

POWELL INDUSTRIES INC
Form 10-Q
May 03, 2017

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, 2017

OR

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

For the transition period from _____ to _____
Commission File Number 001-12488

Powell Industries, Inc.
(Exact name of registrant as specified in its charter)

Delaware 88-0106100
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)
8550 Mosley Road 77075-1180
Houston, Texas
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code:
(713) 944-6900

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company
(Do not check if a smaller reporting company)

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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. "

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

At April 28, 2017, there were 11,428,638 outstanding shares of the registrant's common stock, par value \$0.01 per share.

POWELL INDUSTRIES, INC. AND SUBSIDIARIES
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PART I — FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

POWELL INDUSTRIES, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets (Unaudited)

(In thousands, except share and per share data)

| | March 31, 2017 | September 30, 2016 |
|--|-------------------|-----------------------|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | \$93,468 | \$ 97,720 |
| Short-term investments | 14,874 | — |
| Accounts receivable, less allowance for doubtful accounts of \$310 and \$811 | 66,753 | 101,048 |
| Costs and estimated earnings in excess of billings on uncompleted contracts | 56,618 | 66,106 |
| Inventories | 20,362 | 26,521 |
| Income taxes receivable | 4,196 | 1,713 |
| Deferred income taxes | 4,173 | 4,006 |
| Prepaid expenses | 2,723 | 4,569 |
| Other current assets | 2,834 | 2,457 |
| Total Current Assets | 266,001 | 304,140 |
| Property, plant and equipment, net | 139,417 | 144,977 |
| Goodwill and intangible assets, net | 1,887 | 2,059 |
| Other assets | 12,654 | 11,340 |
| Total Assets | \$419,959 | \$ 462,516 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Current maturities of long-term debt | \$400 | \$ 400 |
| Income taxes payable | 922 | 1,459 |
| Accounts payable | 27,672 | 34,985 |
| Accrued salaries, bonuses and commissions | 12,783 | 22,550 |
| Billings in excess of costs and estimated earnings on uncompleted contracts | 32,539 | 43,974 |
| Accrued product warranty | 3,649 | 4,639 |
| Other accrued expenses | 4,425 | 8,212 |
| Deferred credit – short term (Note D) | 1,522 | 2,029 |
| Total Current Liabilities | 83,912 | 118,248 |
| Long-term debt, net of current maturities | 1,600 | 2,000 |
| Deferred compensation | 4,923 | 4,840 |
| Deferred income taxes | 62 | 138 |
| Other long-term liabilities | 1,510 | 1,466 |
| Deferred credit – long term (Note D) | — | 507 |
| Total Liabilities | 92,007 | 127,199 |
| Commitments and Contingencies (Note F) | | |
| Stockholders' Equity: | | |
| Preferred stock, par value \$.01; 5,000,000 shares authorized; none issued | — | — |
| Common stock, par value \$.01; 30,000,000 shares authorized; 12,234,656 and 12,199,511 shares issued, respectively | 122 | 122 |
| Additional paid-in capital | 53,425 | 52,003 |
| Retained earnings | 324,897 | 331,959 |
| Treasury stock, 806,018 shares at cost | (24,999) | (24,999) |

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| | | |
|--|-----------|------------|
| Accumulated other comprehensive loss | (25,493) | (23,768) |
| Total Stockholders' Equity | 327,952 | 335,317 |
| Total Liabilities and Stockholders' Equity | \$419,959 | \$ 462,516 |

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

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POWELL INDUSTRIES, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Operations (Unaudited)
(In thousands, except per share data)

| | Three months ended March 31, | | Six months ended March 31, | |
|--|---------------------------------|-----------|-------------------------------|-----------|
| | 2017 | 2016 | 2017 | 2016 |
| Revenues | \$104,680 | \$152,266 | \$215,021 | \$302,243 |
| Cost of goods sold | 88,858 | 122,172 | 184,200 | 248,999 |
| Gross profit | 15,822 | 30,094 | 30,821 | 53,244 |
| Selling, general and administrative expenses | 15,994 | 19,024 | 31,692 | 38,425 |
| Research and development expenses | 1,623 | 1,959 | 3,092 | 3,813 |
| Amortization of intangible assets | 88 | 86 | 176 | 174 |
| Restructuring and separation costs | 840 | 3,259 | 840 | 7,056 |
| Operating income (loss) | (2,723) | 5,766 | (4,979) | 3,776 |
| Other income | (507) | (507) | (1,015) | (1,015) |
| Interest expense | 47 | 50 | 81 | 74 |
| Interest income | (89) | (71) | (131) | (71) |
| Income (loss) before income taxes | (2,174) | 6,294 | (3,914) | 4,788 |
| Income tax provision (benefit) | (1,345) | 727 | (2,786) | (320) |
| Net income (loss) | \$(829) | \$5,567 | \$(1,128) | \$5,108 |
| Income (loss) per share: | | | | |
| Basic | \$(0.07) | \$0.49 | \$(0.10) | \$0.45 |
| Diluted | \$(0.07) | \$0.49 | \$(0.10) | 0.45 |
| Weighted average shares: | | | | |
| Basic | 11,445 | 11,369 | 11,441 | 11,382 |
| Diluted | 11,445 | 11,422 | 11,441 | 11,415 |
| Dividends per share | \$0.26 | \$0.26 | \$0.52 | \$0.52 |

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

POWELL INDUSTRIES, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Comprehensive Income (Loss) (Unaudited)

(In thousands)

| | Three months ended March 31, | | Six months ended March 31, | |
|--|------------------------------------|----------|-------------------------------|---------|
| | 2017 | 2016 | 2017 | 2016 |
| Net income (loss) | \$(829) | \$5,567 | \$(1,128) | \$5,108 |
| Foreign currency translation adjustments | 886 | 4,552 | (1,725) | 2,014 |
| Comprehensive income (loss) | \$57 | \$10,119 | \$(2,853) | \$7,122 |

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

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

| | Six months ended March 31, | |
|---|-------------------------------|-----------|
| | 2017 | 2016 |
| Operating Activities: | | |
| Net income (loss) | \$(1,128) | \$5,108 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 6,138 | 6,518 |
| Amortization | 176 | 174 |
| Stock-based compensation | 1,820 | 3,118 |
| Bad debt expense (recovery) | (97) | 339 |
| Deferred income taxes | (243) | 337 |
| Gain on amended supply agreement | (1,015) | (1,015) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net | 34,084 | (1,574) |
| Costs and billings in excess of estimated earnings on uncompleted contracts | (2,074) | 11,810 |
| Inventories | 6,088 | 2,653 |
| Prepaid expenses and other current assets | (1,038) | 2,133 |
| Accounts payable and income taxes payable | (7,453) | (4,756) |
| Accrued liabilities | (14,397) | 106 |
| Other, net | (1,191) | 257 |
| Net cash provided by operating activities | 19,670 | 25,208 |
| Investing Activities: | | |
| Proceeds from sale of property, plant and equipment | — | 39 |
| Purchases of investments | (14,874) | — |
| Purchases of property, plant and equipment | (1,702) | (1,126) |
| Net cash used in investing activities | (16,576) | (1,087) |
| Financing Activities: | | |
| Payments on industrial development revenue bonds | (400) | (400) |
| Shares withheld in lieu of employee tax withholding | (398) | (808) |
| Purchase of treasury shares | — | (3,740) |
| Dividends paid | (5,934) | (5,921) |
| Net cash used in financing activities | (6,732) | (10,869) |
| Net increase (decrease) in cash and cash equivalents | (3,638) | 13,252 |
| Effect of exchange rate changes on cash and cash equivalents | (614) | 537 |
| Cash and cash equivalents, beginning of period | 97,720 | 43,569 |
| Cash and cash equivalents, end of period | \$93,468 | \$57,358 |

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

POWELL INDUSTRIES, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

A. OVERVIEW AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Overview

Powell Industries, Inc. (we, us, our, Powell or the Company) was incorporated in the state of Delaware in 2004 as a successor to a Nevada company incorporated in 1968. The Nevada corporation was the successor to a company founded by William E. Powell in 1947, which merged into the Company in 1977. Our major subsidiaries, all of which are wholly owned, include: Powell Electrical Systems, Inc.; Powell (UK) Limited; Powell Canada Inc. and Powell Industries International, B.V.

