

24 August 2009

Sofame Technologies (SDW.V)

Sofame has embarked on an ambitious strategy of expanding its manufacturing representative base (SMR) while investing in the infrastructure to support a much larger volume of business than it currently enjoys. Booked revenues this year have been extremely disappointing, although the latest sales for 3Q09 were encouraging; the company has been hit by the severe downturn in the capital goods cycle not helped by its own inability to close deals. Sofame has moved to remedy these issues by supporting its SMRs with its own technical personnel in a co-selling role in order to achieve quicker and higher closing rates. Its 'project pipeline' while very large, is lumpy and subject to innumerable vagaries/delays, it therefore lacks earnings visibility; this makes quarterly forecasts of the company's performance extremely tricky. With actual financial 2009 revenues looking to dip below our 'pessimistic' scenario made last October and costs significantly above those anticipated, we have materially lowered our core valuation.

KEY POINTS

- **Profit deferred... again**

The latest results for 3Q09 showed a marked improvement over the previous two quarters and a major improvement on 3Q08, yet the company still posted a net operating loss. Cumulatively, while the results for the 9 month period to 30 June 2009 show revenue to be 32.2% ahead at C\$2.16m and gross profit 38.1% better at C\$901k, the operating loss widened from C\$897k to C\$1.75m. Our estimates indicate that the company will incur a further loss for 4Q09, even though revenues should be over C\$1m.

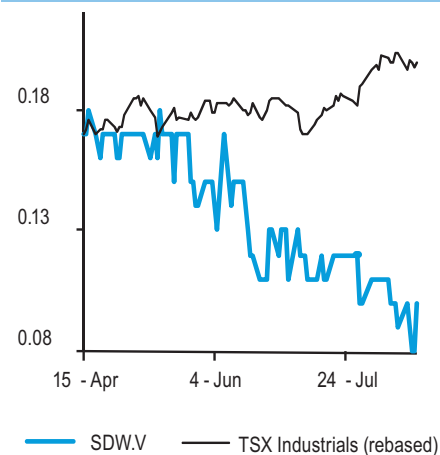
- **New personnel, waiting for the cavalry**

New key sales personnel were appointed at end of April in an attempt to reduce the long sales cycle involved in its custom-engineered products and in early May Michel Brisson assumed the role of President and CEO. Although these changes are positive for the company, we don't see them making much impact until the broader economy improves. Over the last two months, there have been the first signs that the housing market in the US is starting to stabilize and could be the harbinger of better news in 2010. However, the capital goods cycle is likely to lag and so Sofame may not benefit until later. In any case, a higher gas price would act as a more immediate galvanizer sales to persuade wavering customers of the cost benefit.

Price: C\$0.10

Diversified Machinery/Cleantech

Price chart (C\$)



Current fair value of equity

Expected Value	C\$12.5m
Value per share	C\$0.11

Company details

Quote

Shares	
- TSX Venture	SDW.V
Hi-Lo last 12-mos. (C\$)	0.27 - 0.08
Shares issued (m)	99.9
Fully diluted (m)	128
Market Cap'n (C\$m)	10.0
Website:	www.sofame.com

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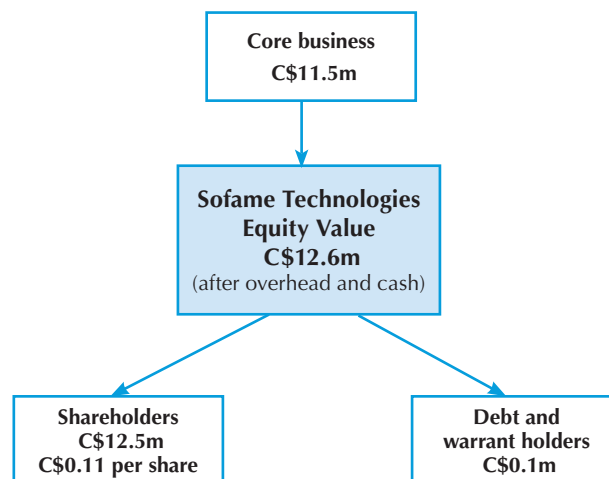
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Fair value summary (C\$m)

Scenario	Core	Optimistic	Pessimistic
Value of firm	11.5	34.3	(5.8)
Add: starting cash + new funds	0.3	0.3	0.3
Total current value for firm	11.8	34.5	(5.6)
Less: starting & new debt	(0.8)	(0.8)	(0.8)
Total value to equity claims	12.6	35.3	(4.8)
Less: Options/Convertibility	0.1	1.4	0.0
Ordinary Equity Holders	12.5	33.9	(4.8)
Value per share (C\$ps)	0.11	0.32	(0.06)

