

POWER SOLUTIONS INTERNATIONAL, INC.

Form 10-Q

November 12, 2013

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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, 2013

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

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 4, 2013, there were 10,479,811 outstanding shares of Common Stock, par value \$0.001, of the registrant.

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POWER SOLUTIONS INTERNATIONAL, INC.

QUARTER ENDED SEPTEMBER 30, 2013

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POWER SOLUTIONS INTERNATIONAL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(Dollar amounts in thousands, except per share amounts)	September 30, 2013	December 31, 2012
ASSETS		
Current assets		
Cash	\$ 8,332	\$ 543
Accounts receivable, net	39,217	37,480
Inventories, net	49,524	39,968
Prepaid expenses and other current assets	3,230	1,910
Deferred income taxes	2,176	2,176
Total current assets	102,479	82,077
Property, plant & equipment, net	11,338	7,145
Other noncurrent assets	1,703	1,543
TOTAL ASSETS	\$ 115,520	\$ 90,765
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	\$ 23,977	\$ 26,579
Income taxes payable		1,074
Accrued liabilities	7,084	5,011
Total current liabilities	31,061	32,664
LONG-TERM OBLIGATIONS		
Revolving line of credit	12,299	30,942
Deferred income taxes	136	136
Private placement warrants	20,120	3,666
Other noncurrent liabilities	583	623
TOTAL LIABILITIES	64,199	68,031
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, 2013 and December 31, 2012.

Common stock \$0.001 par value. Authorized: 50,000,000 shares. Issued: 11,310,736 and 9,909,212 shares at September 30, 2013 and December 31, 2012, respectively. Outstanding: 10,479,811 and 9,078,287 shares at September 30, 2013 and December 31, 2012, respectively.

	11	10
Additional paid-in-capital	54,456	10,862
Retained earnings	1,104	16,112
Treasury stock, at cost, 830,925 shares at September 30, 2013 and December 31, 2012.	(4,250)	(4,250)
TOTAL STOCKHOLDERS EQUITY	51,321	22,734
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 115,520	\$ 90,765

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, 2013		Three months ended September 30, 2012	
	2013	2012	2013	2012
Net sales	\$ 64,628	\$ 51,703	\$ 176,342	\$ 149,890
Cost of sales	52,256	43,293	143,617	124,419
Gross profit	12,372	8,410	32,725	25,471
Operating expenses:				
Research & development and engineering	3,250	2,010	7,310	5,545
Selling and service	1,841	1,315	5,810	4,600
General and administrative	3,159	2,212	8,563	6,024
Total operating expense	8,250	5,537	21,683	16,169
Operating income	4,122	2,873	11,042	9,302
Other expense (income):				
Interest expense	135	249	570	766
Loss on debt extinguishment			270	
Private placement warrant expense (income)	12,605	(199)	21,658	(656)
Other (income) expense, net	(19)		(36)	94
Total other expense	12,721	50	22,462	204
(Loss) income before income taxes	(8,599)	2,823	(11,420)	9,098
Income tax provision	1,382	977	3,588	3,141
Net (loss) income	\$ (9,981)	\$ 1,846	\$ (15,008)	\$ 5,957
Weighted-average common shares outstanding:				
Basic	10,266,176	9,068,024	9,536,687	9,065,699
Diluted	10,266,176	9,068,024	9,536,687	9,065,699
(Loss) earnings per share basic				
Common shares	\$ (0.97)	\$ 0.20	\$ (1.57)	\$ 0.66
(Loss) earnings per share diluted				
Common shares	\$ (0.97)	\$ 0.20	\$ (1.57)	\$ 0.66

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)

	Nine months ended September 30, 2013	Nine months ended September 30, 2012
(Dollar amounts in thousands)		
Cash flows from operating activities		
Net (loss) income	\$ (15,008)	\$ 5,957
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Depreciation and amortization	1,144	748
Deferred income taxes		(308)
Share-based compensation expense	931	267
(Decrease) increase in accounts receivable allowances	(4)	57
Increase (decrease) in valuation of private placement warrants liability	21,658	(656)
Loss on disposal of assets	14	95
Loss on debt extinguishment	270	
(Increase) decrease in operating assets:		
Accounts receivable	(1,733)	(2,285)
Inventories	(9,556)	(11,158)
Prepaid expenses and other assets	58	(91)
Increase (decrease) in operating liabilities:		
Accounts payable	(3,698)	4,878
Accrued liabilities	2,073	(425)
Income taxes payable	(2,126)	165
Other noncurrent liabilities	(40)	113
Net cash used in operating activities	(6,017)	(2,643)
Cash flows from investing activities		
Purchases of property, plant and equipment	(4,322)	(2,900)
Investment in joint venture	(500)	
Net cash used in investing activities	(4,822)	(2,900)
Cash flows from financing activities		
Decrease in cash overdraft		(3,780)
Proceeds from stock offering	36,750	
Initial proceeds from borrowings under revolving line of credit	38,995	
Advances from revolving line of credit noncurrent obligation	59,907	49,156
Repayments of revolving line of credit noncurrent obligation	(78,600)	(43,358)
Repayment of prior revolving line of credit	(38,945)	

