

POWER SOLUTIONS INTERNATIONAL, INC.

Form 10-K

February 26, 2016

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

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

**For the fiscal year ended December 31, 2015**

**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 001-35944**

**POWER SOLUTIONS INTERNATIONAL, INC.**

(Name of Registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of

**33-0963637**  
(I.R.S. Employer

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incorporation or organization)

Identification No.)

201 Mittel Drive

Wood Dale, IL

(Address of principal executive offices)

60191

(Zip Code)

Registrant's telephone number: (630) 350-9400

Securities Registered Pursuant to Section 12(b) of the Act:

Common Stock, par value \$0.001 per share

Securities Registered Pursuant to Section 12(g) of the Act:

None

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ☐ NO ☒

Indicate by check mark if the registrant is not required to file reports pursuant Section 13 and Section 15(d) of the Act. YES ☐ NO ☒

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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. (Check one):

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

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

The aggregate market value of the common stock, par value \$0.001 per share, of the registrant held by non-affiliates of the registrant as of June 30, 2015 (the last business day of the registrant's most recently completed second fiscal quarter) was \$252,013,780 based on the last reported sale price on The NASDAQ Capital Market on June 30, 2015 (although the total market capitalization of the registrant as of such date was approximately \$580,599,613). Shares of the registrant's common stock held by each executive officer and director and by each person who holds 10% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes. As of February 22, 2016, there were 10,752,906 outstanding shares of the common stock, par value \$0.001 per share, of the registrant.



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***Cautionary Note Regarding Forward-Looking Statements***

*This report includes forward-looking statements that reflect our expectations and projections about our future results, performance, prospects and opportunities. These statements can be identified by the fact that they do not relate strictly to historical or current facts. We have tried to identify forward-looking statements by using words such as anticipate, believe, could, estimate, expect, contemplate, intend, may, plan, project, potential, should, w similar expressions, but this is not an exclusive way of identifying such statements. These forward-looking statements include, among others, statements relating to our future financial performance, our business prospects and strategy, anticipated financial position, liquidity and capital needs and other similar matters. These forward-looking statements are based on management s current expectations and assumptions about future events, which are inherently subject to uncertainties, risks and changes in circumstances that are difficult to predict. Our actual results, performance and achievements may differ materially from those expressed in, or implied by, the forward-looking statements contained in this report as a result of various risks, uncertainties and other factors, including those described above under the heading Risk Factors and elsewhere in this report. Accordingly, you should read this report with the understanding that our actual results may be materially different from what we expect.*

*Forward-looking statements speak only as of the date of this report. Except as expressly required under federal securities laws and the rules and regulations of the SEC, we do not undertake any obligation to update any forward-looking statements to reflect events or circumstances arising after the date of this report, whether as a result of new information or future events or otherwise. You should not place undue reliance on the forward-looking statements included in this report or that may be made elsewhere from time to time by us, or on our behalf. All forward-looking statements attributable to us are expressly qualified by these cautionary statements.*

*Except where the context otherwise requires or where otherwise indicated, references in this Form 10-K to we, us, our and our company refer to Power Solutions International, Inc. and its subsidiaries.*

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**PART I**

**Item 1. Business  
Company Overview**

We are a global producer and distributor of a broad range of high performance, certified low-emission, power systems that primarily run on non-diesel fuels such as natural gas, propane and gasoline, which are designed to meet emission standards of the Environmental Protection Agency (EPA) and the California Air Resources Board (CARB). Our customers include large, multinational original equipment manufacturers (OEMs) of off-highway industrial equipment and on-road medium trucks and busses, and we are a sole source provider of alternative fuel power systems for many of these customers. Our industrial power systems are currently used by OEMs in a wide range of industries with a diversified set of applications, including, stationary electricity generators, oil and gas equipment, forklifts, aerial work platforms, industrial sweepers, arbor equipment, agricultural and turf equipment, aircraft ground support equipment, construction and irrigation equipment, and other industrial equipment.

Our power systems are highly engineered, comprehensive systems customized to meet specific industrial OEM application requirements and technical specifications, as well as requirements imposed by environmental regulatory bodies. Our power system configurations range from a basic engine block integrated with appropriate fuel system components to completely packaged power systems. We purchase engines from third party suppliers and produce internally-designed engines, both of which are then integrated into our power systems. A substantial portion of the components we integrate into our power systems consist of internally designed components and components for which we coordinate significant design efforts with third party suppliers; the remainder consist largely of parts that we source off the shelf from third party suppliers. We are able to provide our customers with a comprehensive, emission-certified or non-certified power system which can be incorporated, using a single part number, directly into a customer's specified application.

Our alternative fuel power systems meet or exceed emission standards of the EPA and the CARB and represent a cleaner, and typically less expensive, alternative to diesel fuel power systems. While our power systems primarily run on alternative fuels, we also supply EPA and CARB emission-certified standard fuel power systems, and we are one of the largest suppliers of Perkins and Caterpillar diesel power systems under 275 horsepower. We expect that growth in domestic sales of our low-emission power systems will be driven by the substantial breadth of our emission-certified products, as well as increasing domestic and international demand for alternative fuel power systems given increasingly stringent engine emission regulations. We are also experiencing increasing demand for our power systems from international industrial OEMs that manufacture industrial equipment for the U.S. import market.

