

POWELL INDUSTRIES INC

Form 10-Q

August 08, 2011

**Table of Contents**

**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, 2011**

**OR**

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

**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)*

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

**8550 Mosley Drive,  
Houston, Texas**  
*(Address of principal executive offices)*

**77075-1180**  
*(Zip Code)*

**Registrant's telephone number, including area code:  
(713) 944-6900**

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 the 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 Exchange Act Rule 12b-2).  Yes  No

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

At July 28, 2011, there were 11,744,909 outstanding shares of the registrant's common stock, par value \$0.01 per share.



**POWELL INDUSTRIES, INC. AND SUBSIDIARIES  
TABLE OF CONTENTS**

|  | <b>Page</b> |
|--|-------------|
| <b><u>Part I Financial Information</u></b>   | 3           |
| <u>Item 1. Condensed Consolidated Financial Statements (unaudited)</u>                               | 3           |
| <u>Condensed Consolidated Balance Sheets</u>   | 3           |
| <u>Condensed Consolidated Statements of Operations</u>   | 4           |
| <u>Condensed Consolidated Statements of Cash Flows</u>   | 5           |
| <u>Notes to Condensed Consolidated Financial Statements</u>  | 6           |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 18          |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>                            | 23          |
| <u>Item 4. Controls and Procedures</u>   | 24          |
| <b><u>Part II Other Information</u></b>  | 25          |
| <u>Item 1. Legal Proceedings</u>   | 25          |
| <u>Item 1A. Risk Factors</u>   | 25          |
| <u>Item 6. Exhibits</u>  | 25          |
| <u>Signatures</u>  | 26          |
| <u>EX-31.1</u>   |             |
| <u>EX-31.2</u>   |             |
| <u>EX-32.1</u>   |             |
| <u>EX-32.2</u>   |             |
| <u>EX-101 INSTANCE DOCUMENT</u>  |             |
| <u>EX-101 SCHEMA DOCUMENT</u>  |             |
| <u>EX-101 CALCULATION LINKBASE DOCUMENT</u>  |             |
| <u>EX-101 LABELS LINKBASE DOCUMENT</u>   |             |
| <u>EX-101 PRESENTATION LINKBASE DOCUMENT</u>   |             |

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements****POWELL INDUSTRIES, INC. AND SUBSIDIARIES****Condensed Consolidated Balance Sheets****(In thousands, except share and per share data)**

|  | <b>June 30,<br/>2011<br/>(Unaudited)</b> | <b>September<br/>30,<br/>2010</b> |
|--|--|-----------------------------------|
| <b>ASSETS</b>  |  |                                   |
| Current Assets:  |  |                                   |
| Cash and cash equivalents  | \$ 137,266                               | \$ 115,353                        |
| Accounts receivable, less allowance for doubtful accounts of \$759 and \$907, respectively | 106,809                                  | 91,766                            |
| Costs and estimated earnings in excess of billings on uncompleted contracts                | 43,927                                   | 38,064                            |
| Inventories, net   | 41,344                                   | 38,244                            |
| Income taxes receivable  | 5,191                                    | 6,726                             |
| Deferred income taxes  | 5,307                                    | 3,087                             |
| Prepaid expenses and other current assets  | 6,870                                    | 8,951                             |
| <b>Total Current Assets</b>  | <b>346,714</b>                           | <b>302,191</b>                    |
| Property, plant and equipment, net   | 59,874                                   | 63,676                            |
| Goodwill   | 1,003                                    | 1,003                             |
| Intangible assets, net   | 24,469                                   | 26,132                            |
| Other assets   | 7,722                                    | 7,710                             |
| <b>Total Assets</b>  | <b>\$ 439,782</b>                        | <b>\$ 400,712</b>                 |
| <b>LIABILITIES AND EQUITY</b>  |  |                                   |
| Current Liabilities:   |  |                                   |
| Current maturities of long-term debt and capital lease obligations                         | \$ 1,378                                 | \$ 1,683                          |
| Income taxes payable   | 3,408                                    | 1,500                             |
| Accounts payable   | 46,777                                   | 41,850                            |
| Accrued salaries, bonuses and commissions  | 16,220                                   | 25,064                            |
| Billings in excess of costs and estimated earnings on uncompleted contracts                | 64,565                                   | 31,009                            |
| Accrued product warranty   | 5,078                                    | 5,929                             |
| Other accrued expenses   | 6,729                                    | 7,711                             |
| <b>Total Current Liabilities</b>   | <b>144,155</b>                           | <b>114,746</b>                    |
| Long-term debt and capital lease obligations, net of current maturities                    | 4,387                                    | 5,202                             |
| Deferred compensation  | 3,279                                    | 2,730                             |
| Other liabilities  | 884                                      | 731                               |
| <b>Total Liabilities</b>   | <b>152,705</b>                           | <b>123,409</b>                    |
| Commitments and Contingencies (Note J)   |  |                                   |
| Equity:  |  |                                   |
| Stockholders' Equity:  |  |                                   |

Edgar Filing: POWELL INDUSTRIES INC - Form 10-Q

|   |            |            |
|---|------------|------------|
| Preferred stock, par value \$.01; 5,000,000 shares authorized; none issued  |            |            |
| Common stock, par value \$.01; 30,000,000 shares authorized; 11,744,909 and<br>11,676,955 shares issued and outstanding, respectively | 117        | 117        |
| Additional paid-in capital  | 35,204     | 33,569     |
| Retained earnings   | 251,607    | 244,969    |
| Accumulated other comprehensive income (loss)   | 149        | (1,352)    |
| Total Stockholders' Equity  | 287,077    | 277,303    |
| Total Liabilities and Equity  | \$ 439,782 | \$ 400,712 |

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

**Table of Contents**

**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,<br>2011   | June 30,<br>2010 | June 30,<br>2011  | June 30,<br>2010 |
| Revenues  | \$ 142,135         | \$ 138,880       | \$ 392,407        | \$ 416,931       |
| Cost of goods sold  | 118,637            | 100,636          | 317,401           | 304,337          |
| Gross profit  | 23,498             | 38,244           | 75,006            | 112,594          |
| Selling, general and administrative expenses                | 19,410             | 21,084           | 61,876            | 62,821           |
| Amortization of intangible assets                           | 1,237              | 1,132            | 3,658             | 3,193            |
| Operating income  | 2,851              | 16,028           | 9,472             | 46,580           |
| Other income  |                    |                  | (1,229)           |                  |
| Interest expense  | 88                 | 228              | 296               | 638              |
| Interest income   | (66)               | (49)             | (173)             | (206)            |
| Income before income taxes                                  | 2,829              | 15,849           | 10,578            | 46,148           |
| Income tax provision  | 1,122              | 5,530            | 3,940             | 16,199           |
| Net income  | 1,707              | 10,319           | 6,638             | 29,949           |
| Net income attributable to noncontrolling interest          |                    | (33)             |                   | (159)            |
| Net income attributable to Powell Industries, Inc.          | \$ 1,707           | \$ 10,286        | \$ 6,638          | \$ 29,790        |
| Earnings per share attributable to Powell Industries, Inc.: |                    |                  |                   |                  |
| Basic   | \$ 0.15            | \$ 0.89          | \$ 0.57           | \$ 2.59          |
| Diluted   | \$ 0.14            | \$ 0.88          | \$ 0.56           | \$ 2.56          |
| Weighted average shares:                                    |                    |                  |                   |                  |
| Basic   | 11,740             | 11,556           | 11,730            | 11,518           |
| Diluted   | 11,812             | 11,679           | 11,806            | 11,648           |

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

**Table of Contents**

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

|   | Nine Months Ended |               |
|---|-------------------|---------------|
|   | June 30,<br>2011  | June 30, 2010 |
| Operating Activities:   |                   |               |
| Net income  | \$ 6,638          | \$ 29,949     |
| Adjustments to reconcile net income to net cash used in operating activities: |                   |               |
| Depreciation  | 7,790             | 6,753         |
| Amortization  | 3,708             | 3,244         |
| Stock-based compensation  | 1,117             | 1,492         |
| Bad debt expense  | 82                | 479           |
| Deferred income taxes   | (5,440)           | (2,087)       |
| Gain on sale of investment in joint venture in Kazakhstan                     | (1,229)           |               |
| Changes in operating assets and liabilities:                                  |                   |               |
| Accounts receivable   | (14,151)          | 23,624        |
| Costs and estimated earnings in excess of billings on uncompleted contracts   | (5,846)           | 11,107        |
| Inventories   | (2,747)           | 11,922        |
| Prepaid expenses and other current assets                                     | 3,795             | 1,971         |
| Accounts payable and income taxes payable                                     | 6,459             | (19,958)      |
| Accrued liabilities   | (10,910)          | (6,383)       |
| Billings in excess of costs and estimated earnings on uncompleted contracts   | 33,511            | (9,978)       |
| Other   | 2,464             | 68            |
| Net cash provided by operating activities                                     | 25,241            | 52,203        |
| Investing Activities:   |                   |               |
| Proceeds from sale of fixed assets  | 308               | 14            |
| Purchases of property, plant and equipment                                    | (4,072)           | (3,461)       |
| Proceeds from sale of investment in joint venture in Kazakhstan               | 1,229             |               |
| Buyout of noncontrolling interest Powell Asia                                 |                   | (659)         |
| Acquisition of Powell Canada  |                   | (23,394)      |
| Net cash used in investing activities   | (2,535)           | (27,500)      |
| Financing Activities:   |                   |               |
| Borrowings on Canadian revolving line of credit                               | 4,947             | 891           |
| Payments on Canadian revolving line of credit                                 | (4,955)           | (3,265)       |
| Payments on Canadian term loan  |                   | (242)         |
| Payments on industrial development revenue bonds                              | (400)             | (400)         |
| Payments on deferred acquisition payable                                      |                   | (4,292)       |
| Other   | (250)             | 1,308         |
| Net cash used in financing activities   | (658)             | (6,000)       |



