POWELL INDUSTRIES INC
Form 10-Q
September 11, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON D.C. 20549
FORM 10-Q

(Mark one)

þ **Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended July 31, 2006.**

or

o **Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from __________ to __________ .**

Commission File Number 001-12488

POWELL INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	88-0106100
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
8550 Mosley Drive, Houston, Texas	77075-1180
(Address of principal executive offices)	(Zip Code)

(713) 944-6900

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

o Yes þ No

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

Common Stock, par value $.01 per share; 10,909,946 shares outstanding as of September 6, 2006.

POWELL INDUSTRIES, INC. AND SUBSIDIARIES
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For the Quarter Ended July 31, 2006

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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)

	July 31, 2006 (Unaudited)	October 31, 2005
Assets		
Current Assets:		
Cash and cash equivalents	$ 27,833	$ 24,844
Marketable securities		8,200
Accounts receivable, less allowance for doubtful accounts of $825 and $567, respectively	84,549	65,385
Costs and estimated earnings in excess of billings on uncompleted contracts	39,767	35,328
Inventories, net	30,295	21,616
Income taxes receivable	44	507
Deferred income taxes	643	1,836
Prepaid expenses and other current assets	2,776	4,461
Total Current Assets	185,907	162,177
Property, plant and equipment, net	56,591	55,678
Goodwill	203	203
Intangible assets, net	4,625	3,505
Other assets	6,144	5,096
Total Assets	$ 253,470	$ 226,659
Liabilities and Stockholders Equity		
Current Liabilities:		
Current maturities of long-term debt and capital lease obligations	$ 3,415	$ 2,095
Income taxes payable	4,086	1,185
Accounts payable	31,214	22,104
Accrued salaries, bonuses and commissions	12,367	9,820
Billings in excess of costs and estimated earnings on uncompleted contracts	15,537	15,742
Accrued product warranty	3,384	1,836
Other accrued expenses	7,549	5,957
Total Current Liabilities	77,552	58,739
Long-term debt and capital lease obligations, net of current maturities	17,450	19,436
Deferred compensation	1,733	1,918
Other liabilities	1,526	1,871
Total Liabilities	98,261	81,964

Commitments and contingencies (Note G)

Minority interest	303	281
Stockholders Equity:		
Preferred stock, par value $.01; 5,000,000 shares authorized; none issued		
Common stock, par value $.01; 30,000,000 shares authorized; 11,001,733 and 11,001,733 shares issued, respectively; 10,907,546 and 10,849,278 shares outstanding, respectively	110	110
Additional paid-in capital	12,510	10,252
Retained earnings	143,665	136,670
Treasury stock, 94,187 and 152,455 shares, respectively, at cost	(847)	(1,417)
Accumulated other comprehensive income (loss)	432	(11)
Deferred compensation	(964)	(1,190)
Total Stockholders Equity	154,906	144,414
Total Liabilities and Stockholders Equity	$ 253,470	$ 226,659

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

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Powell Industries, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations (unaudited)
(In thousands, except per share data)

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2006	**2005**	**2006**	**2005**
Revenues	$ 104,021	$ 66,915	$ 286,265	$ 173,518
Cost of goods sold	84,928	54,354	231,652	145,556
Gross profit	19,093	12,561	54,613	27,962
Selling, general and administrative expenses	15,705	9,887	42,540	28,761
Income (loss) before interest, income taxes and minority interest	3,388	2,674	12,073	(799)
Interest expense	476	130	1,137	346
Interest income	(197)	(289)	(736)	(883)
Income (loss) before income taxes and minority interest	3,109	2,833	11,672	(262)
Income tax provision (benefit)	1,345	695	4,655	(680)
Minority interest in net income	7	6	22	7
Net income	$ 1,757	$ 2,132	$ 6,995	$ 411
Net earnings per common share:				
Basic	$ 0.16	$ 0.20	$ 0.64	$ 0.04
Diluted	$ 0.16	$ 0.19	$ 0.63	$ 0.04
Weighted average shares:				
Basic	10,888	10,775	10,869	10,757
Diluted	11,140	10,939	11,090	10,886

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

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Powell Industries, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows (unaudited)
(In thousands)