In addition to our emission-certified power systems, we produce and distribute non-emission-certified power systems for industrial OEMs for particular applications in markets without emission standards (for example, oil and gas equipment used in Canada). Approximately 73% of our net sales for 2015 consisted of sales of emission-certified products, of which approximately 57% consisted of sales of emission certified products for which we hold the applicable regulatory certification, 11% consisted of sales of alternative fuel power systems for which the supplier holds the applicable regulatory certification and 5% consisted of sales of diesel power systems for which the diesel engine supplier holds the applicable regulatory certification. Our remaining sales consisted of non-emission-certified power systems, integrated electrical power generation systems, parts and other components.

**Industry and Market Overview**

***Industrial OEM Market***

The off-highway industrial OEM market represents a diversified set of applications and industry categories that include both stationary and mobile industrial equipment including, but not limited to: power generation, oil and gas, material handling, aerial work platforms, sweepers, arbor, welding, airport ground support, agricultural,

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turf, construction and irrigation. While the power system requirements for the industrial OEM market bear similarities to the requirements for power systems used in automotive applications, there are substantial application differences between automotive and industrial equipment applications. Torque, start, stop, low speed and, with respect to certain applications, indoor use requirements, make direct use of an automotive power system impractical for use in most industrial equipment applications. Recognizing these differences, the EPA and CARB have issued distinct emission standards and regulations for industrial applications, as compared to those for automotive applications. As a result, there is not a direct crossover of available automotive power systems into the industrial OEM market. Power systems used in the industrial OEM market must satisfy these emission standards through a certification process with the EPA and CARB that includes durability testing of the engine emission system at zero and 5,000 hours, production line testing on a quarterly basis and field compliance audit testing. Given the level of engineering and financial resources that automotive engine manufacturers would need to dedicate to supply emission-certified product into the industrial OEM market, and given this market does not represent a core business for these manufacturers, automotive engine manufacturers do not typically compete in the industrial OEM market.

Industrial OEM power systems use internal combustion engines (both diesel and spark-ignited), as well as electric motors. Diesel engine systems, which use compression to initiate ignition to burn fuel, in contrast with spark-ignited engine systems which use a spark plug to initiate the combustion process, currently represent the dominant power systems, depending on the specific industrial application involved. For example, diesel powered equipment is generally used in outdoor industrial applications, while electric motors and alternative fuel, spark-ignited power systems are used for indoor industrial applications where carbon monoxide and air quality issues must be addressed. Both diesel power systems and electric motors have significant limitations. Diesel power systems present unique emission compliance challenges, while electric motors are often not feasible alternatives in industrial applications as a result of limitations on battery storage capacity. These challenges present opportunities to increase demand for spark-ignited power systems within the industrial OEM marketplace.

***Market Trends***

The market for our power systems is continuing to grow globally as a result of several key drivers.

***Increasingly Stringent Regulations and Growing Efforts to Reduce Emissions***

Concerns regarding climate change and other environmental considerations have led to the implementation of laws and regulations that restrict, cap or tax emissions in the automotive industry and throughout other industries. In particular, EPA Tier 4 emission standards, CARB regulations, and policies in Europe, generally referred to as Stage I, II, III and IV regulations, are requiring a significant reduction in the level of emissions and particulate matter produced by diesel power systems. OEMs have experienced pressure to redesign their products to address these emission regulations, as products that are unable to meet emission standards may not be sold in the marketplace. However, we believe few suppliers to industrial OEMs have been capable of providing, or are willing to make the investments of time, financial, and other resources necessary to provide products that meet these more stringent emission regulations.

More stringent EPA and CARB emission regulations associated with diesel power systems have taken effect and are increasing both the cost and product footprint (in other words, the size of the power system) of diesel power products. Internal combustion engines generally produce emissions of carbon monoxide, unburned hydrocarbons (organic compounds consisting entirely of hydrogen and carbon that can be emitted as a result of incomplete fuel combustion and fuel evaporation), and oxides of nitrogen (highly reactive gases formed when oxygen and nitrogen in the air react with each other during combustion), and diesel engines produce particularly high levels of these pollutants. In addition, diesel engines produce particulate matter, which is among the areas of focus of these emission regulations. In



2004, the EPA adopted rules introducing Tier 4 emission standards which significantly reduce permitted emissions of oxides of nitrogen and particulate matter, and restrict hydrocarbon

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emissions, for off-road diesel engines of various sizes. The most recent standards adopted were initially implemented in 2008 and were phased in through 2015. As an example of the increasingly stringent standards to which diesel engines are subject, the most recent permitted levels, which began in 2012, of particulate matter for on-road diesel engines were reduced by approximately 90% from 2009 permitted levels. As a result, manufacturers and suppliers of diesel power systems, in comparison to spark-ignited power systems, face greater challenges in complying with the new emission regulations. A manufacturer of diesel power systems must expend significant resources to develop a compliant power system, often through incorporation of additional components into a power system to reduce levels of particulate and other emissions. These additional components increase the footprint of the diesel engine, as well. This can be a lengthy and expensive process. Based upon our experience with customers and suppliers, and on additional information provided by Power Systems Research, Inc., industrial OEMs are experiencing cost increases of between 30% and 100% for a comprehensive diesel power system with combustion and after-treatments incorporated to satisfy the new requirements. Furthermore, these emission regulations create not only a cost but also a footprint disadvantage for a diesel power system, when compared to a spark-ignited, emission-certified power system.