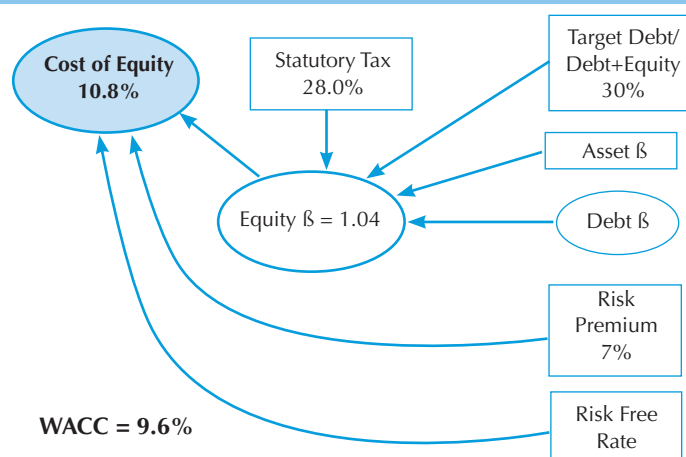
Components of Sofame's entity value



Scenario Assumptions

	Pessimistic				Core				Optimistic			
	2008A	2009F	2010F	2011F	2008A	2009F	2010F	2011F	2008A	2009F	2010F	2011F
Profit & Loss (C\$m)												
Sales	1.69	3.29	5.09	6.78	1.69	3.29	8.06	11.59	1.69	3.29	10.95	16.25
COGS	0.94	1.91	3.26	4.31	0.94	1.91	4.78	6.82	0.94	1.91	6.02	8.88
Gross profit	0.75	1.38	1.83	2.47	0.75	1.38	3.28	4.76	0.75	1.38	4.93	7.37
Gross margin %	44%	42%	36%	36%	44%	42%	41%	41%	44%	42%	45%	45%
Selling & Administrative expense, stock comp; amort.	2.5	3.6	2.8	3.1	2.5	3.6	3.2	3.7	2.5	3.6	3.6	4.3
Operating EBIT	(1.7)	(2.3)	(1.0)	(0.6)	(1.7)	(2.3)	0.1	1.1	(1.7)	(2.3)	1.3	3.1
EBITDA	(1.5)	(1.9)	(0.7)	(0.3)	(1.5)	(1.9)	0.3	1.4	(1.5)	(1.9)	1.6	3.4
EBITDA margin %	n/a	-59%	-14%	-4%	-91%	-59%	4%	12%	n/a	-59%	15%	21%

Weighted cost of capital



- ***No distribution without representation***

Four new SMRs have been added in North America since October 2008 and one SMR in Mexico. North America now has a total of 18 SMRs. Where organizations have multiple plants, Sofame has tried to increase effectiveness by developing relationships at head office as well as local level. Initiatives to reduce the sales cycle by supporting SMRs directly with Sofame's own technical personnel are likely to become evident from 4Q09 onwards.

- ***Patent pending***

A previous patent on the Sofame steam pump expired and is in the process of being upgraded. Management thinks this could make a major difference to the business given that the product has a price tag of around US\$750k, a gross margin of 40 percent and wide application. However, this is not likely to make any impact before 2011.

- ***Capital raising deferred... but not forgotten***

The C\$5m capital raising that was to have gone ahead in July has been shelved. However, on the basis of our core forecasts it is but a plan postponed - only on the basis of our most optimistic forecasts will the company not require further funding; either new equity, further bank lending facilities, or a mixture of both. Management has put the infrastructure in place (and the costs associated that go with that) in order to secure some highly impressive revenue growth but these 'orders' have yet to translate into sales.

With a fundamental deterioration in its cost structure (the true fixed element of its administrative and selling and marketing expense is in excess of C\$2m but probably nearer C\$3m), the business will have to run exceedingly fast just to stay still. Its cost structure seems to imply breakeven sales of around C\$7.0m in 2010, more than double likely 2009 sales.

Highly geared operationally, there does not appear to be a Plan B. The step change in revenues promised in its business plan in 2008 are now not an option, they are a necessity.

- ***Earnings, earnings...***

On the basis of our core projections we estimate 2010 earnings of C\$24k and EPS of C\$0.00024 (C\$0.00019, fully diluted). Our core 2011 earnings are estimated at C\$1.1m and EPS of C\$0.0107 (C\$0.0084, fully diluted), i.e. 2011 P/E ratios of 9.3x and 11.9x, respectively.

- ***"Do ya' deliver?"***

In terms of valuation, the current share price actually reflects our reduced expectations but not the effect of further equity dilution should management decide to go down that funding route. The risk at this juncture is that if sales do not materialize as envisaged and the cost of new funding is prohibitive i.e. too dilutive, both could severely punish our core valuation estimate. On a brighter note, there is also considerable potential upside in the value of equity but the rub is whether management can actually deliver the sales in 2010.

