

POWER SOLUTIONS INTERNATIONAL, INC.

Form 10-Q

November 09, 2015

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended: September 30, 2015

OR

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Transition Period From _____ to _____

Commission File Number: 001-35944

Power Solutions International, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

33-0963637
(IRS Employer
Identification No.)

201 Mittel Drive

Wood Dale, IL
(Address of Principal Executive Offices)

60191
(Zip Code)

Registrant's telephone number, including area code: (630) 350-9400

(Former name or former address, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of November 5, 2015, there were 10,752,105 outstanding shares of Common Stock, par value \$0.001, of the registrant.

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QUARTER ENDED SEPTEMBER 30, 2015

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POWER SOLUTIONS INTERNATIONAL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

| (Dollar amounts in thousands, except per share amounts) | September 30, 2015 | December 31, 2014 |
|---|-------------------------------|------------------------------|
| ASSETS | | |
| Current assets | | |
| Cash | \$ 12,253 | \$ 6,561 |
| Accounts receivable, net | 96,863 | 81,740 |
| Inventories, net | 102,754 | 93,903 |
| Prepaid expenses and other current assets | 5,523 | 4,801 |
| Deferred income taxes | 3,998 | 3,998 |
| Total current assets | 221,391 | 191,003 |
| Property, plant & equipment, net | 25,577 | 20,892 |
| Intangible assets, net | 33,598 | 21,392 |
| Goodwill | 41,800 | 23,546 |
| Other noncurrent assets | 7,706 | 5,804 |
| TOTAL ASSETS | \$ 330,072 | \$ 262,637 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities | | |
| Accounts payable | \$ 43,943 | \$ 60,877 |
| Income taxes payable | | 779 |
| Accrued compensation and benefits | 3,927 | 5,983 |
| Current maturities of long-term debt | | 1,667 |
| Other accrued liabilities | 17,655 | 6,742 |
| Total current liabilities | 65,525 | 76,048 |
| Long-term obligations | | |
| Revolving line of credit | 99,061 | 78,030 |
| Deferred income taxes | 3,241 | 3,241 |
| Private placement warrants | 2,741 | 11,036 |

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| | | |
|--|-------------------|-------------------|
| Long-term debt, less current maturities, net | 53,694 | 2,361 |
| Other noncurrent liabilities | 1,477 | 1,122 |
| TOTAL LIABILITIES | 225,739 | 171,838 |
| COMMITMENTS AND CONTINGENCIES | | |
| STOCKHOLDERS EQUITY | | |
| Series A convertible preferred stock \$0.001 par value. Authorized: 114,000 shares. Issued and outstanding: -0- shares at September 30, 2015 and December 31, 2014. | | |
| Common stock \$0.001 par value. Authorized: 50,000,000 shares. Issued: 11,580,608 and 11,562,209 shares at September 30, 2015 and December 31, 2014, respectively. Outstanding: 10,749,683 and 10,731,284 at September 30, 2015 and December 31, 2014, respectively. | 12 | 12 |
| Additional paid-in-capital | 74,919 | 73,959 |
| Retained earnings | 33,652 | 21,078 |
| Treasury stock, at cost, 830,925 shares at September 30, 2015 and December 31, 2014. | (4,250) | (4,250) |
| TOTAL STOCKHOLDERS EQUITY | 104,333 | 90,799 |
| TOTAL LIABILITIES AND STOCKHOLDERS EQUITY | \$ 330,072 | \$ 262,637 |