Additionally, countries outside of the United States have historically adopted emission regulations aligned with those of the U.S., and accordingly, it is anticipated that regulations comparable to current and future EPA and CARB emission regulations will be implemented internationally. For example, as previously noted, policies implemented in Europe, generally referred to as Stage I, II, III and IV regulations, regulate emissions of off-road mobile equipment. Similar to emission regulations in the U.S., these regulations in Europe call for reductions in emissions of hydrocarbons, oxides of nitrogen and particulate matter, to be phased in over a period of time. If foreign jurisdictions continue to adopt emission regulations consistent with those of the U.S., it is expected that the international industrial OEM market will experience similar pressures to use cost effective, emission-certified power systems.

***Increased Use of Alternative Fuels***

A variety of market factors are contributing to the increased use of alternative (non-diesel) fuels and growth of alternative fuel technology, including economics, energy independence, environmental concerns, and the widespread availability of alternative fuels. Historically, the price of alternative fuels such as natural gas or propane has been substantially less than diesel, and alternative fuels generally produce lower amounts of toxic greenhouse gases and noxious emissions. In the United States, significant domestic propane and natural gas fuel reserves have been identified, and it is believed these reserves could satisfy much of the energy needs of the U.S. for many years. According to a 2013 report published by the Potential Gas Committee (PGC), a nonprofit organization composed of experts working in the natural gas field, the U.S. future natural gas supply at the end of 2012 was 2.7 trillion cubic feet (consisting of PGC's assessments of technically recoverable resources combined with the U.S. Department of Energy's latest determination of proved reserves), which represents an increase of 22.1% from 2010 levels as determined by PGC. The abundance of domestic natural gas resources is expected to increase U.S. energy independence by reducing oil imports from foreign countries. As a result of these market factors, we believe the use of alternative fuels will continue to grow and providers of equipment in industrial OEM categories, such as power generation, that rely significantly on coal and diesel fuel, will face increasing pressure to use alternative fuel power systems.

Additionally, the infrastructure supporting alternative fuels in the United States and Asia continues to expand. Further, the United States and some other countries have taken action to increase demand and support for alternative fuels, in an effort to reduce dependence on imported oil, capitalize on domestic natural gas reserves and reduce emissions from diesel engines. For example, the EPA has provided subsidies in the form of grants and other financing programs for the advancement of alternative fuel technologies (to date directed primarily towards on-road vehicles). Additionally, industry organizations, such as the Propane Education and Research Council, an organization authorized by the U.S. Congress with the passage of the Propane Education and Research Act, award grants to a wide variety of institutions, businesses, universities and government organizations for the continued research, development, demonstration and

commercialization of alternative fuel technologies.

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### ***Industrial OEMs Outsourcing Research and Development of Power Systems***

Industrial OEMs have been following the broader marketplace trend of outsourcing non-core functions. The dynamics of global sourcing and the need for cost competitiveness have led, and should continue to lead, industrial OEMs to assess what operations and system components are core to their business model and what they should outsource to their suppliers and partners. In particular, to comply with frequently changing environmental regulations while remaining competitive, industrial OEMs have been increasingly more reliant on outsourcing to third party suppliers and partners with specialized regulatory and design expertise. This is especially true for international OEMs seeking access to the U.S. market. By outsourcing power system design and production, OEMs are able to focus their resources on overall design and functionality of their products, rather than on developing the sophisticated technology associated with emission-certified power systems. We expect increasingly more industrial OEMs to outsource power systems, system components and subsystems to third party suppliers with the requisite experience and technology.

### ***Penetration by International Suppliers into Regulated Markets***

The implementation of emission regulations domestically and in non-U.S. markets also impacts international suppliers of industrial equipment products outside these regulated markets. International industrial OEMs that supply into regulated industrial OEM markets, including those already doing so and those recognizing emerging opportunities to sell their products into these markets, must meet applicable emission requirements, like those imposed by the EPA and CARB in the U.S. For example, Chinese and other Asian suppliers have recognized that, in order to effectively penetrate and sell into emission regulated industrial OEM markets like North America and Western Europe, their products must be emission-certified. These international industrial OEMs historically have lacked the regulatory and design expertise necessary to develop their own emission-certified power systems. Furthermore, they recognize that, even if they had or could acquire the relevant expertise, it can be much less time consuming and much more cost-effective for them to acquire compliant power systems from third-party suppliers, rather than internally developing and manufacturing their own solutions. Accordingly, just as domestic industrial OEMs are outsourcing this function, so too are international industrial OEMs, and we expect this trend to continue.

