

PIONEER POWER SOLUTIONS, INC.

Form 10-Q

May 15, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2014

OR

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

Commission file number: 001-35212

PIONEER POWER SOLUTIONS, INC.

(Exact name of registrant as specified in its charter)

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Delaware 27-1347616  
(State of incorporation) (I.R.S. Employer Identification No.)

400 Kelby Street, 9th Floor

Fort Lee, New Jersey 07024

(Address of principal executive offices)

(212) 867-0700

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

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

| Class                           | Outstanding at May 14, 2014 |
|---------------------------------|-----------------------------|
| Common Stock, \$0.001 par value | 7,172,255                   |

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PIONEER POWER SOLUTIONS, INC.

Form 10-Q

For the Quarter Ended March 31, 2014

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

PIONEER POWER SOLUTIONS, INC.

Consolidated Statements of Earnings

(In thousands, except per share data)

(Unaudited)

|                                             | Three Months Ended<br>March 31, |           |
|---------------------------------------------|---------------------------------|-----------|
|                                             | 2014                            | 2013      |
| Revenues                                    | \$ 20,893                       | \$ 22,551 |
| Cost of goods sold                          | 15,973                          | 17,470    |
| Gross profit                                | 4,920                           | 5,081     |
| Operating expenses                          |                                 |           |
| Selling, general and administrative         | 3,969                           | 3,521     |
| Foreign exchange (gain) loss                | (44)                            | 61        |
| Total operating expenses                    | 3,925                           | 3,582     |
| Operating income                            | 995                             | 1,499     |
| Interest expense                            | 136                             | 185       |
| Other expense                               | 2                               | 93        |
| Earnings before income taxes                | 857                             | 1,221     |
| Provision for income taxes                  | 267                             | 308       |
| Net earnings                                | \$ 590                          | \$ 913    |
| Earnings per common share:                  |                                 |           |
| Basic                                       | \$ 0.08                         | \$ 0.15   |
| Diluted                                     | \$ 0.08                         | \$ 0.15   |
| Weighted average common shares outstanding: |                                 |           |
| Basic                                       | 7,172                           | 5,907     |
| Diluted                                     | 7,249                           | 5,919     |

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

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PIONEER POWER SOLUTIONS, INC.

Consolidated Statements of Comprehensive Income (Loss)

(In thousands)

(Unaudited)

|                                                                  | Three Months<br>Ended<br>March 31, |        |
|------------------------------------------------------------------|------------------------------------|--------|
|                                                                  | 2014                               | 2013   |
| Net earnings                                                     | \$ 590                             | \$ 913 |
| Other comprehensive income (loss), net of tax:                   |                                    |        |
| Foreign currency translation adjustments                         | (676)                              | (134)  |
| Amortization of net prior service costs and net actuarial losses | 63                                 | 53     |
| Other comprehensive loss                                         | (613)                              | (81)   |
| Comprehensive income (loss)                                      | \$ (23)                            | \$ 832 |

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

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## PIONEER POWER SOLUTIONS, INC.

## Consolidated Balance Sheets

(In thousands)

|                                                                              | March 31,<br>2014<br>(Unaudited) | December<br>31,<br>2013 |
|------------------------------------------------------------------------------|----------------------------------|-------------------------|
| <b>ASSETS</b>                                                                |                                  |                         |
| Current Assets                                                               |                                  |                         |
| Cash and cash equivalents                                                    | \$ -                             | \$ 425                  |
| Accounts receivable, net                                                     | 12,371                           | 9,739                   |
| Inventories, net                                                             | 13,393                           | 12,643                  |
| Income taxes receivable                                                      | 62                               | 65                      |
| Deferred income taxes                                                        | 2,188                            | 1,982                   |
| Prepaid expenses and other current assets                                    | 1,373                            | 1,291                   |
| Total current assets                                                         | 29,387                           | 26,145                  |
| Property, plant and equipment                                                | 11,796                           | 12,213                  |
| Noncurrent deferred income taxes                                             | 1,067                            | 1,091                   |
| Other assets                                                                 | 1,180                            | 1,129                   |
| Intangible assets, net                                                       | 5,162                            | 5,285                   |
| Goodwill                                                                     | 7,950                            | 7,998                   |
| Total assets                                                                 | \$ 56,542                        | \$ 53,861               |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                                  |                                  |                         |
| Current Liabilities                                                          |                                  |                         |
| Bank overdrafts                                                              | \$ 1,619                         | \$ -                    |
| Revolving credit facilities                                                  | 1,614                            | 795                     |
| Accounts payable and accrued liabilities                                     | 10,020                           | 8,370                   |
| Current maturities of long-term debt and capital lease obligations           | 2,114                            | 2,108                   |
| Income taxes payable                                                         | 490                              | 1,072                   |
| Total current liabilities                                                    | 15,857                           | 12,345                  |
| Long-term debt, net of current maturities                                    | 6,524                            | 7,205                   |
| Pension deficit                                                              | 107                              | 213                     |
| Noncurrent deferred income taxes                                             | 3,248                            | 3,306                   |
| Total liabilities                                                            | 25,736                           | 23,069                  |
| Shareholders' Equity                                                         |                                  |                         |
| Preferred stock, par value \$0.001; 5,000,000 shares authorized; none issued | -                                | -                       |
|                                                                              | 7                                | 7                       |

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Common stock, par value \$0.001; 30,000,000 shares authorized; 7,172,255 shares issued and outstanding

|                                            |           |           |
|--------------------------------------------|-----------|-----------|
| Additional paid-in capital                 | 16,201    | 16,164    |
| Accumulated other comprehensive loss       | (2,042)   | (1,429)   |
| Retained earnings                          | 16,640    | 16,050    |
| Total shareholders' equity                 | 30,806    | 30,792    |
| Total liabilities and shareholders' equity | \$ 56,542 | \$ 53,861 |

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

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## PIONEER POWER SOLUTIONS, INC.

## Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

|                                                         | Three Months Ended<br>March 31, |         |
|---------------------------------------------------------|---------------------------------|---------|
|                                                         | 2014                            | 2013    |
| Operating activities                                    |                                 |         |
| Net earnings                                            | \$ 590                          | \$ 913  |
| Depreciation                                            | 325                             | 288     |
| Amortization of intangibles                             | 79                              | 71      |
| Deferred tax expense                                    | (237)                           | (195)   |
| Accrued pension                                         | (98)                            | (72)    |
| Stock-based compensation                                | 36                              | 78      |
| Foreign currency remeasurement gain                     | (117)                           | -       |
| Changes in current operating assets and liabilities:    |                                 |         |
| Accounts receivable, net                                | (2,875)                         | (1,433) |
| Inventories                                             | (1,024)                         | (110)   |
| Prepaid expenses and other assets                       | (64)                            | (521)   |
| Income taxes                                            | (545)                           | (540)   |
| Accounts payable and accrued liabilities                | 1,780                           | (79)    |
| Net cash used in operating activities                   | (2,150)                         | (1,600) |
| Investing activities                                    |                                 |         |
| Additions to property, plant and equipment              | (240)                           | (1,161) |
| Business acquisitions, net of cash acquired             | -                               | (655)   |
| Note receivable                                         | (83)                            | -       |
| Net cash used in investing activities                   | (323)                           | (1,816) |
| Financing activities                                    |                                 |         |
| Increase in bank overdrafts                             | 1,619                           | 1,157   |
| Increase in revolving credit facilities                 | 734                             | 2,555   |
| Repayment of long-term debt                             | (413)                           | (541)   |
| Net cash provided by financing activities               | 1,940                           | 3,171   |
| Decrease in cash and cash equivalents                   | (533)                           | (244)   |
| Effect of foreign exchange on cash and cash equivalents | 108                             | (27)    |

Cash and cash equivalents

|                   |      |        |
|-------------------|------|--------|
| Beginning of year | 425  | 467    |
| End of period     | \$ - | \$ 196 |

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

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1.Basis of Presentation

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

These unaudited consolidated financial statements have been prepared pursuant to the rules of the Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures, normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”), have been condensed or omitted pursuant to those rules and regulations. We believe that the disclosures made are adequate to make the information presented not misleading. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary to fairly state the financial position, results of operations and cash flows with respect to the interim consolidated financial statements have been included. The results of operations for the interim period are not necessarily indicative of the results for the entire fiscal year. The year-end balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP for a year end balance sheet.

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

2.Summary of Significant Accounting Policies

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

Recent Accounting Pronouncements

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

In March 2013, the FASB issued Update No. 2013-05, "Foreign Currency Matters (Topic 830)—Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity." The amendments in this Update resolve the diversity in practice about whether Subtopic 810-10, Consolidation—Overall, or Subtopic 830-30, Foreign Currency Matters—Translation of Financial Statements, applies to the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business (other than a sale of in substance real estate or conveyance of oil and gas mineral rights) within a foreign entity. In addition, the amendments in this Update resolve the diversity in practice for the treatment of business combinations achieved in stages (sometimes also referred to as step acquisitions) involving a foreign entity. For public entities, the amendments in this ASU are effective prospectively for fiscal years, and interim reporting periods within those years, beginning after December 15, 2013. The adoption of this amendment did not have a material impact on the Company's consolidated financial statements.

In July 2013, the FASB issued Update No. 2013-11, "Income Taxes (Topic 740)—Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists." The amendments in this ASU provide guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, similar tax loss, or tax credit carryforward exists. The amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013 and should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Early adoption and retrospective application is permitted. The adoption of this amendment did not have a material impact on the Company's consolidated financial statements.

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3. Inventories

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

|                                             | March<br>31,<br>2014 | December<br>31,<br>2013 |
|---------------------------------------------|----------------------|-------------------------|
| Raw materials                               | \$ 5,733             | \$ 5,210                |
| Work in process                             | 3,342                | 2,635                   |
| Finished goods                              | 4,507                | 5,125                   |
| Provision for excess and obsolete inventory | (189)                | (327)                   |
| Total inventories                           | \$ 13,393            | \$ 12,643               |

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

4. Goodwill and Other Intangible Assets

Changes in goodwill and intangible asset balances for the three months ended March 31, 2014, consisted of the following (in thousands):

|                                 | Goodwill | Intangible<br>assets |
|---------------------------------|----------|----------------------|
| Balance as of December 31, 2013 | \$ 7,998 | \$ 5,285             |
| Amortization                    | -        | (79)                 |
| Foreign currency translation    | (48)     | (44)                 |
| Balance as of March 31, 2014    | \$ 7,950 | \$ 5,162             |

The components of intangible assets as of March 31, 2014 are summarized below (in thousands):

|                                            | Intangible<br>assets | Accumulated<br>amortization | Foreign<br>currency<br>translation | Net<br>book<br>value |
|--------------------------------------------|----------------------|-----------------------------|------------------------------------|----------------------|
| Customer relationships                     | \$ 2,962             | \$ (937)                    | \$ (102)                           | \$ 1,923             |
| Non-compete agreements                     | 465                  | (153)                       | (2)                                | 310                  |
| Trademarks                                 | 2,049                | -                           | (33)                               | 2,016                |
| Technology-related industry accreditations | 950                  | -                           | (37)                               | 913                  |
| Total intangible assets                    | \$ 6,426             | \$ (1,090)                  | \$ (174)                           | \$ 5,162             |

## 5. Other Assets

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

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

6. Debt

Canadian Credit Facilities

The Company's Canadian subsidiaries have maintained credit facilities with Bank of Montreal since October 2009. In June 2011, Pioneer Electrogroupp Canada Inc., together with its subsidiaries, Pioneer Transformers Ltd. and Bemag Transformer Inc., entered into a letter loan agreement with Bank of Montreal (the "Canadian Facilities") that replaced and superseded all prior financing arrangements with the bank. Bemag Transformer Inc. became a party to the Canadian Facilities on July 1, 2011, upon the acquisition of all of its capital shares by the Company.

The Canadian Facilities provide for up to \$23.0 million Canadian dollars ("CAD") (approximately \$20.8 million expressed in U.S. dollars) consisting of a \$10.0 million demand revolving credit facility ("Facility A") to finance ongoing operations, a \$2.0 million term credit facility ("Facility B") that financed a plant expansion, a \$10.0 million term credit facility ("Facility C") to finance acquisitions, capital expenditures or to provide funding to the Company's U.S. operations, a \$50,000 Corporate MasterCard credit facility ("Facility D") and a \$1.0 million foreign exchange settlement risk facility ("Facility E").

The Canadian Facilities are secured by a first-ranking lien in the amount of approximately \$30 million CAD on all of the present and future movable and immovable property of the Company's Canadian subsidiaries.