Latest operating results

On 22 July, Sofame released its results for the three months ending 30 June and the nine month period to 30 June 2009, these are presented with Q-on-Q comparatives and our estimates for 4Q09.

The bottom line

- For the quarter ended 30 June 2009, the net after tax loss was C\$486k compared to 3Q08 net after tax loss of C\$655k in 3Q08; the basic and diluted loss per share was C\$0.0038 in 3Q09, compared to C\$0.0071 in 3Q08.
- For the nine months ended 30 June, the after tax loss increased to C\$2.14m nine months to 30 June 2008 after tax loss of C\$1.15m; the respective loss per share was C\$0.0167 in 2009, compared to a loss of C\$0.0122 in 2008.
- The results per share are based on average outstanding shares in issue of 127.88m in 2009, compared to 94.19m in 2008.

Our view on the numbers

We have noted in the past the tortuous process of turning project pipeline into definitive go-ahead contracts; the current period has proved no exception and arguably it has been one of the most challenging environments ever for the sale of capital equipment (1Q09 and 2Q09 were dire, combined revenues of just C\$616k; the 1Q08 and 2Q08 combined comparative, C\$1.35m).

Quarterly financial statements and the forecast for 4Q09 - third quarter compared

Profit & loss accounts (C\$)	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09F	3Q08 v 3Q09
Turnover	589,411	766,027	276,908	55,523	327,096	289,363	1,542,085	1,127,616	457%
Cost of goods sold	(361,259)	(449,711)	(115,226)	73,491	(183,192)	(160,576)	(818,787)	(620,189)	611%
Production profit	228,152	316,316	161,682	129,014	143,904	128,787	723,298	507,427	347%
Depreciation	(12,499)	(16,464)	(24,692)	(31,512)	(30,736)	(31,718)	(32,293)	(30,000)	31%
Gross profit	215,653	299,852	136,990	97,502	113,168	97,069	691,005	477,427	404%
Amortisation	(1,744)	(1,726)	(1,725)	(101,387)	(22,356)	(34,910)	(37,186)	(82,935)	2056%
SG&A	(382,725)	(433,914)	(727,904)	(437,568)	(628,380)	(683,469)	(812,468)	(900,000)	12%
Stockbased compensation	—	—	—	(395,525)	(203,332)	—	(225,071)	—	
Operating profit	(168,816)	(135,788)	(592,639)	(836,978)	(740,900)	(621,310)	(383,720)	(505,508)	-35%
EBITDA	(154,573)	(117,598)	(566,222)	(704,079)	(687,808)	(554,682)	(314,241)	(392,573)	-45%
Interest expense	(68,236)	(112,736)	(72,476)	(59,934)	(58,625)	(51,371)	(104,680)	(50,000)	44%
Profit before exceptional	(237,052)	(248,524)	(665,115)	(896,912)	(799,525)	(672,681)	(488,400)	(555,508)	-27%
Sofame Europe	—	—	—	(291,127)	(106,390)	(73,703)	2,090	—	
Profit before tax	(237,052)	(248,524)	(665,115)	(1,188,039)	(905,915)	(746,384)	(486,310)	(555,508)	-27%
Income tax	—	—	—	—	—	—	—	—	
Net profit	(237,052)	(248,524)	(665,115)	(1,188,039)	(905,915)	(746,384)	(486,310)	(555,508)	-27%

Source: Objective Capital

Shareholders had to wait until the release of 3Q09 results to see any benefit of the group's growth strategy. Sales in 3Q09 were C\$1.54m compared to C\$0.276k in 3Q08. The gross margin in 3Q09 (after depreciation but before amortization) was 44.8% (3Q08, 49.5%). Although the selling environment is difficult, a compensating factor on the input side has seen some price stabilization for the different components required for Sofame's water-heaters. This has resulted in gross margins being relatively stable.

In summary, for the first nine months of fiscal 2009 turnover was C\$2.16m, a 32.2% increase on fiscal 2008 (C\$1.63m). As we have noted, most of these orders were booked in 3Q09 and derive from shipments of heat recovery equipment to Canadian and American customers.

However, as can be noted, the P&L also had to absorb further charges through stock based compensation schemes so that although 3Q09 has finally delivered the turnover always promised by the business, there is still an attributable loss, albeit at a reduced level when compared to 3Q08. However, even if we add back the stock based compensation charge (which is a non cash charge), there would have still been an attributable loss of C\$261k.

In the cash flow table below, this shows clearly how 3Q08 and 3Q09 both benefitted from significant additions of equity capital that have been necessary to finance the business. But whereas there was a positive change in working capital that benefitted the company in 3Q08 this reversed itself in 3Q09 to the tune of C\$850k. Q-on-Q however the company's cash position increased by C\$179k.