### ***Growing Demand for Sophisticated Electronic Technology and Automotive Grade Quality Standards***

Demanding automotive grade quality, as well as on-time delivery, has become standard practice in the industrial OEM marketplace. Consistent with the trend in the automotive industry, the level of technology and sophistication, including electronic controls, associated with industrial OEM power systems has advanced significantly to meet the growing demand for improved quality, reliability and performance. This has led to an ongoing reduction in the number of suppliers capable of supporting such product requirements.

### ***Our Competitive Strengths***

For over 30 years we have had a history and reputation as a proven supplier of cost-effective, technologically advanced products to the industrial OEM marketplace. We believe that our technological superiority and the comprehensive nature of our product offerings position us to capitalize on developing trends in the industrial OEM markets and drive significant future growth.

### ***Broad Range of Alternative Fuel Power Systems***

Our power systems represent a broad range of emission-certified, alternative fuel products for industrial applications. We are one of only a few providers of industrial OEM products that meet, and in many cases produce emissions at levels significantly lower than, the emission standards of the EPA and CARB. Our alternative fuel engines range in

size from under 1 liter to 22 liters and our power system configurations include any combination of cooling systems, electronic systems, air intake systems, fuel systems, housings, power

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takeoff systems, exhaust systems, hydraulic systems, enclosures, brackets, hoses, tubes and other assembled componentry. We provide standardized fuel system and component technology across our entire range of emission-certified and non-certified power systems. As a result, our OEM customers are able to focus internal engineering and technical support resources, and train their personnel, on one standardized fuel system and one set of electronic controls employed throughout the range of power systems they acquire from us, and are able to reduce their product design and ongoing product support costs.

We believe our broad range of alternative fuel products strategically positions us to capitalize on the cost and packaging disadvantages associated with diesel power systems that are resulting from increased EPA and CARB emission regulations that are taking effect. Given the existing dominance of diesel power systems in the industrial OEM marketplace, even a minor shift in the marketplace from diesel to spark-ignited, alternative fuel power systems will represent a significant growth opportunity for us. Additionally, as international OEMs desire to supply industrial equipment products into the United States and must meet EPA and CARB emission requirements, we provide a fast, certain, cost-effective route for these foreign industrial OEMs to meet these emission requirements because we hold compliance certificates specific to our power systems. We have already secured commercial sales relationships with some of Asia's largest industrial OEMs, and supply EPA and CARB compliant power systems to these industrial OEM customers for incorporation into their product lineups.

### ***Leverageable, OEM-Focused Business Model***

We are able to take advantage of opportunities for component standardization across industry categories, while still providing each industrial OEM with the flexibility to customize as required for particular design and application specifications. We aggregate our product development efforts, and can amortize associated costs, over our large and diverse OEM customer base and across industry categories. Furthermore, we capitalize on volume, economies of scale and global supply opportunities when sourcing component products. We can, therefore, provide our OEM customers with lower cost structures than they would otherwise be able to achieve on their own and help them reduce their part numbers and supply base by consolidating their procurement and assembly efforts down to a single part number product supplied by us. Our component sourcing relationships further enable our OEM customers to recognize resource reductions, inventory reductions and engineering support advantages.

Additionally, our relationships with international OEM customers that supply their industrial equipment into the United States generate opportunities for us to further supplement our business. We believe that once one of our emission-certified power systems is engineered into a foreign industrial OEM's product, that OEM is likely to also incorporate our power systems into its products that do not require emission-compliant power systems. This use by foreign industrial OEMs of our power systems for both their emission-certified and non-emission-compliant power system needs reduces ongoing engineering, aftermarket and field service support requirements, while supporting a product strategy that can easily be adjusted to any future worldwide changes in emission requirements. These relationships further provide us with growth opportunities beyond those dependent upon U.S. demand for emission regulated products, and solidify our supplier and partnership position with our foreign industrial OEM customers. Moreover, even if our relationship with an international OEM customer is limited to United States compliant power systems, we are able to provide additional emission-compliant power systems in the future as emission regulations for industrial equipment begin to emerge that align with regulations in the U.S.



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### ***Superior Technology***

We are a recognized leader in providing industrial OEMs with highly engineered, technologically superior, emission-certified power systems that cover a wide range of possible fuel alternatives. Our power system development and manufacturing processes are supported by in-house design, prototyping, testing and engineering capabilities. We believe our customers are able to realize significant costs savings by leveraging our proven power system technology, our application engineering expertise, the broad range of our EPA and CARB emission-certified power systems and our industrial equipment testing and certification processes. They are also able to focus their efforts on the development of operations and system components core to their business, without having to expend considerable resources and costs associated with the emission certification process, which may require years to perform durability testing of the engine emission system at zero and 5,000 hours, production line testing on a quarterly basis and field compliance audit testing, each of which is mandated and regulated by the EPA and CARB.