We develop, design, manufacture and service custom-engineered equipment and systems for the distribution, control and monitoring of electrical energy. Headquartered in Houston, Texas, we serve the oil and gas refining, offshore oil and gas production, petrochemical, pipeline, terminal, mining and metals, light rail traction power, electric utility, pulp and paper and other industrial markets.

Basis of Presentation

These unaudited condensed consolidated financial statements include the accounts of Powell and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

These unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X for interim financial information. 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. 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 condensed consolidated financial statements have been included. The results of operations for the interim periods are not necessarily indicative of the results for the entire fiscal year. We believe that these financial statements contain all adjustments necessary so that they are not misleading. The year-end balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP.

These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto of Powell and its subsidiaries included in Powell's Annual Report on Form 10-K for the year ended September 30, 2016, which was filed with the Securities and Exchange Commission (SEC) on December 7, 2016.

References to Fiscal 2017 and Fiscal 2016 used throughout this report shall mean our fiscal years ended September 30, 2017 and 2016, respectively.

Use of Estimates

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

New Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued a new standard on revenue recognition that supersedes previously issued revenue recognition guidance. This standard provides a five-step approach to be applied to all contracts with customers and requires expanded disclosures about the nature, amount, timing and uncertainty of revenue (and the related cash flows) arising from customer contracts, significant judgments and changes in judgments used in applying the revenue model and

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the assets recognized from costs incurred to obtain or fulfill a contract. This standard is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017, which would be our fiscal year ending September 30, 2019. We continue to work with various other companies in our industry as well as outside accounting advisors to evaluate this standard and understand the impact that the adoption of this new standard will have on our consolidated financial statements and related disclosures. We believe that we will continue to recognize revenue over time utilizing the cost-to-cost method to measure our progress for the vast majority of our contracts. We have not yet selected a transition method nor have we determined the effect of the standard on our ongoing financial reporting.

In November 2015, the FASB issued an amendment to the topic regarding income taxes which requires an entity to separate deferred income tax liabilities and assets into current and noncurrent amounts in the statement of financial position. Deferred tax liabilities and assets are classified as current or noncurrent based on the classification of the related asset or liability for financial reporting. Deferred tax liabilities and assets that are not related to an asset or liability for financial reporting are classified according to the expected reversal date of the temporary difference. To simplify the presentation of deferred income taxes, the amendments require that deferred income tax liabilities and assets be classified as noncurrent in a classified statement of financial position. This amendment is effective for annual reporting periods beginning after December 15, 2016, which would be our fiscal year ending September 30, 2018. We have no plans for early adoption. The adoption of this guidance is not expected to have a material impact on our consolidated financial position or results of operations.

In February 2016, the FASB issued a new topic on leases which requires lessees to recognize lease assets and lease liabilities on the balance sheet for all leases with terms longer than twelve months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. This would be our fiscal year ending September 30, 2020. We are currently evaluating the impact of our pending adoption of the new standard, but do not expect it to have a material impact on our consolidated financial position or results of operations.

B. EARNINGS PER SHARE

We compute basic earnings per share by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted earnings per common and potential common share includes the weighted average of additional shares associated with the incremental effect of dilutive restricted stock and restricted stock units, as prescribed by the FASB guidance on earnings per share.

The following table reconciles basic and diluted weighted average shares used in the computation of earnings per share (in thousands, except per share data):

| | Three months ended March 31, | | Six months ended March 31, | |
|--|------------------------------------|---------|-------------------------------|---------|
| | 2017 | 2016 | 2017 | 2016 |
| Numerator: | | | | |
| Net income (loss) | \$(829) | \$5,567 | \$(1,128) | \$5,108 |
| Denominator: | | | | |
| Weighted average basic shares | 11,445 | 11,369 | 11,441 | 11,382 |
| Dilutive effect of restricted stock units | — | 53 | — | 33 |
| Weighted average diluted shares with assumed conversions | 11,445 | 11,422 | 11,441 | 11,415 |
| Net income (loss) per share: | | | | |
| Basic | \$(0.07) | \$0.49 | \$(0.10) | \$0.45 |
| Diluted | \$(0.07) | \$0.49 | \$(0.10) | \$0.45 |

For the quarter and six months ended March 31, 2017, we incurred net losses and therefore all potential common shares were deemed to be anti-dilutive.

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

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

| | Three months ended March 31, | | Six months ended March 31, | |
|---|------------------------------------|---------|----------------------------------|--------|
| | 2017 | 2016 | 2017 | 2016 |
| Balance at beginning of period | \$664 | \$1,010 | \$811 | \$746 |
| Bad debt expense (recovery) | 16 | 92 | (97) | 339 |
| Uncollectible accounts written off, net of recoveries | (373) | (141) | (400) | (114) |
| Change due to foreign currency translation | 3 | 15 | (4) | 5 |
| Balance at end of period | \$310 | \$976 | \$310 | \$976 |

Inventories

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

| | March 31, September 30, | |
|---|-------------------------|-----------|
| | 2017 | 2016 |
| Raw materials, parts and subassemblies, net | \$ 19,760 | \$ 25,525 |
| Work-in-progress | 602 | 996 |
| Total inventories | \$ 20,362 | \$ 26,521 |

Cost and Estimated Earnings on Uncompleted Contracts

The components of costs and estimated earnings and related amounts billed on uncompleted contracts are summarized below (in thousands):

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| | March 31, 2017 | September 30, 2016 |
|---|-------------------|-----------------------|
| Costs incurred on uncompleted contracts | \$770,679 | \$ 1,088,921 |
| Estimated earnings | 245,832 | 350,125 |
| | 1,016,511 | 1,439,046 |
| Less: Billings to date | (992,432) | (1,416,914) |
| Net underbilled position | \$24,079 | \$ 22,132 |
| Included in the accompanying balance sheets under the following captions: | | |
| Costs and estimated earnings in excess of billings on uncompleted contracts – underbilled | \$56,618 | \$ 66,106 |
| Billings in excess of costs and estimated earnings on uncompleted contracts – overbilled | (32,539) | (43,974) |
| Net underbilled position | \$24,079 | \$ 22,132 |

Accrued Product Warranty

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

| | Three months ended March 31, 2017 | | Six months ended March 31, 2016 | |
|--|---|----------|---------------------------------------|----------|
| Balance at beginning of period | \$4,230 | \$5,105 | \$4,639 | \$4,930 |
| Increase to warranty expense | 349 | 832 | 719 | 2,158 |
| Deduction for warranty charges | (944) | (1,175) | (1,669) | (2,275) |
| Change due to foreign currency translation | 14 | 25 | (40) | (26) |
| Balance at end of period | \$3,649 | \$4,787 | \$3,649 | \$4,787 |

D. GOODWILL AND INTANGIBLE ASSETS

Our intangible assets consist of goodwill, which is not being amortized, and purchased technology, which is amortized over its estimated useful life. Intangible assets balances, subject to amortization, at March 31, 2017 and September 30, 2016 consisted of the following (in thousands):

| | March 31, 2017 | | | September 30, 2016 | | |
|----------------------|----------------------------|-----------------------------|--------------------------|----------------------------|-----------------------------|--------------------------|
| | Gross Carrying Value | Accumulated Amortization | Net Carrying Value | Gross Carrying Value | Accumulated Amortization | Net Carrying Value |
| Purchased technology | \$ 11,749 | \$ (10,865) | \$ 884 | \$ 11,749 | \$ (10,693) | \$ 1,056 |

Amortization of intangible assets was \$0.2 million for the six months ended March 31, 2017 and 2016.