Quarterly cash flows and forecast for 4Q09 - third quarter compared									
Cash flow from ops (C\$)	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09F	3Q08 v 3Q09
Net profit (loss)	(237,052)	(248,524)	(665,115)	(1,188,039)	(905,915)	(746,384)	(486,310)	(555,508)	-27%
Depreciation & amortisation.	14,243	18,190	26,417	132,899	53,092	66,628	69,479	112,935	163%
Adjustment	—	—	(362,829)	(184,200)	(10,000)	(47,134)	(183,919)	—	-49%
Gross cash flow	(222,809)	(230,334)	(1,001,527)	(1,239,340)	(862,823)	(726,890)	(600,750)	(442,573)	-40%
Change in working capital	(90,560)	(877,219)	236,147	146,110	363,086	553,925	(850,035)	(44,302)	-460%
CFO	(313,369)	(1,107,553)	(765,380)	(1,093,230)	(499,737)	(172,965)	(1,450,785)	(486,875)	90%
Cash flow from investing									
Change in fixed assets	(31,058)	(158,520)	(180,414)	(529,518)	(133,871)	(191,778)	(176,575)	84,824	-2%
Change in other assets	(147,986)	11,941	216,818	18,871	18,872	34,910	34,911	(90)	-84%
CFI	(179,044)	(146,579)	36,404	(510,647)	(114,999)	(156,868)	(141,664)	84,734	-489%
Cash flow from financing									
Change in debt	1,685,764	978,084	(2,956,671)	(1,559,834)	(9,847)	(9,856)	(9,876)	(10,509)	-100%
Change in share capital	50,000	37,500	4,099,210	—	130,000	515,000	1,600,000	—	-61%
Change in CD to Equity	—	—	—	1,550,000	—	(25,000)	—	—	—
Change in contributed surplus	—	—	—	395,525	203,332	—	182,071	—	—
CFF	1,735,764	1,015,584	1,142,539	385,691	323,485	480,144	1,772,195	(10,509)	55%
Net cash change	1,243,351	(238,548)	413,563	(1,218,186)	(291,251)	150,311	179,746	(412,649)	-57%

Source: Objective Capital

Quarterly balance sheets and forecast 4Q09

Balance sheets (quarterly)	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09F	3Q08 v 3Q09
Cash & ST investment	1,681,530	1,442,982	1,856,545	638,359	347,108	497,419	677,165	264,516	-64%
Accounts receivable	168,381	792,216	133,338	170,255	68,096	134,739	260,617	300,000	95%
Inventories	91,113	87,470	91,270	145,518	244,119	248,273	111,049	100,000	22%
Contracts in progress	(28,306)	—	41,382	44,865	46,850	33,001	524,152	500,000	1167%
Pre-paid expenses	107,833	237,064	346,708	182,000	145,648	176,665	316,498	320,000	-9%
Other current assets	—	—	124,142	—	—	—	—	—	-100%
Total current assets	2,020,551	2,559,732	2,593,385	1,180,997	851,821	1,090,097	1,889,481	1,484,516	-27%
Fixed assets	780,354	920,684	1,074,681	1,471,300	1,552,079	1,677,229	1,784,325	1,586,566	66%
Other assets - deferred costs	371,233	359,292	142,474	123,603	104,731	69,821	34,910	35,000	-75%
Total assets	3,172,138	3,839,708	3,810,540	2,775,900	2,508,631	2,837,147	3,708,716	3,106,081	-3%
Bank O/D	—	1,000,000	—	—	—	—	—	—	—
Trade accounts payable	941,215	469,210	573,658	161,684	306,345	446,907	461,806	400,000	-19%
Current LTD	39,250	39,250	39,250	39,250	39,250	38,347	36,909	37,000	-6%
Accrued accounts payable	—	383,342	273,358	177,050	253,571	254,001	359,841	360,000	32%
Deferredd rev/clients dep	160,094	149,267	11,040	7,099	268,247	822,966	482,831	500,000	4273%
Other current liabilities	—	—	—	464,131	306,962	253,141	242,140	250,000	—
Total current liabilities	1,140,559	2,041,069	897,306	849,214	1,174,375	1,815,362	1,583,527	1,547,000	76%
Long term loans	4,358,259	4,336,343	2,379,672	819,838	809,991	801,038	792,600	782,000	-67%
Total liabilities	5,498,818	6,377,412	3,276,978	1,669,052	1,984,366	2,616,400	2,376,127	2,329,000	-27%
Share capital	8,046,488	8,083,988	12,183,198	12,183,198	12,313,198	12,828,198	14,428,198	14,428,198	—
Portion of CD in equity	—	—	—	1,550,000	1,550,000	1,525,000	1,525,000	1,525,000	—
Contributed surplus	—	—	—	395,525	598,857	598,857	780,928	780,928	—
Retained earnings	(10,373,168)	(10,621,692)	(11,649,636)	(13,021,875)	(13,937,790)	(14,731,308)	(15,401,537)	(15,957,045)	32%
Total SHF	(2,326,680)	(2,537,704)	533,562	1,106,848	524,265	220,747	1,332,589	777,081	150%
Total Liab. & SHF	3,172,138	3,839,708	3,810,540	2,775,900	2,508,631	2,837,147	3,708,716	3,106,081	-3%

