

PIONEER POWER SOLUTIONS, INC.

Form 10-Q

November 12, 2014

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 September 30, 2014

OR

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

Commission file number: 001-35212

PIONEER POWER SOLUTIONS, INC.

(Exact name of registrant as specified in its charter)

Delaware 27-1347616  
(State of incorporation) (I.R.S. Employer Identification No.)  
400 Kelby Street, 9th Floor

Fort Lee, New Jersey 07024

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(Address of principal executive offices)

(212) 867-0700

(Registrant's telephone number, including area code)

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, 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  
(Do not check if a 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

The number of shares outstanding of the registrant's Common Stock, \$0.001 par value, as of November 12, 2014 was 7,172,255.

PIONEER POWER SOLUTIONS, INC.

Form 10-Q

For the Quarter Ended September 30, 2014

## TABLE OF CONTENTS

### PART I. FINANCIAL INFORMATION

|                                                                                                                        | Page |
|------------------------------------------------------------------------------------------------------------------------|------|
| <u>Item 1. Financial Statements</u>                                                                                    |      |
| <u>Consolidated Statements of Earnings for the Three and Nine Months Ended September 30, 2014 and 2013</u>             | 1    |
| <u>Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended September 30, 2014 and 2013</u> | 2    |
| <u>Consolidated Balance Sheets at September 30, 2014 and December 31, 2013</u>                                         | 3    |
| <u>Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2014 and 2013</u>                     | 4    |
| <u>Notes to Unaudited Consolidated Financial Statements</u>                                                            | 5    |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                   | 11   |
| <u>Item 4. Controls and Procedures</u>                                                                                 | 18   |
| <u>Item 5. Other Information</u>                                                                                       | 18   |

### PART II. OTHER INFORMATION

|                              |    |
|------------------------------|----|
| <u>Item 1A. Risk Factors</u> | 19 |
| <u>Item 6. Exhibits</u>      | 19 |



Table of Contents

## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements

## PIONEER POWER SOLUTIONS, INC.

## Consolidated Statements of Earnings

(In thousands, except per share data)

(Unaudited)

|                                             | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|---------------------------------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                                             | 2014                                | 2013      | 2014                               | 2013      |
| Revenues                                    | \$ 26,111                           | \$ 22,447 | \$ 68,068                          | \$ 66,993 |
| Cost of goods sold                          | 19,403                              | 16,548    | 52,251                             | 50,434    |
| Gross profit                                | 6,708                               | 5,899     | 15,817                             | 16,559    |
| Operating expenses                          |                                     |           |                                    |           |
| Selling, general and administrative         | 4,071                               | 3,610     | 11,549                             | 10,662    |
| Foreign exchange (gain) loss                | (172)                               | (4)       | (108)                              | 43        |
| Total operating expenses                    | 3,899                               | 3,606     | 11,441                             | 10,705    |
| Operating income                            | 2,809                               | 2,293     | 4,376                              | 5,854     |
| Interest expense                            | 141                                 | 226       | 406                                | 594       |
| Other expense                               | 169                                 | 236       | 171                                | 403       |
| Earnings before income taxes                | 2,499                               | 1,831     | 3,799                              | 4,857     |
| Provision for income taxes                  | 717                                 | 822       | 1,125                              | 1,674     |
| Net earnings                                | \$ 1,782                            | \$ 1,009  | \$ 2,674                           | \$ 3,183  |
| Earnings per common share:                  |                                     |           |                                    |           |
| Basic                                       | \$ 0.25                             | \$ 0.17   | \$ 0.37                            | \$ 0.53   |
| Diluted                                     | \$ 0.25                             | \$ 0.17   | \$ 0.37                            | \$ 0.53   |
| Weighted average common shares outstanding: |                                     |           |                                    |           |
| Basic                                       | 7,172                               | 6,051     | 7,172                              | 5,956     |
| Diluted                                     | 7,226                               | 6,083     | 7,238                              | 5,977     |

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

1

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Table of Contents

PIONEER POWER SOLUTIONS, INC.

Consolidated Statements of Comprehensive Income

(In thousands)

(Unaudited)

|                                                                  | Three Months<br>Ended<br>September 30, |          | Nine Months<br>Ended<br>September 30, |          |
|------------------------------------------------------------------|----------------------------------------|----------|---------------------------------------|----------|
|                                                                  | 2014                                   | 2013     | 2014                                  | 2013     |
| Net earnings                                                     | \$ 1,782                               | \$ 1,009 | \$ 2,674                              | \$ 3,183 |
| Other comprehensive income (loss), net of tax:                   |                                        |          |                                       |          |
| Foreign currency translation adjustments                         | (951)                                  | 249      | (970)                                 | (235)    |
| Amortization of net prior service costs and net actuarial losses | (2)                                    | 53       | 71                                    | 83       |
| Other comprehensive income (loss)                                | (953)                                  | 302      | (899)                                 | (152)    |
| Comprehensive income                                             | \$ 829                                 | \$ 1,311 | \$ 1,775                              | \$ 3,031 |

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

Table of Contents

## PIONEER POWER SOLUTIONS, INC.

## Consolidated Balance Sheets

(In thousands)

|                                                                                                        | September<br>30,<br>2014<br>(Unaudited) | December<br>31,<br>2013 |
|--------------------------------------------------------------------------------------------------------|-----------------------------------------|-------------------------|
| <b>ASSETS</b>                                                                                          |                                         |                         |
| Current Assets                                                                                         |                                         |                         |
| Cash and cash equivalents                                                                              | \$ 682                                  | \$ 425                  |
| Accounts receivable, net                                                                               | 14,125                                  | 9,739                   |
| Inventories, net                                                                                       | 14,671                                  | 12,643                  |
| Income taxes receivable                                                                                | 61                                      | 65                      |
| Deferred income taxes                                                                                  | 2,953                                   | 1,982                   |
| Prepaid expenses and other current assets                                                              | 1,264                                   | 1,291                   |
| Total current assets                                                                                   | 33,756                                  | 26,145                  |
| Property, plant and equipment, net                                                                     | 11,395                                  | 12,213                  |
| Noncurrent deferred income taxes                                                                       | 1,064                                   | 1,091                   |
| Other assets                                                                                           | 1,170                                   | 1,129                   |
| Intangible assets, net                                                                                 | 4,989                                   | 5,285                   |
| Goodwill                                                                                               | 7,934                                   | 7,998                   |
| Total assets                                                                                           | \$ 60,308                               | \$ 53,861               |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                                                            |                                         |                         |
| Current Liabilities                                                                                    |                                         |                         |
| Revolving credit facilities                                                                            | \$ 2,241                                | \$ 795                  |
| Accounts payable and accrued liabilities                                                               | 12,689                                  | 8,370                   |
| Current maturities of long-term debt                                                                   | 1,958                                   | 2,108                   |
| Income taxes payable                                                                                   | 1,990                                   | 1,072                   |
| Total current liabilities                                                                              | 18,878                                  | 12,345                  |
| Long-term debt, net of current maturities                                                              | 5,452                                   | 7,205                   |
| Pension deficit                                                                                        | 34                                      | 213                     |
| Noncurrent deferred income taxes                                                                       | 3,229                                   | 3,306                   |
| Total liabilities                                                                                      | 27,593                                  | 23,069                  |
| Shareholders' Equity                                                                                   |                                         |                         |
| Preferred stock, par value \$0.001; 5,000,000 shares authorized; none issued                           | -                                       | -                       |
| Common stock, par value \$0.001; 30,000,000 shares authorized; 7,172,255 shares issued and outstanding | 7                                       | 7                       |
| Additional paid-in capital                                                                             | 16,312                                  | 16,164                  |
| Accumulated other comprehensive loss                                                                   | (2,328)                                 | (1,429)                 |