The Canadian Facilities require the Company's Canadian operations to comply on a consolidated basis with various financial covenants, including maintaining a minimum fixed charge coverage ratio of 1.25, a maximum funded debt to EBITDA ratio of 2.75 and a limitation on funded debt to less than 60% of capitalization. The Canadian Facilities also restrict the ability of the Company's Canadian operations to, among other things, (i) provide any funding to any person, including affiliates, in an aggregate amount exceeding \$5.0 million CAD or (ii) make distributions in an aggregate amount exceeding 50% of Pioneer Electrogroupp Canada Inc.'s previous year's net income.

Facility A is subject to margin criteria and borrowings bear interest at the bank's prime rate plus 0.50% per annum on amounts borrowed in Canadian dollars, or the bank's U.S. base rate plus 0.50% per annum or LIBOR plus 2.00% per annum on amounts borrowed in U.S. dollars.

Borrowings under Facility B bear interest at the bank's prime rate plus 1.00% per annum with principal repayments becoming due on a five year amortization schedule.

Borrowings under Facility C are repayable according to a five year principal amortization schedule and bear interest at the following rates: if the funded debt to EBITDA ratio is equal to or greater than 2.00, the bank's prime rate plus 1.25% per annum on amounts borrowed in Canadian dollars, or the U.S. base rate plus 1.25% per annum or LIBOR plus 2.50% per annum on amounts borrowed in U.S. dollars; or, if the funded debt to EBITDA ratio is less than 2.00, the bank's prime rate plus 1.00% per annum on amounts borrowed in Canadian dollars, or the U.S. base rate plus 1.00% per annum or LIBOR plus 2.25% per annum on amounts borrowed in U.S. dollars. In addition, Facility C is subject to a standby fee which is calculated monthly using the unused portion of the facility at either 0.625% per annum if the funded debt to EBITDA ratio is equal to or greater than 2.00, or 0.5625% per annum if the funded debt to EBITDA ratio is less than 2.00.

On June 28, 2013, Pioneer Electrogroupp Canada Inc. and certain subsidiary guarantors amended and restated the Canadian Facilities with Bank of Montreal in order to, among other things, provide an additional six months to borrow any amounts not already drawn from Facility C. The Company also entered into a guaranty agreement to guarantee the obligations under the Canadian Facilities.

On January 1, 2014, the three former subsidiaries of Pioneer Electrogroupp Canada Inc., consisting of Pioneer Transformers Ltd., Bemag Transformer Inc. and Pioneer Wind Energy Systems Inc., were vertically amalgamated into Pioneer Electrogroupp Canada Inc., which now continues as the sole borrower under the Canadian Facilities.

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As of March 31, 2014, the Company had approximately \$7.6 million in U.S. dollar equivalents outstanding under the Canadian Facilities and was in compliance with its financial covenant requirements. The Company's borrowings consisted of approximately \$0 outstanding under Facility A, \$1.0 million outstanding under Facility B and \$6.6 million outstanding under Facility C.

United States Credit Facilities

The Company's Jefferson Electric, Inc. subsidiary had a loan agreement with Johnson Bank that included a revolving credit facility with a borrowing base limit of \$6.0 million and a term credit facility which was repaid in full during July 2012. In October 2012, the loan agreement was amended to reduce the interest rate under the revolving credit facility to a floating rate subject to a pricing grid, ranging from 2.25% to 3.50% above one month LIBOR, depending on Jefferson Electric, Inc.'s debt service coverage ratio. Borrowings under the Johnson Bank loan agreement were collateralized by substantially all the U.S. assets of Jefferson Electric, Inc., and an officer of the subsidiary was a guarantor. The Johnson Bank loan agreement, as amended, required Jefferson Electric, Inc. to comply with certain financial covenants, including a requirement to exceed a minimum target for tangible net worth and maintain a minimum debt service coverage ratio. The loan agreement also restricted Jefferson Electric, Inc.'s ability to pay dividends or make distributions, advances or other transfers of assets.

On June 28, 2013, the Company and its wholly-owned U.S. subsidiaries entered into a credit agreement with Bank of Montreal, Chicago Branch (the "U.S. Facilities"). The U.S. Facilities consist of a \$10.0 million demand revolving credit facility that was used to pay off all amounts outstanding under the Johnson Bank loan agreement and is intended to be used to finance ongoing operations; and a \$6.0 million term loan commitment that was available to be drawn by the Company for a period of six months, with principal repayments becoming due on a five year amortization schedule, that was to be used to finance certain permitted acquisitions by the Company and its subsidiaries.

The U.S. Facilities, as amended, require the Company to comply with a two-step test of financial covenants. First, if the Company's funded debt to adjusted EBITDA ratio is less than or equal to 2.75x and its fixed charge coverage ratio is at or above 1.25x, then no further compliance tests are required. Alternatively, the Company may comply with the financial covenant requirements of the U.S. Facilities if its U.S. operations comply with various financial covenants, including (a) maintaining a minimum fixed charge coverage ratio of (i) 1.25 for fiscal quarters ending June 30, 2013 to December 31, 2013, and (ii) 1.35 for fiscal quarters ending on or after March 31, 2014, (b) limiting funded debt to less than 50% of capitalization, and (c) maintaining a maximum funded debt to adjusted EBITDA ratio of (i) 5.25 for fiscal quarters ending June 30, 2013 to December 31, 2013, (ii) 5.00 for the fiscal quarter ending March 31, 2014, (iii) 4.50 for the fiscal quarter ending June 30, 2014, (iv) 4.00 for the fiscal quarter ending September 30, 2014, and (v) 3.75 for fiscal quarters ending on or after December 31, 2014. The U.S. Facilities also restrict the ability of the

Company and its U.S. subsidiaries to incur indebtedness, create or incur liens, make investments, make distributions or dividends and enter into merger agreements or agreements for the sale of any or all assets.

Borrowings under the demand revolving credit facility bear interest, at the Company's option, at the bank's prime rate plus 1.00% per annum on U.S. prime rate loans, or an adjusted LIBOR rate plus 2.25% per annum on Eurodollar loans. Borrowings under the term loan facility bore interest, at the Company's option, at the bank's prime rate plus 1.25% per annum on U.S. prime rate loans, or an adjusted LIBOR rate plus 2.50% per annum on Eurodollar loans. In addition, the term loan facility was subject to a standby fee from June 28, 2013 to December 28, 2013, which was calculated monthly, using the unused portion of the facility, at a rate of 0.625% per annum.

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

As of March 31, 2014, the Company had approximately \$1.6 million outstanding under the demand revolving credit facility and was in compliance with its financial covenant requirements.

