A and R&D cost-cuts, have significantly reduced the company’s cash requirements for this year from outside sources. Previously, we were expecting the company would have to raise over \$4 million in 2009, to fund its operating and investing activities. Our models now estimate the company will have to raise only \$0.35 million in 2009; which can be brought down further if the company continues to cut operating expenses.

**Stock Options and Warrants**

We estimate the company currently has 4.41 million stock options outstanding (weighted average exercise price of \$0.35 per share) and 2.43 million warrants outstanding (weighted average exercise price of \$1.29 per share). None of the outstanding options and warrants are currently ‘in-the-money’.

**Valuation and Rating**

We did not make any major changes to our long-term forecasts in our DCF model. However, in our previous report, we were expecting the company to have to raise close to \$4.25 million in FY2009, and therefore, had included the impact of share dilution in our model. As we are now more confident in the company’s ability to cut costs, we do not foresee a need for any major financing this year. Our valuation increased from \$0.75 per share to \$0.83 per share as we removed the negative impact of potential share dilution from our model.

DCF Valuation - Acceleware Inc.										
(in C\$, 1000's)										
	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	Terminal
FFO	(2,190)	(1,418)	(731)	(324)	(92)	4,183	5,481	7,040	8,188	9,406
WC Investment	(215)	(262)	(185)	(103)	(104)	(140)	(176)	(208)	(134)	(137)
CFO	(2,405)	(1,680)	(916)	(427)	(196)	4,043	5,305	6,832	8,054	9,270
CAPEX	1,008	(200)	(500)	(500)	(500)	(500)	(500)	(500)	(500)	(500)
FCF	(1,397)	(1,880)	(1,416)	(927)	(696)	3,543	4,805	6,332	7,554	8,770
PV	(1,283)	(1,542)	(1,037)	(606)	(406)	1,846	2,236	2,631	2,802	36,148
Discount Rate	12%									
Growth Rate	3%									
Net Present Value	\$40,789									
Debt	356									
Cash	\$1,233									
Total Value	\$41,667									
No. of shares (dil)	50,281									
<b>Fair value per share</b>	<b>\$0.83</b>									

The company’s shares continue to be undervalued compared to industry average valuation multiples. AXE’s shares are currently trading at a forward P/S of 1.2x, and a P/B of 1.4x. The average P/S and P/B of the application software industry are 2.2x and 2.7x, respectively.

**Therefore, based on our review of Q4 results, and our revised valuation model, we reiterate our BUY recommendation, and raise our fair value slightly to \$0.80 per share.**

**Risks** The following risks, though not exhaustive, will cause our estimates to differ from actual results:

- HPC market is highly competitive and barriers to entry in the market are very low.
- Entry into the EM market was relatively easier for the company, as management has had good relationships with the industry for the past two decades. However, the success of the company's entry into new design simulation markets will depend heavily on the company's ability to attract potential partners and timing of entry into new markets.
- AXE will be adversely affected if it is not able to cope with changes in technology. Keep in mind that the HPC market has had rapid technological changes in the past 10 years.
- Like all other companies, the overall performance of the company depends heavily on market growth and will be adversely affected if the overall markets slow down.
- Our models indicate that the company will have to raise about \$0.35 million in FY2009 to fund operations and working capital. An equity financing at current share prices will result in significant share dilution.

**We continue to rate the shares Risk 4 (Speculative).**

## Appendix

### Acceleware Corp.- Income Statement

(in C\$)

	2007	2008	2009E	2010E
<b>Revenues</b>				
Product Sales	2,220,564	3,205,984	1,950,000	2,100,000
Maintenance	179,911	406,135	235,098	765,141
Consulting	-	-	-	-
	<b>2,400,475</b>	<b>3,612,119</b>	<b>2,185,098</b>	<b>2,865,141</b>
<b>Expenses</b>				
Costs of Product Sales	1,383,369	3,041,933	983,294	716,285
General and Administrative	5,295,647	6,485,998	2,049,617	2,152,098
Research and Development	2,046,045	3,639,064	1,523,927	1,600,123
	<b>8,725,061</b>	<b>13,166,995</b>	<b>4,556,838</b>	<b>4,468,506</b>
<b>EBITDA</b>	(6,324,586)	(9,554,876)	(2,371,740)	(1,603,365)
Amortization	211,143	241,522	168,919	131,352
<b>EBIT</b>	<b>(6,535,729)</b>	<b>(9,796,398)</b>	<b>(2,540,659)</b>	<b>(1,734,717)</b>
Interest	231,403	185,797	24,752	(21,067)
Write-down of Assets & Investments	(433,420)	(586,492)		
Gain on disposals		(299,778)	1,108,000	
Taxes	-	-	-	-
<b>Income (Loss)</b>	<b>(6,737,746)</b>	<b>(10,496,871)</b>	<b>(1,407,906)</b>	<b>(1,755,783)</b>
Earnings(Loss) per Share	(0.20)	(0.25)	(0.03)	(0.03)