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|                                            |           |           |
|--------------------------------------------|-----------|-----------|
| Retained earnings                          | 18,724    | 16,050    |
| Total shareholders' equity                 | 32,715    | 30,792    |
| Total liabilities and shareholders' equity | \$ 60,308 | \$ 53,861 |

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

3

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Table of Contents

## PIONEER POWER SOLUTIONS, INC.

## Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

|                                                         | Nine Months Ended<br>September 30, |          |
|---------------------------------------------------------|------------------------------------|----------|
|                                                         | 2014                               | 2013     |
| Operating activities                                    |                                    |          |
| Net earnings                                            | \$ 2,674                           | \$ 3,183 |
| Depreciation                                            | 959                                | 881      |
| Amortization of intangibles                             | 239                                | 213      |
| Deferred tax expense                                    | (1,020)                            | (147)    |
| Accrued pension                                         | (172)                              | (157)    |
| Stock-based compensation                                | 163                                | 152      |
| Foreign currency remeasurement gain                     | (140)                              | -        |
| Changes in current operating assets and liabilities:    |                                    |          |
| Accounts receivable                                     | (4,754)                            | (1,743)  |
| Inventories                                             | (2,412)                            | 1,361    |
| Prepaid expenses and other assets                       | 49                                 | (422)    |
| Income taxes                                            | 975                                | (34)     |
| Accounts payable and accrued liabilities                | 4,535                              | (71)     |
| Net cash provided by operating activities               | 1,096                              | 3,216    |
| Investing activities                                    |                                    |          |
| Additions to property, plant and equipment              | (594)                              | (2,501)  |
| Business acquisitions, net of cash acquired             | -                                  | (1,601)  |
| Note receivable                                         | (109)                              | -        |
| Net cash used in investing activities                   | (703)                              | (4,102)  |
| Financing activities                                    |                                    |          |
| Decrease in bank overdrafts                             | -                                  | (1)      |
| Increase (decrease) in revolving credit facilities      | 1,468                              | (3,044)  |
| Increase in long-term debt                              | -                                  | 455      |
| Repayment of long-term debt                             | (1,513)                            | (1,688)  |
| Net proceeds from issuance of common stock              | (15)                               | 7,869    |
| Net cash (used in) provided by financing activities     | (60)                               | 3,591    |
| Increase in cash and cash equivalents                   | 333                                | 2,705    |
| Effect of foreign exchange on cash and cash equivalents | (76)                               | 118      |

Cash and cash equivalents

Beginning of year

425

467

End of period

\$ 682

\$ 3,290

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

4

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Table of Contents

PIONEER POWER SOLUTIONS, INC.

Notes to Unaudited Consolidated Financial Statements

1. Basis of Presentation

These unaudited consolidated financial statements include the accounts of the Pioneer Power Solutions, Inc. (referred to herein as the “Company,” “Pioneer,” “we,” “our” and “us”) and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain prior year amounts have been reclassified to conform to the current year presentation.

These unaudited consolidated financial statements have been prepared pursuant to the rules of the Securities and Exchange Commission (“SEC”). 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. We believe that the disclosures made are adequate to make the information presented not misleading. 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 consolidated financial statements have been included. The results of operations for the interim period are not necessarily indicative of the results for the entire fiscal year. The year-end balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP for a year end balance sheet.

These unaudited consolidated financial statements should be read in conjunction with the risk factors and the audited consolidated financial statements and notes thereto of the Company and its subsidiaries included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013, which was filed with the SEC on March 14, 2014.

2. Summary of Significant Accounting Policies

The Company’s significant accounting policies were described in Note 2 to the audited consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013. There have been no significant changes in the Company’s accounting policies during the third quarter of 2014.

## Recent Accounting Pronouncements

There have been no recent accounting pronouncements not yet adopted by the Company which would have a material impact on the Company's financial statements.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"), which supersedes nearly all existing revenue recognition guidance under accounting principles generally accepted in United States ("U.S. GAAP"). The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP.

The standard is effective for annual periods beginning after December 15, 2016, and interim periods therein, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients; or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). The Company is currently evaluating the impact of its pending adoption of ASU 2014-09 on its consolidated financial statements and has not yet determined the method by which it will adopt the standard in 2017.

Table of Contents

3. Inventories

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

|                                             | September<br>30,<br>2014 | December<br>31,<br>2013 |
|---------------------------------------------|--------------------------|-------------------------|
| Raw materials                               | \$ 6,324                 | \$ 5,210                |
| Work in process                             | 4,015                    | 2,635                   |
| Finished goods                              | 4,663                    | 5,125                   |
| Provision for excess and obsolete inventory | (331)                    | (327)                   |
| Total inventories                           | \$ 14,671                | \$ 12,643               |

Included in raw materials and finished goods at September 30, 2014 and December 31, 2013 are goods in transit of approximately \$0.2 million and \$0.1 million.

4. Goodwill and Other Intangible Assets

Changes in goodwill and intangible asset balances for the nine months ended September 30, 2014, consisted of the following (in thousands):

|                                  | Goodwill | Intangible<br>assets |
|----------------------------------|----------|----------------------|
| Balance as of December 31, 2013  | \$ 7,998 | \$ 5,285             |
| Amortization                     | -        | (239)                |
| Foreign currency translation     | (64)     | (57)                 |
| Balance as of September 30, 2014 | \$ 7,934 | \$ 4,989             |

The components of intangible assets as of September 30, 2014 are summarized below (in thousands):

|                                            | Intangible<br>assets | Accumulated<br>amortization | Foreign<br>currency<br>translation | Net<br>book<br>value |
|--------------------------------------------|----------------------|-----------------------------|------------------------------------|----------------------|
| Customer relationships                     | \$ 2,962             | \$ (1,064)                  | \$ (109)                           | \$ 1,789             |
| Non-compete agreements                     | 465                  | (186)                       | (2)                                | 277                  |
| Trademarks                                 | 2,049                | -                           | (36)                               | 2,013                |
| Technology-related industry accreditations | 950                  | -                           | (40)                               | 910                  |
| Total intangible assets                    | \$ 6,426             | \$ (1,250)                  | \$ (187)                           | \$ 4,989             |

## 5. Other Assets

In December 2011 and January 2012, the Company made two loans, each in the amount of \$300,000, to a developer of a renewable energy project in the U.S. The promissory notes accrue interest at a rate of 4.5% per annum with a final payment of all unpaid principal and interest becoming fully due and payable upon the earlier to occur of (i) the four year anniversary of the issuance date of the promissory notes, or (ii) an event of default. As defined in the promissory notes, an event of default includes, but is not limited to, the following: any bankruptcy, reorganization or similar proceeding involving the borrower, a sale or transfer of substantially all the assets of the borrower, a default by the borrower relating to any indebtedness due to third parties, the incurrence of additional indebtedness by the borrower without the Company's written consent and failure of the borrower to perform its obligations pursuant to its other agreements with the Company, including its purchase order for pad mount transformers. The full loan balance is outstanding at September 30, 2014.