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Nexus Promissory Note

On July 25, 2012, the Company's indirect wholly owned Mexican subsidiary, Nexus Magneticos de Mexico, S. de R.L. de C.V. ("Nexus"), entered into a term loan agreement with GE CF Mexico, S.A. de C.V. ("GE Capital Mexico"). At closing, GE Capital Mexico advanced to Nexus \$1.65 million under the term loan agreement, less a non-refundable commission of 1% and less a pledge of cash representing 10% of the loan amount. Immediately upon receiving the term loan advance, Nexus made an intercompany loan in the same principal amount to Jefferson Electric, Inc., its controlling shareholder. In turn, Jefferson Electric, Inc. used the intercompany loan proceeds to repay a portion of its outstanding secured indebtedness owed to its U.S. bank. The net proceeds were used by Jefferson Electric, Inc. to fully repay the principal and accrued interest that was then outstanding under its term credit facility with its U.S. bank, as well as to reduce the outstanding balance under its revolving credit facility.

The term loan from GE Capital Mexico is payable in 60 consecutive monthly installments and bears interest, payable monthly, at a rate of 6.93% per annum. The term loan may be prepaid by Nexus in increments of at least \$100,000, subject to the application of certain prepayment and other fees as established in the term loan agreement, which fees were waived in the case of a \$250,000 prepayment made by the Company in December 2013. The term loan agreement contains customary representations and warranties, affirmative and negative covenants and events of default, including covenants that restrict Nexus' ability to create certain liens, incur additional liabilities, make certain types of investments, engage in mergers, consolidations, significant asset sales and affiliate transactions, pay dividends, redeem or repurchase outstanding equity and make capital expenditures.

The obligations of Nexus under the term loan are secured by (i) a pledge of cash in the amount of 10% of the term loan amount, (ii) a trust agreement, pursuant to which Nexus and Jefferson Electric, Inc. transferred title to substantially all of their equipment and machinery assets located in Mexico to a Mexican bank as trustee, to serve as security for all of Nexus' obligations under the term loan agreement, and (iii) a corporate guaranty by the Company of all of Nexus' obligations under the term loan agreement.

Pico Promissory Note

On August 19, 2013, in connection with the acquisition of certain assets from Pico Electrical Equipment, Inc. and Pico Metal Products, Inc., the Company's Pioneer Custom Electrical Products Inc. subsidiary issued a \$455,000 non-interest bearing promissory note to the sellers of the assets. The promissory note is payable in six installments of principal ending on June 19, 2014. The obligations under the Pico promissory note are secured by (i) a security agreement, pursuant to which the note holders were granted a security interest in certain equipment and other collateral owned by Pioneer Custom Electrical Products Inc., and (ii) a corporate guaranty by the Company of all of Pioneer Custom

Electrical Products Inc.'s obligations under the Pico promissory note.

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

|                                          | March<br>31,<br>2014 | December<br>31,<br>2013 |
|------------------------------------------|----------------------|-------------------------|
| Term credit facilities                   | \$ 7,611             | \$ 8,239                |
| Nexus promissory note                    | 777                  | 824                     |
| Pico promissory note                     | 250                  | 250                     |
| Total debt and capital lease obligations | 8,638                | 9,313                   |
| Less current portion                     | (2,114)              | (2,108)                 |
| Total long-term debt                     | \$ 6,524             | \$ 7,205                |

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## 7.Shareholders' Equity

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

As of March 31, 2014, the Company had warrants outstanding to purchase 690,600 shares of common stock with a weighted average exercise price of \$13.49 per share. The warrants expire on dates beginning on April 19, 2014 and ending on September 18, 2018. No warrants were exercised during the three months ended March 31, 2014.

The board of directors is authorized, subject to any limitations prescribed by law, without further vote or action by the shareholders, to issue from time to time up to 5,000,000 shares of preferred stock, \$0.001 par value, in one or more series. Each such series of preferred stock shall have such number of shares, designations, preferences, voting powers, qualifications, and special or relative rights or privileges as shall be determined by the board of directors, which may include, among others, dividend rights, voting rights, liquidation preferences, conversion rights and preemptive rights.

## 8.Stock-Based Compensation

A summary of stock option activity under the 2011 Long-Term Incentive Plan as of March 31, 2014, and changes during the three months ended March 31, 2014, are presented below:

|                                     | Stock<br>Options | Weighted<br>average<br>exercise<br>price | Weighted<br>average remaining<br>contractual term | Aggregate<br>intrinsic<br>value |
|-------------------------------------|------------------|------------------------------------------|---------------------------------------------------|---------------------------------|
| Outstanding as of December 31, 2013 | 261,400          | \$ 9.81                                  | 6.9                                               | \$ 471,300                      |
| Granted                             | 105,000          | 10.21                                    | 9.9                                               | -                               |
| Exercised                           | -                | -                                        | -                                                 | -                               |

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|                                  |         |          |     |            |
|----------------------------------|---------|----------|-----|------------|
| Forfeited                        | -       | -        | -   | -          |
| Outstanding as of March 31, 2014 | 366,400 | \$ 9.92  | 7.6 | \$ 471,300 |
| Exercisable as of March 31, 2014 | 202,400 | \$ 11.10 | 6.2 | \$ 268,399 |

As of March 31, 2014, there were 333,600 shares available for future grants under the Company's 2011 Long-Term Incentive Plan.

Expense for stock-based compensation recorded for the three months ended March 31, 2014 and 2013 was approximately \$36,000 and \$67,000, respectively. At March 31, 2014, the Company had total stock-based compensation expense remaining to be recognized in the statement of earnings of approximately \$0.6 million.

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9. Pension Plan

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

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

|                                                     | Three Months<br>Ended<br>March 31, |       |
|-----------------------------------------------------|------------------------------------|-------|
|                                                     | 2014                               | 2013  |
| Current service cost, net of employee contributions | \$ 11                              | \$ 17 |
| Interest cost on accrued benefit obligation         | 32                                 | 32    |
| Expected return on plan assets                      | (42)                               | (41)  |
| Amortization of transitional obligation             | 3                                  | 3     |
| Amortization of past service costs                  | 2                                  | 2     |
| Amortization of net actuarial gain                  | 9                                  | 15    |
| Total cost of benefit                               | \$ 15                              | \$ 28 |

The Company's policy is to fund the pension plan at or above the minimum level required by law. The Company made \$27,000 and \$28,000 of contributions to its defined benefit pension plan during the three months ended March 31, 2014 and 2013, respectively. Changes in the discount rate and actual investment returns that are lower than the long-term expected return on plan assets could result in the Company making additional contributions.