Edgar Filing: POWELL INDUSTRIES INC - Form 10-Q

|  |            |            |
|--|------------|------------|
| Net increase in cash and cash equivalents                    | 22,048     | 18,703     |
| Effect of exchange rate changes on cash and cash equivalents | (135)      | 992        |
| Cash and cash equivalents at beginning of period             | 115,353    | 97,403     |
| Cash and cash equivalents at end of period                   | \$ 137,266 | \$ 117,098 |

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

5

---

**Table of Contents**

**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 corporation 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.; Transdyn, Inc.; Powell Industries International, Inc.; Switchgear & Instrumentation Limited (S&I) and Powell Canada Inc.

We develop, design, manufacture and service custom engineered-to-order equipment and systems for the management and control of electrical energy and other critical processes. Headquartered in Houston, Texas, we serve the transportation, environmental, energy, industrial and utility industries.

In December 2009, we acquired the business and certain assets of PowerComm Inc. and its subsidiaries (referred to herein as Powell Canada) for \$23.4 million, not including acquisition-related expenses. Powell Canada is headquartered in Edmonton, Alberta, Canada, and provides electrical and maintenance services. Powell Canada is also a manufacturer of switchgear and related products, primarily serving the oil and gas industry in western Canada. The operating results of Powell Canada are included in our Electrical Power Products business segment from the acquisition date. For further information on the Powell Canada acquisition, see Note C.

*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 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 periods 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.

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, 2010, which was filed with the SEC on December 8, 2010.

*Reclassifications*

Certain reclassifications have been made in prior year's financial statements to conform to the presentation used in the current year. These reclassifications have not resulted in any changes to previously reported net income for any periods.

*Use of Estimates*

The preparation of 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 financial statements affect revenue and cost recognition for construction contracts, the allowance for doubtful accounts, provision for excess and obsolete inventory, goodwill and other intangible assets, self-insurance, warranty accruals, income taxes and estimates related to acquisition valuations. The amounts recorded for insurance claims, warranties, legal, income taxes 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

**Table of Contents**

liabilities, in evaluating the amount of liability that should be recorded. Estimates may change as new events occur, additional information becomes available or operating environments change. Actual results may differ from our estimates.

*New Accounting Standards*

In April 2009, the Financial Accounting Standards Board (FASB) issued accounting guidance regarding the accounting for assets acquired and liabilities assumed in a business combination arising from contingencies. This guidance clarifies the initial and subsequent recognition, subsequent accounting and disclosure of assets and liabilities arising from such contingencies in a business combination. This guidance requires that assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value, if the acquisition-date fair value can be reasonably estimated. If the acquisition-date fair value of an asset or liability cannot be reasonably estimated, the asset or liability would be measured at the amount that would be recognized using the accounting guidance related to accounting for contingencies or the guidance for reasonably estimating losses. This accounting guidance became effective for us on October 1, 2010. The adoption of this guidance did not have an impact on our consolidated financial statements.

In January 2010, the FASB issued updated guidance to amend the disclosure requirements related to recurring and nonrecurring fair value measurements. This update requires new disclosures about significant transfers of assets and liabilities between Level 1 and Level 2 of the fair value hierarchy (including the reasons for these transfers) and the reasons for any transfers in or out of Level 3. This update also requires a reconciliation of recurring Level 3 measurements about purchases, sales, issuances and settlements on a gross basis. In addition to these new disclosure requirements, this update clarifies certain existing disclosure requirements. For example, this update clarifies that reporting entities are required to provide fair value measurement disclosures for each class of assets and liabilities, rather than each major category of assets or liabilities. This update also clarifies the requirement for entities to disclose information about both the valuation techniques and inputs used in estimating Level 2 and Level 3 fair value measurements. This update became effective for us with the interim and annual reporting period beginning after December 15, 2009, our fiscal year 2011, except for the requirement to provide the Level 3 activity of purchases, sales, issuances and settlements on a gross basis, which will become effective for us with the interim and annual reporting period beginning after December 15, 2010, our fiscal year 2012. We will not be required to provide the amended disclosures for any previous periods presented for comparative purposes. Other than requiring additional disclosures, adoption of this update for the provisions currently in effect for us did not have a material impact on our consolidated financial statements.

In April 2010, the FASB issued accounting guidance for the milestone method of revenue recognition. This guidance allows entities to make a policy election to use the milestone method of revenue recognition and provides guidance on defining a milestone and the criteria that should be met for applying the milestone method. The scope of this guidance is limited to transactions involving milestones relating to research and development. The guidance includes enhanced disclosure requirements about each arrangement, individual milestones and related contingent consideration, information about substantive milestones and factors considered in the determination. This guidance is effective prospectively to milestones achieved in fiscal years, and interim periods within those years, beginning after June 15, 2010. Early application and retrospective application are permitted. We have evaluated this new guidance and have determined that it will not currently have a significant impact on the determination or reporting of our financial results.

In May 2011, the FASB issued accounting guidance related to fair value measurement, which amends current guidance to achieve common fair value measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards. This guidance generally represents clarification of fair value measurement standards, but also includes instances where a particular principle or requirement for measuring fair value or disclosing information about fair value measurements has changed. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. We will adopt this guidance for our fiscal year beginning October 1, 2012. We do not expect this pronouncement to have a material effect on our consolidated financial statements.

In June 2011, the FASB issued new accounting guidance on the presentation of comprehensive income in financial statements. Entities are required to present total comprehensive income either in a single, continuous statement of comprehensive income or in two separate, but consecutive, statements. Under the single-statement approach, entities must include the components of net income, a total for net income, the components of other comprehensive income and a total for comprehensive income. Under the two-statement approach, entities must report an income statement and, immediately following, a statement of other comprehensive income. Under either method, entities must display adjustments for items reclassified from other comprehensive income to net income in both net income and other comprehensive income. The provisions for this guidance are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, with early adoption permitted. We will adopt this guidance for our fiscal year beginning October 1, 2012.

**Table of Contents***Subsequent Events*

We evaluated subsequent events through the time of filing this Quarterly Report on Form 10-Q. No significant events occurred subsequent to the balance sheet or prior to the filing of this report that would have a material impact on our consolidated financial statements or results of operations taken as a whole.

**B. 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.

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, 2011 (in thousands):

|                                    | Fair Value Measurements at June 30, 2011                       |   |   | Fair Value at June 30, 2011 |
|------------------------------------|--|---|---|-----------------------------|
|                                    | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |                             |
| Assets                             |  |   |   |                             |
| Cash equivalents                   | \$ 88,807  | \$  | \$  | \$ 88,807                   |
| Total                              | \$ 88,807  | \$  | \$  | \$ 88,807                   |
| Liabilities                        |  |   |   |                             |
| Foreign currency forward contracts | \$   | \$ 32   | \$  | \$ 32                       |
| Total                              | \$   | \$ 32   | \$  | \$ 32                       |

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, 2010 (in thousands):

**Fair Value Measurements at September 30, 2010**

**Significant**

|                                    | <b>Quoted<br/>Prices in<br/>Active<br/>Markets<br/>for<br/>Identical<br/>Assets<br/><br/>(Level 1)</b> | <b>Significant<br/>Other<br/><br/>Observable<br/><br/>Inputs<br/><br/>(Level 2)</b> | <b>Unobservable<br/><br/>Inputs<br/><br/>(Level 3)</b> | <b>Fair Value at<br/>September 30,<br/>2010</b> |
|------------------------------------|--|---|--|---|
| <b>Assets</b>                      |  |   |  |   |
| Cash equivalents                   | \$ 64,014  | \$  | \$   | \$ 64,014                                       |
| Total                              | \$ 64,014  | \$  | \$   | \$ 64,014                                       |
| <b>Liabilities</b>                 |  |   |  |   |
| Foreign currency forward contracts | \$   | \$ 47   | \$   | \$ 47   |
| Total                              | \$   | \$ 47   | \$   | \$ 47   |

**Table of Contents**

Cash equivalents, primarily funds held in money market 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.