Also included in Other Assets at September 30, 2014 are deferred financing costs of \$0.3 million, value added taxes of \$0.2 million and a customer note receivable of \$0.1 million as compared to deferred financing costs of \$0.3 million and value added taxes of \$0.2 million at December 31, 2013.

Table of Contents

6. Debt

Canadian Credit Facilities

In June 2013, the Company's Canadian subsidiary, Pioneer Electrogroupp Canada Inc., entered into an amended and restated letter loan agreement with Bank of Montreal (the "Canadian Facilities") that replaced and superseded all of the Company's prior financing arrangements with the bank.

The Canadian Facilities provide for up to \$22.0 million Canadian dollars ("CAD") (approximately \$19.6 million expressed in U.S. dollars) in revolving and term debt. The Canadian facilities consist of a \$10.0 million demand revolving credit facility ("Facility A"), a \$2.0 million term credit facility ("Facility B") and a \$10.0 million term credit facility ("Facility C").

Borrowings on Facility A are subject to margin criteria and are available in either U.S. or Canadian dollars. Pricing for U.S. Base Rate and Canadian Rate loans is the U.S. Base Rate or Canadian Rate plus 0.50%. Borrowings of U.S. dollar LIBOR-based loans are priced at LIBOR plus 2.00%. Borrowings under Facility B bear interest at the Canadian Rate plus 1.00%. Under Facility C, interest rates for borrowings in U.S. dollars are based on either LIBOR (plus 2.00% to 2.25%) or the U.S. Base Rate (plus 1.00% to 1.25%), depending on the Company's leverage ratio. Facility C borrowings in Canadian dollars are priced at the Canadian Rate plus 1.00% to 1.25%, depending on the Company's leverage ratio.

The Canadian Facilities are guaranteed by the Company and are secured by a first-ranking lien in the amount of \$30 million CAD on all of the present and future movable and immovable property of the Company's Canadian subsidiaries. The Canadian Facilities require the Company's Canadian operations to comply on a consolidated basis with various financial covenants, including maintaining a minimum fixed charge coverage ratio, a maximum funded debt to EBITDA ratio and a limitation on funded debt to capitalization.

As of September 30, 2014, the Company had approximately \$6.8 million in U.S. dollar equivalents outstanding under the Canadian Facilities and was in compliance with its financial covenant requirements. The Company's borrowings consisted of \$0 outstanding under Facility A, \$0.9 million outstanding under Facility B and \$5.9 million outstanding under Facility C.

United States Credit Facility

On June 28, 2013, the Company and its wholly-owned U.S. subsidiaries entered into a credit agreement with Bank of Montreal, Chicago Branch (the “U.S. Facility”) consisting of a \$10.0 million demand revolving credit facility.

The U.S. Facility, as amended, requires the Company to comply with a two-step test of financial covenants. First, if the Company’s funded debt to adjusted EBITDA ratio is less than or equal to 2.75x and its fixed charge coverage ratio is at or above 1.25x, then no further compliance tests are required. Alternatively, the Company may comply with the financial covenant requirements of the U.S. Facility if its U.S. operations comply with various financial covenants, including maintaining a maximum funded debt to capitalization ratio, and certain minimum fixed charge coverage ratios and maximum funded debt to adjusted EBITDA ratios which vary by measurement period through December 2014.

Borrowings under the U.S. Facility bear interest, at the Company’s option, at the bank’s prime rate plus 1.00% per annum on prime rate loans, or an adjusted LIBOR rate plus 2.25% per annum on Eurodollar loans.

In connection with the U.S. Facility, the Company and its U.S. subsidiaries and the bank entered into a security agreement, pursuant to which the Company granted a security interest in substantially all of its assets in the U.S., and including 65% of the shares of Pioneer Electrogroupp Canada Inc. held by the Company, to secure the Company’s obligations under the U.S. Facility.

As of September, 2014, the Company had approximately \$2.2 million outstanding under the U.S. Facility and was in compliance with its financial covenant requirements.

Table of Contents

## Nexus Promissory Note

On July 25, 2012, the Company's Mexican subsidiary, Nexus Magneticos de Mexico, S. de R.L. de C.V. ("Nexus"), entered into a \$1.65 million term loan agreement with GE CF Mexico, S.A. de C.V. ("GE Capital Mexico"). The term loan is payable in 60 consecutive monthly installments and bears interest, payable monthly, at a rate of 6.93% per annum. The obligations of Nexus under the term loan are secured by certain machinery and equipment located in Mexico and by a corporate guaranty by the Company.

## Pico Promissory Note

In August 2013, in connection with the acquisition of certain assets from Pico Electrical Equipment, Inc. and Pico Metal Products, Inc., the Company's Pioneer Custom Electrical Products Inc. subsidiary issued a \$455,000 non-interest bearing promissory note to the sellers of the assets. As of September 30, 2014, the principal amount of the promissory note had been repaid in full.

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

|                        | September<br>30,<br>2014 | December<br>31,<br>2013 |
|------------------------|--------------------------|-------------------------|
| Term credit facilities | \$ 6,758                 | \$ 8,239                |
| Nexus promissory note  | 652                      | 824                     |
| Pico promissory note   | -                        | 250                     |
| Total debt             | 7,410                    | 9,313                   |
| Less current portion   | (1,958)                  | (2,108)                 |
| Total long-term debt   | \$ 5,452                 | \$ 7,205                |

## 7.Shareholders' Equity

The Company had 7,172,255 shares of common stock, \$0.001 par value per share, outstanding of as of September 30, 2014 and December 31, 2013, respectively. In September 2013, the Company completed a public offering and issued 1,265,000 shares of its common stock at a gross sales price of \$7.00 per share, resulting in \$7.9 million in net proceeds after deducting the underwriting discount and costs directly attributable to the offering. In connection with the public offering, the Company issued warrants to the underwriters to purchase 50,600 shares of common stock, exercisable at the public offering price, or \$7.00 per share.

As of September 30, 2014, the Company had warrants outstanding to purchase 680,600 shares of common stock with a weighted average exercise price of \$13.45 per share. The warrants expire on dates beginning on December 2, 2014 and ending on September 18, 2018. No warrants were exercised during the three and nine months ended September 30, 2014.