The level and range of our EPA and CARB emission-certified products offering further demonstrates the strength of our technology. Our emission-certified products meet all current existing emission standards of the EPA and CARB. We are able to maintain and enhance our position as a supplier of technologically sophisticated, emission-certified power systems through our experienced and technologically savvy team of application engineers. This team gives us the ability to support and integrate our power systems into a significant number of industrial OEM applications. We believe that our continued recruitment and development of talented personnel will augment our ability to stay ahead of emerging technologies in the industrial OEM marketplace.

Further, we are not captive to our own internal manufactured components and technology. Unlike some of our competitors that focus on developing and manufacturing most of their own product technology and components, we believe that superior technology is derived from having the flexibility to incorporate the best proven technology available in the marketplace. This affords us the flexibility to capitalize on current and emerging technology that best meets the requirements of any given application, as opposed to only using internally-developed technology that might not provide the best solution. As a result, we believe we have access to the best proven technology in the marketplace. We believe this strategy puts us in a strong position to benefit from our significant OEM customer base and aggregation capabilities in order to provide the best available product and technology solutions for our OEM customers.

### ***Dedicated Customer-Centric Product and Application Expertise***

We have a customer-centric business focus, and we continually strive for customer satisfaction at all levels of customer interaction. We commit our attention and efforts to nurturing and expanding relationships with our customers by staying connected with them, being aware of challenges they face and understanding their evolving needs. From production personnel to our customer support staff, our entire team is highly experienced in both the products we sell and the OEM customer applications into which they are integrated. Through our extensive experience in the industrial OEM marketplace and our adaptive technology strategy that we use in developing our power systems, we are able to accept the specific requests of individual customers and provide tailored power systems to meet their needs. We assign a dedicated engineer to each OEM customer for application support and to provide a direct line of communication between the OEM's manufacturing line and our production operations. Our quality, field service support and service operations provide knowledgeable and responsive support to our OEM customers at every point of customer interface.

### ***Growth Strategy***



Our core strategy is to develop comprehensive power systems for the global industrial OEM marketplace. We believe that, with our competitive advantages, our continued pursuit of our core strategy will drive growth in our business. More specifically, we intend to seek future growth as follows:

***Expand Products and Services Provided to Existing OEM Customers***

We continually work to capitalize on organic growth opportunities and build upon our strong existing customer relationships, which in many cases are on a sole source basis. We plan to expand our business with

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existing customers by supporting their growth initiatives as they expand their product lines, enter new markets, and adapt to changing emission standards. We also intend to develop and sell new products to our OEM customers as we broaden our range of emission-certified, alternative fuel power systems.

### ***Establish New Industrial OEM Relationships***

We expect to strengthen our OEM customer base by developing new relationships with industrial OEMs. We seek to acquire new customers and gain new business from OEMs that we do not presently serve by focusing our marketing efforts toward these potential customers and capitalizing on our strong reputation; the depth, breadth and technological sophistication of our power systems; our commitment to customer service; and the cost savings we can offer. Emphasizing our experience and reputation in market categories in which our power systems are already well-established, such as power generation, we are focused on establishing new industrial OEM relationships and capturing a greater portion of the market share. We are also targeting new OEM customers in high-growth market categories, such as on-road and material handling applications, while maintaining and enhancing our penetration in market categories that are growing more slowly. As we gain traction in emerging and high growth markets that did not previously represent significant opportunities for our power systems, we plan to further focus our efforts on potential customers in those categories.

### ***Expand Into New Geographic Markets***

We are focused on expanding our business internationally with OEM customers that require EPA and CARB compliant power systems to access the U.S. market and for non-compliant systems used in products sold outside the U.S. In 2012, we entered into a China-based joint venture with MAT Holdings, Inc. for the purpose of manufacturing, assembling and selling certain engines into the Asian market, initially focusing on the forklift market. In late 2014, we entered into a joint venture with Doosan Infracore Co., Ltd., Doosan PSI, LLC, to design, develop, produce, market and distribute industrial gas power systems to the global power generation market outside of North America and South Korea. Furthermore, because we expect countries outside of the United States to implement emission regulations that are aligned with U.S. standards, we anticipate an opportunity to expand our relationships with industrial OEMs that supply emission-compliant products outside of the U.S. If such emission regulations are implemented consistent with our expectation, we anticipate being able to provide power systems to industrial OEMs that meet applicable foreign emission standards by leveraging our existing technology and experience in developing our EPA and CARB emission-certified products.

### ***Develop New Products***

By leveraging the deep industry experience of our engineering and new product development teams, we are working to broaden the range of our power system product offerings, including engine classes and the industrial OEM market categories into which we supply our products. We capitalize on our technologically sophisticated, in-house design, prototyping, testing and application engineering capabilities to further refine our superior spark-ignited power system technology. We plan to apply our experience and expertise in developing comprehensive, integrated green power systems to expand our spark-ignited alternative fuel offerings.