Source: Objective Capital

The abbreviated balance sheets show a significant jump in contracts in progress in 3Q09 and we have reflected the same in our estimates for 4Q09. We are forecasting that cash will reduce in 4Q09 and the retained deficit is likely to widen further, as we are still predicting a net loss.

The Sofame Steam Pump

Management have high hopes for the rebranding of the Sofame Steam Pump (it is already installed in some of its customers' existing large units); this is a patent pending direct contact stack economizer which can be added to an existing boiler. Its properties make it particularly suitable for large boilers where NOx emissions can be reduced by up to 60 percent and energy efficiencies of between 2%-10% can be achieved. It solves a problem commonly encountered in power plants, where there is no heat sink that can absorb all the heat recovered from the boilers' stacks. The Sofame Steam Pump is mainly used in any application that uses large condensing boilers.

In our last conference call, management reckoned that it would sell for around US\$750k and perhaps an additional US\$1m for the installation package. With a gross margin of 40 percent and perhaps a total market for 10,000 units, this could radically alter the shape of the company. However, in terms of market delivery this is still 12 to 18 months off and its true potential for Sofame is unclear.

Sales, marketing and engineering relationships

In April 2009, two highly seasoned sales professionals, Rob Aldridge and James Olsen joined Sofame. Aldridge joined in the capacity of Sales Director - National Accounts. Olsen joined in the capacity of Sales Director - EPC & Turn-key Contracts. Both men are involved in promoting Sofame's shared savings model where Sofame customers pay nothing up front and share the energy savings with Sofame Finance over a ten year period.

Aldridge spent 25 years working in syndications and vendor financing for major corporations including AT&T, Sun Data and Bombardier Capital where he was responsible for marketing leased executive aircraft. Since 2001, Aldridge has acted as a broker and agent in corporate leasing transactions. Olson is also highly experienced, having acquired over 35 years of HVAC industry experience after serving in the US Navy. Most recently he was in charge of Business Development at Johnson Controls in the Building Efficiency Group dealing specifically with industrial energy efficiency. This experienced team should start to show its metal next financial year.

With Michel Brisson accepting the role of CEO in early May, John Gocek took on the role of COO and also a role as Sales Director. Following this shake up, new sales personnel have been introduced, notably Robert Demers, whose mandate is to train new Representatives' personnel. He is understood to have had very positive results at Canromex of Monterrey, Mexico, who were appointed a SMR on 25 June 2009.

Other hires have included a new business development manager based in Montreal, in order to approach corporate HQ's directly. Where companies have multiple plants, this approach has been deemed more effective than trying to make contact at a local level, where decisions may have to be referred back up the line in any case.

Finally, Sofame has recently appointed a new Director of Engineering with over 25 years of experience from Coen, a major burner manufacturer.

The Sofame Manufacturer's Representative (SMR)

Throughout its 20 year history Sofame has used a combination of direct-to-owner selling methods and a small number of SMRs in designated exclusive territories. To expand the business as currently envisaged, a direct sales approach would not be feasible, hence the SMR route.

At the heart of Sofame's expansion plan and, ultimately, the company's success will be its SMR's. Without a step change in the level of turnover through the SMRs network its ambitious marketing plan will come to naught.

Each of Sofame's SMR is responsible for marketing and selling all Sofame's products and services in an assigned area. Typically, the SMRs will have very high mechanical engineering expertise and represent a variety of complimentary manufacturers on an exclusive basis. The products and services from these relationships will typically be packaged together to sell a bespoke solution to the end user. The SMRs will not only liaise with the end user but also with their architects; the construction managers; consulting engineers and other related parties.

Because a good SMR will have an extensive network in its local area it will be well placed to secure business with those of its existing relationships who might be potential candidates for Sofame's energy saving story. Key for Sofame is to identify and sign up SMR's which offer the prospect of the highest quality and quantity of beneficial relationships where its technology can be used.

Sofame has focused on SMRs in key 'vertical' markets including:

1. Pulp & Paper Mills
2. Food processing
3. Mining
4. Airports
5. Education (universities, colleges)
6. Hospitals
7. District energy

However, because the conversion of 'prospects' has been very slow, Sofame is making increasing levels of technical personnel available to support the SMRs directly. Sofame is also dedicating increasing effort to better effecting top-down relationships with corporate head offices and different plants within the same organization.