Foreign currency forward contracts are valued using an income approach which consists of a discounted cash flow model that takes into account the present value of future cash flows under the terms of the contracts using observable market spot and forward rates as of our reporting date, and are included in Level 2 inputs in the above table. We use these derivative instruments to mitigate non-functional currency transaction exposure on certain contracts with customers and vendors. We mitigate derivative credit risk by transacting with highly rated counterparties. We have evaluated the credit and non-performance risks associated with our derivative counterparties and believe them to be insignificant at June 30, 2011. All contracts are recorded at fair value and marked-to-market at the end of each reporting period, with unrealized gains and losses being included in accumulated other comprehensive income on our Condensed Consolidated Balance Sheets for that period. See Note I for further discussion regarding our derivative instruments.

**C. ACQUISITIONS**

On December 15, 2009, we acquired the business and certain assets of PowerComm Inc. and its subsidiaries, Redhill Systems, Ltd., Nextron Corporation, PCG Technical Services Inc. and Concorde Metal Manufacturing Ltd (the business of which is referred to herein as Powell Canada). Powell Canada is headquartered in Edmonton, Alberta, Canada, and provides electrical and maintenance services in western Canada. Powell Canada is also a manufacturer of switchgear and related products, primarily serving the oil and gas industry in western Canada. This acquisition supports our strategy to expand our geographic presence into Canada, as well as increasing our service and maintenance capabilities.

We paid \$23.4 million, plus expenses of approximately \$2.4 million, for the acquisition from our existing cash and cash equivalents and assumed \$15.1 million of existing bank debt. See the table below for assets acquired and liabilities assumed. In December 2009, approximately \$2.4 million of the \$23.4 million purchase price was placed into an escrow account related to the purchase of PowerComm's 50% interest in the operations of a joint venture in Kazakhstan. This transaction closed in April 2010 and the escrow was released. The finalization of the net asset adjustment related to the Kazakhstan transaction and the calculation of the management fee agreement related to the operating results of the Kazakhstan joint venture from December 16, 2009, through March 31, 2010, as defined in the acquisition agreement, resulted in a refund to the Company of approximately \$472,000. This refund was received by the Company subsequent to September 30, 2010, and reduced the corresponding receivable.

Intangible assets recorded are approximately \$9.0 million and are being amortized over an initial weighted average life of approximately 8.4 years. Goodwill was initially recorded at approximately \$7.2 million and was not amortized. Goodwill represented the excess purchase price over the estimated fair value allocated to the net assets acquired.

During fiscal 2010, our impairment analysis indicated that the goodwill related to the acquisition of Powell Canada was completely impaired, thus a loss on impairment of approximately \$7.5 million was recorded in the fourth quarter of fiscal 2010.

The purchase price allocation was as follows, based on the exchange rate as of December 15, 2009 (in thousands):

|  |           |
|--|-----------|
| Accounts receivable                            | \$ 16,643 |
| Inventories                                    | 4,180     |
| Prepaid expenses and other current assets      | 3,401     |
| Property, plant and equipment                  | 7,863     |
| Goodwill                                       | 7,180     |
| Intangible assets                              | 9,043     |
| Accounts payable and other current liabilities | (7,649)   |
| Capital lease obligations                      | (2,667)   |
| Bank debt assumed                              | (15,072)  |
| Total purchase price                           | \$ 22,922 |

Operating results of Powell Canada are included in our Electrical Power Products business segment in our Condensed Consolidated Statements of Operations from December 15, 2009. Pro forma results, including the results of Powell Canada since the beginning of fiscal year 2009 would not be materially different than the actual results reported. In the fourth quarter of fiscal year 2010, the Company made a strategic decision to exit the 50% owned joint venture in Kazakhstan. We did not record our share of revenue and expense or assets and liabilities as financial information was not available and based on



**Table of Contents**

the fact that this information was not material to the consolidated financial position, results of operations or cash flows of the Company. We received approximately \$1.2 million in the second quarter of fiscal 2011 resulting from the sale of our 50% investment in a joint venture in Kazakhstan, which is recorded in other income in our Condensed Consolidated Statements of Operations.

In October 2010, we acquired certain assets related to a technology for real-time optical fiber-based thermal sensors that have application for monitoring of hot spots in electrical power equipment systems. There were no operations associated with this patent-pending technology acquired. This transaction has been recorded as an increase in intangible assets of approximately \$1.5 million at December 31, 2010, and is being amortized over seven years.

**D. EARNINGS PER SHARE**

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share data):

|   | <b>Three Months Ended<br/>June 30,</b> |             | <b>Nine Months Ended<br/>June 30,</b> |             |
|---|--|-------------|---------------------------------------|-------------|
|   | <b>2011</b>                            | <b>2010</b> | <b>2011</b>                           | <b>2010</b> |
| <i>Numerator:</i>   |  |             |                                       |             |
| Net income attributable to Powell Industries, Inc.          | \$ 1,707                               | \$ 10,286   | \$ 6,638                              | \$ 29,790   |
| <i>Denominator:</i>   |  |             |                                       |             |
| Weighted average basic shares                               | 11,740                                 | 11,556      | 11,730                                | 11,518      |
| Dilutive effect of stock options and restricted stock units | 72                                     | 123         | 76                                    | 130         |
| Weighted average diluted shares with assumed conversions    | 11,812                                 | 11,679      | 11,806                                | 11,648      |
| <i>Net earnings per share:</i>                              |  |             |                                       |             |
| Basic   | \$ 0.15                                | \$ 0.89     | \$ 0.57                               | \$ 2.59     |
| Diluted   | \$ 0.14                                | \$ 0.88     | \$ 0.56                               | \$ 2.56     |

All options were included in the computation of diluted earnings per share for the three and nine months ended June 30, 2011 and 2010, respectively, as the options exercise prices were less than the average market price of our common stock.

**E. DETAIL OF SELECTED BALANCE SHEET ACCOUNTS***Allowance for Doubtful Accounts*

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

|  | <b>Three Months Ended<br/>June 30,</b> |             | <b>Nine Months Ended<br/>June 30,</b> |             |
|--|--|-------------|---------------------------------------|-------------|
|  | <b>2011</b>                            | <b>2010</b> | <b>2011</b>                           | <b>2010</b> |
| Balance at beginning of period                                       | \$ 1,508                               | \$ 1,930    | \$ 907                                | \$ 1,607    |
| Increase (decrease) in bad debt expense                              | (524)                                  | (214)       | 82                                    | 479         |
| Deductions for uncollectible accounts written off, net of recoveries | (221)                                  | 11          | (225)                                 | (387)       |
| Increase (decrease) due to foreign currency translation              | (4)                                    | 13          | (5)                                   | 41          |
| Balance at end of period   | \$ 759                                 | \$ 1,740    | \$ 759                                | \$ 1,740    |

*Warranty Accrual*

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

|   | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|---|---------------------------|-------------|--------------------------|-------------|
|   | <b>June 30,</b>           |             | <b>June 30,</b>          |             |
|   | <b>2011</b>               | <b>2010</b> | <b>2011</b>              | <b>2010</b> |
| Balance at beginning of period                          | \$ 5,763                  | \$ 7,054    | \$ 5,929                 | \$ 7,558    |
| Increase (decrease) in warranty expense                 | (148)                     | (461)       | 759                      | 889         |
| Deductions for warranty charges                         | (728)                     | (344)       | (1,961)                  | (2,092)     |
| Increase (decrease) due to foreign currency translation | 191                       | (2)         | 351                      | (108)       |
| Balance at end of period                                | \$ 5,078                  | \$ 6,247    | \$ 5,078                 | \$ 6,247    |

**Table of Contents***Inventories*

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

|   | <b>June 30,<br/>2011</b> | <b>September<br/>30,<br/>2010</b> |
|---|--------------------------|-----------------------------------|
| Raw materials, parts and subassemblies      | \$ 41,694                | \$ 40,325                         |
| Work-in-progress                            | 6,773                    | 4,646                             |
| Provision for excess and obsolete inventory | (7,123)                  | (6,727)                           |
| Total inventories                           | \$ 41,344                | \$ 38,244                         |

*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):

|   | <b>June 30,<br/>2011</b> | <b>September<br/>30,<br/>2010</b> |
|---|--------------------------|-----------------------------------|
| Costs incurred on uncompleted contracts   | \$ 549,998               | \$ 482,149                        |
| Estimated earnings  | 172,415                  | 138,836                           |
|   | 722,413                  | 620,985                           |
| Less: Billings to date  | 743,051                  | 613,930                           |
| Net underbilled (overbilled) position   | \$ (20,638)              | \$ 7,055                          |
| Included in the accompanying balance sheets under the following captions:               |                          |                                   |
| Costs and estimated earnings in excess of billings on uncompleted contracts underbilled | \$ 43,927                | \$ 38,064                         |
| Billings in excess of costs and estimated earnings on uncompleted contracts overbilled  | (64,565)                 | (31,009)                          |
| Net underbilled (overbilled) position   | \$ (20,638)              | \$ 7,055                          |

**F. GOODWILL AND INTANGIBLE ASSETS**

Goodwill consisted of the following at June 30, 2011 and September 30, 2010 (in thousands):

|                              | <b>June 30,<br/>2011</b> | <b>September<br/>30,<br/>2010</b> |
|------------------------------|--------------------------|-----------------------------------|
| Goodwill                     | \$ 8,183                 | \$ 8,183                          |
| Accumulated impairment loss  | (7,452)                  | (7,452)                           |
| Foreign currency translation | 272                      | 272                               |
| Goodwill, net                | \$ 1,003                 | \$ 1,003                          |

Intangible assets balances, subject to amortization, at June 30, 2011 and September 30, 2010 consisted of the following (in thousands):

|                        | June 30, 2011        |                          | September 30, 2010   |                          |
|------------------------|----------------------|--------------------------|----------------------|--------------------------|
|                        | Gross Carrying Value | Accumulated Amortization | Gross Carrying Value | Accumulated Amortization |
| Supply agreement       | \$ 17,580            | \$ (5,760)               | \$ 17,580            | \$ (4,881)               |
| Purchased technology   | 13,059               | (8,209)                  | 11,444               | (6,953)                  |
| Non-compete agreements | 5,424                | (4,717)                  | 5,363                | (3,706)                  |
| Trade name             | 4,557                | (727)                    | 4,337                | (343)                    |
| Customer relationships | 3,650                | (388)                    | 3,474                | (183)                    |
| Total                  | \$ 44,270            | \$ (19,801)              | \$ 42,198            | \$ (16,066)              |

All goodwill and intangible assets disclosed above are reported in our Electrical Power Products business segment. Amortization of intangible assets recorded for the nine months ended June 30, 2011 and 2010 was approximately \$3.7 million and \$3.2 million, respectively.

