

Pioneer Power Solutions, Inc.
First Quarter Fiscal 2014 Conference Call
May 15, 2014

Operator: Thank you for holding, ladies and gentlemen. Welcome to the Pioneer Power Solutions First Quarter Fiscal 2014 Conference Call on the 15th of May 2014. Throughout today's presentation, all participants will be in a listen-only mode. After the presentation, there will be an opportunity to ask questions. If anybody has difficulty hearing the presentation, please press the star, followed by the zero on your telephone for Operator assistance.

I will now hand the conference over to Andrew Minkow.
Please go ahead, sir.

Andrew Minkow: Thank you, Operator. Good day, and welcome to the Pioneer Power Solutions 2014 First Quarter Financial Results Conference Call. The call today will be hosted by Nathan Mazurek, Chairman and CEO, and by me Andrew Minkow, Chief Financial Officer. Following this discussion there will be a formal Q&A session open to participants on the call. We appreciate having the opportunity to review the results with you.

Before we get started, let me remind you that this call is being broadcast over the Internet and that a recording of the call and the text of Management's prepared remarks will be available on our website. During this call, we will be making forward-looking statements. These statements are based on current expectations and assumptions that are subject to risks and uncertainties that could cause actual results to differ materially. Please refer to the cautionary text regarding forward-looking statements contained in the earnings release issued today, and in the posted version of these prepared remarks, both of which apply to the content of this call.

I'll now turn the call over to our Chairman and CEO, Nathan Mazurek, for opening comments.

Nathan Mazurek: Thank you, Andrew. Good morning to everyone and thank you for joining us today for our conference call. I'll first discuss the business highlights for the first quarter. Then I'll turn the call over back to Andrew who will cover the financial results for the quarter, as well as our guidance for 2014. We will then open the call for questions and answers.

During the first quarter of 2014, we continued to make progress in expanding the business of our 2013 acquisition, primarily Pioneer Critical Power and Pioneer CEP (Custom Electrical Products). We view these two businesses as strategically important as they represent key growth drivers for 2014 and beyond. They help diversify our revenue by end-market and geography and, most importantly, we believe the capabilities of these businesses have brought us, and will continue to be a key differentiating factor in the eyes of our new and existing customers over the long

term. By adding to our overall size as a Company, these newest businesses are expected to help reduce the fluctuations we experience in our base business from quarter to quarter.

Case in point, in the first quarter last year, we benefited from a single large order delivered over several shipping dates, of our liquid-filled transformers to one particular oil and gas customer. In the first quarter of 2014, we shipped a number of notably large projects, but collectively, they were not enough to compare favorably to the first quarter of 2013 in terms of total sales.

As has always been the case for us, the timing of just a few customer orders can have an effect of skewing our quarterly results in a way that is misleading when trying to identify trends, in both directions, up and down. For that reason, internally, we will continue to only measure our performance on an annual basis.

Despite the unfavorable revenue comparison to last year's first quarter, we continue to deliver consistent profitability. Not addressed in the financial tables we've published is the fact that our bookings remain very strong. Our first quarter orders and ending backlog have both improved over what we reported at this time—at the same time last year. Furthermore, our orders in April were the strongest of any single month in our Company's history. Bookings surpassed the eight-figure level and our backlog grew by almost 25% as compared to the 25.4 million we reported as of March 31st, 2014.

I would like to reiterate that most of our business has long sales and production cycles, so these strong April 2014 bookings won't have as much effect on our second quarter as they will on our third and fourth quarters, and indeed, even on the beginning of the 2015 fiscal year. We are particularly encouraged by the momentum in the orders and sales from our two operations that we acquired in 2013, and this progress reinforces our confidence for the future.

Sales from these groups increased significantly on a sequential basis from approximately \$550,000 in the December quarter to 1.7 million in the March quarter. These businesses have also made meaningful contributions to our strong April bookings. Given our confidence in their long-term prospects, we recently accelerated our schedule for hiring additional sales, engineering and manufacturing personnel needed to continue to scale these businesses. This is expected to present a slight drag on our earnings in 2014, but we feel it is an appropriate investment that is necessary to meet our longer-term growth objectives.

We remain optimistic about where we are headed in 2014 and beyond. As Andrew will discuss in more detail in just a few seconds, we are not changing the full year guidance for 2014 that we gave you back in March. Although our quarterly business trends do not always move upwards on a steady sequential slope, our key indicators still suggest that the full year will shape up nicely and it would be

premature to change the commitments we made to the investment community earlier in the year.

I will now turn the call over to Andrew Minkow, our CFO, to provide details of our 2014 first quarter financial results.

Andrew Minkow: Thank you, Nathan. As Nathan mentioned, we made significant progress with our recent acquisitions, yet the year-over-year three-month comparisons were a bit of a challenge. Let's take a look at the results for the March quarter in a little more detail, and then I will address our 2014 guidance.