**Acceleware Corp.- Balance Sheet**  
(in C\$)

	2007	2008	2009E	2010E
<b>Assets</b>				
<b>Current</b>				
Cash	6,196,894	1,052,724	6,128	25,935
Short-term Investments	1,550,017	-	-	-
Accounts Receivables	1,198,480	312,340	327,765	429,771
Inventory	1,077,306	217,981	147,494	143,257
Prepaid Expenses	78,457	47,583	32,776	42,977
	<b>10,101,154</b>	<b>1,630,628</b>	<b>514,164</b>	<b>641,941</b>
Deferred Charges	-	-	-	-
Investment	1,011,313	721,817	721,817	721,817
Property and Equipment	1,456,826	744,596	675,677	744,325
Intangible Assets				
	<b>12,569,293</b>	<b>3,097,041</b>	<b>1,911,657</b>	<b>2,108,083</b>
<b>Liabilities and Shareholders' Equity</b>				
<b>Current</b>				
Accounts Payables and Accrued Liabilities	1,177,404	693,051	491,647	286,514
Current Debt		355,587	355,587	355,587
Deferred Revenue	225,010	247,320	163,882	214,886
	<b>1,402,414</b>	<b>1,295,958</b>	<b>1,011,117</b>	<b>856,987</b>
<b>Shareholders' Equity</b>				
Share Capital	19,131,605	17,667,950	18,017,950	19,917,950
Contributed Surplus	1,365,390	3,960,120	4,117,484	4,323,823
Deficit	(9,330,116)	(19,826,987)	(21,234,893)	(22,990,677)
	<b>11,166,879</b>	<b>1,801,083</b>	<b>900,541</b>	<b>1,251,096</b>
<b>Total Liabilities &amp; S.E</b>	<b>12,569,293</b>	<b>3,097,041</b>	<b>1,911,657</b>	<b>2,108,083</b>

**Acceleware Corp.- Statement of Cash Flows**  
(in C\$)

	<b>2007</b>	<b>2008</b>	<b>2009E</b>	<b>2010E</b>
<b>Cash Flows from Operating Activities</b>				
<b>Loss for the Period</b>	(6,737,746)	(10,496,871)	(1,407,906)	(1,755,783)
Items not Involving Cash:				
Amortization	299,788	483,044	168,919	131,352
Write-Down of Intangible Asset				
Write-Down of Investment & Assets	433,420	1,323,958		
Loss (Gain) on Disposals		299,778	(1,108,000)	
Accrued Interest on Investments		(20,943)		
Stock-Based Compensation	499,048	260,134	157,364	206,339
	<b>(5,505,490)</b>	<b>(8,150,900)</b>	<b>(2,189,623)</b>	<b>(1,418,093)</b>
<b>Changes in Non-Cash Working Capital Items:</b>				
Accounts Receivable	(704,349)	886,140	(15,425)	(102,006)
Prepaid Expenses	(64,376)	30,874	14,807	(10,201)
Inventory	(753,102)	(103,821)	70,487	4,237
Deferred Charges	-	-	-	-
Accounts Payables and Accrued Liabilities	903,125	(484,353)	(201,404)	(205,133)
Deferred Revenue	100,687	22,310	(83,438)	51,003
	<b>(518,015)</b>	<b>351,150</b>	<b>(214,973)</b>	<b>(262,100)</b>
	<b>(6,023,505)</b>	<b>(7,799,750)</b>	<b>(2,404,596)</b>	<b>(1,680,193)</b>
<b>Cash Flows from Financing Activities</b>				
Issuance of Common Shares	15,986,636	870,942	350,000	1,900,000
Issuance of Warrants and Options	-	-	-	-
Debt		350,977		
	<b>15,986,636</b>	<b>1,221,919</b>	<b>350,000</b>	<b>1,900,000</b>
	<b>4,834,453</b>	<b>401,806</b>		
<b>Cash Flows from Investing Activities</b>				
Purchase of Property and Equipment	(1,398,483)	(116,356)	(100,000)	(200,000)
Investments	(2,994,750)	1,550,017		
Sale of Assets			1,108,000	
Net Monetary Assets Acquired				
	<b>(4,393,233)</b>	<b>1,433,661</b>	<b>1,008,000</b>	<b>(200,000)</b>
	<b>(1,648,979)</b>	<b>3,480</b>		
<b>Increase in Cash</b>	<b>5,569,898</b>	<b>(5,144,170)</b>	<b>(1,046,596)</b>	<b>19,807</b>
Cash, Beginning of Period	626,996	6,196,894	1,052,724	6,128
<b>Cash, End of Period</b>	<b>6,196,894</b>	<b>1,052,724</b>	<b>6,128</b>	<b>25,935</b>

**Buy** – Annual expected rate of return exceeds 12% or the expected return is commensurate with risk

**Hold** – Annual expected rate of return is between 5% and 12%

**Sell** – Annual expected rate of return is below 5% or the expected return is not commensurate with risk

**Suspended or Rating N/A**— Coverage and ratings suspended until more information can be obtained from the company regarding recent events.

**Fundamental Research Corp. Risk Rating Scale:**

**1 (Low Risk)** - The company operates in an industry where it has a strong position (for example a monopoly, high market share etc.) or operates in a regulated industry. The future outlook is stable or positive for the industry. The company generates positive free cash flow and has a history of profitability. The capital structure is conservative with little or no debt.

**2 (Below Average Risk)** - The company operates in an industry where the fundamentals and outlook are positive. The industry and company are relatively less sensitive to systematic risk than companies with a Risk Rating of 3. The company has a history of profitability and has demonstrated its ability to generate positive free cash flows (though current free cash flow may be negative due to capital investment). The company’s capital structure is conservative with little to modest use of debt.

**3 (Average Risk)** - The company operates in an industry that has average sensitivity to systematic risk. The industry may be cyclical. Profits and cash flow are sensitive to economic factors although the company has demonstrated its ability to generate positive earnings and cash flow. Debt use is in line with industry averages, and coverage ratios are sufficient.

**4 (Speculative)** - The company has little or no history of generating earnings or cash flow. Debt use is higher. These companies may be in start-up mode or in a turnaround situation. These companies should be considered speculative.

**5 (Highly Speculative)** - The company has no history of generating earnings or cash flow. They may operate in a new industry with new, and unproven products. Products may be at the development stage, testing, or seeking regulatory approval. These companies may run into liquidity issues, and may rely on external funding. These stocks are considered highly speculative.

**Disclaimers and Disclosure**

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