**Table of Contents****G. COMPREHENSIVE INCOME**

Comprehensive income was as follows (in thousands):

|  | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|--|---------------------------|-------------|--------------------------|-------------|
|  | <b>June 30,</b>           |             | <b>June 30,</b>          |             |
|  | <b>2011</b>               | <b>2010</b> | <b>2011</b>              | <b>2010</b> |
| Net income attributable to Powell Industries, Inc.                 | \$ 1,707                  | \$ 10,286   | \$ 6,638                 | \$ 29,790   |
| Unrealized gain (loss) on foreign currency translation, net of tax | (559)                     | (159)       | 1,514                    | (77)        |
| Unrealized loss on derivative contracts, net of tax                | (9)                       | (7)         | (13)                     | (203)       |
| Comprehensive income   | \$ 1,139                  | \$ 10,120   | \$ 8,139                 | \$ 29,510   |

**H. LONG-TERM DEBT**

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

|   | <b>June 30,</b> | <b>September 30,</b> |
|---|-----------------|----------------------|
|   | <b>2011</b>     | <b>2010</b>          |
| Industrial development revenue bonds                  | \$ 4,400        | \$ 4,800             |
| Capital lease obligations                             | 1,365           | 2,085                |
| Subtotal long-term debt and capital lease obligations | 5,765           | 6,885                |
| Less current portion                                  | (1,378)         | (1,683)              |
| Total long-term debt and capital lease obligations    | \$ 4,387        | \$ 5,202             |

*US and UK Revolvers*

In May 2011, we amended our existing credit agreement (Amended Credit Agreement) with a major domestic bank. This amendment to our credit facility was made to expand our US borrowing capacity to provide additional working capital support for the Company, and to terminate the revolving credit facility for the Company's subsidiaries located in the United Kingdom. The Amended Credit Agreement provides for a \$75.0 million revolving credit facility (US Revolver). Obligations are collateralized by the stock of certain of our subsidiaries.

The interest rate for amounts outstanding under the Amended Credit Agreement for the US Revolver is a floating rate based upon the higher of the London interbank offered rate (LIBOR), or the bank's prime rate. Once the applicable rate is determined, a margin ranging from negative 0.5% to 1.75%, as determined by our funded debt to EBITDA ratio, is added to the applicable rate.

The US Revolver provides for the issuance of letters of credit which reduce the amounts which may be borrowed under the revolver. The amount available under the US Revolver was reduced by approximately \$11.6 million for our outstanding letters of credit at June 30, 2011.

There were no borrowings under the US Revolver as of June 30, 2011. Amounts available under the US Revolver were approximately \$63.4 million at June 30, 2011. The US Revolver expires on December 31, 2016.

The Amended Credit Agreement contains certain restrictive and maintenance-type covenants, including restrictions on our ability to pay dividends, as well as restriction on the amount of capital expenditures allowed. 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, 2011, we were in compliance with all of the financial covenants of the Amended Credit Agreement.

*Canadian Revolver*

On December 15, 2009, we entered into a credit agreement with a major international bank (the Canadian Facility) to finance the \$15.1 million debt assumed in the acquisition of Powell Canada, and to provide additional working capital support for our operations in Canada. The Canadian Facility provides for a \$20 million CAD (approximately \$20.5 million) revolving credit facility (the Canadian Revolver), subject to certain limitations including a limitation on borrowings based upon certain financial ratios, as defined in the credit agreement. Expenses associated with the Canadian Facility were approximately \$0.1 million and are classified as deferred loan costs in other assets and are being amortized as a non-cash charge to interest expense over two years.

**Table of Contents**

The Canadian Revolver provides for the issuance of letters of credit which reduce the amounts which may be borrowed under the Canadian Revolver. As of June 30, 2011, there were no letters of credit outstanding under the Canadian Revolver.

There were no borrowings outstanding under the Canadian Revolver and approximately \$20.5 million available at June 30, 2011, subject to a borrowing base calculation. The amount available under the Canadian Revolver was reduced to approximately \$15.9 million based upon the available borrowing base as defined in the Canadian Facility. The Canadian Facility expires on February 29, 2012. The interest rate for amounts outstanding under the Canadian Revolver is a floating interest rate based upon either the Canadian Prime Rate, or the lender's US Bank Rate. Once the applicable rate is determined, a margin of 0.376% to 1.125%, as determined by our consolidated leverage ratio is added to the applicable rate.

The principal financial covenants are consistent with those described in our Amended Credit Agreement. As discussed above, the borrowings under the Canadian Revolver are subject to a borrowing base limitation. The Canadian Facility contains a material adverse effect clause. A material adverse effect is defined as a material change in the operations of Powell or Powell Canada in relation to our financial condition, property, business operations, expected net cash flows, liabilities or capitalization.

The Canadian Facility is secured by the assets of our Canadian operations and provides for customary events of default and carries cross-default provisions with our existing debt agreements. If an event of default (as defined in the Canadian Facility) occurs and is continuing, on the terms and subject to the conditions set forth in the Canadian Facility, amounts outstanding under the Canadian Facility may be accelerated and may become immediately due and payable. As of June 30, 2011, we were in compliance with all of the financial covenants of the Canadian Facility credit agreement.

*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) 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 are in compliance at June 30, 2011. While the Bonds mature in 2021, the reimbursement agreement requires annual redemptions of \$400,000 that commenced on October 25, 2002. A sinking fund is used for the redemption of the Bonds. At June 30, 2011, the balance in the restricted sinking fund was approximately \$334,000 and was recorded in cash and cash equivalents. 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 0.30% per year on June 30, 2011.

**I. DERIVATIVE INSTRUMENTS AND HEDGING STRATEGIES**

We operate in various countries and have operations in the United Kingdom and Canada. These international operations expose us to market risk associated with foreign currency exchange rate fluctuations. We have entered into certain forward contracts to hedge the risk of certain foreign currency rate fluctuations. To the extent we choose to manage volatility associated with the net exposures, we enter into various financial transactions which we account for using the applicable accounting guidance for derivative instruments and hedging activities. Our objective is to hedge the variability in forecasted cash flow due to the foreign currency risk associated with certain long-term contracts. As of June 30, 2011, we held only derivatives that were designated as cash flow hedges related to the U.S. Dollar/British Pound Sterling exchange rate and the Euro/British Pound Sterling exchange rate.

All derivatives are recognized on the Condensed Consolidated Balance Sheet at their fair value and classified based on the instrument's maturity date. The total notional amount of outstanding derivatives as of June 30, 2011 was approximately \$0.8 million.