## 8. Stock-Based Compensation

A summary of stock option activity under the 2011 Long-Term Incentive Plan as of September 30, 2014, and changes during the nine months ended September 30, 2014, are presented below:

|                                      | Stock<br>Options | Weighted<br>average<br>exercise<br>price | Weighted<br>average remaining<br>contractual term | Aggregate<br>intrinsic<br>value |
|--------------------------------------|------------------|------------------------------------------|---------------------------------------------------|---------------------------------|
| Outstanding as of December 31, 2013  | 261,400          | \$ 9.81                                  | 6.2                                               | \$ 416,112                      |
| Granted                              | 105,000          | 10.21                                    | 9.4                                               | -                               |
| Exercised                            | -                | -                                        | -                                                 | -                               |
| Forfeited                            | -                | -                                        | -                                                 | -                               |
| Outstanding as of September 30, 2014 | 366,400          | \$ 9.92                                  | 7.1                                               | \$ 416,112                      |
| Exercisable as of September 30, 2014 | 205,733          | \$ 11.03                                 | 5.7                                               | \$ 242,588                      |

Table of Contents

As of September 30, 2014, there were 333,600 shares available for future grants under the Company's 2011 Long-Term Incentive Plan.

Expense for stock-based compensation recorded for the nine months ended September 30, 2014 and 2013 was approximately \$163,000 and \$152,000, respectively. At September 30, 2014, the Company had total stock-based compensation expense remaining to be recognized in the statement of earnings of approximately \$458,000.

## 9. Pension Plan

The Company's Canadian subsidiary sponsors a defined benefit pension plan at one of its locations in which a majority of its employees there are members. The subsidiary funds 100% of all contributions to the plan. The benefits, or the rate per year of credit service, are established by the Company and updated at its discretion.

The components of the expense the Company incurred under the pension plan are as follows (in thousands):

|                                                     | Three Months<br>Ended<br>September 30, |       | Nine Months<br>Ended<br>September 30, |       |
|-----------------------------------------------------|----------------------------------------|-------|---------------------------------------|-------|
|                                                     | 2014                                   | 2013  | 2014                                  | 2013  |
| Current service cost, net of employee contributions | \$ 7                                   | \$ 13 | \$ 27                                 | \$ 44 |
| Interest cost on accrued benefit obligation         | 32                                     | 32    | 97                                    | 95    |
| Expected return on plan assets                      | (45)                                   | (43)  | (131)                                 | (125) |
| Amortization of transitional obligation             | 3                                      | 3     | 9                                     | 10    |
| Amortization of past service costs                  | 2                                      | 2     | 6                                     | 7     |
| Amortization of net actuarial gain                  | 8                                      | 15    | 25                                    | 43    |
| Total cost of benefit                               | \$ 7                                   | \$ 22 | \$ 33                                 | \$ 74 |

The Company's policy is to fund the pension plan at or above the minimum level required by law. The Company made \$108,000 and \$117,000 of contributions to its defined benefit pension plan during the nine months ended September 30, 2014 and 2013, respectively. Changes in the discount rate and actual investment returns that are lower than the long-term expected return on plan assets could result in the Company making additional contributions.

## 10. Geographical Information

The Company has one material operating segment, being the manufacture and sale of electrical transmission and distribution equipment. Revenues are attributable to countries based on the location of the Company's customers (in thousands):

|               | Three Months Ended |           | Nine Months Ended |           |
|---------------|--------------------|-----------|-------------------|-----------|
|               | September 30,      |           | September 30,     |           |
|               | 2014               | 2013      | 2014              | 2013      |
| Canada        | \$ 12,902          | \$ 12,816 | \$ 35,444         | \$ 39,447 |
| United States | 13,206             | 9,351     | 32,613            | 25,591    |
| Others        | 3                  | 280       | 11                | 1,955     |
| Total         | \$ 26,111          | \$ 22,447 | \$ 68,068         | \$ 66,993 |

Table of Contents

## 11. Basic and Diluted Earnings Per Share

Basic and diluted earnings per common share are calculated based on the weighted average number of shares outstanding during the period. The Company's employee and director stock option awards, as well as incremental shares issuable upon exercise of warrants, are not considered in the calculations if the effect would be anti-dilutive. The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share data):

|                                                                 | Three Months<br>Ended<br>September 30,<br>2014 |          | Nine Months<br>Ended<br>September 30,<br>2014 |          |
|-----------------------------------------------------------------|------------------------------------------------|----------|-----------------------------------------------|----------|
|                                                                 | 2014                                           | 2013     | 2014                                          | 2013     |
| Numerator:                                                      |                                                |          |                                               |          |
| Net earnings                                                    | \$ 1,782                                       | \$ 1,009 | \$ 2,674                                      | \$ 3,183 |
| Denominator:                                                    |                                                |          |                                               |          |
| Weighted average basic shares outstanding                       | 7,172                                          | 6,051    | 7,172                                         | 5,956    |
| Effect of dilutive securities - equity based compensation plans | 47                                             | 32       | 55                                            | 21       |
| Net dilutive effect of warrants outstanding                     | 7                                              | -        | 11                                            | -        |
| Denominator for diluted earnings per common share               | 7,226                                          | 6,083    | 7,238                                         | 5,977    |
| Net earnings per common share:                                  |                                                |          |                                               |          |
| Basic                                                           | \$ 0.25                                        | \$ 0.17  | \$ 0.37                                       | \$ 0.53  |
| Diluted                                                         | \$ 0.25                                        | \$ 0.17  | \$ 0.37                                       | \$ 0.53  |
| Anti-dilutive securities (excluded from per share calculation): |                                                |          |                                               |          |
| Equity based compensation plans                                 | 238                                            | 118      | 223                                           | 118      |
| Warrants                                                        | 630                                            | 640      | 630                                           | 640      |

Table of Contents

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 consolidated interim 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 December 31, 2013, which was filed with the Securities and Exchange Commission on March 14, 2014 and is available on the SEC's website at [www.sec.gov](http://www.sec.gov).

Unless the context requires otherwise, references in this Form 10-Q to the "Company," "Pioneer," "we," "our" and "us" refer to Pioneer Power Solutions, Inc. and its subsidiaries.

Special Note Regarding Forward-Looking Statements

This Form 10-Q contains "forward-looking statements," which include information relating to future events, future financial performance, financial projections, strategies, expectations, competitive environment and regulation. Words such as "may," "should," "could," "would," "predicts," "potential," "continue," "expects," "anticipates," "future," "intends," "estimates," and similar expressions, as well as statements in future tense, identify forward-looking statements. Forward-looking statements should not be read as a guarantee of future performance or results and may not be accurate indications of when such performance or results will be achieved. Forward-looking statements are based on information we have when those statements are made or management's good faith belief as of that time with respect to future events, and are subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in or suggested by the forward-looking statements. Important factors that could cause such differences include, but are not limited to:

- General economic conditions and their effect on demand for electrical equipment, particularly in the commercial construction market, but also in the power generation, industrial production, data center, oil and gas, marine and infrastructure industries.
- The effects of fluctuations in sales on our business, revenues, expenses, net income, earnings per share, margins and profitability.
- Many of our competitors are better established and have significantly greater resources, and may subsidize their competitive offerings with other products and services, which may make it difficult for us to attract and retain customers.
- We depend on Hydro-Quebec Utility Company and Siemens Industry, Inc. for a large portion of our business, and any change in the level of orders from Hydro-Quebec Utility Company or Siemens Industry, Inc., could have a significant impact on our results of operations.
- The potential loss or departure of key personnel, including Nathan J. Mazurek, our chairman, president and chief executive officer.

