

POWELL INDUSTRIES INC
Form 10-Q
August 08, 2018

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

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2018

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 001-12488

Powell Industries, Inc.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)
8550 Mosley Road
Houston, Texas
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code:
(713) 944-6900

88-0106100
(I.R.S. Employer
Identification No.)
77075-1180

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 Web site, 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, smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input checked="" type="checkbox"/>	Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>	Emerging growth company <input type="checkbox"/>
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(Do not check if a smaller reporting company)

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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. "

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

At August 3, 2018, there were 11,470,038 outstanding shares of the registrant's common stock, par value \$0.01 per share.

POWELL INDUSTRIES, INC. AND SUBSIDIARIES
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PART I — FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

POWELL INDUSTRIES, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets (Unaudited)

(In thousands, except share and per share data)

	June 30, 2018	September 30, 2017
ASSETS		
Current Assets:		
Cash and cash equivalents	\$40,075	\$ 68,359
Short-term investments	15,218	26,829
Restricted cash	19,952	15,104
Accounts receivable, less allowance for doubtful accounts of \$239 and \$179	72,682	53,852
Costs and estimated earnings in excess of billings on uncompleted contracts	70,939	51,554
Inventories	22,854	18,448
Income taxes receivable	7,471	8,222
Deferred income taxes	—	3,539
Prepaid expenses	2,978	3,701
Other current assets	253	463
Total Current Assets	252,422	250,071
Property, plant and equipment, net	130,545	139,420
Restricted cash	3,635	9,747
Goodwill and intangible assets, net	1,558	1,719
Other assets	13,882	13,800
Deferred income taxes	6,608	229
Total Assets	\$408,650	\$ 414,986
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Current maturities of long-term debt	\$400	\$ 400
Accounts payable	33,726	33,269
Accrued salaries, bonuses and commissions	16,268	14,984
Billings in excess of costs and estimated earnings on uncompleted contracts	39,437	26,166
Accrued product warranty	2,363	3,174
Income taxes payable	1,418	1,219
Other accrued expenses	5,507	5,860
Deferred credit – short term	—	507
Total Current Liabilities	99,119	85,579
Long-term debt, net of current maturities	1,200	1,600
Deferred compensation	5,652	5,314
Other long-term liabilities	1,232	1,197
Total Liabilities	107,203	93,690
Commitments and Contingencies (Note E)		
Stockholders' Equity:		
Preferred stock, par value \$.01; 5,000,000 shares authorized; none issued	—	—
Common stock, par value \$.01; 30,000,000 shares authorized; 12,276,056 and 12,234,656 and shares issued, respectively	123	122
Additional paid-in capital	56,235	54,329
Retained earnings	292,974	310,598

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Treasury stock, 806,018 shares at cost	(24,999)	(24,999)
Accumulated other comprehensive loss	(22,886)	(18,754)
Total Stockholders' Equity	301,447	321,296
Total Liabilities and Stockholders' Equity	\$408,650	\$ 414,986

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

POWELL INDUSTRIES, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Operations (Unaudited)
(In thousands, except per share data)

	Three months ended		Nine months ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Revenues	\$122,130	\$85,927	\$313,819	\$300,948
Cost of goods sold	103,755	76,873	272,469	261,073
Gross profit	18,375	9,054	41,350	39,875
Selling, general and administrative expenses	16,174	14,761	48,462	46,453
Research and development expenses	1,632	1,726	4,926	4,818
Amortization of intangible assets	44	87	161	263
Restructuring and separation expenses	—	—	—	840
Operating income (loss)	525	(7,520)	(12,199)	(12,499)
Other income	—	(507)	(507)	(1,522)
Interest expense	51	41	153	122
Interest income	(215)	(156)	(711)	(287)
Income (loss) before income taxes	689	(6,898)	(11,134)	(10,812)
Income tax provision (benefit)	388	(3,683)	(2,443)	(6,469)
Net income (loss)	\$301	\$(3,215)	\$(8,691)	\$(4,343)
Income (loss) per share:				
Basic	\$0.03	\$(0.28)	\$(0.76)	\$(0.38)
Diluted	\$0.03	\$(0.28)	\$(0.76)	(0.38)
Weighted average shares:				
Basic	11,514	11,463	11,503	11,449
Diluted	11,587	11,463	11,503	11,449
Dividends per share	\$0.26	\$0.26	\$0.78	\$0.78

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

POWELL INDUSTRIES, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Comprehensive Loss (Unaudited)

(In thousands)

	Three months		Nine months ended	
	ended June 30,		June 30,	
	2018	2017	2018	2017
Net income (loss)	\$301	\$(3,215)	\$(8,691)	\$(4,343)
Foreign currency translation adjustments	(2,543)	2,849	(4,132)	1,124
Comprehensive loss	\$(2,242)	\$(366)	\$(12,823)	\$(3,219)

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

POWELL INDUSTRIES, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows (Unaudited)
(In thousands)

	Nine months ended June 30,	
	2018	2017
Operating Activities:		
Net loss	\$(8,691)	\$(4,343)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation	9,494	9,218
Amortization	161	263
Stock-based compensation	2,485	2,304
Bad debt expense (recovery)	110	(226)
Deferred income tax benefit	(2,840)	(915)
Gain on amended supply agreement	(507)	(1,522)
Cash received from amended supply agreement	—	2,333
Changes in operating assets and liabilities:		
Accounts receivable, net	(19,252)	23,847
Costs and billings in excess of estimated earnings on uncompleted contracts	(6,211)	17,861
Inventories	(4,542)	7,519
Income taxes	945	(6,206)
Prepaid expenses and other current assets	924	2,022
Accounts payable	1,288	(9,627)
Accrued liabilities	355	(14,017)
Other, net	224	(1,387)
Net cash provided by (used in) operating activities	(26,057)	27,124
Investing Activities:		
Purchases of short-term investments	(20,712)	(60,018)
Maturities of short-term investments	31,444	4,654
Changes in restricted cash	1,264	(25,301)
Purchases of property, plant and equipment	(3,978)	(2,520)
Proceeds from sale of property, plant and equipment	56	11
Net cash provided by (used in) investing activities	8,074	(83,174)
Financing Activities:		
Payments on industrial development revenue bonds	(400)	(400)
Shares withheld in lieu of employee tax withholding	(578)	(398)
Dividends paid	(8,934)	(8,904)
Net cash used in financing activities	(9,912)	(9,702)
Net decrease in cash and cash equivalents	(27,895)	(65,752)
Effect of exchange rate changes on cash and cash equivalents	(389)	516
Cash and cash equivalents, beginning of period	68,359	97,720
Cash and cash equivalents, end of period	\$40,075	\$32,484

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

POWELL INDUSTRIES, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

A. OVERVIEW AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Overview

Powell Industries, Inc. (we, us, our, Powell or the Company) was incorporated in the state of Delaware in 2004 as a successor to a Nevada company incorporated in 1968. The Nevada company was the successor to a company founded by William E. Powell in 1947, which merged into the Company in 1977. Our major subsidiaries, all of which are wholly owned, include: Powell Electrical Systems, Inc.; Powell (UK) Limited; Powell Canada Inc. and Powell Industries International, B.V.