### ***Selectively Pursue Complementary Strategic Transactions***

We may enter into strategic transactions, such as acquisitions of, or joint ventures or partnerships with, companies that present complementary non-organic growth opportunities. Specifically, we will seek opportunities that extend or supplement our presence into new geographic markets or industrial OEM market categories, expand our customer base, add new products or service applications or provide significant operating synergies. During 2015, we acquired

Powertrain Integration (Powertrain), a leading designer and integrator of engines for Class 3 through Class 7 medium duty trucks and busses for the North American and Asian market. This acquisition expands our customer base and provides a foray into medium duty truck platform space in the United States. During 2014, we acquired Professional Power Products, Inc. ( 3PI ), a designer and manufacturer of large, custom engineered, integrated electrical power generation systems serving the global diesel and natural

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gas power generation market. This acquisition extends our global reach and broadens our product offerings. We believe that there may be additional domestic or international strategic opportunities available to us as the sophistication of technology and amount of resources necessary to develop and supply power systems that meet increasingly stringent emission standards continue to increase.

### ***Expand into On-Road Markets***

We have developed an internally designed, state-of-the-art, 8.8 liter fuel flexible engine that we sell into both the industrial market (off-road) and the truck and bus market (on-road). This unique engine has been designed to be easily integrated as a drop-in solution for both off-road and on-road OEM applications. During 2014, the EPA certified our 8.8-liter propane and natural gas fueled engine for on-road applications. This engine has a wide range of applications, including vocational trucks, school and transit buses, medium-duty delivery fleets, recreational vehicles, tow and utility trucks, and waste-hauling trucks. While competitive spark-ignited engines are typically derived from light duty pickup trucks, our 8.8L engine was designed specifically to replace a diesel engine. This requirement led us towards a purpose built, low-speed torque intensive power system with little crossover with light duty automotive applications. The resulting design can be bolted into the chassis where a more expensive diesel engine previously sat. This engine strategically positions us with a comprehensive range of powertrains for vehicles in the Class 3 through Class 7 truck and bus market and the aforementioned acquisition of Powertrain Integration has strengthened our position.

### **Company History**

Founded in 1985, we began as a Perkins diesel power system distributor, and we sought to break the then-prevalent OEM focus on the diesel engine as a commodity by providing value-added engineering, procurement and packaging of products and services to the industrial OEM marketplace. Because of our expanded product and service offerings, we played a significant role in moving the industrial OEM marketplace from a simple, engine-centric model to a more comprehensive model. This comprehensive power system model includes engineering, procurement and packaging solutions for cooling, electronics, air intake, fuel systems, power takeoff, exhaust, hydraulics and packaging application requirements. Through implementation of our strategy, we grew our diesel power system sales and became one of the largest Perkins diesel power system distributors in the world, a position we still maintain today.

Our desire to expand our product and service offerings, coupled with the success of our strategy in the diesel marketplace, motivated us to move into the spark-ignited power systems marketplace. Beginning in the mid-1990s and continuing through today, we have applied our strategy to spark-ignited gasoline and alternative fuel products. In applying our extensive, prior experience developing power systems for our diesel power system OEM customers to the spark-ignited industrial OEM marketplace, and addressing the growing demand for diesel alternatives as a result of environmental and economic considerations, we have developed a comprehensive range of alternative fuel power systems. As a result, we have become a significant supplier of power systems to prominent OEM customers located throughout North America, as defined by the continent to which we ship a product. Sales to OEM customers located throughout North America represent approximately 91% of our net sales in 2015. We also sell our power systems to OEM customers located throughout the Pacific Rim (approximately 7% of our net sales in 2015) and Europe (approximately 2% of our net sales in 2015).

On April 29, 2011, our company, The W Group, Inc. completed a reverse acquisition transaction with Format, Inc. (which is now Power Solutions International, Inc.), in which PSI Merger Sub, Inc., a Delaware corporation that was newly-created as a wholly-owned subsidiary of Format, merged into The W Group, and The W Group remained as the surviving corporation of the merger. In that transaction, The W Group became a wholly-owned subsidiary of Power Solutions International, Inc.

Format was incorporated in the state of Nevada on March 21, 2001 for the purpose of providing EDGARization service to various commercial and corporate entities. Due to the nominal operations and assets of Format, this reverse acquisition transaction was accounted for as a recapitalization.

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The reverse recapitalization transaction was consummated under Delaware corporate law pursuant to an agreement and plan of merger. Upon completion of the reverse recapitalization, Format changed its name to Power Solutions International, Inc. All of the outstanding shares of common stock of The W Group held by the three stockholders of The W Group at the closing of the reverse recapitalization converted into shares of our common and preferred stock. These shares represented a substantial majority of the shares of our common stock and shares of preferred stock outstanding immediately following the consummation of the reverse recapitalization transaction. As a result of the reverse recapitalization, Power Solutions International, Inc. succeeded to the business of The W Group. On August 26, 2011, we completed a migratory merger and Power Solutions International, Inc., a Nevada corporation, merged into its wholly-owned subsidiary, Power Solutions International, Inc., a Delaware corporation. Power Solutions International, Inc., a Delaware corporation, continued as the surviving entity of the migratory merger. Pursuant to the migratory merger, among other things, our shares of preferred stock converted into shares of our common stock, we effected a 1-for-32 reverse stock split of our common stock and we changed our state of incorporation from Nevada to Delaware.