First quarter revenues were 20.9 million, down 7.4% from 22.6 million in the first quarter of 2013. Breaking this down further, the 1.7 million year-over-year decrease is net of a 1.7 million of incremental sales from our recently acquired businesses.

Pioneer Critical Power and Pioneer CEP delivered significant quarterly sequential growth and are tracking well to meet our full year guidance. The contribution of these businesses was offset by a 3.4 million decline from electrical transformer sales, which was driven by the impact of foreign currency translation of approximately 5%; the inclusion of a large project order that Nathan referenced earlier in the first quarter of 2013, which by its nature was non-recurring; and by declines in some of our least profitable short cycle sales channels.

The gross profit for the quarter was up to 4.9 million, or a 23.5% gross margin, compared to \$5.1 million of gross profit, or a 22.5% gross margin in the first quarter of 2013. Thus, our gross margin percentage increased by 1%. The gross margin improvement was driven by an overall shift in our sales mix towards more engineered to order transformers, and the addition of higher margin, switchgear type equipment in 2014, of which we sold almost none during 2013. Numerically though, transformers remain the biggest driver of our overall gross margin.

Our liquid-filled margin was down slightly due to a lower mix of largely long production run industrial jobs during the quarter. Our dry-type businesses, on the other hand, delivered strong gross margin increases thanks to the implementation of new cost savings initiatives and a mix of volume that was less weighted towards our least profitable catalog-type product categories.

For the quarter, selling, general and administrative expenses were approximately 4 million, or 19% of revenues, compared to just 3.5 million, or 15.6% of revenues in the previous year. The 12.7% increase in absolute dollars of SG&A was driven primarily by expenses related to new businesses we acquired during 2013, as well as an increase in our corporate G&A expense, consisting primarily of higher personnel, information technology and public Company costs.

As Nathan mentioned, we accelerated the hiring of people in several high-skill departments at our newly acquired operations, particularly at Pioneer CEP. This played a part in our higher operating expenses during the quarter, and is being done in anticipation of near-term business. The effort underscores our confidence in the scalability of these businesses throughout 2014.

Our operating income for the quarter decreased 34% to \$995,000, from 1.5 million in the first quarter of 2013. The decrease was driven by softer job-based revenue and higher SG&A, which were partially offset by an increase in our gross profit margins.

Our net earnings declined 35% in the quarter to \$590,000 from \$913,000 in the prior year's quarter. Our adjusted EBITDA was 1.4 million during the quarter compared to 1.9 million in the first quarter of 2013, and our non-GAAP EPS was \$0.10, down 44% from \$0.18 in the prior year. As a reminder, during 2013, we completed a follow-on offering of our common stock, increasing our share count significantly and diluting our EPS by approximately 22%. So the additional shares accounted for approximately half of the decrease in our EPS.

That concludes our prepared remarks on the operating statements. We would be happy to take clarifying questions later on the call.

Turning to the balance sheet, our process of de-levering, through internal cash flow continues. Our total debt is down to 10.9 million, as compared to 12.5 million in September of last year, immediately following the completion of our public offering. Our credit agreements generally limit us to a maximum leverage ratio of 2.75 times EBITDA, and we are currently at 1.3 times.

Although we show no cash on hand as of March 31, our quarterly liquidity position has never been stronger with over 10 million in available and un-drawn borrowing capacity under our revolving credit facilities. Our ratio of current assets to liabilities stands at 1.85 times to one, and we are very comfortable with our current liquidity position and overall balance sheet. Absent any future acquisitions, we have no foreseeable need to raise additional equity or debt capital.

Lastly, I'd like to provide you with an update on our full-year revenue, EBITDA and earnings guidance for 2014. We are not modifying our guidance for each of these metrics, which are for revenues in the range of 92 to 96 million, Adjusted EBITDA of between nine and 10 million, and non-GAAP diluted EPS of between \$0.75 and \$0.80. The underlying assumptions also remain the same, which I won't be reiterating in full right now, but does include a foreign exchange rate of \$0.90 to one Canadian dollar, which is expected to affect approximately 55% of our revenue, as compared to 60% in 2013.

Without any acquisitions, we expect our revenue to grow between 5 and 9%, led by our Critical Power and Pioneer CEP divisions, from which we

expect major gains in 2014, collectively growing from 1.8 million of 2013 sales, to between 10 million and 14 million in 2014. Critical Power is also expected to make a meaningful contribution to our bottom line, while Pioneer CEP is not budgeted to begin contributing profit until towards the end of the year.

In addition, our revenue and profit guidance considers the composition of our current backlog, which indicates that our strongest quarters are expected to be the third and fourth of 2014. For comparison purposes, the second and third quarters were our strongest during 2013.