On August 7, 2006, we purchased certain assets related to the manufacturing of ANSI medium-voltage switchgear and circuit breaker business from General Electric Company (GE). In connection with the acquisition, we entered into a 15-year supply agreement with GE pursuant to which GE would purchase from us all of their requirements for ANSI medium-voltage switchgear and circuit breakers and other related equipment and components (the Products). In connection with the acquisition, we recorded an intangible asset related to this supply agreement. On December 30, 2013, we and GE amended the supply agreement to allow GE to manufacture similar Products for sale immediately and allow them to begin purchasing Products from other suppliers beginning December 31, 2014. In return, GE paid us \$10 million upon execution of the amended supply agreement and agreed to pay an additional \$7 million over three years, beginning March 2015. As of March 31, 2017, the remaining balance of \$2.3 million due was classified as other current assets and was received in April 2017. We wrote off the intangible asset related to the original supply agreement and recorded a deferred credit in the amount of \$8.1 million at December 31, 2013, the amount by which the proceeds from GE exceeded the unamortized balance of our intangible asset. We are amortizing this deferred

credit over the four-year life of the agreement and have recognized gains in other income of \$1.0 million for the six months ended March 31, 2017 and 2016.

E. LONG-TERM DEBT

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

| | March 31, September 30, | |
|--|-------------------------|----------|
| | 2017 | 2016 |
| Industrial development revenue bonds | \$ 2,000 | \$ 2,400 |
| Less current portion | (400) | (400) |
| Total long-term debt and capital lease obligations | \$ 1,600 | \$ 2,000 |

U.S. Revolver

We have a \$75.0 million revolving credit facility (U.S. Revolver) to provide working capital support and letters of credit. The interest rate for amounts outstanding under the U.S. Revolver is a floating rate based upon the higher of the Federal Funds Rate plus 0.5%, the bank's prime rate, or the Eurocurrency rate plus 1.00%. Once the applicable rate is determined, a margin ranging up to 1.75%, as determined by our consolidated leverage ratio, is added to the applicable rate. The U.S. Revolver provides for the issuance of letters of credit which reduce the amounts that may be borrowed under this revolver. We had \$21.4 million of outstanding letters of credit under the U.S. Revolver at March 31, 2017.

There were no borrowings outstanding under the U.S. Revolver as of March 31, 2017. Amounts available under the U.S. Revolver were \$53.6 million at March 31, 2017. The U.S. Revolver expires on December 31, 2018.

The U.S. Revolver contains certain restrictive and maintenance-type covenants, such as restrictions on the amount of capital expenditures allowed. It also contains financial covenants defining various financial measures and the levels of these measures with which we must comply, as well as a "material adverse change" clause. A "material adverse change" is defined as a material change in our operations, business, properties, liabilities or condition (financial or otherwise) or a material impairment of our ability to perform our obligations under our credit agreements.

The U.S. Revolver is collateralized by a pledge of 100% of the voting capital stock of each of our domestic subsidiaries and 65% of the voting capital stock of each non-domestic subsidiary. The U.S. Revolver provides for customary events of default and carries cross-default provisions with other existing debt agreements. If an event of default (as defined in the U.S. Revolver) occurs and is continuing, on the terms and subject to the conditions set forth in the U.S. Revolver, amounts outstanding under the U.S. Revolver may be accelerated and may become immediately due and payable. As of March 31, 2017, we were in compliance with all of the financial covenants of the U.S.

Revolver.

Canadian Revolver

We have a \$7.5 million credit agreement with a major international bank in Canada (the Canadian Revolver) to provide working capital support and letters of credit for our operations in Canada. The interest rate for amounts outstanding under the Canadian Revolver is a floating interest rate based upon either the Canadian Prime Rate, or the lender's Bankers' Acceptance Rate. Once the applicable rate is determined, a margin of 0.50% to 1.75%, as determined by our consolidated leverage ratio, is added to the applicable rate. The Canadian Revolver provides for the issuance of letters of credit which reduce the amounts that may be borrowed under this revolver. There were no outstanding letters of credit under the Canadian Revolver at March 31, 2017.

There were no borrowings outstanding under the Canadian Revolver as of March 31, 2017 and amounts available under the Canadian Revolver were \$7.5 million at March 31, 2017. The Canadian Revolver expires on March 31, 2018.

The principal financial covenants are consistent with those described in our U.S. Revolver. The Canadian Revolver contains a "material adverse effect" clause. A "material adverse effect" is defined as a material change in the operations of Powell or Powell Canada Inc. in relation to our financial condition, property, business operations, expected net cash flows, liabilities or capitalization.

The Canadian Revolver is secured by the assets of our Canadian operations and provides for customary events of default and carries cross-default provisions with our existing debt agreements. If an event of default (as defined in the Canadian Revolver) occurs and is continuing, per the terms and subject to the conditions set forth in the Canadian

Revolver, amounts outstanding under the Canadian Revolver may be accelerated and may become immediately due and payable. As of March 31, 2017, we were in compliance with all of the financial covenants of the Canadian Revolver.

Industrial Development Revenue Bonds

We borrowed \$8.0 million in October 2001 through a loan agreement funded with proceeds from tax-exempt industrial development revenue bonds (Bonds). These Bonds were issued by the Illinois Development Finance Authority and were used for the completion of our Northlake, Illinois facility. Pursuant to the Bond issuance, a reimbursement agreement between us and a major domestic bank required an issuance by the bank of an irrevocable direct-pay letter of credit (Bond LC), as collateral, to the Bonds' trustee to guarantee payment of the Bonds' principal and interest when due. The Bond LC is subject to both early termination and extension provisions customary to such agreements, as well as various covenants, for which we were in compliance at March 31, 2017. While the Bonds mature in 2021, the reimbursement agreement requires annual redemptions of \$0.4 million that commenced on October 25, 2002. A sinking fund is used for the redemption of the Bonds. The Bonds bear interest at a floating rate determined weekly by the Bonds' remarketing agent, which was the underwriter for the Bonds and is an affiliate of the bank. This interest rate was 1.04% as of March 31, 2017.

F. COMMITMENTS AND CONTINGENCIES

Long-Term Debt

See Note E herein for discussion of our long-term debt.

Letters of Credit and Surety Bonds

Certain customers require us to post bank letter of credit guarantees or surety bonds. These guarantees and surety bonds assure that we will perform under the terms of our contract. In the event of default, the counterparty may demand payment from the bank under a letter of credit or performance by the surety under a bond. To date, there have been no significant expenses related to either letters of credit or surety bonds for the periods reported. We were contingently liable for secured and unsecured letters of credit of \$21.4 million as of March 31, 2017. We also had surety bonds totaling \$216.0 million that were outstanding, with additional bonding capacity of \$534.0 million available, at March 31, 2017.