10. Geographical Information

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

|               | Three Months Ended |           |
|---------------|--------------------|-----------|
|               | March 31,          |           |
|               | 2014               | 2013      |
| Canada        | \$ 10,574          | \$ 14,295 |
| United States | 10,319             | 7,399     |
| Others        | -                  | 857       |
| Total         | \$ 20,893          | \$ 22,551 |

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## 11. Basic and Diluted Earnings Per Share

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

|                                                                 | Three Months<br>Ended<br>March 31, |         |
|-----------------------------------------------------------------|------------------------------------|---------|
|                                                                 | 2014                               | 2013    |
| Numerator:                                                      |                                    |         |
| Net earnings                                                    | \$ 590                             | \$ 913  |
| Denominator:                                                    |                                    |         |
| Weighted average basic shares outstanding                       | 7,172                              | 5,907   |
| Effect of dilutive securities - equity based compensation plans | 63                                 | 12      |
| Net dilutive effect of warrants outstanding                     | 14                                 | -       |
| Denominator for diluted earnings per common share               | 7,249                              | 5,919   |
| Net earnings per common share:                                  |                                    |         |
| Basic                                                           | \$ 0.08                            | \$ 0.15 |
| Diluted                                                         | \$ 0.08                            | \$ 0.15 |
| Anti-dilutive securities (excluded from per share calculation): |                                    |         |
| Equity based compensation plans                                 | 223                                | 118     |
| Warrants                                                        | 640                                | 640     |

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the accompanying consolidated interim financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q and with our Annual Report on Form 10-K for the year ended December 31, 2013, which was filed with the Securities and Exchange Commission on March 14, 2014 and is available on the SEC's website at [www.sec.gov](http://www.sec.gov).

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

Special Note Regarding Forward-Looking Statements

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

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

- The potential loss or departure of key personnel, including Nathan J. Mazurek, our chairman, president and chief executive officer.
- Our ability to expand our business through strategic acquisitions.
- Our ability to integrate acquisitions and related businesses.
- Our ability to generate internal growth, maintain market acceptance of our existing products and gain acceptance for our new products.
- Unanticipated increases in raw material prices or disruptions in supply could increase production costs and adversely affect our profitability.
- Restrictive loan covenants and/or our ability to repay or refinance debt under our credit facilities could limit our future financing options and liquidity position and may limit our ability to grow our business.
- Our ability to realize revenue reported in our backlog.
- Operating margin risk due to competitive pricing and operating efficiencies, supply chain risk, material, labor or overhead cost increases, interest rate risk and commodity risk.
- Strikes or labor disputes with our employees may adversely affect our ability to conduct our business.
- A majority of our revenue and a significant portion of our expenditures are derived or spent in Canadian dollars. However, we report our financial condition and results of operations in U.S. dollars. As a result, fluctuations between the U.S. dollar and the Canadian dollar will impact the amount of our revenues and earnings.

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- The impact of geopolitical activity on the economy, changes in government regulations such as income taxes, climate control initiatives, the timing or strength of an economic recovery in our markets and our ability to access capital markets.
- Our chairman controls a majority of our combined voting power, and may have, or may develop in the future, interests that may diverge from yours.
- Future sales of large blocks of our common stock may adversely impact our stock price.
- The liquidity and trading volume of our common stock.

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

## Overview

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

## Foreign Currency Exchange Rates

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

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

| Quarter Ended | 2014                       |                                                              |                    | 2013                       |                                                              |                    |
|---------------|----------------------------|--------------------------------------------------------------|--------------------|----------------------------|--------------------------------------------------------------|--------------------|
|               | Consolidated Balance Sheet | Consolidated Statements of Earnings and Comprehensive Income |                    | Consolidated Balance Sheet | Consolidated Statements of Earnings and Comprehensive Income |                    |
|               |                            | Period Average                                               | Cumulative Average |                            | Period Average                                               | Cumulative Average |
| March 31      | \$0.9046                   | \$0.9062                                                     | \$0.9062           | \$0.9843                   | \$0.9912                                                     | \$0.9912           |

#### Critical Accounting Policies

There have been no material changes to our critical accounting policies as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2013.

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## Results of Operations

## Three Months Ended March 31, 2014 Compared to Three Months Ended March 31, 2013

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

|                                        | Three Months Ended |           |             |
|----------------------------------------|--------------------|-----------|-------------|
|                                        | March 31,<br>2014  | 2013      | %<br>Change |
| Electrical transformers                |                    |           |             |
| Liquid-filled                          | \$ 9,557           | \$ 11,870 | -19.5%      |
| Dry-type                               | 9,603              | 10,670    | -10.0%      |
|                                        | 19,160             | 22,540    | -15.0%      |
| Circuit protection & control equipment | 1,733              | 11        | pos.        |
| Total revenue                          | \$ 20,893          | \$ 22,551 | -7.4%       |

For the three months ended March 31, 2014, our consolidated revenue decreased to \$20.9 million, down \$1.7 million, or 7.4%, from \$22.6 million during the three months ended March 31, 2013. The change in our revenue includes a \$3.4 million decline in sales of electrical transformers during the 2014 quarter, or 15.0% on a year-over-year basis (or down approximately 10% in constant currency). Partially offsetting this decline in our revenue was \$1.7 million of incremental sales from Pioneer Critical Power Inc. and Pioneer Custom Electrical Products Corp., or Pioneer CEP, the businesses which we acquired in 2013, up from \$0.5 million of revenue during the prior quarter ended on December 31, 2013.

During the three months ended March 31, 2014, the decrease in our liquid-filled transformer sales was driven by foreign currency translation (-7%) together with, among other factors, the comparative effect of one large project that shipped during the three months ended March 31, 2013 to a user in the Canadian oil & gas sector. The decrease in our dry-type transformer sales resulted mostly from reduced demand in our short cycle, standard product sales channels (orders from brand label and Canadian wholesale distributor customers) and to a lesser extent was impacted by foreign currency translation (-2%). Offsetting these decreases, our dry-type transformer sales benefitted from increased shipments of custom-engineered, medium voltage units, together with an increase in OEM sales activity that was led

by the addition of a large new customer in the data center sector.