But why has it been so difficult to close deals, despite a huge pipeline of projects? The credit crunch almost brought capital spending decisions to a halt at the end of last year and this has been reflected in 1Q09 and 2Q09 results. The stalled capital goods cycle is further compounded by the perception that smaller companies may find it even more difficult to deliver than their larger brethren in these conditions. Thus far Sofame has had to survive through repeated capital infusions and it may be the case that some SMRs have held back.

In this regard, a Sofame Percotherm™ unit was delivered to Princeton University's CHP plant in 3Q09 and news of its imminent start-up should reassure other American customers considering Sofame equipment to maximise boiler plant efficiency.

On another level, bespoke engineered solutions are just not as simple to close as in other equipment markets. The distribution channels for customer engineered and manufactured HVAC equipment are intimately linked with architects and consulting engineers. All mechanical products sold to a building owner, or into a construction project, have to be specified by consulting engineers and the lead time for sales development is typically 6-18 months but perhaps two years in the case of utilities and airports. During this period, the cost savings parameters that would have been used to make the case for the capital spend decision could have altered radically (e.g., in June 2007 NYMEX Henry Hub gas price reached almost US\$14 per MMBtu compared to a current mid price of around US\$3.78 per MMBtu).

The Emperor's clothes - a note on projecting sales revenue for 2009-2012

We have kept to the same methodology that we used in our initiation report to derive our turnover estimates. These are derived from the existing Sofame Manufacturers Representative (SMRs) base and prospects, and the likely proportion of the total existing 'prospect pipeline' that converts into delivered sales in the year in question.

Outstanding bid pipeline with projected close dates up to 30 September 2009*

Sector project is in	Price (C\$'000)	Projected Gross Margin
Energy/Heating	359	39%
Industrial/commercial	95	50%
Packaging	174	48%
Energy	2,286	50%
Energy/Heating	459	21%
Food processing	926	71%
Pulp & Paper	861	46%
Food processing	250	40%
Brewery	179	40%
Municipal	326	43%
Municipal	103	38%
Industrial	508	31%
Energy/Heating	1,925	41%
Packaging	1,714	44%
Pharmaceuticals	605	35%
Hospital	450	40%
Pumps	749	34%
Food processing	1,124	38%
Hospital	405	38%
Pharmaceuticals	99	22%
Sub-total	13,595	

* proposals made by Sofame which they hope to close by Sep 09. There is no guarantee any of these will be closed.

Source: Sofame

As at April 2009, Sofame had 13 SMRs accounting for 75 projects in total. This 'project pipeline' amounted to C\$37.7m. From this list, 20 projects with a combined value of C\$13.6m had 'close dates' for the current financial year with end customers engaged in sectors that include paper, food processing, packaging, breweries and hospitals. We show this part of the pipeline in the table above.

We have respected commercial confidentiality. As you would expect the composition of the project pipeline has changed quite radically since last year as a number of large ethanol based projects are no longer viable and no longer feature within it.

The median value of the pipeline was just under C\$500K. (In the management discussion of its 3Q09 results, management notes that it has more than eighty "deposited submissions" and/or waiting approval for a value of more than C\$40m). Overall management expects to win some 49 percent of the projects listed. In our core projections for financial 2010, we deem a 12 percent conversion rate of this pipeline, or sales revenue worth approximately C\$8.0m will be booked.

We also assume that in addition, five new SMRs will be appointed, but in view of the 'gestation' period required from enquiry to sale, no new sales will be booked

from this expanded base until the following year. So, in any year that a new SMR is appointed we do not assume any contribution until the following year. Bearing in mind the lead times for some companies, this seems a prudent approach.

For these five newly appointed distributors, we assume that they are able to negotiate a total of six new prospects each, at the median price and each year there is a similar conversion ratio into sales, that is 12 percent.

Essentially, what we have is a model of the existing prospect pipeline, augmented by an expanded SMR base (lagged) with an assumed number of prospects, these in turn are converted each year at a certain rate. There is no scientific rule that says the conversion factor has to be 12 percent, or any other number, but from our experience this rate of conversion into firm orders, especially in the current economic climate, would represent a successful strategy in our view.

In our most likely case for any given new SMR that develops a prospect pipeline we assume that 48 percent of the original book comes good, but it actually takes four years to execute that pipeline.

Strategic relationships

In March 2009, Sofame signed a strategic retainer relationship with David Gottfried, CEO of Regenerative Ventures and co-founder of the U.S. and World Green Building Councils (USGBC) in 1993. The USGBC is the creator of LEED® (Leadership in Energy and Environmental Design) Building Standards. In 1998 he set up the World Green Building Council, which guides the establishment of national green building councils in about 50 countries.