- Our ability to expand our business through strategic acquisitions.
- Our ability to integrate acquisitions and related businesses.
- Our ability to generate internal growth, maintain market acceptance of our existing products and gain acceptance for our new products.
- Unanticipated increases in raw material prices or disruptions in supply could increase production costs and adversely affect our profitability.
- Restrictive loan covenants and/or our ability to repay or refinance debt under our credit facilities could limit our future financing options and liquidity position and may limit our ability to grow our business.
- Our ability to realize revenue reported in our backlog.
- Operating margin risk due to competitive pricing and operating efficiencies, supply chain risk, material, labor or overhead cost increases, interest rate risk and commodity risk.
- Strikes or labor disputes with our employees may adversely affect our ability to conduct our business.
- A majority of our revenue and a significant portion of our expenditures are derived or spent in Canadian dollars. However, we report our financial condition and results of operations in U.S. dollars. As a result, fluctuations between the U.S. dollar and the Canadian dollar will impact the amount of our revenues and earnings.
- The impact of geopolitical activity on the economy, changes in government regulations such as income taxes, climate control initiatives, the timing or strength of an economic recovery in our markets and our ability to access capital markets.
- Our chairman controls a majority of our combined voting power, and may have, or may develop in the future, interests that may diverge from yours.
- Future sales of large blocks of our common stock may adversely impact our stock price.
- The liquidity and trading volume of our common stock.

Table of Contents

The foregoing does not represent an exhaustive list of matters that may be covered by the forward-looking statements contained herein or risk factors that we are faced with that may cause our actual results to differ from those anticipated in our forward-looking statements. Moreover, new risks regularly emerge and it is not possible for us to predict or articulate all risks we face, nor can we assess the impact of all risks on our business or the extent to which any risk, or combination of risks, may cause actual results to differ from those contained in any forward-looking statements. Except to the extent required by applicable laws or rules, we undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise. You should carefully review the risk factors and other cautionary statements in our other reports filed with the SEC for a discussion of the foregoing and other risks that relate to our business and investing in shares of our common stock.

Overview

We manufacture specialty electrical transmission and distribution equipment and provide a broad range of custom-engineered and general purpose solutions for applications in the utility, industrial and commercial markets. We are headquartered in Fort Lee, New Jersey and operate from eight additional locations in the U.S., Canada and Mexico for manufacturing, centralized distribution, engineering, sales and administration.

Foreign Currency Exchange Rates

Although we have elected to report our results in accordance with U.S. GAAP and in U.S. dollars, several of our business units are Canadian operations whose functional currency is the Canadian dollar. As such, the financial position, results of operations, cash flows and equity of these operations are initially consolidated in Canadian dollars. Their assets and liabilities are then translated from Canadian dollars to U.S. dollars by applying the foreign currency exchange rate in effect at the balance sheet date, while the results of their operations and cash flows are translated to U.S. dollars by applying foreign currency exchanges rates in effect during the reporting period. The resulting translation adjustments are included in other comprehensive income or loss.

The financial position and operating results of our Canadian operations have been translated to U.S. dollars by applying the following exchange rates, expressed as the number of U.S. dollars to one Canadian dollar for each period reported:

2014

2013

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|               |               | Consolidated Statements of |                            |               |          | Consolidated Statements of |                            |
|---------------|---------------|----------------------------|----------------------------|---------------|----------|----------------------------|----------------------------|
|               |               | Consolidated               | Earnings and Comprehensive |               |          | Consolidated               | Earnings and Comprehensive |
|               |               | Balance Sheet              | Income                     |               |          | Balance Sheet              | Income                     |
|               |               | Period                     | Cumulative                 |               |          | Period                     | Cumulative                 |
| Quarter Ended | End of Period | Average                    | Average                    | End of Period | Average  | Average                    |                            |
| March 31      | \$0.9046      | \$0.9062                   | \$0.9062                   | \$0.9843      | \$0.9912 | \$0.9912                   |                            |
| June 30       | \$0.9372      | \$0.9170                   | \$0.9116                   | \$0.9508      | \$0.9771 | \$0.9842                   |                            |
| September 30  | \$0.8929      | \$0.9180                   | \$0.9137                   | \$0.9706      | \$0.9629 | \$0.9769                   |                            |

Critical Accounting Policies

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 December 31, 2013.

Table of Contents

## Results of Operations

## Three and Nine Months Ended September 30, 2014 Compared to Three and Nine Months Ended September 30, 2013

Revenue. We have one material operating segment, being the manufacture and sale of electrical transmission and distribution equipment. The following table represents our revenues by major product category for the periods indicated (in thousands, except percentages):

|                                        | Three Months Ended<br>September 30, |           |             | Nine Months Ended<br>September 30, |           |             |
|----------------------------------------|-------------------------------------|-----------|-------------|------------------------------------|-----------|-------------|
|                                        | 2014                                | 2013      | %<br>Change | 2014                               | 2013      | %<br>Change |
| Electrical transformers                |                                     |           |             |                                    |           |             |
| Liquid-filled                          | \$ 11,656                           | \$ 11,455 | 1.8         | \$ 30,663                          | \$ 33,909 | (9.6)       |
| Dry-type                               | 10,901                              | 10,142    | 7.5         | 30,725                             | 31,722    | (3.1)       |
|                                        | 22,557                              | 21,597    | 4.4         | 61,388                             | 65,631    | (6.5)       |
| Circuit protection & control equipment | 3,554                               | 850       | 318.1       | 6,680                              | 1,362     | 390.5       |
| Total revenue                          | \$ 26,111                           | \$ 22,447 | 16.3        | \$ 68,068                          | \$ 66,993 | 1.6         |

For the three months ended September 30, 2014, our consolidated revenue was \$26.1 million, up \$3.7 million, or 16.3%, from \$22.4 million during the three months ended September 30, 2013. The change in our revenue includes a \$1.0 million increase in sales of electrical transformers during the 2014 quarter, or up 4.4% (5.6% in constant currency) on a year-over-year basis. Revenue from circuit protection and control equipment (or CPC) sold by our Critical Power and Pioneer CEP business units increased to \$3.6 million, up 318% from \$0.9 million of revenue during the three months ended September 30, 2013.

For the nine months ended September 30, 2014, our consolidated revenue was \$68.1 million, up \$1.1 million, or 1.6%, from \$67.0 million during the nine months ended September 30, 2013. Lower transformer sales drove the overall change in our revenue, which were down \$4.2 million during the first nine months of 2014, or 6.5% (3.1% in constant currency) as compared to the first nine months of 2013. This decline was offset by sales of CPC equipment, which increased nearly fivefold, to \$6.7 million, up from \$1.4 million during the nine months ended September 30, 2013.