We develop, design, manufacture and service custom-engineered products and systems for the distribution, control and monitoring of electrical energy. Headquartered in Houston, Texas, we serve the oil and gas refining, onshore and offshore oil and gas production, petrochemical, pipeline, terminal, mining and metals, light rail traction power, electric utility, pulp and paper and other heavy industrial markets.

Basis of Presentation

These unaudited condensed consolidated financial statements include the accounts of Powell and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

These unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X for interim financial information. Certain information and footnote disclosures, normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP), have been condensed or omitted pursuant to those rules and regulations. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary to fairly state the financial position, results of operations and cash flows with respect to the interim condensed consolidated financial statements have been included. The results of operations for the interim periods are not necessarily indicative of the results for the entire fiscal year. We believe that these financial statements contain all adjustments necessary so that they are not misleading.

These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto of Powell and its subsidiaries included in Powell's Annual Report on Form 10-K for the year ended September 30, 2017, which was filed with the Securities and Exchange Commission (SEC) on December 6, 2017.

References to Fiscal 2018 and Fiscal 2017 used throughout this report shall mean our fiscal years ended September 30, 2018 and 2017, respectively.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying footnotes. The most significant estimates used in our condensed consolidated financial statements affect revenue and cost recognition for construction contracts, the allowance for doubtful accounts, provision for excess and obsolete inventory, warranty accruals and income taxes. The amounts recorded for warranties, legal, income taxes, impairment of long-lived assets (when applicable) and other contingent liabilities require judgments regarding the amount of expenses that will ultimately be incurred. We base our estimates on historical experience and on various other assumptions, as well as the specific circumstances surrounding these contingent liabilities, in evaluating the amount of liability that should be recorded. Additionally, the recognition of deferred tax assets requires estimates related to future income and other assumptions regarding timing and future profitability. Estimates routinely change as new events occur, additional information becomes available or operating environments change. Actual results may differ from our prior estimates.

New Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued a new standard on revenue recognition that supersedes previously issued revenue recognition guidance. This standard provides a five-step approach to be applied

to all contracts with customers and requires expanded disclosures about the nature, amount, timing and uncertainty of revenue (and the related cash flows) arising from customer contracts, significant judgments and changes in judgments used in applying the revenue model and the assets recognized from costs incurred to obtain or fulfill a contract. This standard is effective for fiscal years, and interim

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periods within those years, beginning after December 15, 2017, which would be our fiscal year ending September 30, 2019. We plan to use the modified retrospective basis upon adoption which could result in a cumulative effect adjustment as of October 1, 2018, if material. We continue to hold regular meetings with our implementation team which includes training and evaluating contracts to identify potential impacts of the standard on our current accounting policies and disclosures. We will update our accounting policies and procedures and determine the impact from this new standard on our contracts outstanding as of October 1, 2018. While we are still evaluating the potential impact of this standard on our financial statements, we believe accounting for variable consideration, cancellations for convenience clauses and the number of performance obligations contained in each contract could have the greatest significance. We have not yet been able to estimate the impact the new revenue recognition criteria will have on our consolidated financial statements and related disclosures, but the impact on our financial statements from this guidance will be determined in large part by the contracts that are in progress as of the adoption date.

In November 2015, the FASB issued an amendment to the topic regarding income taxes which requires an entity to separate deferred income tax liabilities and assets into current and noncurrent amounts in the statement of financial position. Deferred tax liabilities and assets are classified as current or noncurrent based on the classification of the related asset or liability for financial reporting. Deferred tax liabilities and assets that are not related to an asset or liability for financial reporting are classified according to the expected reversal date of the temporary difference. To simplify the presentation of deferred income taxes, the amendments require that deferred income tax liabilities and assets be classified as noncurrent in a classified statement of financial position. We have adopted this topic prospectively in Fiscal 2018 and our statement of financial position reflects this reclassification. We have not retrospectively adjusted prior periods.

In February 2016, the FASB issued a new topic on leases which requires lessees to recognize lease assets and lease liabilities on the balance sheet for all leases with terms longer than twelve months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The new topic is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. This would be our fiscal year ending September 30, 2020. We are still evaluating the potential impact of this topic on our financial statements.

In November 2016, the FASB issued a new topic on the statement of cash flows that changes the presentation of restricted cash and cash equivalents on the statement of cash flows. Restricted cash and restricted cash equivalents will be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. This topic is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, which would be our fiscal year ending September 30, 2019. We are still evaluating this new topic, but do not expect it to have a material impact on our statement of cash flows.

In May 2017, the FASB issued a new topic on modification accounting with regards to stock based compensation. This new topic clarifies when a change to the terms or conditions of a share-based payment award should be accounted for as a modification. An entity should account for the effects of a modification unless the fair value, vesting conditions and classification, as an equity instrument or a liability instrument, of the modified award are the same before and after a change to the terms or conditions of the share-based payment award. This topic is effective for annual reporting periods beginning after December 15, 2017, which is our fiscal year ending September 30, 2019. We are still evaluating this new topic, but do not expect it to have a material impact on our consolidated financial position or results of operations.

B. EARNINGS PER SHARE

We compute basic earnings per share by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted earnings per common and potential common share includes the weighted average of additional shares associated with the incremental effect of dilutive restricted stock and restricted stock units, as prescribed by the FASB guidance on earnings per share.

The following table reconciles basic and diluted weighted average shares used in the computation of earnings per share (in thousands, except per share data):

	Three months ended June 30, 2018		Nine months ended June 30, 2017	
Numerator:				
Net income (loss)	\$301	\$(3,215)	\$(8,691)	\$(4,343)
Denominator:				
Weighted average basic shares	11,514	11,463	11,503	11,449
Dilutive effect of restricted stock units	73	—	—	—
Weighted average diluted shares	11,587	11,463	11,503	11,449
Income (loss) per share:				
Basic	\$0.03	\$(0.28)	\$(0.76)	\$(0.38)
Diluted	\$0.03	\$(0.28)	\$(0.76)	\$(0.38)

For the quarter ended June 30, 2017 and nine months ended June 30, 2018 and 2017, we incurred net losses and therefore all potential common shares were deemed to be anti-dilutive.