Pioneer Critical Power Inc., which we acquired on March 6, 2013, accounted for the majority of our sales of circuit protection & control equipment during the 2014 quarter, which consisted mostly of two large projects – one for a wastewater treatment facility and the other at a U.S. military site. Pioneer CEP, which we established in August 2013 to serve electrical distributors in the U.S. Southwest with low voltage, manufactured-to-order equipment solutions, accounted for the remainder of our sales of circuit protection & control equipment during the quarter.

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

|                                        | Three Months Ended |           |        |
|----------------------------------------|--------------------|-----------|--------|
|                                        | March 31,          | 2013      | %      |
|                                        | 2014               |           | Change |
| Cost of sales                          | \$ 15,973          | \$ 17,470 | -8.6%  |
| Gross profit                           | \$ 4,920           | \$ 5,081  | -3.2%  |
| Gross margin percentage:               |                    |           |        |
| Electrical transformers                | 23.0%              | 22.5%     | 0.5%   |
| Circuit protection & control equipment | 29.6%              | -13.4%    | 43.0%  |
| Consolidated                           | 23.5%              | 22.5%     | 1.0%   |

For the three months ended March 31, 2014, our gross margin percentage was 23.5% of revenues, as compared to 22.5% during the three months ended March 31, 2013. Our gross margin percentage on sales of transformers increased by 0.5% during the three months ended March 31, 2014, driven by a sales mix that was more heavily-weighted towards engineered-to-order transformers. This margin improvement was achieved despite the overall decrease in our transformer sales volume (-15%) which occurred mostly in our least profitable, catalogue-type product categories. Although still a small contributor in terms of total gross profit dollars, sales of circuit protection and control equipment had the effect of increasing our consolidated gross margin percentage by 0.5% during the three months ended March 31, 2014. Our gross margin percentage in this product category reflects a blend between shipments for critical power applications, which generally produce margins significantly higher than our consolidated average, offset by sales of custom low-voltage equipment produced by our Pioneer CEP operation which is currently undergoing a major expansion in terms of sales, engineering and production staff.

Selling, General and Administrative Expense. For the three months ended March 31, 2014, our selling, general and administrative expense increased by approximately \$0.5 million, or 12.7%, to \$4.0 million, as compared to \$3.5 million during the three months ended March 31, 2013. The increase in our selling, general and administrative expense during the 2014 quarter, as compared to the same quarter of 2013, was primarily due to an additional five months (combined) of operations for the two businesses we acquired in 2013, as well as to an increase in our corporate expenses, consisting primarily of higher personnel, information technology and public company costs. Selling, general and administrative expense in our transformer businesses was down 7.7% on a year-over-year basis. As a percentage of total revenue, our selling, general and administrative expense increased to 19.0% during the three months ended March 31, 2014, as compared to 15.6% during the three months ended March 31, 2013.

Foreign Exchange (Gain) Loss. During the three months ended March 31, 2014 and 2013, approximately 51% and 63%, respectively, of our consolidated operating revenues were denominated in Canadian dollars and most of our expenses were denominated and disbursed in U.S. dollars. We have not historically engaged in currency hedging activities. Fluctuations in foreign currency exchange rates between the time we initiate and then settle transactions with our customers and suppliers can have an impact on our operating results. For the three months ended March 31, 2014, we recorded a gain of \$45,000 due to currency fluctuations, compared to a loss of approximately \$61,000 during the three months ended March 31, 2013.

Interest Expense. For the three months ended March 31, 2014, interest expense was approximately \$136,000, as compared to \$185,000 during the three months ended March 31, 2013. The decrease in our interest expense was due to lower average borrowings outstanding, at lower marginal interest rates, under our credit facilities so far during 2014, as compared to 2013.

Other Expense (Income). For the three months ended March 31, 2014, other non-operating expense was approximately \$2,000, as compared to \$93,000 during the three months ended March 31, 2013. The 2013 other expense resulted from professional fees and costs incurred in connection with an acquisition.

Provision for Income Taxes. For the three months ended March 31, 2014, our provision for income taxes reflects an effective tax rate on earnings before income taxes of 31.2%, as compared to 25.2% during the three months

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ended March 31, 2013. The increase in our effective income tax rate reflects several factors, but was driven primarily by the fact that our Canadian operations are subject to lower corporate tax rates relative to our U.S. operations, and that our Canadian operations represented a lower percentage of our consolidated taxable income during the first quarter of 2014, as compared to the same quarter of 2013.

**Net Earnings.** We generated net earnings of \$0.6 million for the three months ended March 31, 2014, as compared to \$0.9 million during the three months ended March 31, 2013. Net earnings per basic and diluted share for the three months ended March 31, 2014 were \$0.08, as compared to \$0.15 for the three months ended March 31, 2013. The decrease in net earnings was driven mostly by lower long cycle project shipment volume, which can vary widely from quarter-to-quarter, the effect of foreign currency translation, and higher operating expenses which arose from recent acquisitions and investments made to support our future growth. On a per share basis, our net earnings were diluted by our public offering of common stock in September 2013. During the three months ended March 31, 2014 we had approximately 1.3 million additional weighted average diluted shares outstanding, or an increase of 22%, as compared to the same quarter of 2013.

**Backlog.** Our order backlog at March 31, 2014 was \$25.4 million, as compared to \$24.4 million at December 31, 2013 and \$24.0 million at March 31, 2013. Our backlog is based on orders expected to be delivered in the future, most of which is expected to occur during the next six months. New orders placed during the three months ended March 31, 2014 totaled \$23.1 million, an increase of approximately 2.6% (or up 8.1% in constant currency) as compared to new orders of \$22.5 million that were placed during the three months ended March 31, 2013.

**Liquidity and Capital Resources**

**General.** At March 31, 2014, we had no cash and cash equivalents and had total debt of \$10.3 million. We have historically met our cash needs through a combination of cash flows from operating activities and bank borrowings under our revolving credit facilities. Our cash requirements are generally for operating activities, debt repayment, capital improvements and acquisitions. We believe that working capital, borrowing capacity available under our credit facilities and funds generated from operations should be sufficient to finance our cash requirements for anticipated operating activities, capital improvements and principal repayments of debt through at least the next twelve months.

**Cash Provided by (Used in) Operating Activities.** Cash used by our operating activities was approximately \$2.2 million during the three months ended March 31, 2014, compared to cash used in our operating activities of \$1.6 million during the three months ended March 31, 2013. The principal elements of cash provided by operating activities during the three months ended March 31, 2014 were \$0.6 million of net earnings and \$0.4 million of non-cash expenses consisting of depreciation, amortization and stock-based compensation. These sources of cash

during the period were offset by \$2.7 million of cash used for working capital and \$0.5 million related to deferred taxes, pension costs and unrealized gains related to currency translation included in our net earnings.