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Net change in revolving line of credit current obligation		4,249	
Payments on long-term debt and capital lease obligations		(21)	
Proceeds from exercise of private placement warrants	3,865		178
Payment of withholding taxes for net settlement of share-based awards	(2,063)		
Excess tax benefit from exercise of share-based awards	1,642		
Cash paid for financing and transaction fees	(2,923)		(226)
Net cash provided by financing activities	18,628		6,198
Net change in cash	7,789		655
Cash at beginning of period	543		
Cash at end of period	\$ 8,332	\$	655
Supplemental disclosures of cash flow information			
Cash paid for interest	\$ 567	\$	666
Cash paid for income taxes	4,074		3,290
Supplemental disclosure of non-cash transactions			
Unpaid property, plant and equipment	\$ 998	\$	815
Fair value of private placement warrants exercised	5,204		52
Unpaid financing and transaction fees	98		

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, is the successor in a migratory merger 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), and in connection with this transaction, Format changed its corporate name to Power Solutions International, Inc. The W Group remained as the surviving corporation of the reverse acquisition, becoming a wholly-owned subsidiary of Power Solutions International.

The W Group was the accounting acquiror in the reverse recapitalization with Format, Inc. Accordingly, with respect to the period prior to the reverse recapitalization, it is The W Group s historical financial position and results of operations that are presented in the unaudited condensed consolidated financial statements, with The W Group s historical equity restated to reflect the originally issued and outstanding equity of Format, plus the equity issued by Power Solutions International, pursuant to the reverse recapitalization.

Unless the context otherwise requires, the Company refers to The W Group prior to the closing of the reverse recapitalization on April 29, 2011, and Power Solutions International, Inc. as successor to the business of The W Group, following the completion of the reverse recapitalization.

Refer to Note 4, Reverse recapitalization of The W Group, private placement, reverse split and migratory merger, for further description of these transactions.

Nature of business operations

The Company is a global producer and distributor of a broad range of high performance, certified low emission, power systems for original equipment manufacturers of off-highway industrial equipment (industrial OEMs). The Company s customers include companies that are large, industry-leading and/or multinational organizations, and the Company is a sole source provider of alternative fuel power systems for most of its customers. The Company s products and services are sold predominantly to customers throughout North America, as well as, to customers located throughout Asia 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 to its customers 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 has recently begun producing an internally-designed engine, all of which engines are then integrated into the Company's power systems. Additionally, the Company has begun 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 to its customers 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 and non-certified power systems and aftermarket components.

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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 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.

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 PSI s Annual Report on Form 10-K for the fiscal year ended December 31, 2012. As these financial statements have been prepared pursuant to the rules and regulations of the SEC, certain information and disclosures normally included in the financial statements and related notes prepared in accordance with GAAP have been condensed or omitted.

Principles of consolidation

The unaudited condensed consolidated financial statements include the accounts of Power Solutions International, Inc., and its direct and indirect wholly-owned subsidiaries, The W Group, Inc., Power Production, Inc., Power Great Lakes, Inc., Power Solutions, Inc., Power Global Solutions, Inc., Auto Manufacturing, Inc., Torque Power Source Parts, Inc., XISync, LLC, PSI International, LLC, and Power Properties, L.L.C. Collectively, these entities produce and distribute off-highway industrial engines and provide aftermarket support for the industrial engine market. All significant intercompany balances and transactions have been eliminated in the consolidation.

Significant accounting policies

The Company s significant accounting policies as of December 31, 2012 are described in the Company s Annual Report on Form 10-K, filed with the Securities and Exchange Commission on March 12, 2013. There have been no material changes with respect to the Company s significant accounting policies subsequent to December 31, 2012.