The following table presents the fair value of derivative instruments included within the Condensed Consolidated Balance Sheets as of June 30, 2011:

|  | <b>Asset Derivatives</b>                                 |                       | <b>Liability Derivatives</b> |              |
|--|--|-----------------------|------------------------------|--------------|
|  | <b>Fair</b>  |                       | <b>Fair</b>                  |              |
|  | <b>Balance</b>   |                       | <b>Balance</b>               |              |
|  | <b>Sheet</b>   |                       | <b>Sheet</b>                 |              |
|  | <b>Location</b>  | <b>Value</b>          | <b>Location</b>              | <b>Value</b> |
|  |  | <b>(in thousands)</b> |                              |              |
| Derivatives designated as hedging instruments: |  |                       |                              |              |
| Foreign exchange forwards                      | Prepaid<br>expenses<br>and<br>other<br>current<br>assets | \$                    | Other<br>accrued<br>expenses | \$ 32        |
| Total derivatives                              |  | \$                    |                              | \$ 32        |



**Table of Contents**

The following table presents the fair value of derivative instruments included within the Condensed Consolidated Balances Sheets as of September 30, 2010:

|  | <b>Asset Derivatives</b>                  |                       | <b>Liability Derivatives</b> |              |
|--|---|-----------------------|------------------------------|--------------|
|  | <b>Fair</b>                               |                       | <b>Fair</b>                  |              |
|  | <b>Balance</b>                            |                       | <b>Balance</b>               |              |
|  | <b>Sheet</b>                              |                       | <b>Sheet</b>                 |              |
|  | <b>Location</b>                           | <b>Value</b>          | <b>Location</b>              | <b>Value</b> |
|  |   | <b>(in thousands)</b> |                              |              |
| Derivatives designated as hedging instruments: |   |                       |                              |              |
| Foreign exchange forwards                      | Prepaid expenses and other current assets | \$                    | Other accrued expenses       | \$ 47        |
| Total derivatives                              |   | \$                    |                              | \$ 47        |

The following table presents the amounts affecting the Condensed Consolidated Statements of Operations for the three and nine month periods ended June 30, 2011:

|   | <b>Amount of Gain (Loss)</b>                                   |                      |   | <b>Amount of Gain (Loss)</b>  |                      |
|---|--|----------------------|---|---|----------------------|
|   | <b>Recognized in Other Comprehensive Income on Derivatives</b> |                      |   | <b>Reclassified from Accumulated Other Comprehensive Income into Income</b> |                      |
|   | <b>Three Months</b>  | <b>Nine Months</b>   | <b>Location of Gain (Loss) Reclassified from Accumulated Other comprehensive Income into Income</b> | <b>Three Months</b>   | <b>Nine Months</b>   |
|   | <b>Ended</b>   | <b>Ended</b>         |   | <b>Ended</b>  | <b>Ended</b>         |
|   | <b>June 30, 2011</b>   | <b>June 30, 2011</b> |   | <b>June 30, 2011</b>  | <b>June 30, 2011</b> |
| <b>Derivatives designated:</b>              | <b>(in thousands)</b>  |                      |   | <b>(in thousands)</b>   |                      |
| Derivatives designated as cash flow hedges: |  |                      |   |   |                      |
| Foreign exchange forwards                   | \$ (14)  | \$ (19)              | Revenues  | \$ 3  | \$ 45                |
| Total designated cash flow hedges           | \$ (14)  | \$ (19)              |   | \$ 3  | \$ 45                |

The following table presents the amounts affecting the Condensed Consolidated Statements of Operations for the three and nine month periods ended June 30, 2010:

|   | Amount of Gain<br>(Loss)<br>Recognized in Other<br>Comprehensive<br>Income on<br>Derivatives <sup>1</sup> |                                    | Location of<br>Gain (Loss)<br>Reclassified<br>from<br>Accumulated<br>Other<br>comprehensive<br>Income<br>into Income | Amount of Gain<br>(Loss)<br>Reclassified from<br>Accumulated Other<br>Comprehensive<br>Income<br>into Income <sup>1</sup> |                                    |
|---|---|------------------------------------|--|---|------------------------------------|
|   | Three<br>Months   | Nine<br>Months                     |  | Three<br>Months   | Nine<br>Months                     |
|   | Ended   | Ended                              |  | Ended   | Ended                              |
|   | June<br>30,<br>2010<br>(in thousands)   | June 30,<br>2010<br>(in thousands) |  | June<br>30,<br>2010<br>(in thousands)   | June 30,<br>2010<br>(in thousands) |
| <b>Derivatives designated:</b>              |   |                                    |  |   |                                    |
| Derivatives designated as cash flow hedges: |   |                                    |  |   |                                    |
| Foreign exchange forwards                   | \$ (10)   | \$ 761                             | Revenues   | \$ 32   | \$ (154)                           |
| Total designated cash flow hedges           | \$ (10)   | \$ 761                             |  | \$ 32   | \$ (154)                           |

<sup>1</sup> For the three and nine month periods ended June 30, 2010, we recorded in revenues an immaterial amount of ineffectiveness from cash flow hedges.

Refer to Note B for a description of how the above financial instruments are valued in accordance with the fair value measurement accounting guidance for the three and nine month periods ended June 30, 2011.

#### *Cash Flow Hedges*

The purpose of our foreign currency hedging activities is to protect us from the risk that the eventual cash flows resulting from transactions that are denominated in currencies other than the U.S. Dollar will be adversely affected by changes in exchange rates. We are currently hedging our exposure to the reduction in value of forecasted foreign currency cash flows through foreign currency forward agreements through September 30, 2011, for transactions denominated in the British Pound Sterling.

All changes in the fair value of outstanding cash flow hedge derivatives, except the ineffective portion, are recorded in accumulated other comprehensive income, until net income is affected by the variability of cash flows of the hedged transaction, or until it is probable that the forecasted transaction will not occur. In most cases, amounts recorded in accumulated other comprehensive income will be released to net income some time after the maturity of the related derivative. The Condensed Consolidated Statements of Operations classification of effective hedge results is the same as that of the underlying exposure. Results of hedges of revenue and

**Table of Contents**

product costs are recorded in revenue and costs of sales, respectively, when the underlying hedged transaction affects net income. Results of hedges of selling and administrative expense, if any, are recorded together with those costs when the related expense is recorded. In addition, any ineffective portion of the changes in the fair value of the derivatives designated as cash flow hedges are reported in the Condensed Consolidated Statements of Operations as the changes occur.

As of June 30, 2011, approximately \$29,900 of deferred net losses (net of tax) on outstanding derivatives recorded in accumulated other comprehensive income are expected to be reclassified to net income during the next twelve months as a result of underlying hedged transactions being recorded in net income. Actual amounts ultimately reclassified to net income are dependent on the exchange rates in effect when the derivative contracts that are currently outstanding mature. As of June 30, 2011, the maximum term over which we are hedging exposure to the variability of cash flows for our forecasted and recorded transactions is three months. For the three and nine months ended June 30, 2011, we recorded in selling, general and administrative expense an immaterial amount of ineffectiveness from cash flow hedges.

*Credit Risk*

We are exposed to credit-related losses in the event of non-performance by counterparties to hedging instruments. The ability of financial counterparties to perform under financial instruments has become less certain. We attempt to take into account the financial viability of counterparties in both valuing the instruments and determining their effectiveness as hedging instruments. If a counterparty was unable to perform, our ability to qualify for hedging certain transactions would be compromised and the realizable value of the financial instruments would be uncertain. As a result, our results of operations and cash flows would be impacted.

**J. COMMITMENTS AND CONTINGENCIES***Letters of Credit and Bonds*

Certain customers require us to post bank letter of credit guarantees or performance bonds issued by a surety. These guarantees and performance bonds 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 performance bond. To date, there have been no significant expenses related to either for the periods reported. We were contingently liable for secured and unsecured letters of credit of \$11.6 million as of June 30, 2011. We also had performance and maintenance bonds totaling approximately \$202.1 million that were outstanding, with additional bonding capacity of approximately \$397.9 million available, at June 30, 2011.

We have a facility agreement (Facility Agreement) between S&I and a large international bank. This \$13.6 million Facility Agreement provides S&I the ability to enter into forward exchange contracts, currency options and performance bonds. At June 30, 2011, we had outstanding a total of approximately \$5.1 million of contingent obligations under this Facility Agreement.

The Facility Agreement provides for financial covenants, customary events of default and carries cross-default provisions with our Amended Credit Facility. If an event of default (as defined in the Facility Agreement) occurs and is continuing, on the terms and subject to the conditions set forth in the Facility Agreement, obligations outstanding under the Facility Agreement may be accelerated and may become or be declared immediately due and payable.

*Litigation*

We are involved in various legal proceedings, claims and other disputes arising in the ordinary course of business which, in general, are subject to uncertainties and the outcomes are not predictable. We do not believe that the ultimate conclusion of these disputes could materially affect our financial position or results of operations taken as a whole.

**K. STOCK-BASED COMPENSATION**

Refer to our Annual Report on Form 10-K for the fiscal year ended September 30, 2010 for a full description of our existing stock-based compensation plans.

*Restricted Stock Units*

In October 2009 and October 2010, we granted approximately 34,700 and 35,000 restricted stock units (RSUs), respectively, with a fair value of \$38.36 and \$30.79 per unit, respectively, to certain officers and key employees. An additional 5,000 RSUs were granted in October 2010, with a fair value of \$32.12. The RSUs vest over a three-year

period from their date of issuance. The fair value of the

**Table of Contents**

RSUs was based on the closing price of our common stock as reported on the NASDAQ Global Market (NASDAQ) on the grant dates. The actual amount of the RSUs earned will be based on the cumulative earnings per share as reported relative to established goals for the three-year performance cycle which began October 1 of the year granted, and ranges from 0% to 150% of the target RSUs granted. At June 30, 2011, there were approximately 105,000 RSUs outstanding. The RSUs do not have voting rights of common stock, and the shares of common stock underlying the RSUs are not considered issued and outstanding until actually issued.

During the first quarter of fiscal 2011, we granted approximately 15,000 RSUs with a fair value ranging from \$30.79 to \$32.12 to certain officers and key employees. The RSUs vest over a three-year period from their date of issuance. These RSUs are time-based, rather than performance based, as those discussed above.

During the nine months ended June 30, 2011, we recorded compensation expense of approximately \$0.1 million related to the RSUs. We recorded compensation expense of approximately \$1.0 million related to the RSUs for the nine months ended June 30, 2010.