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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POWER SOLUTIONS INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

| (Dollar amounts in thousands, except per share amounts) | Three months ended September 30, 2015 | Three months ended September 30, 2014 | Nine months ended September 30, 2015 | Nine months ended September 30, 2014 |
|---|--|--|---|---|
| Net sales | \$ 112,008 | \$ 93,972 | \$ 292,776 | \$ 244,085 |
| Cost of sales | 96,700 | 75,344 | 243,637 | 198,131 |
| Gross profit | 15,308 | 18,628 | 49,139 | 45,954 |
| Operating expenses: | | | | |
| Research & development and engineering | 5,562 | 4,501 | 16,973 | 11,844 |
| Selling and service | 2,979 | 2,706 | 8,525 | 6,871 |
| General and administrative | 4,280 | 3,410 | 10,953 | 9,814 |
| Amortization of intangible assets | 1,099 | 492 | 2,755 | 492 |
| Total operating expenses | 13,920 | 11,109 | 39,206 | 29,021 |
| Operating income | 1,388 | 7,519 | 9,933 | 16,933 |
| Other (income) expense: | | | | |
| Interest expense | 1,374 | 407 | 2,986 | 887 |
| Contingent consideration | (50) | (3,208) | (50) | (3,782) |
| Private placement warrant | (8,750) | (858) | (8,040) | (1,190) |
| Other expense, net | 171 | 34 | 260 | 109 |
| Total other (income) | (7,255) | (3,625) | (4,844) | (3,976) |
| Income before income taxes | 8,643 | 11,144 | 14,777 | 20,909 |
| Income tax (benefit) provision | (466) | 3,996 | 2,203 | 7,504 |
| Net income | \$ 9,109 | \$ 7,148 | \$ 12,574 | \$ 13,405 |
| Weighted-average common shares outstanding: | | | | |
| Basic | 10,814,765 | 10,794,229 | 10,804,720 | 10,676,792 |
| Diluted | 11,068,925 | 11,167,598 | 11,120,721 | 11,125,116 |
| Earnings per share basic Common shares | \$ 0.84 | \$ 0.66 | \$ 1.16 | \$ 1.26 |

| | | | | | | | | |
|----------------------------|----|------|----|------|----|------|----|------|
| Earnings per share diluted | | | | | | | | |
| Common shares | \$ | 0.03 | \$ | 0.56 | \$ | 0.41 | \$ | 1.10 |

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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POWER SOLUTIONS INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

| (Dollar amounts in thousands) | Nine months ended September 30, 2015 | Nine months ended September 30, 2014 |
|--|--|--|
| Cash flows from operating activities | | |
| Net income | \$ 12,574 | \$ 13,405 |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: | | |
| Depreciation | 3,067 | 1,799 |
| Amortization | 3,464 | 1,333 |
| Deferred income taxes | | 1,512 |
| Non-cash interest expense | 305 | 62 |
| Share-based compensation expense | 854 | 982 |
| Increase (decrease) in accounts receivable allowances | 625 | (250) |
| Increase in inventory reserves | 698 | 615 |
| Amortization of inventory step up to fair value | 453 | 482 |
| Decrease in valuation of private placement warrants liability | (8,040) | (1,190) |
| Decrease in valuation of contingent consideration liability | (50) | (3,782) |
| Loss on investment in joint ventures | 260 | 136 |
| Loss on disposal of assets | 142 | 77 |
| (Increase) decrease in operating assets, net of effects of business combinations: | | |
| Accounts receivable | (10,605) | (21,917) |
| Inventories | 589 | (23,398) |
| Prepaid expenses and other assets | (1,795) | (2,342) |
| Increase (decrease) in operating liabilities, net of effects of business combinations: | | |
| Accounts payable | (23,659) | 19,549 |
| Accrued compensation and benefits and other accrued liabilities | (1,046) | (133) |
| Income taxes payable | (779) | (27) |
| Other noncurrent liabilities | 355 | (363) |
| Net cash used in operating activities | (22,588) | (13,450) |
| Cash flows from investing activities | | |
| Purchases of property, plant & equipment | (6,661) | (4,749) |
| Business combinations, net of cash acquired | (34,396) | (44,122) |
| Investment in joint ventures | (1,000) | (350) |