We have a \$6.2 million facility agreement (Facility Agreement) between Powell (UK) Limited and a large international bank. This Facility Agreement provides Powell (UK) Limited the ability to enter into bank guarantees as well as forward exchange contracts and currency options. At March 31, 2017, we had outstanding guarantees totaling \$4.7 million under this Facility Agreement and amounts available under this Facility Agreement were \$1.5 million. This facility expires in May 2017. The Facility Agreement provides for financial covenants and customary events of default, and carries cross-default provisions with our U.S. Revolver. If an event of default (as defined in the Facility Agreement) occurs and is continuing, per the terms and subject to the conditions set forth therein, obligations outstanding under the Facility Agreement may be accelerated and may become or be declared immediately due and payable. As of March 31, 2017, we were in compliance with all of the financial covenants of the Facility Agreement.

Litigation

We are involved in various legal proceedings, claims and other disputes arising from our commercial operations, projects, employees and other matters which, in general, are subject to uncertainties and in which the outcomes are not predictable. Although we can give no assurances about the resolution of pending claims, litigation or other disputes and the effect such outcomes may have on us, management believes that any ultimate liability resulting from the outcome of such proceedings, to the extent not otherwise provided or covered by insurance, will not have a material adverse effect on our consolidated financial position or results of operations or liquidity.

Liquidated Damages

Certain of our customer contracts have schedule and performance obligation clauses that, if we fail to meet them, could require us to pay liquidated damages. Each individual contract defines the conditions under which the customer may make a claim against us. As of March 31, 2017, our exposure to possible liquidated damages was \$2.7 million, of which approximately \$1.7 million is probable. Based on our actual or projected failure to meet these various contractual commitments, \$1.6 million has been recorded as a reduction to revenue. We will attempt to obtain change orders, contract extensions or accelerate project completion which may resolve the potential for any unaccrued liquidated damage. Should we fail to achieve relief on some or all of these contractual obligations, we could be required to pay additional liquidated damages, which could negatively impact our future operating results.

G. STOCK-BASED COMPENSATION

Refer to our Annual Report on Form 10-K for the fiscal year ended September 30, 2016 for a full description of our existing stock-based compensation plans.

Restricted Stock Units

We issue restricted stock units (RSUs) to certain officers and key employees of the Company. The fair value of the RSUs is based on the closing price of our common stock as reported on the NASDAQ Global Market on the grant dates. These grants vest over a three-year period from their date of issuance. Sixty percent of the grant is time-based and vests over a three-year period on each anniversary of the grant date, based on continued employment. The remaining forty percent of the grant will be earned based on the three-year earnings performance of the Company following the grant date. At March 31, 2017, there were 193,537 RSUs outstanding. The RSUs do not have voting rights but do receive dividend equivalents upon vesting; additionally, the shares of common stock underlying the RSUs are not considered issued and outstanding until vested and common stock is issued.

RSU activity (number of shares) for the six months ended March 31, 2017 is summarized below:

| | Number of Restricted Stock Units | Weighted Average Fair Value Per Share |
|-----------------------------------|--|---|
| Outstanding at September 30, 2016 | 159,988 | \$ 43.12 |
| Granted | 61,100 | 39.65 |
| Vested | (27,551) | 39.08 |
| Outstanding at March 31, 2017 | 193,537 | \$ 42.60 |

During the six months ended March 31, 2017 and 2016, we recorded compensation expense of \$1.3 million and \$2.7 million, respectively, related to the RSUs. The higher compensation expense recorded in the six months ended March 31, 2016 was primarily due to the departure of our former Chief Executive Officer in December 2015, which included the accelerated vesting of 60,909 shares.

Restricted Stock

Beginning with the February 2017 grant, fifty-percent of the restricted stock granted to each of our non-employee directors vests immediately, while the remaining fifty-percent will vest on the anniversary of the grant date.

Compensation expense will be recognized immediately for the first fifty-percent of the restricted stock granted, while compensation expense for the remaining fifty-percent will be recognized over the remaining vesting period based on the price per share on the grant date. In February 2017, 17,000 shares of restricted stock were issued to our non-employee directors at a price of \$34.24 per share under the 2014 Director Plan.

During the six months ended March 31, 2017 and 2016, we recorded compensation expense of \$0.5 million and \$0.4 million, respectively, related to restricted stock grants.

H. FAIR VALUE MEASUREMENTS

We measure certain financial assets and liabilities at fair value. Fair value is defined as an “exit price” which represents the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in valuing an asset or liability. The accounting guidance requires the use of valuation techniques to measure fair value that maximize the use of observable inputs and minimize the use of unobservable inputs. As a basis for considering such assumptions and inputs, a fair value hierarchy has been established which identifies and prioritizes three levels of inputs to be used in measuring fair value. The three levels of the fair value hierarchy are as follows:

Level 1 — Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 — Inputs other than the quoted prices in active markets that are observable either directly or indirectly, including: quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets

and liabilities in markets that are not active or other inputs that are observable or can be corroborated by observable market data.

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Level 3 — Unobservable inputs that are supported by little or no market data and require the reporting entity to develop its own assumptions.

The following table summarizes the fair value of our assets and liabilities that were accounted for at fair value on a recurring basis as of March 31, 2017 (in thousands):

| Fair Value Measurements at March 31, 2017 | | | | |
|---|-----------|-------------|--------------|------------|
| | Quoted | | | |
| | Prices | | | |
| | in | Significant | Significant | Fair Value |
| | Active | Other | Unobservable | at |
| | Markets | Observable | Inputs | March 31, |
| | for | Inputs | (Level 3) | 2017 |
| | Identical | (Level 2) | | |
| | Assets | | | |
| | (Level | | | |
| | 1) | | | |
| Assets: | | | | |
| Cash equivalents | \$78,265 | \$ | —\$ | —\$ 78,265 |
| Short-term investments | 14,874 | — | — | 14,874 |
| Deferred compensation | 782 | 4,984 | — | 5,766 |
| Liabilities: | | | | |
| Deferred compensation | — | 4,567 | — | 4,567 |

The following table summarizes the fair value of our assets and liabilities that were accounted for at fair value on a recurring basis as of September 30, 2016 (in thousands):

| Fair Value Measurements at September 30, 2016 | | | | |
|---|-----------|-------------|--------------|---------------|
| | Quoted | | | |
| | Prices | | | |
| | in | Significant | Significant | Fair Value at |
| | Active | Other | Unobservable | September 30, |
| | Markets | Observable | Inputs | 2016 |
| | for | Inputs | (Level 3) | |
| | Identical | (Level 2) | | |
| | Assets | | | |
| | (Level | | | |
| | 1) | | | |
| Assets: | | | | |
| Cash equivalents | \$435 | \$ | —\$ | —\$ 435 |
| Deferred compensation | 1,643 | 4,130 | — | 5,773 |
| Liabilities: | | | | |
| Deferred compensation | — | 4,449 | — | 4,449 |

Cash equivalents, primarily funds held in money market savings instruments, are reported at their current carrying value which approximates fair value due to the short-term nature of these instruments and are included in cash and cash equivalents in our Condensed Consolidated Balance Sheets.

Fair Value of Other Financial Instruments

Fair value guidance requires certain fair value disclosures be presented in both interim and annual reports. The estimated fair value amounts of financial instruments have been determined using available market information and valuation methodologies described below.

Short-term Investments – Short-term investments include time deposits with original maturities of three months or more.

Deferred Compensation – We hold investments in an irrevocable Rabbi Trust for our deferred compensation plan. These assets include both mutual fund investments and company-owned life insurance policies. Under the plan, participants designate investment options to serve as the basis for measurement of the notional value of their accounts. The fair values of the underlying securities of these funds are based on quoted market prices and are categorized as Level 1 in the fair value measurement hierarchy. The company-owned life insurance policies are valued at cash surrender value and are therefore categorized as Level 2 in the fair value measurement hierarchy.