C. DETAIL OF SELECTED BALANCE SHEET ACCOUNTS

Allowance for Doubtful Accounts

Activity in our allowance for doubtful accounts receivable consisted of the following (in thousands):

	Three months ended June 30, 2018		Nine months ended June 30, 2017	
Balance at beginning of period	\$264	\$310	\$179	\$811
Bad debt expense (recovery)	18	(129)	110	(226)
Uncollectible accounts written off, net of recoveries	(36)	(92)	(44)	(493)
Change due to foreign currency translation	(7)	1	(6)	(2)
Balance at end of period	\$239	\$90	\$239	\$90

Inventories

The components of inventories are summarized below (in thousands):

	June 30, 2018	September 30, 2017
Raw materials, parts and subassemblies, net	\$21,402	\$ 17,848
Work-in-progress	1,452	600
Total inventories	\$22,854	\$ 18,448

Cost and Estimated Earnings on Uncompleted Contracts

The components of costs and estimated earnings and related amounts billed on uncompleted contracts are summarized below (in thousands):

	June 30, 2018		September 30, 2017
Costs incurred on uncompleted contracts	\$ 823,190		\$ 987,164
Estimated earnings	246,852		316,970
	1,070,042		1,304,134
Less: Billings to date	(1,038,540)		(1,278,746)
Net underbilled position	\$ 31,502		\$ 25,388
Included in the accompanying balance sheets under the following captions:			
Costs and estimated earnings in excess of billings on uncompleted contracts	\$ 70,939		\$ 51,554
Billings in excess of costs and estimated earnings on uncompleted contracts	(39,437)		(26,166)
Net underbilled position	\$ 31,502		\$ 25,388

Accrued Product Warranty

Activity in our product warranty accrual consisted of the following (in thousands):

	Three months ended June 30,		Nine months ended June 30,	
	2018	2017	2018	2017
Balance at beginning of period	\$2,241	\$3,649	\$3,174	\$4,639
Increase in warranty expense	1,036	593	970	1,313
Deduction for warranty charges	(891)	(949)	(1,752)	(2,618)
Change due to foreign currency translation	(23)	39	(29)	(2)
Balance at end of period	\$2,363	\$3,332	\$2,363	\$3,332

D. LONG-TERM DEBT

Long-term debt consisted of the following (in thousands):

	June 30, September 30,	
	2018	2017
Industrial development revenue bonds	\$1,600	\$ 2,000
Less current portion	(400)	(400)
Total long-term debt	\$1,200	\$ 1,600

U.S. Revolver

We have a \$75.0 million revolving credit facility (U.S. Revolver) to provide working capital support and letters of credit which expires on June 27, 2022. The amount available under the U.S. Revolver at June 30, 2018 was reduced by \$22.3 million for our outstanding letters of credit. Currently, our U.S. Revolver can only be used for letters of credit until we meet certain financial ratios. There were no loans outstanding under the U.S. Revolver as of June 30, 2018.

Per the terms of the U.S. Revolver, we are required to maintain a cash balance in a pledged cash collateral account equal to 102% of the outstanding amount of any loans and letter of credit obligations until we meet certain financial ratios. As of June 30, 2018, the balance in the pledged account was \$23.6 million. The cash collateral associated with the outstanding letters of credit that are due to expire beyond twelve months has been classified as non-current restricted cash on the balance sheet. As of June 30, 2018, there was \$52.7 million available for the issuance of letters of credit under the U.S. Revolver.

The interest rate for amounts outstanding under the U.S. Revolver is a floating rate based upon the higher of the Federal Funds Rate plus 0.5%, the bank's prime rate, or the Eurocurrency rate plus 1.00%. Once the applicable rate is determined, a margin ranging up to 1.25% is added to the applicable rate.

The U.S. Revolver is collateralized by a pledge of 100% of the voting capital stock of each of our domestic subsidiaries and 65% of the voting capital stock of each non-domestic subsidiary. The U.S. Revolver provides for customary events of default and carries cross-default provisions with other existing debt agreements. If an event of default (as defined in the U.S. Revolver) occurs and is continuing, on the terms and subject to the conditions set forth in the U.S. Revolver, amounts outstanding under the U.S. Revolver

may be accelerated and may become immediately due and payable. It also contains financial covenants defining various financial measures and the levels of these measures with which we must comply, as well as a “material adverse change” clause. A “material adverse change” is defined as a material change in our operations, business, properties, liabilities or condition (financial or otherwise) or a material impairment of our ability to perform our obligations under our credit agreements. As of June 30, 2018, we were in compliance with all of the financial covenants of the U.S. Revolver.

Industrial Development Revenue Bonds

We borrowed \$8.0 million in October 2001 through a loan agreement funded with proceeds from tax-exempt industrial development revenue bonds (Bonds). These Bonds were issued by the Illinois Development Finance Authority and were used for the completion of our Northlake, Illinois facility. Pursuant to the Bond issuance, a reimbursement agreement between us and a major domestic bank required an issuance by the bank of an irrevocable direct-pay letter of credit (Bond LC), as collateral, to the Bonds’ trustee to guarantee payment of the Bonds’ principal and interest when due. The Bond LC is subject to both early termination and extension provisions customary to such agreements, as well as various covenants, for which we were in compliance at June 30, 2018. While the Bonds mature in 2021, the reimbursement agreement requires annual redemptions of \$0.4 million that commenced on October 25, 2002. A sinking fund is used for the redemption of the Bonds. The Bonds bear interest at a floating rate determined weekly by the Bonds’ remarketing agent, which was the underwriter for the Bonds and is an affiliate of the bank. This interest rate was 1.58% as of June 30, 2018.

E. COMMITMENTS AND CONTINGENCIES

Letters of Credit, Surety Bonds and Bank Guarantees

Certain customers require us to post letters of credit or surety bonds which assure that we will perform under the terms of our contract. In the event of default, the counterparty may demand payment from the bank under a letter of credit or performance by the surety under a bond. To date, there have been no significant expenses related to either letters of credit or surety bonds for the periods reported. We were contingently liable for letters of credit of \$22.3 million as of June 30, 2018. We also had surety bonds totaling \$168.3 million that were outstanding, with additional bonding capacity of \$581.7 million available, at June 30, 2018.

Additionally, we have a \$6.6 million facility agreement (Facility Agreement) between Powell (UK) Limited and a large international bank. This Facility Agreement provides Powell (UK) Limited the ability to enter into bank guarantees as well as forward exchange contracts and currency options. At June 30, 2018, we had outstanding guarantees totaling \$3.2 million under this Facility Agreement and amounts available under this Facility Agreement were \$3.4 million. The Facility Agreement provides for financial covenants and customary events of default, and carries cross-default provisions with our U.S. Revolver. If an event of default (as defined in the Facility Agreement) occurs and is continuing, per the terms and subject to the conditions set forth therein, obligations outstanding under the Facility Agreement may be accelerated and declared immediately due and payable. As of June 30, 2018, we were in compliance with all of the financial covenants of the Facility Agreement.

Litigation

We are involved in various legal proceedings, claims and other disputes arising from our commercial operations, projects, employees and other matters which, in general, are subject to uncertainties and in which the outcomes are not predictable. Although we can give no assurances about the resolution of pending claims, litigation or other disputes and the effect such outcomes may have on us, management believes that any ultimate liability resulting from the outcome of such proceedings, to the extent not otherwise provided or covered by insurance, will not have a material adverse effect on our consolidated financial position or results of operations or liquidity.