Cash Provided by (Used in) Investing Activities. Cash used in investing activities during the three months ended March 31, 2014 was approximately \$0.3 million, as compared to \$1.8 million during the three months ended March 31, 2013. During the three months ended March 31, 2014, additions to our property, plant and equipment increased to \$0.2 million, up from \$0.1 million (excluding the building expansion described below) during the three months ended March 31, 2013, primarily as a result of growth investments in our engineered-to-order manufacturing capacity and information technology systems. In addition, during the three months ended March 31, 2014, we provided \$83,000 of financial assistance to one of our transformer customers in the form of a secured note receivable. Our uses of cash in investing activities during the three months ended March 31, 2013 included \$1.0 million for the expansion of our Canadian dry-type transformer manufacturing facility, and approximately \$0.7 million of cash to finance an acquisition.

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**Cash Provided by (Used in) Financing Activities.** Cash provided by our financing activities was approximately \$1.9 million during three months ended March 31, 2014, as compared to cash provided of \$3.2 million during the three months ended March 31, 2013. During the three months ended March 31, 2014, our cash provided by financing activities included approximately \$2.4 million of increased bank overdrafts and borrowings outstanding under our revolving credit facilities, offset by principal payments of \$0.4 million on our long-term debt. During the three months ended March 31, 2013, bank overdrafts and borrowings under our revolving credit facilities provided cash of \$3.7 million and we made scheduled principal repayments on our long-term debt of \$0.5 million.

**Working Capital.** As of March 31, 2014, we had net working capital of \$13.5 million, compared to net working capital of \$13.8 million, including \$0.4 million of cash and equivalents at December 31, 2013. Our current assets were approximately 1.8 times our current liabilities at March 31, 2014, as compared to 2.1 times as at December 31, 2013. At March 31, 2014 and December 31, 2013, we had \$10.2 million and \$8.7 million, respectively, of available and unused borrowing capacity from our revolving credit facilities, without taking into account cash and equivalents on hand. However, the availability of this capacity under our revolving credit facilities is subject to restrictions on the use of proceeds and is dependent upon our ability to satisfy certain financial and operating covenants, including financial ratios.

**Credit Facilities and Long-Term Debt**

**Canadian Credit Facilities.** Our Canadian subsidiaries have maintained credit facilities with Bank of Montreal since October 2009. In June 2011, our wholly owned subsidiary Pioneer Electrogroupp Canada Inc. entered into a letter loan agreement with Bank of Montreal (the “Canadian Facilities”) that replaced and superseded all of our businesses’ prior financing arrangements with the bank.

Our Canadian Facilities, as amended, provide for up to \$23.0 million Canadian dollars (“CAD”) (approximately \$20.8 million expressed in U.S. dollars) consisting of a \$10.0 million CAD demand revolving credit facility (“Facility A”) to finance ongoing operations, a \$2.0 million CAD term credit facility (“Facility B”) that financed a plant expansion, a \$10.0 million CAD term credit facility (“Facility C”) that financed a business acquisition and the purchase and expansion of its manufacturing facilities, a \$50,000 CAD Corporate MasterCard credit facility and a \$1.0 million CAD foreign exchange settlement risk facility.

The Canadian Facilities require us to comply on a consolidated Canadian basis with various financial covenants, including maintaining a minimum fixed charge coverage ratio, a maximum funded debt to EBITDA ratio and a limitation on funded debt as a percent of capitalization.

Facility A is subject to margin criteria and borrowings bear interest at Bank of Montreal's prime rate plus 0.50% per annum on amounts borrowed in Canadian dollars, or its U.S. base rate plus 0.50% per annum or LIBOR plus 2.00% per annum on amounts borrowed in U.S. dollars.

Borrowings under Facility B bear interest at Bank of Montreal's prime rate plus 1.00% per annum with principal repayments becoming due on a five year amortization schedule.

Borrowings under Facility C are repayable according to a five year principal amortization schedule and bear interest at the following rates: if the funded debt to EBITDA ratio is equal to or greater than 2.00, Bank of Montreal's prime rate plus 1.25% per annum on amounts borrowed in Canadian dollars, or its U.S. base rate plus 1.25% per annum or LIBOR plus 2.50% per annum on amounts borrowed in U.S. dollars; or, if the funded debt to EBITDA ratio is less than 2.00, Bank of Montreal's prime rate plus 1.00% per annum on amounts borrowed in Canadian dollars, or its U.S. base rate plus 1.00% per annum or LIBOR plus 2.25% per annum on amounts borrowed in U.S. dollars. In addition, Facility C is subject to a standby fee which is calculated monthly using the unused portion of the facility at either 0.625% per annum if the funded debt to EBITDA ratio is equal to or greater than 2.00, or 0.5625% per annum if the funded debt to EBITDA ratio is less than 2.00.

On June 28, 2013, Pioneer Electrogroupp Canada Inc. and certain subsidiary guarantors amended and restated the letter loan agreement with Bank of Montreal in order to, among other things, provide an additional six months to borrow any amounts not already drawn from Facility C. We also entered into a guaranty agreement to guarantee the obligations under the amended and restated letter loan agreement.

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As of March 31, 2014, we had approximately \$7.6 million in U.S. dollar equivalents outstanding under our Canadian Facilities and we were in compliance with our financial covenant requirements. Our borrowings consisted of \$0 outstanding under Facility A, \$1.0 million outstanding under Facility B and \$6.6 million outstanding under Facility C.

United States Credit Facilities. Our Jefferson Electric, Inc. subsidiary had a loan agreement with Johnson Bank that included a revolving credit facility with a borrowing base limit of \$6.0 million. Effective as of October 31, 2012, the credit facility was extended for an additional year, with interest ranging from 2.25% to 3.50% above one month LIBOR, depending on Jefferson Electric, Inc.'s debt service coverage ratio.

On June 28, 2013, in connection with entering into a credit agreement with Bank of Montreal, Chicago Branch (the "U.S. Facilities"), we repaid all amounts outstanding under the Johnson Bank facility. The U.S. Facilities, as amended, consist of a \$10.0 million demand revolving credit facility that was used to repay Johnson Bank and will be used to finance ongoing operations; and a now expired \$6.0 million term loan facility that was to be used to finance certain permitted acquisitions by us and our subsidiaries.