In order to provide further description related to its policy on revenue recognition, the Company has outlined its policy below:

Revenue recognition

The Company recognizes revenue upon transfer of title and risk of loss to the customer, which is typically when products are shipped, provided there is persuasive evidence of an arrangement, the sales price is fixed or determinable and management believes collectability is reasonably assured.

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. There were no new accounting pronouncements that have been issued or adopted during the three months ended September 30, 2013, that are expected to have a significant effect on the Company s unaudited condensed consolidated financial statements.

4. Reverse recapitalization of The W Group, private placement, reverse split and migratory merger

On April 29, 2011, Power Solutions International, Inc. (formerly known as Format, Inc.) completed a reverse acquisition transaction (Reverse Recapitalization) in which PSI Merger Sub, Inc., a Delaware corporation that was newly-created as a wholly-owned subsidiary of Power Solutions International, Inc., merged with and into The W Group. The W Group remained as the surviving corporation of the reverse acquisition transaction and became a wholly-owned subsidiary of Power Solutions International, Inc. Pursuant to an agreement and plan of merger, all of the outstanding shares of common stock of The W Group held by the three stockholders of The W Group at the closing of the reverse acquisition transaction converted into, and Power Solutions International, Inc. issued to the three stockholders of The W Group, an aggregate of 10,000,000 shares of common stock and 95,960.90289 shares of Series A Convertible Preferred Stock (both share amounts prior to the Reverse Split defined below).

In accordance with ASC 805, *Business Combinations*, The W Group was considered the accounting acquiror for accounting purposes, and accounted for the transaction as a reverse recapitalization because (1) The W Group's former stockholders received the greater portion of the voting rights in the combined entity, (2) The W Group's senior management represented all of the senior

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management of the combined entity and (3) immediately prior to the transaction, Format, Inc., was a company with nominal operations and assets. Consequently, the assets and liabilities and the historical operations that are reflected in Power Solutions International, Inc.'s unaudited condensed consolidated financial statements are those of The W Group and have been recorded at the historical cost basis of The W Group, with a recapitalization adjustment to report the issued equity of PSI.

The results of operations of Format, Inc. have not been included in the unaudited condensed consolidated statement of operations from the date of the Reverse Recapitalization, April 29, 2011, because Format had nominal operations and assets, which consisted mostly of cash immediately prior to consummation of the Reverse Recapitalization transaction. In accordance with the accounting for an entity with nominal operations and assets under a reverse recapitalization transaction, the net income and equity of Format immediately prior to the Reverse Recapitalization were reclassified to preferred equity. The related party obligations owed by Format immediately prior to the Reverse Recapitalization were settled through the terms of a repurchase agreement, while the remaining obligations were settled with the available cash on Format Inc.'s balance sheet. Immediately prior to the reverse acquisition transaction, Format had assets with a net book value of \$5,000 which were written off in connection with the transaction.

Concurrent with the closing of the Reverse Recapitalization, Power Solutions International, Inc. and The W Group entered into a purchase agreement (Private Placement) whereby Power Solutions International, Inc. completed the sale of an aggregate of 18,000 shares of PSI preferred stock together with warrants (Private Placement Warrants) representing the right to purchase an aggregate of 24,000,007 shares of PSI common stock (share amount prior to the Reverse Split (as defined below)), subject to certain limitations on exercise. The shares of PSI preferred stock issued in the Private Placement were initially convertible into an aggregate of 48,000,007 shares of PSI common stock (share amount prior to the Reverse Split), subject to certain limitations. In consideration, Power Solutions International, Inc. and The W Group received proceeds of \$18.0 million before transaction fees, costs and expenses of approximately \$5.1 million in connection with the Reverse Recapitalization and Private Placement.

In connection with the Private Placement, the Company also issued to Roth Capital Partners, LLC (Roth) a warrant (Roth Warrant) to purchase initially 3,360,000 shares of PSI common stock (share amount prior to the Reverse Split), subject to certain limitations on exercise set forth in the Roth Warrant. On September 1, 2011, the Roth Warrant was exercised.

In connection with, and prior to the consummation of, the Reverse Recapitalization, the board of directors of Format approved a 1-for-32 reverse stock split of issued and outstanding shares of the Company's common stock (Reverse Split), immediately following the effectiveness of which each 32 issued and outstanding shares of the Company's common stock would automatically convert into one share of Company common stock. Any stockholder of the Company that would otherwise be entitled to a fraction of a share of the Company's common stock (after aggregating all fractional shares of the Company's common stock to be received by such holder) as a result of the Reverse Split, would receive an additional share of the Company's common stock (i.e., the aggregate