Liquidated Damages

Certain of our customer contracts have schedule and performance obligation clauses that, if we fail to meet them, could require us to pay liquidated damages. Each individual contract defines the conditions under which the customer may make a claim against us. As of June 30, 2018, our exposure to possible liquidated damages was \$2.6 million, of which approximately \$1.6 million is probable. Based on our actual or projected failure to meet these various contractual commitments, \$1.5 million has been recorded as a reduction to revenue. Of the \$1.5 million recorded as a

reduction to revenue, approximately \$1.0 million was recognized in prior periods. We will attempt to obtain change orders, contract extensions or accelerate project completion which may resolve the potential for any unaccrued liquidated damage. Should we fail to achieve relief on some or all of these contractual obligations, we could be required to pay additional liquidated damages, which could negatively impact our future operating results.

F. STOCK-BASED COMPENSATION

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Refer to our Annual Report on Form 10-K for the fiscal year ended September 30, 2017 for a full description of our existing stock-based compensation plans.

Restricted Stock Units

We issue restricted stock units (RSUs) to certain officers and key employees of the Company. The fair value of the RSUs is based on the price of our common stock as reported on the NASDAQ Global Market on the grant dates. The typical annual grant vests over a three-year period from the date of issuance. Sixty percent of those grants are time-based and vest over a three-year period on each anniversary of the grant date, based on continued employment. The remaining forty percent of the grant will be earned based on the three-year earnings performance of the Company following the grant date. At June 30, 2018, there were 199,317 RSUs outstanding. The RSUs do not have voting rights but do receive dividend equivalents upon vesting; additionally, the shares of common stock underlying the RSUs are not considered issued and outstanding until vested and common stock is issued.

RSU activity (number of shares) for the nine months ended June 30, 2018 is summarized below:

	Number of Restricted Stock Units	Weighted Average Fair Value Per Share
Outstanding at September 30, 2017	177,737	\$ 37.00
Granted	88,000	29.88
Vested	(43,620)	35.30
Forfeited/canceled	(22,800)	41.88
Outstanding at June 30, 2018	199,317	\$ 33.69

During the nine months ended June 30, 2018 and 2017, we recorded compensation expense of \$2.0 million and \$1.7 million, respectively, related to the RSUs.

Restricted Stock

Each non-employee director receives 2,000 restricted shares of the Company's common stock annually. Fifty-percent of the restricted stock granted to each of our non-employee directors vests immediately, while the remaining fifty-percent will vest on the first anniversary of the grant date. Compensation expense is recognized immediately for the first fifty-percent of the restricted stock granted, while compensation expense for the remaining fifty-percent is recognized over the remaining vesting period based on the price per share on the grant date. In February 2018, 12,000 shares of restricted stock were issued to our non-employee directors under the 2014 Director Plan at a price of \$27.88 per share. In April 2018, we issued 2,000 shares of restricted stock to a non-employee director at a price of \$27.15 per share.

During the nine months ended June 30, 2018 and 2017, we recorded compensation expense of \$0.4 million and \$0.6 million, respectively, related to restricted stock.

G. FAIR VALUE MEASUREMENTS

We measure certain financial assets and liabilities at fair value. Fair value is defined as an "exit price" which represents the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in valuing an asset or liability. The accounting guidance requires the use of valuation techniques to measure fair value that maximize the use of observable inputs and minimize the use of unobservable inputs. As a basis for considering such assumptions and inputs, a fair value hierarchy has been established which identifies and prioritizes three levels of inputs to be used in measuring fair value. The three levels of the fair value hierarchy are as follows:

Level 1 — Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 — Inputs other than the quoted prices in active markets that are observable either directly or indirectly, including: quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active or other inputs that are observable or can be corroborated by observable market data.

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Level 3 — Unobservable inputs that are supported by little or no market data and require the reporting entity to develop its own assumptions.

The following table summarizes the fair value of our assets and liabilities that were accounted for at fair value on a recurring basis as of June 30, 2018 (in thousands):

	Fair Value Measurements at June 30, 2018			
	Quoted			
	Prices			
	in			
	Active	Significant	Significant	Fair
	Markets	Other	Unobservable	Value at
	for	Observable	Inputs	June 30,
	Identical	Inputs	(Level 3)	2018
	Assets	(Level 2)		
	(Level			
	1)			
Assets:				
Cash and cash equivalents	\$40,075	\$	—\$	—\$40,075
Short-term investments	15,218	—	—	15,218
Restricted cash	23,587	—	—	23,587
Deferred compensation	—	6,591	—	6,591

Liabilities:

Deferred compensation	—	5,377	—	5,377
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The following table summarizes the fair value of our assets and liabilities that were accounted for at fair value on a recurring basis as of September 30, 2017 (in thousands):

	Fair Value Measurements at September 30, 2017			
	Quoted			
	Prices			
	in			
	Active	Significant	Significant	Fair Value at
	Markets	Other	Unobservable	September 30,
	for	Observable	Inputs	2017
	Identical	Inputs	(Level 3)	
	Assets	(Level 2)		
	(Level			
	1)			
Assets:				
Cash and cash equivalents	\$68,359	\$	—\$	—\$ 68,359
Short-term investments	26,829	—	—	26,829
Restricted cash	24,851			24,851
Deferred compensation	—	6,442	—	6,442
Liabilities:				
Deferred compensation	—	4,991	—	4,991

Fair value guidance requires certain fair value disclosures be presented in both interim and annual reports. The estimated fair value amounts of financial instruments have been determined using available market information and valuation methodologies described below.

Cash and cash equivalents

Cash and cash equivalents, primarily funds held in money market savings instruments, are reported at their current carrying value which approximates fair value due to the short-term nature of these instruments and are included in cash and cash equivalents in our Condensed Consolidated Balance Sheets.

Short-term Investments – Short-term investments include time deposits with original maturities of three months or more.

Restricted Cash – Restricted cash represents a pledged cash collateral balance which is required under our U.S. Revolver and is held in an interest-bearing account. See Note D for further discussion on restricted cash.

Deferred Compensation – We hold investments in an irrevocable Rabbi Trust for our deferred compensation plan. These assets include both mutual fund investments and company-owned life insurance policies. Under the plan, participants designate investment options to serve as the basis for measurement of the notional value of their accounts. The mutual funds and company-owned life insurance policies are combined in the plan and are therefore categorized as Level 2 in the fair value measurement hierarchy.

There were no transfers between levels within the fair value measurement hierarchy during the quarter ended June 30, 2018.

H. INCOME TAXES

The calculation of the effective tax rate is as follows (in thousands):

	Three months ended June 30,		Nine months ended June 30,	
	2018	2017	2018	2017
Income (loss) before income taxes	\$689	\$(6,898)	\$(11,134)	\$(10,812)
Income tax provision (benefit)	388	(3,683)	(2,443)	(6,469)
Net income (loss)	\$301	\$(3,215)	\$(8,691)	\$(4,343)
Effective tax rate	56	% 53	% 22	% 60

On December 22, 2017, President Trump signed into law the Tax Cuts and Jobs Act (the Act). The Act lowers the corporate tax rate from 35% to 21% effective January 1, 2018. As a result, the U.S. federal statutory rate for Fiscal 2018 is a reduced blended U.S. tax rate of 24.5%. The final impact of the Act may differ from our estimates based on changes in interpretations or assumptions we make, as well as the issuance of additional guidance.