*Restricted Stock*

Under the 2006 Equity Compensation Plan (the 2006 Plan), any employee of the Company and its subsidiaries and consultants are eligible to participate in the plan and receive awards. Awards can take the form of options, stock appreciation rights, stock awards and performance unit awards.

In October 2010, approximately 11,000 shares of restricted stock were issued to the executive management of the Company at a price of \$30.79 per share under the 2006 Plan. The restricted stock grant vests 33% per year over a three-year period on each anniversary of the grant date. Compensation expense is recognized over a three-year vesting period based on the \$30.79 price per share on the grant date.

In October 2009, 10,000 shares of restricted stock were issued to our President and Chief Executive Officer at a price of \$37.67 per share under the 2006 Plan. The restricted stock grant vests 20% per year over a five-year period on each anniversary of the grant date. Compensation expense is recognized over the five-year vesting period based on the \$37.67 price per share on the grant date.

We have a Restricted Stock Plan for the benefit of members of the Board of Directors of the Company who, at the time of their service, are not employees of the Company or any of its affiliates. Subject to certain conditions and restrictions as determined by the Compensation Committee of the Board of Directors and proportionate adjustments in the event of stock dividends, stock splits and similar corporate transactions, each eligible director will receive 2,000 shares of restricted stock annually. In June 2011, 16,000 shares of restricted stock were issued at a price of \$33.49 per share. The restricted stock grants vest 50% per year over a two-year period on each anniversary of the grant date. During the nine months ended June 30, 2011, we recorded compensation expense of approximately \$0.8 million related to restricted stock grants. We recorded compensation expense of approximately \$0.6 million related to restricted stock grants for the nine months ended June 30, 2010.

*Stock Options*

Stock option activity for the nine months ended June 30, 2011 was as follows:

|                                   | <b>Stock<br/>Options</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Remaining<br/>Weighted<br/>Average<br/>Contractual<br/>Term<br/>(Years)</b> | <b>Aggregate<br/>Intrinsic<br/>Value<br/>(in<br/>thousands)</b> |
|-----------------------------------|--------------------------|--|--|---|
| Outstanding at September 30, 2010 | 128,600                  | \$ 18.41   |  |   |
| Granted                           |                          |  |  |   |
| Exercised                         | (21,066)                 | 18.25  |  |   |
| Forfeited / Cancelled             | (4,000)                  | 18.44  |  |   |

Edgar Filing: POWELL INDUSTRIES INC - Form 10-Q

|                              |         |          |      |          |
|------------------------------|---------|----------|------|----------|
| Outstanding at June 30, 2011 | 103,534 | \$ 18.44 | 0.99 | \$ 1,909 |
| Exercisable at June 30, 2011 | 103,534 | \$ 18.44 | 0.99 | \$ 1,909 |

16

---

**Table of Contents****L. BUSINESS SEGMENTS**

We manage our business through operating segments, which are comprised of two reportable business segments: Electrical Power Products and Process Control Systems. Electrical Power Products includes equipment and systems for the distribution and control of electrical energy. Process Control Systems consists principally of instrumentation, computer controls, communications and data management systems to control and manage critical processes.

The table below reflects certain information relating to our operations by business segment. All revenues represent sales from unaffiliated customers. The accounting policies of the business segments are the same as those described in the summary of significant accounting policies. Corporate expenses are allocated to the operating business segments primarily based on revenues.

Detailed information regarding our business segments is shown below (in thousands):

|  | <b>Three Months Ended<br/>June 30,</b> |             | <b>Nine Months Ended<br/>June 30,</b> |             |
|--|--|-------------|---------------------------------------|-------------|
|  | <b>2011</b>                            | <b>2010</b> | <b>2011</b>                           | <b>2010</b> |
| Revenues:                              |  |             |                                       |             |
| Electrical Power Products              | \$ 135,191                             | \$ 129,396  | \$ 371,397                            | \$ 390,926  |
| Process Control Systems                | 6,944                                  | 9,484       | 21,010                                | 26,005      |
| Total                                  | \$ 142,135                             | \$ 138,880  | \$ 392,407                            | \$ 416,931  |
| Gross profit:                          |  |             |                                       |             |
| Electrical Power Products              | \$ 21,422                              | \$ 35,131   | \$ 69,637                             | \$ 103,158  |
| Process Control Systems                | 2,076                                  | 3,113       | 5,369                                 | 9,436       |
| Total                                  | \$ 23,498                              | \$ 38,244   | \$ 75,006                             | \$ 112,594  |
| Income before income taxes:            |  |             |                                       |             |
| Electrical Power Products              | \$ 2,689                               | \$ 14,939   | \$ 10,968                             | \$ 43,107   |
| Process Control Systems                | 140                                    | 910         | (390)                                 | 3,041       |
| Total                                  | \$ 2,829                               | \$ 15,849   | \$ 10,578                             | \$ 46,148   |
| Depreciation and amortization expense: |  |             |                                       |             |
| Electrical Power Products              | \$ 3,951                               | \$ 3,567    | \$ 11,325                             | \$ 9,813    |
| Process Control Systems                | 39                                     | 43          | 123                                   | 133         |
| Total                                  | \$ 3,990                               | \$ 3,610    | \$ 11,448                             | \$ 9,946    |

Income before income taxes includes a \$1.2 million gain recorded in the second quarter of fiscal 2011 resulting from cash received from the sale of our 50% equity investment in Kazakhstan. This gain is recorded in our Electrical Power Products business segment.

**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 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, 2010, which was filed with the Securities and Exchange Commission on December 8, 2010 and is available on the SEC's website at [www.sec.gov](http://www.sec.gov).*

**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 and capital spending. Forward-looking statements are generally accompanied by words such as estimate, project, predict, believe, expect, anticipate, plan, goal or other words that convey the uncertainty of future events or outcomes. 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:

The current economic uncertainty and financial market conditions have negatively impacted and may continue to impact our customer base, suppliers and backlogs.

Our operations could be adversely impacted by the Macondo well incident, the continuing effects from the U.S. government moratorium on offshore deepwater drilling projects and related new regulations.

Our industry is highly competitive.

International and political events may adversely affect our operations.

Fluctuations in the price and supply of raw materials used to manufacture our products may reduce our profits.

Our volume of fixed-price contracts and the use of percentage-of-completion accounting could result in volatility in our results of operations.

Our acquisition strategy involves a number of risks.

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

Our operating results may vary significantly from quarter to quarter.

We may be unsuccessful at generating profitable internal growth.



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.

**Table of Contents**

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

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

We may incur additional healthcare costs arising from federal healthcare reform legislation.

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

Catastrophic events could disrupt our business.

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 many of these factors in more detail in our Annual Report on Form 10-K for the year ended September 30, 2010. 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 of matters that are the subject of our forward-looking statements. 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.

**Overview**

We develop, design, manufacture and service custom engineered-to-order equipment and systems for the management and control of electrical energy and other critical processes. Headquartered in Houston, Texas, we serve the transportation, environmental, energy, industrial and utility industries. Our business operations are consolidated into two business segments: Electrical Power Products and Process Control Systems. Financial information related to these business segments is included in Note L of Notes to Condensed Consolidated Financial Statements. Revenues and costs are primarily related to engineered-to-order equipment and systems which precludes us from providing detailed price and volume information.

The markets in which Powell participates in are capital-intensive and cyclical in nature. Cyclicity is driven by customer demand, global economic markets and potential environmental or regulatory impacts which affect the manner in which our customers proceed with capital projects. Our customers analyze various factors including the short-term demand for oil and electrical energy, the overall banking environment, federal and state budgets, the outlook for offshore drilling and related regulatory actions and the drive towards environmental controls over the type and way energy is produced and utilized. These factors over the last two fiscal years have contributed to decisions by customers to delay or to change where they place new capital projects, which decreased our backlog of orders to \$282.3 million entering fiscal 2011, down \$83.5 million from the beginning of fiscal 2010. However, during the past nine months, orders received were \$600.4 million compared to \$360.2 million during the same nine-month period of fiscal 2010 and our backlog has increased to \$491.4 million at June 30, 2011. Some of our recent orders received are large petrochemical and offshore oil and gas construction projects which will take several months to produce and some were awarded in competitive bid situations. This increased competition, along with higher commodity prices, will place downward pressure on gross profit compared to last fiscal year as we work to fulfill these orders in fiscal 2011 and 2012.

In December 2009, we acquired the business and certain assets of PowerComm Inc. and its subsidiaries (referred to herein as Powell Canada) for \$23.4 million, excluding debt assumed of \$15.1 million and not including acquisition-related expenses. Powell Canada is headquartered in Edmonton, Alberta, Canada, and provides electrical and maintenance services. Powell Canada is also a manufacturer of switchgear and related products, primarily serving the oil and gas industry in western Canada. The operating results of Powell Canada are included in our Electrical Power Products business segment from the acquisition date.