	Nine Months Ended July 31,	
	2006	**2005**
Operating Activities:		
Net income	$ 6,995	$ 411
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	4,906	3,244
Amortization of unearned restricted stock	138	91
Stock-based compensation	1,841	
Bad debt expense	254	30
Loss (gain) on disposition of assets	79	(21)
Net realized gain on available-for-sale securities		(28)
Deferred income taxes	(991)	(1,048)
Other	22	149
Changes in operating assets and liabilities:		
Accounts receivable, net	(18,681)	(19,961)
Costs and estimated earnings in excess of billings on uncompleted contracts	(4,238)	(5,680)
Inventories	(8,490)	(3,359)
Prepaid expenses and other current assets	2,174	(2,762)
Other assets	573	68
Accounts payable and income taxes payable	11,690	(770)
Accrued liabilities	5,578	128
Billings in excess of costs and estimated earnings on uncompleted contracts	(302)	1,473
Deferred compensation	(60)	351
Other liabilities	85	(37)
Net cash provided by (used in) operating activities	1,573	(27,721)
Investing Activities:		
Proceeds from sale of fixed assets	29	46
Proceeds from maturities and sales of available-for-sale securities		3,817
Purchases of property, plant and equipment	(4,803)	(3,226)
Proceeds from sale of short-term auction rate securities	8,200	43,060
Purchases of short-term auction rate securities		(5,000)
Acquisition of S&I		(18,460)
Acquisition of UMS	(1,524)	
Net cash provided by investing activities	1,902	20,237
Financing Activities:		
Borrowings on U.S. revolving line of credit	3,791	5,905
Payments on U.S. revolving line of credit	(3,791)	(5,905)

Borrowings on UK term loan		10,598
Payments on UK term loan	(1,107)	
Payments on UK revolving line of credit	(913)	
Proceeds from short-term financing	897	
Payments on short-term financing	(160)	
Payments on capital lease obligations	(73)	(119)
Debt issue costs		(461)
Tax benefit from exercise of stock options	134	234
Proceeds from exercise of stock options	640	1,350
Net cash (used in) provided by financing activities	(582)	11,602
Net increase in cash and cash equivalents	2,893	4,118
Effect of exchange rate changes on cash and cash equivalents	96	
Cash and cash equivalents at beginning of period	24,844	8,974
Cash and cash equivalents at end of period	$ 27,833	$ 13,092

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

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POWELL INDUSTRIES, INC. AND SUBSIDIARIES

Notes To Condensed Consolidated Financial Statements (Unaudited)

A. OVERVIEW AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Overview

We develop, design, manufacture and service equipment and systems for the management and control of electrical energy and other critical processes. Headquartered in Houston, Texas, we serve the transportation, environmental, 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 I herein.

Note B contains information related to our acquisitions of Switchgear & Instrumentation Limited in July 2005, herein referred to as S&I, and Utility Metering Specialists, Inc. in July 2006, herein referred to as UMS. The operating results of both acquisitions are included in our Electrical Power Products business segment.

Subsequent to the period covered by this report, we acquired certain assets from General Electric Company s Consumer and Industrial Division as described in Note K herein.

Basis of Presentation

The condensed consolidated financial statements include the accounts of Powell Industries, Inc. and its wholly-owned subsidiaries (we, us, our, Powell, or the Company). All significant intercompany accounts and transactions are eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared using accounting principles generally accepted in the United States of America (GAAP) for interim financial information in accordance with the rules of Regulation S-X of the Securities and Exchange Commission. Accordingly, these interim financial statements do not include all annual disclosures required by GAAP. These financial statements should be read in conjunction with the financial statements and related footnotes included in the Company s annual report on Form 10-K for the year ended October 31, 2005. In the opinion of management, these condensed consolidated financial statements include all adjustments, consisting of normal recurring adjustments that are necessary for a fair presentation of our financial position, results of operations and cash flows. The interim period results are not necessarily indicative of the results to be expected for the full fiscal year.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying footnotes. The amounts we record for insurance claims, warranties, legal and other contingent liabilities require judgments regarding the amount of expenses that will ultimately be incurred. We base our estimates on historical experience and on various other assumptions, as well as the specific circumstances surrounding these contingent liabilities, in evaluating the amount of liability that should be recorded. Estimates may change as new events occur, additional information becomes available, or operating environments change. Actual results may differ from our estimates. The most significant estimates used in our financial statements affect revenue and cost recognition for construction contracts, legal accruals, the allowance for doubtful accounts, self-insurance, warranty accruals and postretirement benefit obligations.