## **Our Products and Industry Categories**

### ***Power Systems for Off-Highway Industrial Equipment***

Our power systems are customized to meet specific industrial OEM application requirements. Power system configurations range from a basic engine block integrated with appropriate fuel system components to completely packaged power systems that include any combination of cooling systems, electronic systems, air intake systems, fuel systems, housings, power takeoff systems, exhaust systems, hydraulic systems, enclosures, brackets, hoses, tubes and other assembled componentry.

Our power systems include (1) EPA and CARB emission-certified spark-ignited water-cooled internal combustion engines ranging from 0.97 liters to 22 liters, which use alternative fuels and gasoline, (2) non-certified spark-ignited water-cooled internal combustion engines ranging up to 22 liters, which similarly use alternative fuels and gasoline, and (3) emission-certified Perkins engines ranging from 0.5 liters to 7.1 liters, which use diesel fuel. Our diesel and alternative fuel power systems use water-cooled (as opposed to air-cooled), multi-cylinder engines.

Our products are sold into a diversified set of markets within the industrial OEM industry, including power generation, oil and gas, material handling, aerial work platforms, sweepers, arbor products, welding, airport ground support, agricultural, turf, construction and irrigation. Different types of power systems are used within different industry categories (from which we receive varying, unequal amounts of revenues).

### ***Power Generation***

We offer EPA and CARB emission-certified power systems, including 0.97 liter to 22 liter power systems that use alternative fuels, for stationary emergency and non-emergency power generation products. Emergency engines are stationary engines which operate solely in emergency situations and during required periodic testing and maintenance. Examples include engines used in generators to produce power for critical networks when electrical power from the local utility provider is interrupted, and stand-by engines that pump water in the event of a fire or flood. Non-emergency products include prime power generation products, which produce continuous generation of power for an extended period of time, and peak shaving products, which generate power at times of maximum power demand.

We currently supply our power systems to a substantial number of manufacturers of power generation products. We believe that our customers choose our power systems because of our broad range of emission-certified, spark-ignited

power systems for this industry category. Additionally, by using a common fuel system and electronic controls across our range of power systems, we provide our customers with the opportunity to support and train their personnel on one standardized fuel system and one set of electronic controls employed throughout the range of products they acquire from us.

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***Oil and Gas***

The oil and gas market category includes oil field pumps/components, compressors, on-site power generation and other machines and equipment used in the production of oil and gas. Previously, OEMs competing in these markets were generally not concerned about fuel economy, cost of repair or efficiency of operation. Today, however, there is a growing focus in this market category on, and understanding of, the costs associated with down time, the value of fuel savings with more economical solutions and the benefits of using product portfolios with consistent fuel systems and aftermarket support. We provide a power generation system to completed wells that is significantly more cost competitive when compared to the cost of using diesel fuel or utility grid power. Our power systems are capable of burning free well-head gas, thereby providing a distinct opportunity for oil producers to save on their operating expenses which becomes more important as the cost per barrel of oil decreases, as has happened during 2015. When the price of oil declines, oil becomes a more favorable source of fuel in the short term and alternative fuel systems can suffer. Our focus is not with the rigs doing the drilling inherent in oil exploration and requiring significant capital costs, but on the completed wells where existing production is far less sensitive to oil price volatility than is exploration. We believe that our installed base of flare gas fueled generators to the existing number of wells leaves us with significant future opportunities for our power systems in this market category, especially as oil prices rebound.

We are continuing to develop relationships with oil and gas companies for their well head jacks, compressors and power generators. We provide pre-certified, as opposed to site-certified, power systems. Site certification is a tedious and costly process for oil and gas equipment OEMs that can take many hours to source components and integrate them into existing fuel system hardware (if even possible).

***Material Handling    Forklift Trucks***

The material handling market category includes forklift trucks and other mobile products used for movement, handling and storage of materials within a facility or at a specific location. We provide spark-ignited power systems into the high volume 1.5, 3.5 and 5 ton capacity forklift markets, and may expand production in the future to support the 8 and 10 ton forklift markets in connection with anticipated increases in diesel prices resulting from regulations on diesel engines that took effect in 2015.

Demand is currently strong in the United States for our material handling power systems as a result of emission and OSHA regulations. Based upon data supplied by Power Systems Research, Inc., we believe that, in the United States, nearly 100% of the indoor forklift market uses spark-ignited liquid propane gas or electric powered units (with approximately equal market shares), in contrast to Asian and European forklift markets which currently use diesel in excess of 80% of all applications. In connection with the implementation of EPA Tier 4 and European Stage IV regulations, and the resulting price increases related to the compliance of diesel engines with these regulations, we expect foreign markets for spark-ignited liquid propane gas power systems to grow. We expect this growth to drive increased international demand for our power systems.