**Results of Operations**

*Revenue and Gross Profit*

Consolidated revenues increased \$3.2 million to \$142.1 million in the third quarter of fiscal 2011 compared to \$138.9 million in the third quarter of fiscal 2010. For the third quarter of fiscal 2011, domestic revenues increased by 3.5% to \$96.8 million compared to

**Table of Contents**

the third quarter of 2010. Total international revenues remained comparable at \$45.3 million in the third quarter of 2011 compared to the third quarter of 2010. Gross profit for the third quarter of fiscal 2011, as compared to the third quarter of fiscal 2010, decreased by approximately \$14.7 million, to \$23.5 million, and gross profit as a percentage of revenues decreased to 16.5% in the third quarter of fiscal 2011, compared to 27.5% in the third quarter of fiscal 2010. The decrease in gross profit and gross profit as a percentage of revenues resulted from the mix of projects in our backlog which was awarded in a more competitive environment than projects in process in fiscal 2010. We anticipate continued pressure on gross margin levels going forward given the overall mix and pricing of jobs currently in our backlog.

For the nine months ended June 30, 2011, consolidated revenues decreased \$24.5 million to \$392.4 million compared to \$416.9 million for the nine months ended June 30, 2010. Revenues decreased as a result of reduced backlog at the beginning of fiscal 2011, as discussed above. For the first nine months of fiscal 2011, domestic revenues decreased by 13.2% to \$262.3 million compared to the first nine months of fiscal 2010. Total international revenues increased to \$130.1 million in the first nine months of 2011 compared to \$114.6 million in the first nine months of fiscal 2010. The acquisition of Powell Canada contributed approximately \$19.1 million of this increase in international revenues during the first nine months of 2011. Gross profit for the first nine months of fiscal 2011, as compared to the first nine months of fiscal 2010, decreased by approximately \$37.6 million, to \$75.0 million, as a result of the reduction in volume and pressure on margins, as discussed above. These factors also contributed to the decrease in gross profit as a percentage of revenues to 19.1% for the first nine months of fiscal 2011, compared to 27.0% for the first nine months of fiscal 2010.

*Electrical Power Products*

Our Electrical Power Products business segment recorded revenues of \$135.2 million in the third quarter of fiscal 2011, compared to \$129.4 million for the third quarter of fiscal 2010. In the third quarter of 2011, revenues from public and private utilities were approximately \$37.0 million, compared to \$32.7 million in the third quarter of fiscal 2010. Revenues from industrial and commercial customers totaled \$90.7 million in the third quarter of 2011, an increase of \$3.6 million compared to the third quarter of fiscal 2010. Municipal and transit projects generated revenues of \$7.5 million in the third quarter of fiscal 2011 compared to \$9.6 million in the third quarter of fiscal 2010. Business segment gross profit, as a percentage of revenues, was 15.8% in the third quarter of fiscal 2011, compared to 27.1% in the third quarter of fiscal 2010. This decrease in gross profit as a percentage of revenues resulted primarily from the pressure on margins, as discussed above. Gross profit in fiscal 2010 benefitted from the favorable execution of large projects, as well as cancellation fees and the successful negotiation of change orders on projects which were substantially completed in prior periods.

For the nine months ended June 30, 2011, our Electrical Power Products segment recorded revenues of \$371.4 million, compared to \$390.9 million for the nine months ended June 30, 2010. In the first nine months of fiscal 2011, revenues from public and private utilities were approximately \$101.5 million, compared to \$114.8 million in the first nine months of fiscal 2010. Revenues from commercial and industrial customers totaled \$249.1 million in the first nine months of fiscal 2011, an increase of \$1.1 million compared to the first nine months of fiscal 2010. Municipal and transit projects generated revenues of \$20.8 million in the first nine months of fiscal 2011, compared to \$28.1 million in the first nine months of fiscal 2010.

For the nine months ended June 30, 2011, gross profit from the Electrical Power Products business segment, as a percentage of revenues, was 18.8%, compared to 26.4% for the nine months ended June 30, 2010. This decrease in gross profit as a percentage of revenues resulted primarily from the reduction in volume and pressure on margins, as discussed above. The gross profit in 2010 benefitted from strong market demand when the projects were negotiated, reduced costs on project completion from operational efficiencies, a reduced work force, cancellation fees for orders that were cancelled from our backlog and the successful negotiation of change orders for which the costs were previously recognized.

*Process Control Systems*

Our Process Control Systems business segment recorded revenues of \$6.9 million in the third quarter of fiscal 2011, a decrease from \$9.5 million in the third quarter of fiscal 2010. Business segment gross profit, as a percentage of revenues, decreased to 29.9% in the third quarter of fiscal 2011 compared to 32.8% in the third quarter of fiscal 2010.

This decrease resulted from a less favorable mix of projects compared to the third quarter of fiscal 2010. For the nine months ended June 30, 2011, our Process Control Systems business segment recorded revenues of \$21.0 million, a decrease from \$26.0 million for the nine months ended June 30, 2010. Business segment gross profit decreased as a percentage of revenues to 25.6% for the first nine months of fiscal 2011, compared to 36.3% for the first nine months of fiscal 2010. This decrease in gross profit as a percentage of revenues is related to a less favorable mix of projects.

**Table of Contents**

For additional information related to our business segments, see Note L of Notes to Condensed Consolidated Financial Statements.

*Consolidated Selling, General and Administrative Expenses*

Consolidated selling, general and administrative expenses decreased to 13.7% of revenues in the third quarter of fiscal 2011 compared to 15.2% of revenues in the third quarter of fiscal 2010. Selling, general and administrative expenses were \$19.4 million for the third quarter of fiscal 2011, compared to \$21.1 million for the third quarter of fiscal 2010. These decreases are primarily due to reduced short-term and long-term incentive compensation resulting from lower earnings and a decrease in commissions and bad debt expense. Selling, general and administrative expenses decreased as a percentage of revenues as a result of our increase in revenues, along with the decreases discussed above.

For the nine months ended June 30, 2011, consolidated selling, general and administrative expenses increased to 15.8% of revenues, compared to 15.1% of revenues for the nine months ended June 30, 2010. Selling, general and administrative expenses were \$61.9 million for the first nine months of fiscal 2011, compared to \$62.8 million for the first nine months of fiscal 2010. This decrease is primarily related to reduced short-term and long-term incentive compensation resulting from lower earnings. In the prior year there were also acquisition related costs of approximately \$2.3 million related to the acquisition of Powell Canada. Selling, general and administrative expenses increased as a percentage of revenues as a result of our decline in revenues, along with the fact that portions of our sales and administrative support infrastructure is necessary to support our customers, invest in information systems, continue research and development and pursue project opportunities.

*Other Income*

Other income consists of a \$1.2 million gain recorded in the second quarter of fiscal 2011 resulting from cash received from the sale of our 50% equity investment in Kazakhstan.

*Interest Expense and Income*

Interest expense was \$88,000 and \$296,000 for the three and nine months ended June 30, 2011, respectively, a decrease of approximately \$140,000 and \$342,000 compared to the three and nine months ended June 30, 2010, respectively. The decrease in interest expense was primarily due to lower amounts outstanding under our credit facilities during the first nine months of fiscal 2011.

Interest income was approximately \$66,000 and \$173,000 for the three and nine months ended June 30, 2011, respectively, compared to approximately \$49,000 and \$206,000 for the three and nine months ended June 30, 2010, respectively.

*Provision for Income Taxes*

Our provision for income taxes reflects an effective tax rate on earnings before income taxes of 39.7% in the third quarter of fiscal 2011, compared to 34.9% in the third quarter of fiscal 2010. For the first nine months of fiscal 2011, our effective tax rate was 37.2%, compared to 35.1% for the first nine months of fiscal 2010. The effective tax rates for both the third quarter of fiscal 2011 and the first nine months of fiscal 2011 have been negatively impacted by our inability to record the tax benefit related to pre-tax losses in Canada, offset by the favorable impact on our effective tax rate for the domestic production activities deduction and the research and development credit in the United States.

*Net Income Attributable to Powell Industries, Inc.*

In the third quarter of fiscal 2011, we generated net income of \$1.7 million, or \$0.14 per diluted share, compared to \$10.3 million, or \$0.88 per diluted share, in the third quarter of fiscal 2010. For the nine months ended June 30, 2011, we recorded net income of \$6.6 million, or \$0.56 per diluted share, compared to \$29.8 million, or \$2.56 per diluted share, for the nine months ended June 30, 2010.

**Table of Contents*****Backlog***

The order backlog at June 30, 2011, was \$491.4 million, compared to \$282.3 million at September 30, 2010, and \$309.9 million at the end of the third quarter of fiscal 2010. New orders placed during the third quarter of fiscal 2011 totaled \$197.7 million compared to \$136.1 million in the third quarter of fiscal 2010. Backlog has increased primarily due to an increase in activity in petrochemical and offshore oil and gas construction projects.

***Liquidity and Capital Resources***

Cash and cash equivalents increased to approximately \$137.3 million at June 30, 2011, primarily as a result of cash flow provided by operations of approximately \$25.2 million during the first nine months of fiscal 2011. As of June 30, 2011, current assets exceeded current liabilities by 2.4 times and our debt to total capitalization was 2.0%.