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Foreign Currency Translation

The functional currency for our foreign subsidiaries is the local currency in which the entity is located. The financial statements of all subsidiaries with a functional currency other than the U.S. Dollar have been translated into U.S. Dollars in accordance with Statement of Financial Accounting Standards No. 52, *Foreign Currency Translation*. All assets and liabilities of foreign operations are translated into U.S. Dollars using period-end exchange rates and all revenues and expenses are translated at average rates during the respective period. The U.S. Dollar results that arise from such translation, as well as exchange gains and losses on intercompany balances of a long-term investment nature, are included in the cumulative currency translation adjustments in accumulated other comprehensive income (loss) in stockholders equity.

Supplemental disclosures of cash flow information

	Nine Months Ended July 31,	
	2006	2005
Cash paid during the period for:		
Interest	$ 934	$ 326
Income taxes	2,645	562
Non-cash investing and financing activities:		
Change in fair value of marketable securities during the period, net of $0 and $9 income taxes, respectively	$	$ 26
Receivable for stock options exercised	24	
Issuance of common stock for deferred directors fees	24	14
Restricted stock grants	129	
Unrealized gain on forward contracts		13
Unrealized foreign currency gain/(loss)	443	(67)
Accrued acquisition costs		485

Stock-Based Compensation

In the first quarter of fiscal 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123R). We adopted the new statement using the modified prospective method of adoption, which does not require restatement of prior periods. The revised standard eliminated the intrinsic value method of accounting for share-based employee compensation under APB Opinion No. 25, *Accounting for Stock-Based Compensation*, which we previously used (see pro-forma disclosure of prior period included herein). The revised standard generally requires the recognition of the cost of employee services for share-based compensation based on the grant date fair value of the equity or liability instruments issued and any unearned or deferred compensation (contra-equity accounts) related to awards prior to adoption be eliminated against the appropriate equity accounts. Also under the new standard, excess income tax benefits related to share-based compensation expense that must be recognized directly in equity are considered financing rather than operating cash flow activities. The effect of the adoption of the new standard on cash flows in the third quarter of 2006 was not material.

Under SFAS No. 123R, we continue to use the Black-Scholes option pricing model to estimate the fair value of our stock options. However, we will apply the expanded guidance under SFAS No. 123R for the development of our assumptions used as inputs for the Black-Scholes option pricing model for grants issued after November 1, 2005. Expected volatility is determined using historical volatilities based on historical stock prices for a period equal to the expected term. The expected volatility assumption is adjusted if future volatility is expected to vary from historical experience. The expected term of options represents the period of time that options granted are expected to be outstanding and falls between the option s vesting and contractual expiration dates. The risk-free interest rate is based on the yield at the date of grant of a zero-coupon U.S. Treasury bond whose maturity period equals the option s expected term.

Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss), which is included as a component of stockholders equity net of tax, includes unrealized gains or losses on available-for-sale marketable securities, derivative instruments and currency translation adjustments in foreign consolidated subsidiaries.

New Accounting Pronouncement

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the Company s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes.* FIN 48 also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The provisions of FIN 48 are to be applied to all tax positions upon initial adoption of this standard. Only tax positions that meet the more likely than not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption of FIN 48. FIN 48 is effective for our fiscal year beginning October 1, 2007. The Company is currently evaluating the impact of adopting FIN 48.

Reclassifications

Certain reclassifications have been made in prior period financial statements to conform to current period presentation. These reclassifications had no effect on net income, financial position or cash flows.

B. ACQUISITION

Utility Metering Specialists, Inc. (UMS)

On July 14, 2006, we acquired certain assets and hired the service and administrative employees of an electrical services company in Louisiana for approximately $1.5 million. The purchase price was paid from existing cash and short-term marketable securities. This acquisition allows us to extend sales and service to the Eastern Gulf Coast Region. As this acquisition is not material to the consolidated financial results or financial position of the Company, no additional disclosure is included in these Notes to Condensed Consolidated Financial Statements. Approximately $1.5 million of the purchase price is included in intangible assets in the Condensed Consolidated Balance Sheets. The purchase price resulted primarily in additional intangible assets and as a result such amounts are subject to further adjustment as information becomes available.