Finally, the below-the-line item assumptions on our operating statement, we still expect a higher effective income tax rate at or above 30% and a higher share count at approximately 7.2 million, due to the full-year impact of the 2013 public offering.

This concludes my remarks, and I will now turn the call back over to Nathan.

Nathan Mazurek: Thank you, Andrew. To reiterate, we are increasingly enthusiastic about our business for 2014 and beyond. Through our most recent acquisitions, we are staged to deliver solid operating results for the full year of 2014, results we intend to exceed in 2015 by investing this year in those businesses and by appropriately positioning our organization now. I look forward to updating you as we continue to make progress in the upcoming quarters.

Operator, I'd like to open the call for questions, please.

Operator: Thank you, sir. If any participants would like to ask a question, please press the star, followed by the one on your telephone. If you wish to cancel this request, please press the star, followed by the two. Your questions will be polled in the order they are received. There will be a short pause while participants register for questions.

The first question comes from Philip Shen. Please go ahead, sir.

Philip Shen: Hey guys, thanks for taking my questions.

Nathan Mazurek: Our pleasure, Philip.

Philip Shen: So I'd like to start off with bookings. You guys had some nice bookings in Q1, as well as into April, if not the strongest in April ever for the Company. Can you talk to us about, you know, what happened? You know, what are you seeing in the business from your customers, and also give us a sense for what kind of bookings you expect in May, for example?

Nathan Mazurek: Yes, I mean, May—we're only halfway through May, so I'll go backwards—this is Nathan. You know, it's developing strongly, not as—you know, just like a quarter up or a quarter down, it doesn't—you know, it doesn't tell the whole story, you know, an unbelievable April doesn't mean that's going to happen again in May. They're strong in May as well. Not as sort of off the charts as April was.

It's just that kind of timing, you know. Certain big jobs get booked, both on the Critical Power—primarily on Critical Power and on the liquid-filled transformer side, and the CEP business really has gone from a zero backlog business to about a million dollars, which is, you know, which is a great testimony to them, and the fact that their backlog is now meaningful to us as a Company.

Philip Shen: Great. Can you share with us what backlog was at the end of Q1 '14 and what the—what it was one year ago?

Nathan Mazurek: Yes.

Andrew Minkow: Yes, I mean I—I think we can...

Nathan Mazurek: (Cross-talking) disclose it.

Andrew Minkow: It was—at the end of March, it was 25.4 million, (inaudible).

Philip Shen: Okay, great.

Nathan Mazurek: Year. (ph)

Andrew Minkow: So as of April the backlog is up almost 25% compared to March. It's above 20% but below 25%.

Philip Shen: Great. On the call, Andrew, I think you talked about—actually I think it was Nathan, but investments and sales and that it could be a slight drag on earnings in 2014. Can you talk to us about how much of an op ex increase we could see and how does op ex trend, by quarter, in 2014?

Andrew Minkow: I can't put a specific number on it for you right now. I can tell you that—as of January 1 through March 31—in our US operations, we have added seven more people, and some of them are in manufacturing/technical area of expertise that hit our gross margin, while other of the hires are impacting our operating expense (ph). So I'll have to get back to you at another time to put a better fix on those numbers, but—the reason we highlight it is not so much that we expect it to have a very significant impact on our overall operating expense ratio, as much as it is delaying by a little bit the time at which we expect our Los Angeles—our CEP operation—to begin being EBITDA positive.

Philip Shen: Great. One more question and I'll jump back in queue. In terms of, you know, acquisitions, what's your latest thinking? What do you see out there, anything near-term, in terms of where you're targeting? Perhaps you can characterize, you know, different...

Nathan Mazurek: Right, we're targeting...

Philip Shen: (Cross-talking).

Nathan Mazurek: Yes, we're targeting, you know, within our industry of electrical transmission and distribution. You know, within Critical Power, within CEP, related products to what we're doing and—that's just targeting. I'd say we're engaged in discussions with several—engaging serious discussions with several possibilities, some bigger, some smaller. We were very close in January, with another small publicly-traded business from a service side, for our Critical Power business, gave them everything they wanted and at the end of January, they decided to stay independent. February was a similar story but with a privately-held business in our space.

So we're out there. We can always do better on acquisitions, just as we can always do better executing the day-to-day business, but we're engaged.

Philip Shen: Okay, great. That's helpful. Thanks, Nathan. I'll jump back in queue.

Operator: Thank you. Once again, if you would like to ask a question, please press the star, followed by the one on your telephone. To cancel, press the star, followed by the two.

Once again, it's the star, followed by the one, or star, followed by the two to cancel your request.

There are no further questions at this time, sir.

Nathan Mazurek: Okay, thank you Operator. Thank you all for joining.

Operator: This concludes today's conference call. Thanks for participating.