At June 30, 2011, we had cash and cash equivalents of approximately \$137.3 million, compared to approximately \$115.4 million at September 30, 2010. We have a \$75.0 million revolving credit facility in the U.S., which expires in December 2016. As of June 30, 2011, there were no amounts borrowed under our U.S. line of credit. We also have a \$20.5 million revolving credit facility, which is subject to a borrowing base calculation as defined in the credit agreement, in Canada. At June 30, 2011, there was no balance outstanding under the Canadian revolving credit facility. Total long-term debt and capital lease obligations, including current maturities, totaled \$5.8 million at June 30, 2011, compared to \$6.9 million at September 30, 2010. Letters of credit outstanding were \$11.6 million at June 30, 2011, compared to \$15.2 million at September 30, 2010, which reduce our availability under our credit facilities. Amounts available under the U.S. revolving credit facility were approximately \$63.4 million at June 30, 2011. Amounts available under the Canadian revolving credit facility were approximately \$15.9 million at June 30, 2011. For further information regarding our debt, see Notes H and J of Notes to Condensed Consolidated Financial Statements.

We believe that cash and cash equivalents, projected cash flows from operations and borrowing capacity under our existing credit facilities should be sufficient to finance anticipated operating activities, capital improvements and debt repayments for the foreseeable future.

***Operating Activities***

Cash provided by operating activities was approximately \$25.2 million during the first nine months of fiscal 2011 and approximately \$52.2 million during the first nine months of fiscal 2010. Cash flow from operations is primarily influenced by demand for our products and services and is impacted as our progress billing milestones and payment terms with our customers are matched with the payment terms with our suppliers. Cash flow from operations decreased during the first nine months of fiscal 2011 compared to the same period in the prior year, primarily due to the reduction in income from operations.

***Investing Activities***

Investments in property, plant and equipment during the first nine months of fiscal 2011 totaled approximately \$4.1 million, compared to \$3.5 million during the first nine months of fiscal 2010. During the first nine months of fiscal 2011, we received cash of approximately \$1.2 million from the sale of our 50% equity investment in Kazakhstan. During the first nine months of fiscal 2010, we acquired Powell Canada for approximately \$23.4 million. Additionally, approximately \$0.6 million was paid to acquire the noncontrolling interest related to our joint venture in Singapore (Powell Asia), which has been strategically realigned from an operating entity to a sales and marketing function within Powell.

***Financing Activities***

Net cash used in financing activities was approximately \$0.7 million for the first nine months of fiscal 2011 and approximately \$6.0 million for the first nine months of fiscal 2010. During the first nine months of fiscal 2010, we repaid the outstanding balance of the deferred acquisition payable to General Electric Company of \$4.3 million.

***New Accounting Standards***

See Note A to our condensed consolidated financial statements included in this report for information on new accounting standards.

**Table of Contents****Critical Accounting Policies**

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, 2010.

**Outlook**

The markets in which Powell participates in are capital-intensive and cyclical in nature. Cyclicity is driven by customer demand, global economic markets and potential environmental or regulatory impacts which affect the manner in which our customers proceed with capital projects. Our customers analyze various factors including the short-term demand for oil and electrical energy, the overall banking environment, federal and state budgets, the outlook for offshore drilling and related regulatory actions and the drive towards environmental controls over the type and way energy is produced and utilized. These factors over the last two fiscal years have contributed to decisions by customers to delay or to change where they place new capital projects, which decreased our backlog of orders to \$282.3 million entering fiscal 2011, down \$83.5 million from the beginning of fiscal 2010. However, during the past nine months, orders received were \$600.4 million compared to \$360.2 million during the same nine-month period of fiscal 2010 and our backlog has increased to \$491.4 million at June 30, 2011. Some of our recent orders received are for large petrochemical and offshore oil and gas construction projects which will take several months to produce and some were awarded in competitive bid situations. This increased competition, along with higher commodity prices, has placed downward pressure on gross profit compared to last fiscal year as we work to fulfill these orders in fiscal 2011 and 2012.

Growth in demand for energy is expected to continue over the long term. New infrastructure investments will be needed to ensure the available supply of petroleum products. New power generation and distribution infrastructure will also be needed to meet the growing demand for electrical energy. New power generation plants will also be needed to replace the aging facilities across the United States, as those plants reach the end of their life cycle. A heightened concern for environmental damage, together with the uncertainty of gasoline prices, has expanded the popularity of urban transit systems, which should drive demand for investment in transit infrastructure, contingent upon available financing. Opportunities for future projects continue, however, the timing and pricing of many of these projects is difficult to predict. The demand for our products and services should continue to increase as investments in large capital-intensive infrastructure projects begin to receive funding and support. The increase in our backlog to \$491.4 million at June 30, 2011 resulted from several large projects awarded related to petrochemical and offshore oil and gas construction projects which will help solidify our backlog going into fiscal 2012.

**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 interest rates, foreign exchange rates and commodity prices.

**Interest Rate Risk**

We are subject to market risk resulting from changes in interest rates related to our floating rate bank credit facility. A hypothetical 100 basis point increase in variable interest rates would not 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, we have in the past and may in the future enter into such contracts. During each of the past three years, we have not experienced a significant effect on our business due to changes in interest rates.

**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.

## **Table of Contents**

The resulting translation adjustments are recorded as accumulated other comprehensive income (loss), a component of stockholders' equity in our 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. Our international operations are financed utilizing local credit facilities denominated in local currencies. Additionally, expenses associated with these transactions are generally contracted and paid for in the same local currencies. A 10% unfavorable change in the U.S. Dollar exchange rate, relative to other functional currencies in which we operate, would not materially impact our consolidated balance sheet at June 30, 2011.

During fiscal 2010 and the first nine months of fiscal 2011, we entered into nine foreign currency forward contracts to manage the volatility of future cash flows on certain long-term contracts that are denominated in the British Pound Sterling. The contracts are designated as cash flow hedges for accounting purposes. The changes in fair value related to the effective portion of the hedges are recognized as a component of accumulated other comprehensive income on our Condensed Consolidated Balance Sheets. At June 30, 2011, we recorded a net liability of approximately \$32,000 on our Condensed Consolidated Balance Sheets related to these transactions.

### **Commodity Price Risk**

We are subject to market risk from fluctuating market prices of certain raw materials. 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.

### **Market Risk**

We are also exposed to general market and other 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 producers, oil and gas pipelines, refineries, petrochemical plants, electrical power generators, public and private utilities, co-generation facilities, mining/metals operations, pulp and paper plants, transportation authorities, governmental agencies and other large 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.

### **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 Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Commission 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 Securities Exchange Act of 1934, as amended) 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, 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 Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission'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.

**Internal Control over Financial Reporting**

There has been no change in our internal control over financial reporting during the nine months ended June 30, 2011, that has

**Table of Contents**

materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Design and Operation of Control Systems**

Our management, including the CEO and CFO, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and breakdowns can occur because of simple errors or mistakes. Controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or personnel, or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

**PART II OTHER INFORMATION****Item 1. Legal Proceedings**

We are involved in various legal proceedings, claims and other disputes arising in the ordinary course of business which, in general, are subject to uncertainties and the outcomes are not predictable. We do not believe that the ultimate conclusion of these disputes could materially affect our financial position or results of operations.

**Item 1A. Risk Factors**

There are no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the fiscal year ended September 30, 2010.

**Item 6. Exhibits**

| <b>Number</b> | <b>Description of Exhibits</b>   |
|---------------|--|
| 3.1           | 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).   |
| 3.2           | By-laws of Powell Industries, Inc. (filed as Exhibit 3.2 to our Form 8-A/A filed November 1, 2004, and incorporated herein by reference).  |
| 10.1          | Ninth Amendment to Credit Agreement, dated as of May 18, 2011, among Powell Industries, Inc., as Parent, the subsidiaries of Powell Industries, Inc. identified therein, as Borrowers, Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C issues, and the Lenders party thereto (filed as Exhibit 10.1 to our Form 8-K dated May 28, 2011, and incorporated herein by reference). |
| *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         | 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.   |
| *32.2         |  |

Edgar Filing: POWELL INDUSTRIES INC - Form 10-Q

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.

\*101 Interactive Data File.

\* Filed herewith

25

---

**Table of Contents**

**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)

August 8, 2011  
Date

By: /s/ Patrick L. McDonald  
Patrick L. McDonald  
President and Chief Executive Officer  
(Principal Executive Officer)

August 8, 2011  
Date

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

26

---

**Table of Contents**

**EXHIBIT INDEX**

| <b>Number</b> | <b>Exhibit Title</b>   |
|---------------|--|
| 3.1           | 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).   |
| 3.2           | By-laws of Powell Industries, Inc. (filed as Exhibit 3.2 to our Form 8-A/A filed November 1, 2004, and incorporated herein by reference).  |
| 10.1          | Ninth Amendment to Credit Agreement, dated as of May 18, 2011, among Powell Industries, Inc., as Parent, the subsidiaries of Powell Industries, Inc. identified therein, as Borrowers, Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C issues, and the Lenders party thereto (filed as Exhibit 10.1 to our Form 8-K dated May 28, 2011, and incorporated herein by reference). |
| *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         | 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.   |
| *32.2         | 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.   |
| *101          | Interactive Data File.   |
| *             | Filed herewith   |