Switchgear & Instrumentation Limited (S&I)

On July 4, 2005, we acquired selected assets and assumed certain operating liabilities and contracts of Switchgear & Instrumentation Limited. S&I s primary manufacturing facility is in the United Kingdom. This acquisition is part of our overall strategy to increase our international presence. S&I affords us the opportunity to serve our customers with products covering a wider range of electrical standards and opens new geographic markets previously closed due to a lack of product portfolio. The fit, culture and market position of Powell and S&I are favorably comparable with similar reputations in engineered-to-order solutions. S&I is a supplier of medium- and low-voltage switchgear, intelligent motor control systems, and power distribution solutions to a wide range of process industries, with a focus on oil and gas, petrochemical and other process-related industries. Total consideration paid for S&I was approximately $18.0 million (excluding expenses of approximately $1.2 million). Approximately $10.3 million was funded from existing cash and investments and the balance was provided from the UK Term Loan (as defined in Note F herein). The results of operations of S&I are included in our Condensed Consolidated Financial Statements from July 4, 2005. The Condensed Consolidated Balance Sheets include an allocation of the purchase price to the assets acquired and liabilities assumed based on estimates of fair value.

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The purchase price allocation was as follows (in thousands):

Accounts receivable	$ 4,730
Costs and estimated earnings in excess of billings	4,492
Inventories	3,745
Prepaid expenses and other current assets	379
Property, plant and equipment	9,542
Intangible assets	3,846
Accounts payable	(5,793)
Billings in excess of costs and estimated earnings	(1,440)
Other accrued expenses	(334)
Total purchase price	$ 19,167

The amounts assigned to property, plant and equipment were based on independent appraisals of the property and plant, as well as the more significant pieces of machinery and equipment.
The amounts allocated to intangible assets related to the S&I acquisition were as follows (in thousands):

	Amount	Estimated Life
Unpatented technology	$ 2,175	7 years
Tradenames	1,025	10 years
Backlog	646	6 months
Total	$ 3,846	

The unaudited pro forma data presented below reflects the results of Powell Industries, Inc. and the acquisition of S&I assuming the acquisition was completed on November 1, 2004 (in thousands, except per share data):

	Three Months Ended July 31, 2005	Nine Months Ended July 31, 2005
Revenues	$ 73,791	$ 213,880
Net income	$ 1,458	$ 246
Net earnings per common share:		
Basic	$ 0.14	$ 0.02
Diluted	$ 0.13	$ 0.02

The unaudited pro forma information includes the operating results of S&I prior to the acquisition date adjusted to include the pro forma impact of the following:

1) Impact of additional interest expense related to the portion of the purchase price financed with the UK Term Loan and lower interest income as a result of the sale of available-for-sale securities used to fund the remainder of the purchase price;

2) Elimination of the operating results of certain businesses of S&I which were not acquired;

3) Elimination of lease expense and recording of additional depreciation expense related to assets which were previously leased from S&I s previous parent;

4) Impact of amortization expense related to intangible assets;

5) Adjustment to the income tax provision to reflect the statutory rate in the United Kingdom.

The unaudited pro forma results above do not purport to be indicative of the results that would have been obtained if the acquisition occurred as of the beginning of the period presented or that may be obtained in the future.

Prior to the acquisition by Powell, S&I s operating results were reported under accounting principles generally accepted in the United Kingdom (UK GAAP). Revenues and costs related to long-term contracts accounted for under UK GAAP were not recognized on a percentage-of-completion basis of accounting. UK GAAP allows companies to recognize revenue on long-term contracts when the contract is complete (completed contract method). The unaudited pro forma results above were prepared based on the Company s best estimate of

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percentage-of-completion for long-term contracts under SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*.

C. EARNINGS PER SHARE

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

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2006	**2005**	**2006**	**2005**
Numerator:				
Net income	$ 1,757	$ 2,132	$ 6,995	$ 411
Denominator:				
Denominator for basic earnings per share-weighted average shares	10,888	10,775	10,869	10,757
Dilutive effect of stock options	252	164	221	129