Industrial Development Revenue Bonds– The fair value of our long-term debt depends primarily on the coupon rate of our industrial development revenue bonds. The carrying value of our long-term debt at March 31, 2017, approximates fair value based on the current coupon rate of the bonds, which is reset weekly. It is classified as a Level 2 input in the fair value measurement hierarchy as there is an active market for the trading of these industrial development revenue bonds.

There were no transfers between levels within the fair value measurement hierarchy during the three months ended March 31, 2017.

I. INCOME TAXES

The calculation of the effective tax rate is as follows (in thousands):

| | Three months ended | | Six months ended | |
|-----------------------------------|--------------------|---------|------------------|---------|
| | March 31, | | March 31, | |
| | 2017 | 2016 | 2017 | 2016 |
| Income (loss) before income taxes | \$(2,174) | \$6,294 | \$(3,914) | \$4,788 |
| Income tax provision (benefit) | (1,345) | 727 | (2,786) | (320) |
| Net income (loss) | \$(829) | \$5,567 | \$(1,128) | \$5,108 |
| Effective tax rate | 62 | % 12 | % 71 | % (7)% |

We recorded an income tax benefit of \$1.3 million in the second quarter of Fiscal 2017, compared to an income tax provision of \$0.7 million in the second quarter of Fiscal 2016. The effective tax rate for the second quarter of Fiscal 2017 was 62% compared to an effective tax rate of 12% in the second quarter of Fiscal 2016. The effective tax rates for the second quarter of Fiscal 2017 and 2016 were favorably impacted by the lower tax rate in the United Kingdom, the relative amounts of income/loss recognized in various jurisdictions, as well as the utilization of net operating loss carryforwards in Canada that are fully reserved with a valuation allowance.

We recorded an income tax benefit of \$2.8 million for the six months ended March 31, 2017, compared to an income tax benefit of \$0.3 million for the six months ended March 31, 2016. The effective tax rate was 71% for the six months ended March 31, 2017 compared to a 7% benefit for the six months ended March 31, 2016. The effective tax rates for the six months ended March 31, 2017 and 2016 were favorably impacted by the lower tax rate in the United Kingdom, the relative amounts of income/loss recognized in various jurisdictions, as well as the utilization of net operating loss carryforwards in Canada that are fully reserved with a valuation allowance. A discrete item related to the closing of an IRS audit recorded in the first quarter of Fiscal 2017 also favorably impacted the effective tax rate due to the release of a \$0.3 million FIN 48 reserve relating to the Research and Development Tax Credit (R&D Tax Credit). Additionally, the effective tax rate for the six months ended March 31, 2016 was favorably impacted by a \$0.8 million discrete item recorded in the first quarter of Fiscal 2016 related to the retroactive reinstatement of the R&D Tax Credit.

J. RESTRUCTURING AND SEPARATION COSTS

During the second quarter of Fiscal 2017, we incurred \$0.8 million of restructuring costs as we continue to reduce our overall cost structure to better align our costs with future production requirements. In the second quarter of Fiscal 2016, we incurred \$3.3 million of separation costs due to the restructuring of our senior management team and workforce reductions.

For the six months ended March 31, 2016, we incurred \$7.1 million of restructuring costs due to the workforce reductions mentioned above, as well as the departure of our former Chief Executive Officer in December 2015.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

We are including the following discussion to inform our existing and potential shareholders generally of some of the risks and uncertainties that can affect our Company and to take advantage of the “safe harbor” protection for forward-looking statements that applicable federal securities law affords.

From time to time, our management or persons acting on our behalf make forward-looking statements to inform existing and potential shareholders about our Company. These statements may include projections and estimates concerning the timing and success of specific projects and our future backlog, revenues, income, acquisitions and capital spending. Forward-looking statements include information concerning future results of operations and financial condition. Statements that contain words such as “believes,” “expects,” “anticipates,” “intends,” “estimates,” “continues,” “should,” “could,” “may,” “plan,” “project,” “predict,” “will” or similar expressions may be forward-looking statements. In addition, sometimes we will specifically describe a statement as being a forward-looking statement and refer to this cautionary statement.

In addition, various statements in this Quarterly Report on Form 10-Q, including those that express a belief, expectation or intention, as well as those that are not statements of historical fact, are forward-looking statements. These forward-looking statements speak only as of the date of this report; we disclaim any obligation to update these statements unless required by securities law, and we caution you not to rely on them unduly. We have based these forward-looking statements on our current expectations and assumptions about future events. While our management considers these expectations and assumptions to be reasonable, they are inherently subject to significant business, economic, competitive, regulatory and other risks, contingencies and uncertainties, most of which are difficult to predict and many of which are beyond our control. These risks, contingencies and uncertainties relate to, among other matters, the following:

Due to the cyclical nature of the oil and gas industry, our business may be adversely impacted by extended periods of low oil or gas prices or unsuccessful exploration efforts which may decrease our customers' spending and therefore our results in the future.

Economic uncertainty and financial market conditions may impact our customer base, suppliers and backlog.

Our stock price could decline or fluctuate significantly due to unforeseen circumstances. These fluctuations may cause our stockholders to incur losses.

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

The use of percentage-of-completion accounting on our fixed-price contracts could result in volatility in our results of operations.

The majority of our contracts contain performance obligations that may subject us to penalties or additional liabilities.

Fluctuations in the price and supply of materials used to manufacture our products may reduce our profits and could materially impact our ability to meet commitments to our customers.

Our industry is highly competitive.

Our operations could be adversely impacted by the effects of government regulations, including regulations related to conflict minerals.

Changes in tax laws and regulations may change our effective tax rate and could have a material effect on our financial results.

Our international operations expose us to risks that are different from, or possibly greater than, the risks we are exposed to domestically and may adversely affect our operations.

Our operating results may vary significantly from quarter to quarter.

The departure of key personnel could disrupt our business.

Our business requires skilled labor and we may be unable to attract and retain qualified employees.

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

Quality problems with our products could harm our reputation and erode our competitive position.

A failure in our business systems or cyber security attacks on any of our facilities, or those of third parties, could adversely affect our business and our internal controls.

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

• Changes in and compliance with environmental laws could adversely impact our financial results.

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

• Catastrophic events could disrupt our business.

• Unforeseen difficulties with expansions, relocations or consolidations of existing facilities could adversely affect our operations.

• Acquisitions involve a number of risks.

We believe the items we have outlined above are important factors that could cause estimates included in our financial statements to differ materially from actual results and those expressed in a forward-looking statement made in this report or elsewhere by us or on our behalf. We have discussed these factors in more detail in our Annual Report on Form 10-K for the year ended September 30, 2016. These factors are not necessarily all of the factors that could affect us. Unpredictable or unanticipated factors we have not discussed in this report could also have material adverse effects on actual results. We do not intend to update our description of important factors each time a potential important factor arises, except as required by applicable securities laws and regulations. We advise our shareholders that they should (1) be aware that factors not referred to above could affect the accuracy of our forward-looking statements and (2) use caution when considering our forward-looking statements.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the accompanying condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q and with our Annual Report on Form 10-K for the year ended September 30, 2016 which was filed with the Securities and Exchange Commission (SEC) on December 7, 2016 and is available on the SEC's website at www.sec.gov.