During the nine months ended September 30, 2014, the effect of foreign currency translation accounted for approximately two-thirds (-6.6%) of the decrease in our liquid-filled transformer sales. The remainder of the decline

was due to a number of large, unrepeatable project-based orders delivered during the first nine months of 2013, particularly in the oil and gas sector, that were not fully replaced during the 2014 period. Utility sales of liquid-filled transformers were stable on a year-over-year basis (in constant currency), reflecting lower capital spending by our largest Canadian utility customers, offset by a significant increase in U.S. utility sales which remains a small component of our liquid-filled transformer revenue. The net decrease in our dry-type transformer sales during the nine months ended September 30, 2014 occurred mostly during the first two quarters and resulted from lower demand in our Canadian electrical distributor channel, compounded by the effect of currency translation. Our U.S. sales of dry-type transformers were up approximately 1.0% during the first nine months of 2014, and up over 9% during the September 2014 quarter, led by strong gains in custom-engineered OEM sales channel.

Critical Power accounted for approximately half of our sales of CPC equipment during the nine months ended September 30, 2014, consisting mainly of backup power equipment and controls for large data center projects. Pioneer CEP, which we established in August 2013 to serve electrical distributors in the U.S. Southwest, represented the other half of our sales of CPC equipment during the nine months ended September 30, 2014.

Table of Contents

Gross Margin. The following table represents our gross margin by major product category for the periods indicated (in thousands, except percentages):

|                                        | Three Months Ended |           |        | Nine Months Ended |           |        |
|----------------------------------------|--------------------|-----------|--------|-------------------|-----------|--------|
|                                        | September 30,      |           | %      | September 30,     |           | %      |
|                                        | 2014               | 2013      | Change | 2014              | 2013      | Change |
| Cost of sales                          | \$ 19,403          | \$ 16,548 | 17.3   | \$ 52,251         | \$ 50,434 | 3.6    |
| Gross profit                           | \$ 6,708           | \$ 5,899  | 13.7   | \$ 15,817         | \$ 16,559 | (4.5)  |
| Gross margin percentage:               |                    |           |        |                   |           |        |
| Electrical transformers                | 24.4%              | 25.9%     | (1.5)  | 22.8%             | 24.5%     | (1.7)  |
| Circuit protection & control equipment | 34.1%              | 36.0%     | (1.9)  | 27.8%             | 35.8%     | (8.0)  |
| Consolidated                           | 25.7%              | 26.3%     | (0.6)  | 23.2%             | 24.7%     | (1.5)  |

For the three months ended September 30, 2014, our gross margin percentage was 25.7% of revenues, as compared to 26.3% during the three months ended September 30, 2013. Our gross margin percentage on sales of transformers decreased by 1.5% during the three months ended September 30, 2014, driven mostly by a less favorable sales mix in liquid-filled transformers, the effect of which was lessened by a slightly higher gross margin on increased sales of dry-type transformers, as compared to the three months ended September 30, 2013. During the three months ended September 30, 2014, the 1.9% decrease in our gross margin percentage on sales of CPC equipment reflects several factors, but was mostly driven by the fact that Critical Power, generally our highest gross profit margin business line, accounted for only 70% of CPC equipment sales during the September 2014 quarter, as compared to 85% of CPC equipment sales during the quarter ended September 2013. The remaining CPC equipment sales during each period were by Pioneer CEP, our newest business whose revenues have been growing rapidly and whose products attract an inherently lower gross margin percentage than Critical Power solutions.

For the nine months ended September 30, 2014, our gross margin percentage was 23.2% of revenues, compared to 24.7% during the nine months ended September 30, 2013. The 1.5% decrease in our gross margin was due to several of the factors described above, but was driven mostly by lower project-based industrial orders for our liquid-filled transformers as compared to the prior year period. We generally achieve higher gross margins from sales of our engineered-to-order products (principally liquid-filled transformers and systems for critical power applications) than we do from the sale of our dry-type transformers, a large portion of which consists of catalogue designs sold on a wholesale basis through our distribution network. For the nine months ended September 30, 2014, as compared to the nine months ended September 30, 2013, liquid-filled transformers represented 45.0% of our consolidated revenue (down from 50.6%), dry-type transformers represented 45.1% (down from 47.4%) and circuit protection and control equipment represented 9.8% (up from 2.0%).

**Selling, General and Administrative Expense.** For the three months ended September 30, 2014, our selling, general and administrative expense increased by \$0.5 million, or by 12.8%, to \$4.1 million as compared to the three months ended September 30, 2013. The change in our selling, general and administrative expense during the 2014 quarter, as compared to the same quarter of 2013, reflects the combination of higher expense due to acquisitions and at the corporate level (including the expansion of our strategic sales group), offset by lower operating expenses across all of our transformer businesses. As a percentage of total revenue, our selling, general and administrative expense decreased to 15.6% during the three months ended September 30, 2014, as compared to 16.1% during the three months ended September 30, 2013.

For the nine months ended September 30, 2014, our selling, general and administrative expense increased by approximately \$0.8 million, or 8.3%, to \$11.5 million, as compared to \$10.7 million during the nine months ended September 30, 2013. The increase was driven mostly by having additional months of operations in the 2014 period for the two businesses we acquired during the 2013 period (\$1.4 million of incremental expense). In addition, during the nine months ended September 30, 2014 our corporate expenses increased by \$0.5 million, primarily due to the expansion of our corporate selling group. Offsetting these increases, selling, general and administrative expense in our transformer businesses were down \$1.0 million, or 12.7%, primarily as a result of lower variable selling expense including commissions and freight. As a percentage of total revenue, our selling, general and administrative expense increased to 17.0% during the nine months ended September 30, 2014, as compared to 15.9% during the nine months ended September 30, 2013.

**Foreign Exchange (Gain) Loss.** During the three and nine months ended September 30, 2014, approximately 57% of our consolidated operating revenues were denominated in Canadian dollars and most of our expenses were denominated and disbursed in U.S. dollars. We have not historically engaged in currency hedging activities. Fluctuations in foreign currency exchange rates between

Table of Contents

the time we initiate and then settle transactions with our customers and suppliers can have an impact on our operating results. For the three months ended September 30, 2014, we recorded a gain of approximately \$172,000 due to currency fluctuations, compared to a gain of approximately \$4,000 during the three months ended September 30, 2013. For the nine months ended September 30, 2014, we recorded a gain of approximately \$108,000, compared to a loss of approximately \$43,000 during the nine months ended September 30, 2013.

**Interest Expense.** For the three and nine months ended September 30, 2014, interest expense was approximately \$141,000 and \$406,000, respectively, as compared to \$226,000 and \$594,000 during the three and nine months ended September 30, 2013. The decrease in our interest expense was due to lower average borrowings outstanding, at lower marginal interest rates, under our credit facilities so far during 2014, as compared to 2013.