In the third quarter of Fiscal 2018, the effective tax rate was negatively impacted by the relative amounts of income/loss recognized in various jurisdictions as well as a foreign tax loss which is reserved with a valuation allowance. The effective tax rate for the third quarter of Fiscal 2017 was favorably impacted by discrete items recognized during the quarter, primarily related to the Research and Development Tax Credit (R&D Tax Credit). The effective tax rate for the third quarter of Fiscal 2017 was also favorably impacted by the lower tax rate in the United Kingdom, the relative amounts of income/loss recognized in various jurisdictions, as well as the utilization of net operating loss carryforwards in Canada that are fully reserved with a valuation allowance.

The effective tax rate for the nine months ended June 30, 2018 decreased due to the lower U.S. corporate tax rate as well as a foreign tax loss which is reserved with a valuation allowance. Additionally we recorded deferred tax expense of \$0.7 million due to the re-measurement of our U.S. deferred tax assets under the Act, which are not expected to be realized prior to the end of Fiscal 2018. The effective tax rate for the nine months ended June 30, 2017 was favorably impacted by discrete items, primarily related to the R&D Tax Credit. The effective tax rate for the nine months ended June 30, 2017 was also favorably impacted by the lower tax rate in the United Kingdom, the relative amounts of income/loss recognized in various jurisdictions, as well as the utilization of net operating loss carryforwards in Canada that are fully reserved with a valuation allowance.

I. SUBSEQUENT EVENTS

On August 6, 2018, our Board of Directors declared a quarterly cash dividend on our common stock in the amount of \$0.26 per share. The dividend is payable on September 19, 2018 to shareholders of record at the close of business on August 22, 2018.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

We are including the following discussion to inform our existing and potential shareholders generally of some of the risks and uncertainties that can affect our Company and to take advantage of the “safe harbor” protection for forward-looking statements that applicable federal securities law affords.

From time to time, our management or persons acting on our behalf make forward-looking statements to inform existing and potential shareholders about our Company. These statements may include projections and estimates concerning the timing and success of specific projects and our future backlog, revenues, income, acquisitions and capital spending. Forward-looking statements include information concerning future results of operations and financial condition. Statements that contain words such as “believes,” “expects,” “anticipates,” “intends,” “estimates,” “continues,” “should,” “could,” “may,” “plan,” “project,” “predict,” “will” or similar expressions may be forward-looking statements. In addition, sometimes we will specifically describe a statement as being a forward-looking statement and refer to this cautionary statement.

In addition, various statements in this Quarterly Report on Form 10-Q, including those that express a belief, expectation or intention, as well as those that are not statements of historical fact, are forward-looking statements. These forward-looking statements speak only as of the date of this report; we disclaim any obligation to update these statements unless required by securities law, and we caution you not to rely on them unduly. We have based these forward-looking statements on our current expectations and assumptions about future events. While our management considers these expectations and assumptions to be reasonable, they are inherently subject to significant business, economic, competitive, regulatory and other risks, contingencies and uncertainties, most of which are difficult to predict and many of which are beyond our control. These risks, contingencies and uncertainties relate to, among other matters, the following:

Our business is largely dependent on customers in the oil and gas markets and we are adversely impacted by extended periods of low oil or gas prices, which decrease our customers' spending, the demand for our products and services and the prices we are able to charge. This has had, and may continue to have, an adverse effect on our future operating results.

Economic uncertainty and financial market conditions may impact our customer base, suppliers and backlog.

Our backlog is subject to unexpected adjustments and cancellations and, therefore, may not be a reliable indicator of our future earnings.

The use of percentage-of-completion accounting on our fixed-price contracts could result in volatility in our results of operations.

The majority of our contracts contain performance obligations that may subject us to penalties or additional liabilities.

Fluctuations in the price and supply of materials used to manufacture our products may reduce our profits and could adversely impact our ability to meet commitments to our customers.

Our industry is highly competitive.

Our operations could be adversely impacted by the effects of government regulations.

Changes in tax laws and regulations may change our effective tax rate and could have a material effect on our financial results.

Our international operations expose us to risks that are different from, or possibly greater than, the risks we are exposed to domestically and may adversely affect our operations.

The departure of key personnel could disrupt our business.

Our business requires skilled labor and we may be unable to attract and retain qualified employees.

We are exposed to risks relating to the use of subcontractors on some of our projects.

Actual and potential claims, lawsuits and proceedings could ultimately reduce our profitability and liquidity and weaken our financial condition.

Quality problems with our products could harm our reputation and erode our competitive position.

A failure in our business systems or cyber security attacks on any of our facilities, or those of third parties, could adversely affect our business and our internal controls.

We carry insurance against many potential liabilities, but our management of risk may leave us exposed to unidentified or unanticipated risks.

Changes in and compliance with environmental laws could adversely impact our financial results.

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• Technological innovations by competitors may make existing products and production methods obsolete.

• Catastrophic events could disrupt our business.

• Unforeseen difficulties with expansions, relocations or consolidations of existing facilities could adversely affect our operations.

• Growth and product diversification through strategic acquisitions involves a number of risks.

• Provisions of our charter documents or Delaware law could delay or prevent an acquisition of our company, even if the acquisition would be beneficial to our stockholders, and could make it more difficult to change management.

• Our stock price could decline or fluctuate significantly due to unforeseen circumstances. These fluctuations may cause our stockholders to incur losses.

• Obtaining surety bonds, letters of credit, bank guarantees, or other financial assurances, may be necessary for us to successfully bid on and obtain certain contracts.

• Failure to remain in compliance with covenants or obtain waivers or amendments under our credit agreement could adversely impact our business.

• Failures or weaknesses in our internal controls over financial reporting could adversely affect our ability to report on our financial condition and results of operations accurately and/or on a timely basis.

We believe the items we have outlined above are important factors that could cause estimates included in our financial statements to differ materially from actual results and those expressed in a forward-looking statement made in this report or elsewhere by us or on our behalf. We have discussed these factors in more detail in our Annual Report on Form 10-K for the year ended September 30, 2017. These factors are not necessarily all of the factors that could affect us. Unpredictable or unanticipated factors we have not discussed in this report could also have material adverse effects on actual results. We do not intend to update our description of important factors each time a potential important factor arises, except as required by applicable securities laws and regulations. We advise our shareholders that they should (1) be aware that factors not referred to above could affect the accuracy of our forward-looking statements and (2) use caution when considering our forward-looking statements.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the accompanying condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q and with our Annual Report on Form 10-K for the year ended September 30, 2017 which was filed with the Securities and Exchange Commission (SEC) on December 6, 2017 and is available on the SEC's website at www.sec.gov.

Overview

We develop, design, manufacture and service custom-engineered equipment and systems for the distribution, control and monitoring of electrical energy. Headquartered in Houston, Texas, we serve the oil and gas refining, onshore and offshore oil and gas production, petrochemical, pipeline, terminal, mining and metals, light rail traction power, electric utility, pulp and paper and other heavy industrial markets. Revenues and costs are primarily related to custom engineered-to-order equipment and systems and are accounted for under percentage-of-completion accounting which precludes us from providing detailed price and volume information. Our backlog includes various projects that typically take a number of months to produce.