Overview

We develop, design, manufacture and service custom-engineered equipment and systems for the distribution, control and monitoring of electrical energy. Headquartered in Houston, Texas, we serve the oil and gas refining, offshore oil and gas production, petrochemical, pipeline, terminal, mining and metals, light rail traction power, electric utility, pulp and paper and other industrial markets. Revenues and costs are primarily related to custom engineered-to-order equipment and systems and are accounted for under percentage-of-completion accounting which precludes us from providing detailed price and volume information. Our backlog includes various projects that typically take a number of months to produce.

The markets in which we participate are capital intensive and cyclical in nature. Cyclicity is predominantly driven by customer demand, global economic conditions and anticipated environmental, safety or regulatory changes that affect the manner in which our customers proceed with capital investments. Our customers analyze various factors including the demand and price for oil, gas and electrical energy, the overall economic and financial environment, governmental budgets, regulatory actions and environmental concerns. These factors influence the release of new capital projects by our customers, which are traditionally awarded in competitive bid situations. Scheduling of projects is matched to the customer requirements and projects typically take a number of months to produce. Schedules may change during the course of any particular project and our operating results can therefore be impacted by factors outside of our control. Due to the significant decline in oil and gas prices from late 2014 levels, many of our customers have reduced their capital budgets and cut costs, and in certain instances have delayed or cancelled projects that we were pursuing. As a result, our project backlog has declined, and may continue to decline, which may further negatively impact our operations for the foreseeable future. In response to our reduced project backlog and the challenging market outlook in our core oil, gas and petrochemical markets, we took steps in Fiscal 2016, and have taken additional actions in Fiscal 2017, to reduce our overall cost structure and better align our costs with future production requirements.

Our strategy in Canada has been to replicate our project-based integration model that we use in our U.S. operations, which allows for the design, fabrication, integration and testing of our products at a single location. This strategic initiative presented challenges for our Canadian operations in prior years, resulting in inefficiencies that led to higher operating costs, gross margin deterioration and operating losses. We took various actions in Canada to mitigate these challenges and continue to see improvements in operational performance. However, our Canadian project backlog has declined due to the adverse market conditions discussed above and we expect these adverse market conditions to negatively impact our Canadian operations for the foreseeable future.

Results of Operations

Quarter Ended March 31, 2017 Compared to the Quarter Ended March 31, 2016 (Unaudited)

Revenue and Gross Profit

Revenues decreased by 31%, or \$47.6 million, to \$104.7 million in the second quarter of Fiscal 2017, compared to the second quarter of Fiscal 2016, primarily due to the continued decrease in our project backlog as we complete existing projects and continue to see lower demand from our customers in our core oil, gas and petrochemical markets.

Domestic revenues decreased by 29%, or \$31.2 million, to \$75.5 million in the second quarter of Fiscal 2017, compared to the second quarter of Fiscal 2016, and international revenues decreased by 36%, or \$16.3 million, to \$29.1 million in the second quarter of Fiscal 2017, compared to the second quarter of Fiscal 2016. This reduction in revenue year over year was driven by the decline in our project backlog mentioned above. Revenues from commercial and industrial customers decreased by 40%, or \$45.7 million, to \$69.9 million in the second quarter of Fiscal 2017, compared to the second quarter of Fiscal 2016. Revenues from public and private utilities decreased by 40%, or \$10.4 million, to \$16.0 million in the second quarter of Fiscal 2017, compared to the second quarter of Fiscal

2016. Revenues from municipal and transit projects increased by 84%, or \$8.6 million, to \$18.8 million in the second quarter of Fiscal 2017, compared to the second quarter of Fiscal 2016 due to the timing of transit projects and our ability to ramp up across various facilities to meet our customer schedules.

Gross profit for the second quarter of Fiscal 2017 decreased by 47%, or \$14.3 million, to \$15.8 million, compared to the second quarter of Fiscal 2016, primarily due to the decrease in revenues. Gross profit as a percentage of revenues decreased to 15% in the second quarter of Fiscal 2017, compared to 20% in the second quarter of Fiscal 2016. Our Canadian operations continued to see positive improvement in gross profit, which was offset primarily by the decline in gross profit in various domestic operations.

Margins continued to be negatively impacted by our reduced volume as a result of weak oil and gas market conditions, competitive pricing pressures and increased volume from our transit projects, which typically have lower margins.

Selling, General and Administrative Expenses

Selling, general and administrative expenses decreased by 16%, or \$3.0 million, to \$16.0 million during the second quarter of Fiscal 2017, compared to the second quarter of Fiscal 2016, primarily due to the cost reduction efforts we took in Fiscal 2016 in response to our reduced project backlog and adverse market outlook. Selling, general and administrative expenses, as a percentage of revenues, increased to 15% during the second quarter of Fiscal 2017, compared to 12% during the second quarter of Fiscal 2016, primarily due to the reduction in revenue quarter over quarter.

Restructuring and Separation Costs

In the second quarter of Fiscal 2017, we incurred \$0.8 million in restructuring and separation costs as we continue to reduce our overall cost structure to better align our costs with future production requirements. In the second quarter of Fiscal 2016, we incurred approximately \$3.3 million of separation costs due to the restructuring of our senior management team and a reduction in our work force.

Income Tax Provision (Benefit)

We recorded an income tax benefit of \$1.3 million in the second quarter of Fiscal 2017, compared to an income tax provision of \$0.7 million in the second quarter of Fiscal 2016. The effective tax rate for the second quarter of Fiscal 2017 was 62% compared to an effective tax rate of 12% in the second quarter of Fiscal 2016. The effective tax rates for the second quarter of Fiscal 2017 and 2016 were favorably impacted by the lower tax rate in the United Kingdom, the relative amounts of income/loss recognized in various jurisdictions, as well as the utilization of net operating loss carryforwards in Canada that are fully reserved with a valuation allowance.

Net income (Loss)

In the second quarter of Fiscal 2017, we recorded a loss of \$0.8 million, or \$0.07 per diluted share compared to income of \$5.6 million, or \$0.49 per diluted share, in the second quarter of Fiscal 2016. Our decrease in selling, general and administrative expenses and restructuring and separation costs in the second quarter of Fiscal 2017 partially offset the reduction in revenue and gross profit compared to the second quarter of Fiscal 2016, as our project backlog has declined due to depressed market conditions, primarily in our core oil, gas and petrochemical markets.

Backlog

The order backlog at March 31, 2017 was \$227.9 million, which declined from \$291.4 million at September 30, 2016. New orders declined during the second quarter of Fiscal 2017 to \$62.0 million, compared to \$116.9 million in the second quarter of Fiscal 2016, primarily due to lower demand from our customers in our core oil, gas and petrochemical markets.

Six Months Ended March 31, 2017 Compared to the Six Months Ended March 31, 2016 (Unaudited)

Revenue and Gross Profit

Revenues decreased by 29% or \$87.2 million, to \$215.0 million for the six months ended March 31, 2017, compared to the six months ended March 31, 2016, primarily due to the continued decrease in our project backlog as we complete existing projects and continue to see lower demand from our customers in our core oil, gas and petrochemical markets. Domestic revenues decreased by 24%, or \$51.1 million, to \$161.2 million for the six months ended March 31, 2017, compared to the six months ended March 31, 2016, and international revenues decreased by 40% or \$36.2 million, to \$53.9 million for the six months ended March 31, 2017, compared to the six months ended March 31, 2016. This reduction in revenue year over year was driven by the decline in our project backlog mentioned above. Revenues from commercial and industrial customers decreased by 37%, or \$85.5 million, to \$142.6 million for the six months ended March 31, 2017, compared to the six months ended March 31, 2016. Revenues from public and private utilities decreased by 41%, or \$22.6 million, to \$32.5 million for the six months ended March 31, 2017, compared to the six months ended March 31, 2016. Revenues from municipal and transit projects increased by 111%,

or \$21.0 million, to \$39.9 million for the six months ended March 31, 2017, compared to the six months ended March 31, 2016 due to the timing of transit projects and our ability to ramp up across various facilities to meet our customer schedules.