The U.S. Facilities require us to comply with a two-step test of financial covenants. First, as measured on a consolidated basis, if our funded debt to adjusted EBITDA ratio is less than or equal to 2.75x and our fixed charge coverage ratio is at or above 1.25x, then no further compliance tests are required. Alternatively, we may comply with the financial covenant requirements of the U.S. Facilities if our U.S. operations maintain a maximum funded debt to capitalization ratio and various minimum fixed charge coverage ratios and maximum funded debt to adjusted EBITDA ratios which are set at different thresholds by time period. The U.S. Facilities also restrict our ability to incur indebtedness, create or incur liens, make investments, make distributions or dividends and enter into merger agreements or agreements for the sale of any or all our assets.

Borrowings under the demand revolving credit facility bear interest, at our option, at the bank's prime rate plus 1.00% per annum on U.S. prime rate loans, or an adjusted LIBOR rate plus 2.25% per annum on Eurodollar loans. Borrowings under the term loan facility bore interest, at our option, at the bank's prime rate plus 1.25% per annum on U.S. prime rate loans, or an adjusted LIBOR rate plus 2.50% per annum on Eurodollar loans. In addition, the term loan facility was subject to a standby fee from June 28, 2013 to December 28, 2013, which was calculated monthly, using the unused portion of the facility, at a rate of 0.625% per annum.

Our obligations under the U.S. Facilities are guaranteed by all our wholly-owned U.S. subsidiaries. In addition, we and our wholly-owned U.S. subsidiaries granted a security interest in substantially all of our assets, including 65% of

the shares of Pioneer Electrogroupp Canada Inc. held by us, to secure our obligations for borrowed money under the U.S. Facilities.

As of March 31, 2014, we had \$1.6 million outstanding under the demand revolving credit facility and we were in compliance with its financial covenant requirements.

**Nexus Promissory Note.** On July 25, 2012, Nexus Magneticos de Mexico, S. de R.L. de C.V., a subsidiary of Jefferson Electric, Inc., entered into a \$1.7 million term loan agreement with GE CF Mexico, S.A. de C.V. The term loan from GE CF Mexico, S.A. de C.V. is payable in 60 consecutive monthly installments and bears interest, payable monthly, at a rate of 6.93% per annum. We provided a guaranty to GE CF Mexico, S.A. de C.V. of all of Nexus Magneticos de Mexico, S. de R.L. de C.V.'s obligations under the term loan agreement. As of March 31, 2014, there was approximately \$0.8 million outstanding.

**Pico Promissory Note.** On August 19, 2013, in connection with the acquisition of certain assets from Pico Electrical Equipment, Inc. and Pico Metal Products, Inc., our Pioneer CEP subsidiary issued a \$455,000 non-interest bearing promissory note to the sellers of the assets. The promissory note is payable in six installments of principal ending on June 19, 2014. In addition, we also entered into a guaranty agreement to guarantee the obligations of Pioneer CEP under the promissory note.

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Capital Expenditures

In June 2012, we completed the acquisition of the land and building comprising our dry-type transformer facility in Canada at a cost of approximately \$1.1 million. Between 2012 and 2013 we completed construction to expand the location's manufacturing floor space by approximately 16,000 square feet. Including the cost of new machinery and equipment, the capital budget for the entire expansion project was approximately \$1.9 million, all of which was disbursed before the end of 2013. We have no major future capital projects planned, or significant replacement spending anticipated during 2014.

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Item 4. Controls and Procedures

Management's Conclusions Regarding Effectiveness of Disclosure Controls and Procedures

We conducted an evaluation, under the supervision and participation of management including our chief executive officer and chief financial officer, of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) of the Securities Exchange Act of 1934, as amended). There are inherent limitations to the effectiveness of any system of disclosure controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based upon this evaluation, our chief executive officer and chief financial officer have concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of March 31, 2013.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended March 31, 2014 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II – OTHER INFORMATION

Item 1A. Risk Factors

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

Item 6. Exhibits

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

SIGNATURES

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

PIONEER POWER SOLUTIONS, INC.

Date: May 15,      /s/ Nathan J. Mazurek  
2014

Nathan J. Mazurek  
President, Chief Executive Officer and

Chairman of the Board of Directors

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

Date: May 15,  
2014

/s/ Andrew Minkow

Andrew Minkow

Chief Financial Officer, Secretary and Treasurer

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

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EXHIBIT INDEX

Exhibit

| No.   | Description                                                                                                                                                                                                                                                                                                                                                                                                     |
|-------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1   | Composite Certificate of Incorporation (Incorporated by reference to Exhibit 3.1 to Amendment No. 4 to the Registration Statement on Form S-1 of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on June 21, 2011).                                                                                                                                                             |
| 3.2   | Bylaws (Incorporated by reference to Exhibit 3.2 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on December 2, 2009).                                                                                                                                                                                                                     |
| 4.1   | Form of Securities Purchase Agreement (Incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on December 7, 2009).                                                                                                                                                                                     |
| 4.2   | Form of \$10.00 Warrant (Incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on December 7, 2009).                                                                                                                                                                                                   |
| 4.3   | Form of \$16.25 Warrant (Incorporated by reference to Exhibit 10.3 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on December 7, 2009).                                                                                                                                                                                                   |
| 4.4   | Warrant to Purchase Common Stock, dated April 30, 2010, issued to Thomas Klink (Incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on May 4, 2010).                                                                                                                                                  |
| 4.5   | Warrant to Purchase Common Stock, dated April 26, 2010 (Incorporated by reference to Exhibit 4.6 to Post-Effective Amendment No. 1 to Registration Statement on Form S-1 of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on June 1, 2010).                                                                                                                                   |
| 4.6   | Form of Warrant to Purchase Common Stock, dated September 24, 2013, issued to Roth Capital Partners, LLC and to Monarch Capital Group, LLC (Incorporated by reference to Exhibit 4.8 to Amendment No. 1 to Registration Statement on Form S-1 of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on September 10, 2013).                                                        |
| 31.1* | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                             |
| 31.2* | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                             |
| 32.1* | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                             |
| 32.2* | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                             |
| 101** | The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2014, formatted in XBRL (eXtensible Business Reporting Language), (i) Consolidated Statements of Earnings, (ii) Consolidated Balance Sheets, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Cash Flows and (v) Notes to the Consolidated Financial Statements. |

\* Filed herewith.

\*\* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

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