The markets in which we participate are capital intensive and cyclical in nature. Cyclicity is predominantly driven by customer demand, global economic conditions and anticipated environmental, safety or regulatory changes that affect the manner in which our customers proceed with capital investments. Our customers analyze various factors including the demand and price for oil, gas and electrical energy, the overall economic and financial environment, governmental budgets, regulatory actions and environmental concerns. These factors influence the release of new capital projects by our customers, which are traditionally awarded in competitive bid situations. Scheduling of projects is matched to the customer requirements and projects typically take a number of months to produce. Schedules may change during the course of any particular project and our operating results can therefore be impacted by factors outside of our control.

Due to the significant decline in oil and gas prices from peak 2014 levels, many of our customers have reduced their capital budgets and cut costs, and in certain instances have delayed or cancelled projects that we were pursuing. As a result, our revenues and project backlog declined. In response to our reduced project backlog and the challenging market outlook in our core oil, gas and petrochemical markets, we took steps in Fiscal 2016 and 2017 to reduce our overall cost structure and better align our costs with future production requirements. Since the second half of Fiscal 2017, our core oil, gas and petrochemical markets have begun to strengthen resulting in increased revenues and backlog.

Results of Operations

Quarter Ended June 30, 2018 Compared to the Quarter Ended June 30, 2017 (Unaudited)

Revenue and Gross Profit

Revenues increased by 42%, or \$36.2 million, to \$122.1 million in the third quarter of Fiscal 2018, compared to the third quarter of Fiscal 2017, primarily due to an increase in orders from our domestic operations in Fiscal 2018. Domestic revenues increased by 66%, or \$36.2 million, to \$91.3 million in the third quarter of Fiscal 2018, compared to the third quarter of Fiscal 2017. International revenues were \$30.8 million in the third quarter of Fiscal 2018 and the third quarter of Fiscal 2017. Our international revenue includes both revenue generated from our international facilities as well as export revenues from our domestic facilities. Revenues from commercial and industrial customers increased by 94%, or \$45.3 million, to \$93.3 million in the third quarter of Fiscal 2018, compared to the third quarter of Fiscal 2017. Revenues from public and private utilities decreased by 32%, or \$9.1 million, to \$19.3 million in the third quarter of Fiscal 2018, compared to the third quarter of Fiscal 2017. Revenues from municipal and transit projects were \$9.5 million in the third quarter of Fiscal 2018, and the third quarter of Fiscal 2017. The increase in commercial and industrial revenues and decrease in public and private utilities revenues were primarily due to the timing of projects.

Gross profit for the third quarter of Fiscal 2018 increased by 103%, or \$9.3 million, to \$18.4 million, compared to the third quarter of Fiscal 2017. Gross profit as a percentage of revenues increased to 15% in the third quarter of Fiscal 2018, compared to 11% in the third quarter of Fiscal 2017. Gross profit and margins are improving due to improved efficiencies in our manufacturing facilities and increased volumes due to the increased demand.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased by \$1.4 million, to \$16.2 million during the third quarter of Fiscal 2018, compared to \$14.8 million in the third quarter of Fiscal 2017, primarily due to the timing of variable performance based compensation. Selling, general and administrative expenses, as a percentage of revenues, decreased to 13% during the third quarter of Fiscal 2018, compared to 17% during the third quarter of Fiscal 2017, primarily due to the increase in revenues.

Income Tax Provision/Benefit

We recorded an income tax provision of \$0.4 million in the third quarter of Fiscal 2018, compared to an income tax benefit of \$3.7 million in the third quarter of Fiscal 2017. The effective tax rate for the third quarter of Fiscal 2018 was 56% compared to an effective tax rate of 53% in the third quarter of Fiscal 2017. On December 22, 2017, President Trump signed into law the Tax Cuts and Jobs Act (the Act). The Act lowered the corporate tax rate from 35% to 21% effective January 1, 2018. The final impact of the Act may differ from our estimates based on changes in interpretations or assumptions we make, as well as the issuance of additional guidance. In the third quarter of Fiscal 2018, the effective tax rate was negatively impacted by the relative amounts of income/loss recognized in various jurisdictions as well as a foreign tax loss which is reserved with a valuation allowance. The effective tax rate for the third quarter of 2017 was favorably impacted by discrete items recognized during the quarter, primarily related to the Research and Development Tax Credit (R&D Tax Credit). The effective tax rate for the third quarter of Fiscal 2017 was also favorably impacted by the lower tax rate in the United Kingdom, the relative amounts of income/loss recognized in various jurisdictions, as well as the utilization of net operating loss carryforwards in Canada that are fully reserved with a valuation allowance.

Net Income/Loss

In the third quarter of Fiscal 2018, we recorded income of \$0.3 million, or \$0.03 per diluted share compared to a net loss of \$3.2 million, or \$0.28 per diluted share, in the third quarter of Fiscal 2017. This improvement in operating results over the prior year was primarily due to the increase in revenues and gross profit from increased bookings and backlog, primarily from our core oil, gas and petrochemical markets.

Backlog

New orders increased during the third quarter of Fiscal 2018 to \$139.2 million, compared to \$90.7 million in the third quarter of Fiscal 2017, primarily due to increased demand from our customers in our core oil, gas and petrochemical markets. The order backlog at June 30, 2018 was \$316.2 million, an increase from \$299.8 million at March 31, 2018.

Nine Months Ended June 30, 2018 Compared to the Nine Months Ended June 30, 2017 (Unaudited)

Revenue and Gross Profit

Revenues increased by 4%, or \$12.9 million, to \$313.8 million for the nine months ended June 30, 2018, compared to the nine months ended June 30, 2017, primarily due to the increase in orders in Fiscal 2018. Domestic revenues increased by 3%, or \$6.6 million, to \$222.9 million for the nine months ended June 30, 2018, compared to the nine months ended June 30, 2017. This was primarily due to remediation efforts following Hurricane Harvey which resulted in approximately \$7 million of revenue. International revenues increased by 7%, or \$6.2 million, to \$90.9 million for the nine months ended June 30, 2018, compared to the nine months ended June 30, 2017. Our international revenue includes both revenue generated from our international facilities as well as export revenues from our domestic facilities. The increase in international revenues resulted from an increase in oil and gas export projects manufactured at our domestic facilities. Revenues from commercial and industrial customers increased by 18%, or \$34.2 million, to \$224.8 million for the nine months ended June 30, 2018, compared to the nine months ended June 30, 2017. Revenues from public and private utilities increased by 11%, or \$6.4 million, to \$67.4 million for the nine months ended June 30, 2018, compared to the nine months ended June 30, 2017. Revenues from municipal and transit projects decreased by 56%, or \$27.7 million, to \$21.6 million for the nine months ended June 30, 2018, compared to the nine months ended June 30, 2017. The increase in commercial and industrial revenues and public and private utilities revenues and the decline in municipal and transit projects were primarily due to the timing of projects.