Gross profit for the six months ended March 31, 2017 decreased by 42%, or \$22.4 million, to \$30.8 million, compared to the six months ended March 31, 2016, primarily due to the decrease in revenues. Gross profit as a percentage of revenues decreased to 14% for the six months ended March 31, 2017, compared to 18% for the six months ended March 31, 2016. Our Canadian operations experienced an increase in gross profit, which was offset primarily by the decline in gross profit from our domestic operations. Margins were negatively impacted primarily by our reduced volume as a result of weak oil and gas market conditions, competitive pricing pressure and increased volume from our transit projects, which typically have lower margins.

Selling, General and Administrative Expenses

Selling, general and administrative expenses decreased by 18%, or \$6.7 million, to \$31.7 million for the six months ended March 31, 2017, compared to the six months ended March 31, 2016, primarily due to the cost reduction efforts we took in Fiscal 2016 in response to our reduced project backlog and adverse market outlook. Selling, general and administrative expenses, as a percentage of revenues, increased to 15% for the six months ended March 31, 2017, compared to 13% for the six months ended March 31, 2016, primarily due to the reduction in revenue discussed above.

Restructuring and Separation Costs

For the six months ended March 31, 2017, we incurred \$0.8 million in restructuring and separation costs as we continue to reduce our overall cost structure to better align our costs with future production requirements. For the six months ended March 31, 2016, we incurred \$7.1 million of separation costs due to workforce reductions, as well as the departure of our former Chief Executive Officer in December 2015.

Income Tax Benefit

We recorded an income tax benefit of \$2.8 million for the six months ended March 31, 2017, compared to an income tax benefit of \$0.3 million for the six months ended March 31, 2016. The effective tax rate for the six months ended March 31, 2017 was 71% compared to a 7% benefit for six months ended March 31, 2016. The effective tax rates for the six months ended March 31, 2017 and 2016 were favorably impacted by the lower tax rate in the United Kingdom, the relative amounts of income/loss recognized in various jurisdictions, as well as the utilization of net operating loss carryforwards in Canada that are fully reserved with a valuation allowance. A discrete item related to the closing of an IRS audit recorded in the first quarter of Fiscal 2017 also favorably impacted the effective tax rate due to the release of a \$0.3 million FIN 48 reserve relating to the Research and Development Tax Credit (R&D Tax Credit).

Additionally, the effective tax rate for the six months ended March 31, 2016 was favorably impacted by a \$0.8 million discrete item recorded in the first quarter of Fiscal 2016 related to the retroactive reinstatement of the R&D Tax Credit.

Net income (Loss)

For the six months ended March 31, 2017, we recorded a loss of \$1.1 million, or \$0.10 per diluted share compared to income of \$5.1 million, or \$0.45 per diluted share, for the six months ended March 31, 2016. Our decrease in selling, general and administrative costs in the six months ended March 31, 2017, partially offset the reduction in revenue and gross profit compared to the six months ended March 31, 2016 as our project backlog has declined due to depressed market conditions, primarily in our core oil, gas and petrochemical markets.

Backlog

The order backlog at March 31, 2017 was \$227.9 million, which declined from \$291.4 million at September 30, 2016. New orders declined during the six months ended March 31, 2017 to \$152.8 million, compared to \$218.6 million for the six months ended March 31, 2016, primarily due to lower demand from our customers in our core oil, gas and petrochemical markets.

Liquidity and Capital Resources

Cash, cash equivalents and short-term investments increased to \$108.3 million at March 31, 2017, compared to \$97.7 million at September 30, 2016. As of March 31, 2017, current assets exceeded current liabilities by 3.2 times and our debt to total capitalization was 0.61%.

We have a \$75.0 million revolving credit facility in the U.S. As of March 31, 2017, there were no amounts borrowed under this line of credit. We also have a \$7.5 million revolving credit facility in Canada, and as of March 31, 2017 there were no amounts borrowed under this line of credit. Total letters of credit outstanding under our U.S. credit facility, which reduce our availability, were \$21.4 million at March 31, 2017 and \$26.8 million at September 30, 2016. There were no letters of credit outstanding under

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the Canadian revolving credit facility at March 31, 2017 or September 30, 2016. Amounts available at March 31, 2017 under the U.S. and Canadian revolving credit facilities were \$53.6 million and \$7.5 million, respectively. Total long-term debt, including current maturities, totaled \$2.0 million at March 31, 2017, compared to \$2.4 million at September 30, 2016. For further information regarding our debt, see Notes E and F of Notes to Condensed Consolidated Financial Statements.

Approximately \$34 million of our cash and short-term investments at March 31, 2017 was held outside of the United States for international operations. It is our intention to indefinitely reinvest all current and future foreign earnings internationally in order to ensure sufficient working capital to support our international operations. In the event that we elect to repatriate some or all of the foreign earnings that were previously deemed to be indefinitely reinvested outside the U.S., under current tax laws we would incur additional tax expense upon such repatriation.

We believe that cash and short-term investments available and borrowing capacity under our existing credit facilities should be sufficient to finance future operating activities, capital improvements and debt repayments for the foreseeable future. We continue to monitor the factors that drive our markets and will continue to strive to maintain our leadership and competitive advantage in the markets we serve while aligning our cost structures with market conditions.

Operating Activities

Cash provided by operating activities decreased to \$19.7 million for the six months ended March 31, 2017, compared to cash provided by operating activities of \$25.2 million during the same period in Fiscal 2016. This decrease in operating cash flow in the six months ended March 31, 2017 was primarily from increased incentive compensation payments in the first quarter of Fiscal 2017 and the reduction in earnings year over year, offset by reductions in accounts receivable due to lower project activity. Cash flow from operations is primarily influenced by the timing of milestone payments from our customers and the payment terms with our suppliers.

Investing Activities

Net cash used in investing activities during the six months ended March 31, 2017 totaled \$16.6 million compared to \$1.1 million during the same period in Fiscal 2016. For the six months ended March 31, 2017, we invested \$14.9 million in short-term investments and spent approximately \$1.7 million on purchases of plant and equipment.

Financing Activities

Net cash used in financing activities was \$6.7 million for the six months ended March 31, 2017 and \$10.9 million during the same period in Fiscal 2016. This reduction was primarily due to the completion of our share repurchase program in December 2015 discussed below.

Share Repurchase Program

On December 17, 2014, our Board of Directors authorized a share repurchase program which allowed us to repurchase up to \$25 million of our outstanding stock. The purchases were made from time to time in the open market through Rule 10b5-1 trading plans in accordance with applicable laws, rules and regulations. The repurchase of shares was funded from cash on hand and cash provided by operating activities. The Repurchase Program expired on December 31, 2015. As of December 31, 2015, we had purchased 806,018 shares at an aggregate cost of \$25 million under the Repurchase Program. The average purchase price per share since inception of the program was \$31.02.

New Accounting Standards

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

Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations are based on our condensed consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities known to exist at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. We evaluate our estimates on an ongoing basis, based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. There can be no assurance that actual results will not differ from those estimates.

There have been no material changes to our critical accounting policies as disclosed in our Annual Report on Form 10-K for the year ended September 30, 2016.