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| | | |
|--|-----------|----------|
| Net cash used in investing activities | (42,057) | (49,221) |
| Cash flows from financing activities | | |
| Advances from revolving line of credit noncurrent obligation | 85,180 | 67,946 |
| Repayments of revolving line of credit noncurrent obligation | (64,149) | (11,831) |
| Proceeds from long-term debt | 55,000 | 5,000 |
| Proceeds from exercise of private placement warrants | 65 | 1,425 |
| Excess tax benefit from exercise of share-based awards | 102 | 2,469 |
| Payment of withholding taxes from net settlement of share-based awards | (316) | (361) |
| Payments on long-term debt | (4,028) | (555) |
| Cash paid for financing and transaction fees | (1,517) | (126) |
| Net cash provided by financing activities | 70,337 | 63,967 |
| Increase in cash | 5,692 | 1,296 |
| Cash at beginning of period | 6,561 | 6,306 |
| Cash at end of period | \$ 12,253 | \$ 7,602 |
| Supplemental disclosures of cash flow information | | |
| Cash paid for interest | \$ 1,416 | \$ 748 |
| Cash paid for income taxes | 5,971 | 3,828 |
| Supplemental disclosure of non-cash transactions | | |
| Unpaid property, plant & equipment | \$ 575 | \$ 937 |
| Fair value of private placement warrants exercised | 255 | 7,320 |

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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POWER SOLUTIONS INTERNATIONAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

(Tabular dollar amounts in thousands, except per share amounts)

1. Description of the company and business operations

Description of the company

Power Solutions International, Inc., a Delaware corporation (*Company*), is the successor in a migratory merger (*Migratory Merger*) effective August 26, 2011, to Power Solutions International, Inc., a Nevada corporation. Power Solutions International and *PSI* refer to Power Solutions International, Inc., a Nevada corporation, prior to the consummation of the Migratory Merger, and Power Solutions International, Inc., a Delaware corporation, following the consummation of the Migratory Merger.

Power Solutions International, Inc., a Nevada corporation, was formerly known as Format, Inc. (*Format*), and prior to the consummation of a reverse recapitalization, was engaged, to a limited extent, in EDGARizing corporate documents for filing with the Securities and Exchange Commission (*SEC*) and in providing limited commercial printing services. On April 29, 2011, Format consummated a reverse acquisition transaction with The W Group, Inc. and its subsidiaries (*The W Group*) (*Reverse Recapitalization*), and in connection with this transaction, Format changed its corporate name to Power Solutions International, Inc. The W Group was considered the accounting acquirer and remained as the surviving corporation of the reverse acquisition, becoming a wholly-owned subsidiary of Power Solutions International, Inc.

Nature of business operations

The Company is a global producer and distributor of a broad range of high performance, certified low emission power systems, including alternative fuel power systems for original equipment manufacturers of off-highway industrial equipment (*industrial OEMs*), on-road markets, and large custom-engineered integrated electrical power generation systems. The Company's customers include large, industry-leading and/or multinational organizations. The Company's products and services are sold predominantly to customers throughout North America, as well as to customers located throughout the Pacific Rim and Europe. The Company operates as one business and geographic segment.

The Company's power systems are highly engineered, comprehensive systems which, through its technologically sophisticated development and manufacturing processes, including its in-house design, prototyping, testing and engineering capabilities and its analysis and determination of the specific components to be integrated into a given power system (driven in large part by emission standards and cost restrictions required, or desired, to be met), allow the Company to provide its customers with power systems customized to meet specific industrial OEM application requirements, other technical specifications of customers, and requirements imposed by environmental regulatory bodies. The Company's power system configurations range from a basic engine integrated with appropriate fuel system components to completely packaged power systems that include any combination of cooling systems, electronic systems, air intake systems, fuel systems, housings, power takeoff systems, exhaust systems, hydraulic systems, enclosures, brackets, hoses, tubes and other assembled componentry. The Company purchases engines from third party suppliers and produces an internally-designed engine, all of which are then integrated into the Company's power systems. Additionally, the Company is designing and developing other engines in-house. Of the other components that the Company integrates into its power systems, a substantial portion consist of internally designed components and components for which the Company coordinates significant design efforts with third party suppliers, with the

remainder consisting largely of parts that are sourced off-the-shelf from third party suppliers. Some of the key components (including purchased engines) embody proprietary intellectual property of the Company's suppliers. As a result of its design and manufacturing capabilities, the Company is able to provide its customers with a comprehensive power system which can be incorporated, using a single part number, directly into a customer's specified application. Capitalizing on its expertise in developing and manufacturing emission-certified power systems and its access to the latest power system technologies, the Company believes that it is able to provide complete green power systems to industrial OEMs at a low cost and with fast design turnaround. In addition to the certified products described above, the Company sells diesel, gasoline and non-certified power systems and aftermarket components.