Through his company, Regenerative Ventures (www.regenv.com), Gottfried selectively assists a handful of leading greentech companies to help build their businesses and also increase public awareness of their innovative green products. The LEED certification system is a certification programme that awards buildings points for satisfying LEED green building criteria in six major environmental categories and has been a widely adopted standard for new building construction and renovation projects.

Gottfried believes that many of North America's power plants and boiler rooms are generally inefficient and that Sofame's technology can make a significant contribution towards efficiencies and cost savings, resulting in a reduction of carbon dioxide and greenhouse gases. Gottfried is committed to helping Sofame the benefits of which should start to accrue in 2010/11.

Director relationships

Worth noting is André Caillé's contribution as Corporate Director and Senior Strategic Advisor to the Board. He has a long and impeccable pedigree, holding various senior positions between 1982 and 1987 with Gaz Métropolitain, including President and Chief Executive Officer from 1987 to 1996. He was also Director of Environmental Protection Services and Deputy Minister of the Environment of Quebec, from 1974 to 1982 and from 2004 to 2007 he served as President of the World Energy Council. Over the years, Mr Caillé has been the recipient of many prestigious awards and in 2004 he was made a Knight of the Legion of Honour of the French Republic. He is actively supporting Sofame's new proactive marketing initiatives, and with his widespread contacts and knowledge of the industry, this should help unlock doors in 2010/11.

Carbon relationships

Offset verification body adjusts rules for Canadian projects - latest

On 23 July 2009, the Voluntary Carbon Standard Association (VCSA) announced that it would now allow voluntary offset projects in Canada to issue its internationally recognised Voluntary Carbon Units (VCUs) without evidence from the Canadian government that the corresponding number of Kyoto compliance units¹ have been cancelled.

This evidentiary precondition was unattainable for developers because the Canadian government would not issue a letter confirming cancellation of the Kyoto compliance units¹ - in effect rendering all offset projects in Canada ineligible for VCU issuance. The letter had been "required" by the VCSA to mitigate the risk that the emission reductions underlying VCUs would also be counted as reductions in Canada's aggregate emissions (hence "double-counting" the benefit of the reductions).

The VCSA Board concluded that the requirement should no longer be applicable in Canada because without any reasonable prospect of a Kyoto-compliant regulatory framework, or Kyoto-compliant emissions reductions in the country, there would be no risk of double-counting.

The implication of this ruling is very positive for the development of offset projects in Canada and for Sofame in particular. Until this development, many projects that were rendered ineligible in Canada by this, would have been eligible if located in the United States because the latter did not ratify the Kyoto Protocol.

¹ called "Assigned Amount Units," or AAUs

The VCSA announcement levels the playing field and can therefore be expected to create a significant incentive for the development of offset projects in Canada. Accordingly, the longer term impact from this ruling for Sofame should be very beneficial.

Cancellation of proposed July 2009 capital raising

At the end of April, Sofame announced that it had appointed Desjardins Securities, as lead agent for a prospectus offering of common shares for gross proceeds of up to C\$5.0m. The shares were to have been 'qualified investments' under the province of Québec's recently-implemented Quebec Stock Savings Plan II (REA II). As an accredited company any local investor who subscribed to the issue would have been entitled to a 150 percent allowance against their income taxes.

Sofame was intending to use the funding to intensify marketing activities, hire sales and engineering staff, for working capital and general corporate purposes. However, the shares were never effectively underwritten and with the fall back in the share price management concluded that it would not be in existing shareholders' best interests.

Despite this, management has still gone ahead with key hires pursuing its growth strategy, with all the risk that implies when funding has not been in place. Moreover, our cash flow analysis indicates that unless the company is able to meet our most optimistic of scenarios, management will be compelled to seek either further equity, debt finance or a combination of both in order to adequately fund the business through 2010.

Yet further expansion of the equity base during 2009...

In May 2009, warrant holders exercised their rights to convert 11,935,185 warrants. The company issued 11,935,185 common shares at prices ranging from \$0.10 to \$0.15 per share. In connection with this exercise of warrants, Sofame issued an aggregate of 8,000,000 additional warrants to 21 eligible investors who exercised their warrants by the Friday, 15 May 2009 deadline. Each warrant entitles the holder to acquire one additional common share of Sofame at an exercise price of \$0.20 for a period of five years expiring 15 May 2014.

As at 30 June 2009, there were 99,894,216 outstanding ordinary shares, an increase of 11,935,185 shares in 3Q09.