Outlook

The markets in which we participate are capital-intensive and cyclical in nature. Cyclicity is predominantly driven by customer demand, global economic conditions and anticipated environmental or regulatory changes which affect the manner in which our customers proceed with capital investments. Our customers analyze various factors including the demand and price for oil, gas and electrical energy, the overall economic and financial environment, governmental budgets, regulatory actions and environmental concerns. These factors influence the release of new capital projects by our customers, which are traditionally awarded in competitive bid situations. Scheduling of projects is matched to customer requirements. Projects typically take a number of months to produce, and schedules may change during the course of any particular project.

A significant portion of our revenues have historically been from the oil, gas and petrochemical markets. Unfavorable oil and gas commodity price levels have caused, and may continue to cause, our customers to change their strategies or delay or cancel planned projects. The reduction in available projects across the markets we serve has increased market price pressures during this downward market cycle. This reduction in new business opportunities and increased market price pressures have impacted, and will continue to negatively impact, our backlog, revenues and operating results. It is difficult to predict the duration of the current depressed market cycle.

Our operating results have been, and may continue to be, negatively impacted by factors such as the timing of new order awards, customer approval of final engineering and design specifications and delays in customer construction schedules, all of which have and may continue to have, a negative impact on the timing of project execution. Our operating results also have been, and may continue to be, impacted by the timing and resolution of change orders, project close-out and resolution of potential contract claims and liquidated damages, all of which could improve or deteriorate gross margins during the period in which these items are resolved with our customers. These factors may result in periods of underutilization of our resources and facilities and negatively impact our ability to cover our fixed costs. If our core oil, gas and petrochemical markets remain depressed, or decline further, our project backlog could continue to decline and negatively impact our operations. In response to our reduced project backlog and depressed market outlook, we took steps in Fiscal 2016, and have taken additional actions in Fiscal 2017, to reduce our overall cost structure and better align our costs with future production requirements. We continue to assess our cost structure, operating performance and service offerings as the oil, gas and petrochemical markets remain challenging and uncertain. However, these actions will not be sufficient to avoid operating losses in the near-term and we expect to report a net loss in Fiscal 2017.

We believe that our strong working capital position, cash available, low debt position and borrowing capacity under our existing credit facilities should be sufficient to finance future operating activities, research and development initiatives, capital improvements and debt repayments for the foreseeable future. We continue to monitor the factors that drive our markets and will continue to strive to maintain our leadership and competitive advantage in the markets we serve while aligning our cost structures with market conditions.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to certain market risks arising from transactions we have entered into in the normal course of business. These risks primarily relate to fluctuations in market conditions, commodity prices, foreign exchange rates and interest rates.

Market Risk

We are exposed to general market risk and its potential impact on accounts receivable or costs and estimated earnings in excess of billings on uncompleted contracts. The amounts recorded may be at risk if our customers' ability to pay these obligations is negatively impacted by economic conditions. Our customers and their industries are typically engineering, procurement and construction firms, oil and gas refining, offshore oil and gas production, petrochemical, pipeline, terminal, mining and metals, light rail traction power, electric utility, pulp and paper and other heavy industrial customers. We maintain ongoing discussions with customers regarding contract status with respect to payment status, change orders and billing terms in an effort to monitor collections of amounts billed.

Commodity Price Risk

We are subject to market risk from fluctuating market prices of certain raw materials used in our products. While such materials are typically available from numerous suppliers, commodity raw materials are subject to price fluctuations. We attempt to pass along such commodity price increases to our customers on a contract-by-contract basis to avoid a negative effect on profit margin.

While we may do so in the future, we have not currently entered into any derivative contracts to hedge our exposure to commodity risk. We continue to experience price volatility with some of our key raw materials and components. Fixed-price contracts may limit our ability to pass cost increases to our customers, thus negatively impacting our earnings. Fluctuations in commodity prices may have a material impact on our future earnings and cash flows.

Foreign Currency Transaction Risk

We have operations that expose us to currency risk in the British Pound Sterling, the Canadian Dollar and to a lesser extent the Euro. Amounts invested in our foreign operations are translated into U.S. Dollars at the exchange rates in effect at the balance sheet date. The resulting translation adjustments are recorded as accumulated other comprehensive income (loss), a component of stockholders' equity in our condensed consolidated balance sheets. We believe the exposure to the effects that fluctuating foreign currencies have on our consolidated results of operations is limited because the foreign operations primarily invoice customers and collect obligations in their respective currencies or U.S. Dollars. Additionally, expenses associated with these transactions are generally contracted and paid for in the same local currencies. For the six months ended March 31, 2017, our realized foreign exchange gains were \$0.4 million and are included in selling, general and administrative expenses in the Condensed Consolidated Statements of Operations.

Our accumulated other comprehensive loss, which is included as a component of stockholders' equity, was \$25.5 million as of March 31, 2017, an increase of \$1.7 million compared to September 30, 2016. This increase in comprehensive loss was primarily a result of fluctuations in the currency exchange rates for the Canadian Dollar and British Pound Sterling as we remeasured the foreign operations of those divisions.

We do not currently hedge our exposure to potential foreign currency translation adjustments.

Interest Rate Risk

If we decide to borrow under one of our credit facilities, we will be subject to market risk resulting from changes in interest rates related to our floating rate bank credit facility. If we were to make such borrowings, a hypothetical 100 basis point increase in variable interest rates may result in a material impact to our financial statements. While we do not currently have any derivative contracts to hedge our exposure to interest rate risk, in the past we have entered and may in the future enter into such contracts. During each of the periods presented, we have not experienced a significant effect on our business due to changes in interest rates.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We have established and maintain a system of disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed in our reports filed with the SEC pursuant to the Securities Exchange Act of 1934, as amended (Exchange Act), is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that such information is accumulated and communicated to our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), as appropriate, to allow timely decisions regarding required disclosures.

Management, with the participation of our CEO and CFO, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of the end of the period covered by this report. Based on such evaluation, our CEO and CFO have each concluded that as of the end of the period covered by this report, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate, to allow timely decisions regarding required disclosures.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

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We are involved in various legal proceedings, claims and other disputes arising from our commercial operations, projects, employees and other matters which, in general, are subject to uncertainties and in which the outcomes are not predictable. Although we can give no assurances about the resolution of pending claims, litigation or other disputes and the effect such outcomes may have on us, management believes that any ultimate liability resulting from the outcome of such proceedings, to the extent not otherwise provided or covered by insurance, will not have a material adverse effect on our consolidated financial position or results of operations or liquidity.

Item 1A. Risk Factors

There are no material changes from the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2016.

Item 6. Exhibits

| Number | Description of Exhibits |
|----------|---|
| 3.1 | Certificate of Incorporation of Powell Industries, Inc. filed with the Secretary of State of the State of Delaware on February 11, 2004 (filed as Exhibit 3.1 to our Form 8-A/A filed November 1, 2004, and incorporated herein by reference). |
| 3.2 | Amended and Restated Bylaws of Powell Industries, Inc. (filed as Exhibit 3.1 to our Form 8-K filed October 12, 2012, and incorporated herein by reference). |
| *31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a). |
| *31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a). |
| *32.1 | Certification of Chief Executive Officer Pursuant to Section 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| *32.2 | Certification of Chief Financial Officer Pursuant to Section 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| *101.INS | XBRL Instance Document |
| *101.SCH | XBRL Taxonomy Extension Schema Document |
| *101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| *101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| *101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| *101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |
| * Filed | herewith |

SIGNATURES

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

POWELL INDUSTRIES, INC.
(Registrant)

Date: May 3, 2017 By: /s/ Brett A. Cope
Brett A. Cope
President and Chief Executive Officer
(Principal Executive Officer)

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

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