Gross profit for the nine months ended June 30, 2018 increased by 4%, or \$1.5 million, to \$41.4 million, compared to the nine months ended June 30, 2017. Gross profit as a percentage of revenues was 13% for both the nine months ended June 30, 2018 and 2017. Gross profit is improving due to improved efficiencies in our manufacturing facilities and increased volumes due to the increased demand.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased by 4%, or \$2.0 million, to \$48.5 million for the nine months ended June 30, 2018, compared to the nine months ended June 30, 2017, primarily due to the timing of variable

performance based compensation. Selling, general and administrative expenses, as a percentage of revenues, was 15% for both the nine months ended June 30, 2018 and 2017.

Restructuring and Separation Expenses

In the nine months ended June 30, 2018, we had no restructuring or separation expenses. However, in the nine months ended June 30, 2017, we incurred \$0.8 million in restructuring and separation expenses as we continued to reduce our overall cost structure to better align our costs with future production requirements.

Income Tax Benefit

We recorded an income tax benefit of \$2.4 million for the nine months ended June 30, 2018 compared to an income tax benefit of \$6.5 million for the nine months ended June 30, 2017. However, the effective tax rate for the nine months ended June 30, 2018 was 22% compared to an effective tax rate of 60% for the nine months ended June 30, 2017. The effective tax rate for the nine months ended June 30, 2018 decreased due to the lower U.S. corporate tax rate as well as a foreign tax loss which is reserved with a valuation allowance. Additionally we recorded deferred tax expense of \$0.7 million due to the re-measurement of our U.S. deferred tax assets under the Act, which are not expected to be realized prior to the end of Fiscal 2018. The effective tax rate for the nine months ended June 30, 2017 was favorably impacted by discrete items, primarily related to the R&D Tax Credit. The effective tax rate for the nine months ended June 30, 2017 was also favorably impacted by the lower tax rate in the United Kingdom, the relative amounts of income/loss recognized in various jurisdictions, as well as the utilization of net operating loss carryforwards in Canada that are fully reserved with a valuation allowance.

Net Loss

For the nine months ended June 30, 2018, we recorded a loss of \$8.7 million, or \$0.76 per diluted share compared to a net loss of \$4.3 million, or \$0.38 per diluted share, for the nine months ended June 30, 2017. The increase in our net loss compared to the prior year was primarily due to the reduction in our income tax benefit as a result of the Act.

Backlog

New orders increased during the nine months ended June 30, 2018 to \$380.6 million, compared to \$243.5 million for the nine months ended June 30, 2017, primarily due to increased demand from our customers in our core oil, gas and petrochemical markets. The order backlog at June 30, 2018 was \$316.2 million, an increase from \$250.1 million at September 30, 2017.

Liquidity and Capital Resources

As of June 30, 2018, current assets exceeded current liabilities by 2.5 times and our debt to total capitalization was 0.53%.

Cash, cash equivalents and short-term investments decreased to \$55.3 million at June 30, 2018, compared to \$95.2 million at September 30, 2017 as cash has been used in operations to fund working capital requirements from our increased project volume. We had restricted cash held in a pledged collateral account related to our U.S. Revolver of \$23.6 million at June 30, 2018 and \$24.9 million at September 30, 2017. For further information regarding our U.S. Revolver, see Note D of Notes to Condensed Consolidated Financial Statements.

Our U.S. Revolver is a \$75.0 million revolving credit facility in the U.S. As of June 30, 2018, there were no amounts borrowed under this facility. Total letters of credit outstanding under our U.S. Revolver, which reduce our availability, were \$22.3 million at June 30, 2018 and \$24.1 million at September 30, 2017. Currently, our U.S. Revolver can only be used for letters of credit until we meet certain financial ratios. As of June 30, 2018, there was \$52.7 million available for the issuance of letters of credit under the U.S. Revolver. Total long-term debt, including current maturities, totaled \$1.6 million at June 30, 2018, compared to \$2.0 million at September 30, 2017. For further information regarding our debt, see Notes D and E of Notes to Condensed Consolidated Financial Statements.

Approximately \$31 million of our cash and short-term investments at June 30, 2018 was held outside of the United States for international operations. It is our intention to indefinitely reinvest all current and future foreign earnings internationally in order to ensure sufficient working capital to support our international operations. In the event that we elect to repatriate some or all of the foreign earnings that were previously deemed to be indefinitely reinvested outside the U.S., under current tax laws we would incur additional tax expense upon such repatriation.

We believe that our strong working capital position and available cash and short-term investments should be sufficient to finance future operating activities, capital improvements and debt repayments for the foreseeable future. We continue to monitor the factors that drive our markets and will continue to strive to maintain our leadership and

competitive advantage in the markets we serve while aligning our cost structures with market conditions.

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Operating Activities

Cash used in operating activities decreased to \$26.1 million during the nine months ended June 30, 2018, compared to cash provided by operating activities of \$27.1 million during the same period in Fiscal 2017. This decrease in operating cash flow for the nine months ended June 30, 2018 was primarily due to the reduction in earnings year over year and increases in accounts receivable, project billings and inventories as our increased project volume requires cash to fund the growth. Cash flow from operations is primarily influenced by project volume, the timing of milestone payments from our customers and the payment terms with our suppliers.

Investing Activities

Net cash provided by investing activities during the nine months ended June 30, 2018 totaled \$8.1 million compared to cash used in investing activities of \$83.2 million during the same period in Fiscal 2017. This increase in Fiscal 2018 was primarily due to maturities of short-term investments. For the nine months ended June 30, 2018, our net short-term investment surplus was \$10.7 million and we spent approximately \$4.0 million on purchases of plant improvements and equipment. For the nine months ended June 30, 2017, we had net short-term investment purchases of \$55.4 million as well as the establishment of restricted cash of \$25.3 million.

Financing Activities

Net cash used in financing activities was \$9.9 million and \$9.7 million during the nine months ended June 30, 2018 and 2017, respectively. These amounts primarily consisted of cash dividends of approximately \$8.9 million in each period.

New Accounting Standards

See Note A of Notes to Condensed Consolidated Financial Statements included in this report for information on new accounting standards.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based on our condensed consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities known to exist at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. We evaluate our estimates on an ongoing basis, based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. There can be no assurance that actual results will not differ from those estimates.

There have been no material changes to our critical accounting policies as disclosed in our Annual Report on Form 10-K for the year ended September 30, 2017.

For the nine months ended June 30, 2018, our operating loss was positively impacted by \$2.9 million due to changes in contract estimates related to projects in progress at the beginning of the period. These changes in estimates resulted primarily from, among other things, successful execution and close-out improvements, as well as other changes in facts and circumstances during the period.

Outlook

The markets in which we participate are capital-intensive and cyclical in nature. Cyclicity is predominantly driven by customer demand, global economic conditions and anticipated environmental or regulatory changes which affect the manner in which our customers proceed with capital investments. Our customers analyze various factors including the demand and price for oil, gas and electrical energy, the overall economic and financial environment, governmental budgets, regulatory actions and environmental concerns. These factors influence the release of new capital projects by our customers, which are traditionally awarded in competitive bid situations. Scheduling of projects is matched to customer requirements. Projects typically take a number of months to produce, and schedules may change during the course of any particular project.