Financials

Profit & loss accounts

Year ended 31st September (C\$m)	2008	2009	2010	2011	2012
Turnover	1.7	3.3	8.1	11.6	15.1
Cost of goods sold (pre-depreciation)	0.9	1.8	4.7	6.7	8.8
Production profit	0.8	1.5	3.4	4.9	6.3
Depreciation & amortisation	0.2	0.3	0.3	0.3	0.3
Selling, administrative expense and stock based compensation	2.4	3.5	3.0	3.5	4.0
EBIT	(1.7)	(2.3)	0.1	1.1	2.1
EBITDA	(1.5)	(1.9)	0.3	1.4	2.4
Net interest	(0.3)	(0.3)	(0.0)	(0.0)	(0.0)
Reorganisation/Sofame Europe	(0.3)	(0.2)	—	—	—
Profit before taxation	(2.3)	(2.7)	0.0	1.1	2.1
Taxation	—	—	—	—	—
Profit after taxation	(2.3)	(2.7)	0.0	1.1	2.1
Dividends	—	—	—	—	—
Retained earnings	(2.3)	(2.7)	0.0	1.1	2.1
Fully diluted earnings per share	-\$0.0202	-\$0.0210	\$0.0002	\$0.0084	\$0.0164

Cashflow statement

Year ended 31st September (C\$m)	2008	2009	2010	2011	2012
Cash flow from operations					
Net profit (loss)	(2.3)	(2.7)	0.0	1.1	2.1
Depreciation	0.1	0.1	0.1	0.1	0.1
Amortisation	0.1	0.2	0.2	0.2	0.2
Adjustment	(0.5)	(0.2)	—	—	—
Gross cash flow	(2.7)	(2.6)	0.3	1.4	2.4
Change in working capital	(0.6)	0.0	(0.4)	(0.2)	(0.0)
CFO	(3.3)	(2.6)	(0.1)	1.2	2.4
Cash flow to investing					
Change in fixed assets	(0.9)	(0.4)	(0.0)	(0.1)	(0.1)
Change in other assets	0.1	0.1	(0.6)	(0.1)	(0.3)
CFI	(0.8)	(0.3)	(0.6)	(0.2)	(0.4)
Cash flow from financing					
Change in debt	(0.1)	(0.0)	(0.2)	(0.4)	(0.0)
Change in share capital	4.2	2.2	—	—	—
Change in CD to Equity	(0.2)	(0.0)	—	—	—
Change in contributed surplus	0.4	0.4	—	—	—
Dividend	—	—	—	—	—
CFF	4.3	2.6	(0.2)	(0.4)	(0.0)
Net cash change	0.2	(0.4)	(0.9)	0.6	2.0

Balance sheets

Year ended 31st September (C\$m)	2008	2009	2010	2011	2012
Cash and temporary investments	0.6	0.3	(0.7)	(0.1)	1.9
Accounts receivable (AR)	0.2	0.3	0.7	1.1	1.4
Inventories (stock)	0.1	0.1	0.3	0.4	0.5
Contracts in progress	0.0	0.5	0.6	0.8	1.1
Pre-paid expenses	0.2	0.3	0.7	1.1	1.4
Total Current Assets	1.2	1.5	1.6	3.3	6.2
Fixed Assets	1.5	1.6	1.3	1.1	0.9
Other assets - deferred costs	0.1	0.0	0.6	0.8	1.1
Total Assets	2.8	3.1	3.6	5.2	8.2
Current liabilities					
Notes/outstanding cheques	—	—	—	—	—
Trade Accounts payable (AP)	0.2	0.4	0.7	1.1	1.4
Current portion of Long Term Debt	0.0	0.0	0.0	0.0	0.0
Accrued accounts payable	0.2	0.4	0.8	1.1	1.4
Deferred revenue and clients deposits	0.0	0.5	0.7	1.0	1.2
Other current liabilities	0.5	0.3	—	—	—
Total current liabilities	0.8	1.5	2.2	3.2	4.1
Long Term Loans	0.8	0.8	0.5	0.1	0.1
Total Liabilities	1.7	2.3	2.8	3.3	4.2
Called up share capital	12.2	14.4	14.4	14.4	14.4
Portion of convertible debentures included in equity	1.6	1.5	1.5	1.5	1.5
Contributed surplus	0.4	0.8	0.8	0.8	0.8
Accumulated deficit	(13.0)	(16.0)	(15.9)	(14.9)	(12.8)
Total Shareholders' funds	1.1	0.8	0.8	1.9	4.0
Total Liab & SHF	2.8	3.1	3.6	5.2	8.2

Source: Objective Capital

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Gabriel Didham, CFA
Objective Capital

Robert Stockfis

Robert has over 15 years experience in consultancy and business analysis in the UK and the Far East. He has previously worked for Standard Chartered Securities, Nomura and the Thai independent broker Seamico.

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