**Other Expense (Income).** For the three and nine months ended September 30, 2014, other non-operating expense was \$169,000 and \$171,000, as compared to \$236,000 and \$403,000 during the three and nine months ended September 30, 2013. The 2014 other expense resulted primarily from legal and other expenses incurred in connection with an acquisition which was not completed. The 2013 other expense resulted from professional fees and costs incurred in connection with two completed acquisitions.

**Provision for Income Taxes.** For the three and nine months ended September 30, 2014, our provision for income taxes reflects an effective tax rate on earnings before income taxes of 28.7% and 29.6%, respectively, as compared to 44.9% and 34.5% during the three and nine months ended September 30, 2013. Most of our taxable income is derived in Canada where we are subject to lower corporate tax rates relative to our U.S. operations. Our effective income tax rate was significantly higher during the 2013 periods as a result of taxable distributions received from our Canadian subsidiaries during that year, and to a lesser extent due to the impact of acquisition-related expenses that were non-deductible.

**Net Earnings.** We generated net earnings of \$1.8 million and \$2.7 million for the three and nine months ended September 30, 2014, as compared to \$1.0 million and \$3.2 million during the three and nine months ended September 30, 2013. Net earnings per basic and diluted share for the three and nine months ended September 30, 2014 were \$0.25 and \$0.37, as compared to \$0.17 and \$0.53 for the three and nine months ended September 30, 2013. During the three months ended September 30, 2014, as compared to the three months ended September 30, 2013, our net earnings increased primarily due to a significant profit contribution by our Critical Power business, together with improved performance across all of our transformer businesses, the combination of which was sufficient to outweigh the increase in our corporate expenses and an unfavorable change in foreign currency rates for translation purposes. During the nine months ended September 30, 2014, as compared to the nine months ended September 30, 2013, the decrease in our net earnings was driven mostly by a lower profit contribution from our Canada-based transformer businesses, together with operating losses stemming from our most recent acquisition which were expected, and by higher corporate expenses resulting from the expansion of our strategic sales group. On a per share basis, our net earnings were diluted by our public offering of common stock in September 2013. During the three and nine months ended September 30, 2014 we had approximately 1.1 million and 1.3 million additional weighted average diluted

shares outstanding, respectively, or an increase of 19% and 21%, respectively, as compared to the same periods of 2013.

**Backlog.** Our order backlog at September 30, 2014 was \$27.6 million, up \$3.2 million, or 13%, as compared to \$24.4 million at December 31, 2013 and up \$6.2 million, or 29%, as compared to \$21.4 million at September 30, 2013. Our backlog is based on orders expected to be delivered in the future, most of which is expected to occur during the next nine months. New orders placed during the three and nine months ended September 30, 2014 totaled \$22.8 million and \$74.0 million, respectively, representing increases of approximately 20% and 14% as compared to new orders of \$19.0 million and \$64.8 million that were placed during the three and nine months ended September 30, 2013.

#### Liquidity and Capital Resources

**General.** At September 30, 2014, we had approximately \$0.1 million of cash and cash equivalents and had total debt of \$9.7 million. We have historically met our cash needs through a combination of cash flows from operating activities and bank borrowings under our revolving credit facilities. Our cash requirements are generally for operating activities, debt repayment, capital improvements and acquisitions. We believe that working capital, borrowing capacity available under our credit facilities and funds generated from operations should be sufficient to finance our cash requirements for anticipated operating activities, capital improvements and principal repayments of debt through at least the next twelve months.

**Cash Provided by (Used in) Operating Activities.** Cash provided by our operating activities was approximately \$1.1 million during the nine months ended September 30, 2014, compared to cash provided by our operating activities of \$3.2 million during the nine months ended September 30, 2013. The principal elements of cash used by operating activities during the nine months ended

Table of Contents

September 30, 2014 were \$2.7 million of net earnings and approximately \$1.3 million of non-cash expenses consisting of depreciation, amortization and stock-based compensation. These sources of cash during the period were offset by \$1.6 million of cash used for working capital purposes and \$1.3 million related to deferred taxes, pension costs and unrealized gains related to currency translation included in our net earnings.

**Cash Provided by (Used in) Investing Activities.** Cash used in investing activities during the nine months ended September 30, 2014 was approximately \$0.7 million, as compared to \$4.1 million during the nine months ended September 30, 2013. During the nine months ended September 30, 2014, additions to our property, plant and equipment decreased to \$0.6 million, down from \$2.5 million during the nine months ended September 30, 2013 when we expanded one of our manufacturing facilities. In addition, during the nine months ended September 30, 2014, we made investments of approximately \$109,000 in secured notes receivable due from two of our trade partners. Our uses of cash in investing activities during the nine months ended September 30, 2013 also included \$1.6 million for acquisitions.

**Cash Provided by (Used in) Financing Activities.** Cash used by our financing activities was approximately \$0.1 million during nine months ended September 30, 2014, as compared to cash provided of \$3.6 million during the nine months ended September 30, 2013. During the nine months ended September 30, 2014, our cash used by financing activities included approximately \$1.4 million of increased borrowings outstanding under our revolving credit facilities, offset by principal payments of \$1.5 million on our long-term debt. During the nine months ended September 30, 2013, our cash provided by financing activities included approximately \$7.9 million of net proceeds from a public offering of 1,265,000 shares of our common stock, of which we used \$3.1 million to reduce our bank overdrafts and borrowings under our revolving credit facilities and we made net repayments on our long-term debt of \$1.2 million.

**Working Capital.** As of September 30, 2014, we had net working capital of \$14.9 million, compared to net working capital of \$13.8 million, including \$0.4 million of cash and equivalents at December 31, 2013. Our current assets were approximately 1.8 times our current liabilities at September 30, 2014, as compared to 2.1 times as at December 31, 2013. At September 30, 2014 and December 31, 2013, we had \$10.6 million and \$8.7 million, respectively, of available and unused borrowing capacity from our revolving credit facilities, without taking into account cash and equivalents on hand. However, the availability of this capacity under our revolving credit facilities is subject to restrictions on the use of proceeds and is dependent upon our ability to satisfy certain financial and operating covenants, including financial ratios.

**Credit Facilities and Long-Term Debt**

**Canadian Credit Facilities.** Our Canadian subsidiaries have maintained credit facilities with Bank of Montreal since October 2009. In June 2013, our Canadian subsidiary entered into an amended and restated letter loan agreement (the

“Canadian Facilities”) that replaced and superseded all our prior financing arrangements with the bank.

Our Canadian Facilities provide for up to \$22.0 million Canadian dollars (“CAD”) (\$19.6 million expressed in U.S. dollars) in revolving and term debt. The Canadian Facilities consist of a \$10.0 million demand revolving credit facility (“Facility A”), a \$2.0 million term credit facility (“Facility B”) and a \$10.0 million term credit facility (“Facility C”).

All obligations under the Canadian Facilities are guaranteed by us and are secured by a first-ranking lien in the amount of \$30 million CAD on all of the present and future movable and immovable property of our Canadian subsidiaries.