A significant portion of our revenues have historically been from the oil, gas and petrochemical markets. Oil and gas commodity price levels have stabilized and our customers are beginning to invest in maintenance and small projects; however, customers

continue to delay their major capital investments. The reduction in available projects has increased price pressures over the past two years and has impacted, and may continue to negatively impact, our backlog, revenues and operating results.

Our operating results have been impacted by factors such as the timing of new order awards, customer approval of final engineering and design specifications and delays in customer construction schedules, all of which have had a negative impact on the timing of project execution. Our operating results also have been, and could continue to be, impacted by the timing and resolution of change orders, project close-out and resolution of potential contract claims and liquidated damages, all of which could improve or deteriorate gross margins during the period in which these items are resolved with our customers. These factors may result in periods of underutilization of our resources and facilities and negatively impact our ability to cover our fixed costs. We continue to assess our cost structure, operating performance and service offerings as the oil, gas and petrochemical markets remain challenging and uncertain. During the first nine months of Fiscal 2018, we have experienced an increase in bookings and are beginning to see an improvement in revenues and operating results that we anticipate will continue for the remainder of Fiscal 2018 and into Fiscal 2019. We continue to focus on maintaining our cash position, improving efficiencies in production and investing in future business opportunities.

Our increase in project volume has required cash to fund operations, but we believe that our strong working capital position and available cash and short-term investments should be sufficient to finance future operating activities, research and development initiatives, capital improvements and debt repayments for the foreseeable future. We continue to monitor the factors that drive our markets and will continue to strive to maintain our leadership and competitive advantage in the markets we serve while aligning our cost structures with market conditions.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to certain market risks arising from transactions we have entered into in the normal course of business. These risks primarily relate to fluctuations in market conditions, commodity prices, foreign exchange rates and interest rates.

Market Risk

We are exposed to general market risk and its potential impact on accounts receivable or costs and estimated earnings in excess of billings on uncompleted contracts. The amounts recorded may be at risk if our customers' ability to pay these obligations is negatively impacted by economic conditions. Our customers and their industries are typically engineering, procurement and construction firms, oil and gas refining, offshore oil and gas production, petrochemical, pipeline, terminal, mining and metals, light rail traction power, electric utility, pulp and paper and other heavy industrial customers. We maintain ongoing discussions with customers regarding contract status with respect to payment status, change orders and billing terms in an effort to monitor collections of amounts billed.

Commodity Price Risk

We are subject to market risk from fluctuating market prices of certain raw materials used in our products. While such materials are typically available from numerous suppliers, commodity raw materials are subject to price fluctuations. We attempt to pass along such commodity price increases to our customers on a contract-by-contract basis to avoid a negative effect on profit margin. While we may do so in the future, we have not currently entered into any derivative contracts to hedge our exposure to commodity risk. We continue to experience price volatility with some of our key raw materials and components. Fixed-price contracts may limit our ability to pass cost increases to our customers, thus negatively impacting our earnings. Fluctuations in commodity prices may have a material impact on our future earnings and cash flows.

Foreign Currency Transaction Risk

We have operations that expose us to currency risk in the British Pound Sterling, the Canadian Dollar and to a lesser extent the Euro. Amounts invested in our foreign operations are translated into U.S. Dollars at the exchange rates in effect at the balance sheet date. The resulting translation adjustments are recorded as accumulated other comprehensive income (loss), a component of stockholders' equity in our condensed consolidated balance sheets. We believe the exposure to the effects that fluctuating foreign currencies have on our consolidated results of operations is limited because the foreign operations primarily invoice customers and collect obligations in their respective

currencies or U.S. Dollars. Additionally, expenses associated with these transactions are generally contracted and paid for in the same local currencies. For the nine months ended June 30, 2018, our realized foreign exchange losses were \$0.4 million and are included in selling, general and administrative expenses in the Condensed Consolidated Statements of Operations.

Our accumulated other comprehensive loss, which is included as a component of stockholders' equity, was \$22.9 million as of June 30, 2018, an increase of \$4.1 million compared to September 30, 2017. This increase in comprehensive loss was primarily a result of fluctuations in the currency exchange rates for the Canadian Dollar and British Pound Sterling as we remeasured the foreign operations of those divisions.

We do not currently hedge our exposure to potential foreign currency translation adjustments.

Interest Rate Risk

If we decide to borrow under our credit facility, we will be subject to market risk resulting from changes in interest rates related to our floating rate bank credit facility. If we were to make such borrowings, a hypothetical 100 basis point increase in variable interest rates may result in a material impact to our financial statements. While we do not currently have any derivative contracts to hedge our exposure to interest rate risk, in the past we have entered and may in the future enter into such contracts. During each of the periods presented, we have not experienced a significant effect on our business due to changes in interest rates.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We have established and maintain a system of disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed in our reports filed with the SEC pursuant to the Securities Exchange Act of 1934, as amended (Exchange Act), is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that such information is accumulated and communicated to our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), as appropriate, to allow timely decisions regarding required disclosures.

Management, with the participation of our CEO and CFO, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of the end of the period covered by this report. Based on such evaluation, our CEO and CFO have each concluded that as of the end of the period covered by this report, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate, to allow timely decisions regarding required disclosures.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

We are involved in various legal proceedings, claims and other disputes arising from our commercial operations, projects, employees and other matters which, in general, are subject to uncertainties and in which the outcomes are not predictable. Although we can give no assurances about the resolution of pending claims, litigation or other disputes and the effect such outcomes may have on us, management believes that any ultimate liability resulting from the outcome of such proceedings, to the extent not otherwise provided or covered by insurance, will not have a material adverse effect on our consolidated financial position or results of operations or liquidity.

Item 1A. Risk Factors

There are no material changes from the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2017.

Item 6. Exhibits

Number	Description of Exhibits
3.1	<u>Certificate of Incorporation of Powell Industries, Inc. filed with the Secretary of State of the State of Delaware on February 11, 2004 (filed as Exhibit 3.1 to our Form 8-A/A filed November 1, 2004, and incorporated herein by reference).</u>
3.2	<u>Amended and Restated Bylaws of Powell Industries, Inc. (filed as Exhibit 3.1 to our Form 8-K filed October 12, 2012, and incorporated herein by reference).</u>
*31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a).
*31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a).
*32.1	<u>Certification of Chief Executive Officer Pursuant to Section 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
*32.2	<u>Certification of Chief Financial Officer Pursuant to Section 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
*101.INS	XBRL Instance Document
*101.SCH	XBRL Taxonomy Extension Schema Document
*101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
*101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
*101.LAB	XBRL Taxonomy Extension Label Linkbase Document
*101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
* Filed herewith	

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

POWELL INDUSTRIES, INC.
(Registrant)

Date: August 8, 2018 By: /s/ Brett A. Cope
Brett A. Cope
President and Chief Executive Officer
(Principal Executive Officer)

By: /s/ Don R. Madison
Don R. Madison
Executive Vice President
Chief Financial and Administrative Officer
(Principal Financial Officer)