2. Basis of presentation

Unaudited condensed consolidated financial statements

The unaudited condensed consolidated financial statements of Power Solutions International, Inc. present information in accordance with generally accepted accounting principles in the U.S. (GAAP), have been prepared pursuant to the rules and regulations of the SEC for interim financial reporting and, in the opinion of management, reflect all normal and recurring adjustments necessary to present fairly the interim periods of the unaudited condensed consolidated financial position, results of operations and cash flows of the Company and its wholly-owned subsidiaries for the periods presented.

Certain amounts recorded in the prior period unaudited condensed consolidated financial statements presented have been reclassified to conform to the current period financial statement presentation. These reclassifications had no effect on previously reported net income.

These unaudited condensed consolidated financial statements should be read in conjunction with, and have been prepared in conformity with the accounting principles reflected in, the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2014. As these financial statements have been prepared pursuant to the rules and regulations of the SEC, certain information and disclosures normally included in annual financial statements and related notes prepared in accordance with GAAP have been condensed or omitted. The results of operations for the three and nine months ended September 30, 2015 are not necessarily indicative of the results to be expected for the full year.

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Principles of consolidation

The unaudited condensed consolidated financial statements presented herein include the accounts of Power Solutions International, Inc. and its direct and indirect wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Significant accounting policies

The Company's significant accounting policies as of December 31, 2014 are described in the Company's Annual Report on Form 10-K, filed with the Securities and Exchange Commission on March 13, 2015. There have been no material changes with respect to the Company's significant accounting policies subsequent to December 31, 2014.

3. Recently issued accounting pronouncements

The Company evaluates the pronouncements of authoritative accounting organizations, including the Financial Accounting Standards Board (FASB), to determine the impact of new pronouncements on GAAP and the Company. In May of 2014, the FASB and International Accounting Standards Board jointly issued a final standard on revenue recognition which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. This standard will supersede most current revenue recognition guidance. Under the new standard, entities are required to identify the following within a contract with a customer: the separate performance obligations in the contract; the transaction price; allocation of the transaction price to the separate performance obligations in the contract; and the appropriate amount of revenue to be recognized when (or as) the entity satisfies each performance obligation. Entities have the option of using either retrospective transition or a modified approach in applying the new standard. On July 9, 2015, the FASB voted to issue a final Accounting Standards Update (ASU) that defers for one year the effective date of the new revenue standard and allows early adoption as of the original effective date (i.e., annual reporting periods beginning after December 15, 2016, including interim reporting periods within those annual periods). After reviewing and discussing the feedback received, the Board decided to adopt the standard as originally proposed. Thus, the anticipated final ASU will be effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2017. The Company is currently evaluating the approach it will use to apply the new standard and the impact that the adoption of the new standard will have on the Company's unaudited condensed consolidated financial statements.

In April of 2015, the FASB issued guidance to simplify the presentation of debt issuance costs. This new guidance requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. Although the standard is effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years, the Company chose to early adopt this guidance as of June 30, 2015, and has therefore presented the debt issuance costs associated with the issuance of its 5.5% Senior Notes as a direct deduction from the carrying value of the liability as of September 30, 2015. Refer to Note 9, Debt for further details related to the issuance of the Company's 5.5% Senior Notes.

There were no additional new accounting pronouncements or guidance that have been issued or adopted by authoritative accounting organizations during the three months ended September 30, 2015, that are expected to have a significant effect on the Company's unaudited condensed consolidated financial statements.

4. Acquisitions

When appropriate, the Company accounts for business combinations in accordance with ASC 805, *Business Combinations*, and, as such, assets acquired and liabilities assumed are recorded at their respective fair values. The excess of the acquisition consideration over the