As of September 30, 2014, we had approximately \$6.8 million in U.S. dollar equivalents outstanding under our Canadian Facilities and we were in compliance with our financial covenant requirements. Our borrowings consisted of \$0 outstanding under Facility A, \$0.9 million outstanding under Facility B and \$5.9 million outstanding under Facility C.

United States Credit Facility. In June 2013, we entered into a credit agreement with Bank of Montreal, Chicago Branch (the “U.S. Facility”), consisting of a \$10.0 million demand revolving credit facility that replaced a smaller facility we maintained with another bank.

Borrowings under the U.S. Facility bear interest, at our option, at the bank’s prime rate plus 1.00% per annum on U.S. prime rate loans, or an adjusted LIBOR rate plus 2.25% per annum on Eurodollar loans.

Our obligations under the U.S. Facility are guaranteed by all our wholly-owned U.S. subsidiaries. In addition, we and our wholly-owned U.S. subsidiaries granted a security interest in substantially all of our assets, including 65% of the shares of Pioneer Electrogroup Canada Inc. held by us, to secure our obligations under the U.S. Facility.

Table of Contents

As of September 30, 2014, we had \$2.2 million outstanding under the U.S. Facility and we were in compliance with its financial covenant requirements.

Nexus Promissory Note. In July 2012, our Mexican subsidiary entered into a \$1.7 million term loan agreement with GE Capital Mexico. The term loan is guaranteed by us and is payable in 60 consecutive monthly installments and bears interest, payable monthly, at a rate of 6.93% per annum. As of September 30, 2014, there was approximately \$0.7 million outstanding.

Pico Promissory Note. In August, 2013, in connection with the acquisition of certain assets from Pico Electrical Equipment, Inc. and Pico Metal Products, Inc., we issued a \$455,000 non-interest bearing promissory note to the sellers of the assets. As of September 2014, the principal amount of the promissory note had been repaid in full.

Capital Expenditures

Between 2012 and 2013 we completed construction to expand and equip approximately 16,000 square feet of additional manufacturing floor space at our dry-type transformer facility in Canada. This project accounted for most of our additions to property, plant and equipment during the nine months ended September 30, 2013. We have no major future capital projects planned, or significant replacement spending anticipated during the balance of 2014.

Table of Contents

Item 4. Controls and Procedures

Management's Conclusions Regarding Effectiveness of Disclosure Controls and Procedures

We conducted an evaluation, under the supervision and participation of management including our chief executive officer and chief financial officer, of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) of the Securities Exchange Act of 1934, as amended). There are inherent limitations to the effectiveness of any system of disclosure controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based upon this evaluation, our chief executive officer and chief financial officer have concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of September 30, 2014.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2014 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 5. Other Information

On November 11, 2014, we entered into the first amendment to that certain employment agreement, dated as of March 30, 2012, between us and Nathan J. Mazurek pursuant to which we (i) extended the term of the employment agreement from March 31, 2015 to March 31, 2018 and (ii) adjusted Mr. Mazurek's annual base salary to be \$410,000, for the period beginning on November 11, 2014 and ending on December 31, 2015, \$425,000, for the period beginning on January 1, 2016 and ending on December 31, 2016 and \$440,000, for the period beginning on January 1, 2017 and ending on March 31, 2018.

On November 11, 2014, we entered into the first amendment to that certain employment agreement, dated as of March 30, 2012, between us and Andrew Minkow pursuant to which we (i) extended the term of the employment agreement from March 31, 2015 to March 31, 2018 and (ii) adjusted Mr. Minkow's annual base salary to be \$305,000, for the period beginning on November 11, 2014 and ending on December 31, 2015, \$315,000, for the period beginning on January 1, 2016 and ending on December 31, 2016 and \$325,000, for the period beginning on January 1, 2017 and

ending on March 31, 2018.

Table of Contents

PART II – OTHER INFORMATION

Item 1A. Risk Factors

There have been no material changes in the Company's risk factors from those disclosed in the Annual Report on Form 10-K for the year ended December 31, 2013.

Item 6. Exhibits

See the Exhibit Index following the signature page to this Quarterly Report on Form 10-Q for a list of exhibits filed or furnished with this report, which Exhibit Index is incorporated herein by reference.

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.

PIONEER POWER SOLUTIONS, INC.

Date: November 12, 2014      /s/ Nathan J. Mazurek

Nathan J. Mazurek  
President, Chief Executive Officer and

Chairman of the Board of Directors

(Principal Executive Officer duly authorized to sign on behalf of Registrant)

Date: November 12, 2014      /s/ Andrew Minkow

Andrew Minkow

Chief Financial Officer, Secretary and Treasurer

(Principal Financial Officer and Principal Accounting Officer duly authorized to sign on behalf of Registrant)

Table of Contents

EXHIBIT INDEX

Exhibit

| No.   | Description                                                                                                                                                                                                                                                                                                                                                                                             |
|-------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1   | Composite Certificate of Incorporation (Incorporated by reference to Exhibit 3.1 to Amendment No. 4 to the Registration Statement on Form S-1 of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on June 21, 2011).                                                                                                                                                     |
| 3.2   | Bylaws (Incorporated by reference to Exhibit 3.2 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on December 2, 2009).                                                                                                                                                                                                             |
| 4.1   | Form of Securities Purchase Agreement (Incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on December 7, 2009).                                                                                                                                                                             |
| 4.2   | Form of \$10.00 Warrant (Incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on December 7, 2009).                                                                                                                                                                                           |
| 4.3   | Form of \$16.25 Warrant (Incorporated by reference to Exhibit 10.3 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on December 7, 2009).                                                                                                                                                                                           |
| 4.4   | Warrant to Purchase Common Stock, dated April 30, 2010, issued to Thomas Klink (Incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on May 4, 2010).                                                                                                                                          |
| 4.5   | Warrant to Purchase Common Stock, dated April 26, 2010 (Incorporated by reference to Exhibit 4.6 to Post-Effective Amendment No. 1 to Registration Statement on Form S-1 of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on June 1, 2010).                                                                                                                           |
| 4.6   | Form of Warrant to Purchase Common Stock, dated September 24, 2013, issued to Roth Capital Partners, LLC and to Monarch Capital Group, LLC (Incorporated by reference to Exhibit 4.8 to Amendment No. 1 to Registration Statement on Form S-1 of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on September 10, 2013).                                                |
| 10.1* | First Amendment to Employment Agreement, dated as of November 11th, 2014, by and between Pioneer Power Solutions, Inc. and Nathan J. Mazurek.                                                                                                                                                                                                                                                           |
| 10.2* | First Amendment to Employment Agreement, dated as of November 11th, 2014, by and between Pioneer Power Solutions, Inc. and Andrew Minkow.                                                                                                                                                                                                                                                               |
| 31.1* | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                     |
| 31.2* | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                     |
| 32.1* | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                     |
| 32.2* | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                     |
| 101   | The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2014, formatted in XBRL (eXtensible Business Reporting Language), (i) Consolidated Statements of Earnings, (ii) Consolidated Balance Sheets, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Cash Flows and (v) Notes to the Consolidated Financial |

Statements.

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\* Filed herewith.

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