***Aerial Work Platforms***

The aerial work platforms market category consists of aerial work platforms, or machines used to provide access to areas typically inaccessible because of their height. Rental companies represent a majority of all purchasers in this industry category. We currently sell our liquid propane gas/gasoline dual fuel power systems to aerial work platform OEMs.

As a result of the increase in diesel engine pricing related to the implementation of EPA Tier 4 regulations, we expect to see an increase in the number of OEMs in the aerial work platforms market which consider our liquid propane gas



and gasoline powered power systems as an alternative to diesel powered power systems.

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### ***Industrial Sweepers***

The industrial indoor sweeper market category consists of machines that clean and sweep various indoor surfaces. The power systems for this market category use both spark-ignited and diesel engines, as well as electric motors. We currently sell our 30 to 80 horsepower liquid propane gas and gasoline power systems to industrial indoor sweeper OEMs.

### ***Arbor Products***

The arbor products market category includes wood chippers and grinders. We currently provide engines to four of the largest OEMs of wood chippers in the United States. We also design and manufacture our own proprietary power take-off clutch, which may be applied to any of our arbor product power systems. See **Other Engine Power Products** Power Take Off ( PTO ) Clutch Assemblies for Industrial Applications.

We believe that our diesel power systems maintain a leading position in the market for wood chippers that use water-cooled engines. We believe the diesel regulations that took effect in 2015 have caused EPA Tier 4 diesel engine packages to become more expensive and, as a result, have opened the market for consideration of our gasoline and other alternative fuel engine packages.

### ***Other Industry Categories***

We provide power systems within other industrial OEM markets, including welding, airport ground support, agricultural, turf, construction and irrigation.

### ***Power Systems for On-Road and Off-Road equipment***

We have developed an internally designed, state-of-the-art, 8.8 liter fuel flexible engine that we sell into both the industrial market (off-road) and the truck and bus market (on-road). This unique engine has been designed to be easily integrated as a drop-in solution for both off-road and on-road OEM applications.

### ***Other Engine Power Systems Products***

### ***Power Take Off (PTO) Clutch Assemblies for Industrial Applications***

We design and manufacture our own proprietary PTO clutch assemblies, which are mechanical components that drive separate power to various parts of a given piece of industrial equipment, for industrial applications. Our PTO clutch assemblies are designed for heavy duty industrial applications.

### ***Customized OEM Subsystems, Kits and Componentry***

Through our global sourcing capabilities, we supply engine packaging, subsystems, kits and componentry associated with cooling systems, electronic systems, air intake systems, fuel systems, housings and power takeoff systems, exhaust systems, hydraulic systems and enclosures to industrial OEMs for incorporation into their applications, in addition to the complete engine power systems we provide to these OEMs.

### ***Connected Asset Services***

We offer connected asset services through MasterTrak, our telematics tool, which consists of a hardware unit and related services. This hardware unit is integrated into OEM equipment, collects critical data from this equipment and transmits this data back to an OEM, service provider or end-user through wireless telecommunications technology. The services allow our customers to see the data and monitor the performance of their equipment. We provide services to our OEM customers that allow these OEMs and their customers to remain connected to their equipment, even as the equipment is being operated in the field. These capabilities and services are in many respects similar to General Motors Company's *ONSTAR*® (a registered trademark of OnStar LLC) service.

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We offer MasterTrak with our engine power systems as a bundled offering, and also on a stand-alone basis both to our OEM customers and to other businesses to which we do not currently supply our power systems. We have also developed a relationship with SmartEquip, based in Norwalk, Connecticut, to incorporate MasterTrak into SmartEquip's aftermarket service platform for industry suppliers.

### ***Service and Support***

#### ***Aftermarket and Service Parts***

We have extensive aftermarket and service parts programs. These programs consist of: (1) internal aftermarket service parts programs with worldwide sales and distribution capabilities, and (2) internal OEM developed service parts programs for components and products supplied by us. We continue to focus on, and invest in, the aftermarket portion of our business. We have grown our industrial spark-ignited engine parts business by employing experts in the gas engine aftermarket field, increasing our investment in the global sourcing of parts and expanding parts books and online ordering capabilities. We have also developed stocking programs and maintenance kits that enable OEMs, service dealers and distributors to reduce downtime and increase product use.

We have focused on capturing the aftermarket sales of the value added components that we include in our power systems. With a significant portion of the selling prices of our power systems coming from value added components, this is a large, continuing growth opportunity for our aftermarket business.

#### ***Product and Warranty Support***

We provide technical support and training to our OEM customers. These services include in-plant training and support through web and phone based field service. Our dedicated team of product and application engineers delivers high quality, responsive technical support to our OEM customers. We further support our OEM customers by engaging regional providers to perform warranty service and offer support for our power systems. In general, we reimburse these third-party regional providers for the warranty services that they perform for our power systems.

### **Customers**

Our customers include companies that are large, industry-leading and/or multinational organizations that demand best-in-class engineering support, automotive grade product quality and on-time delivery. We believe that the number of competitors capable of supporting not just the sophisticated technology requirements, but also the world class automotive engineering, quality and delivery requirements emphasized by industrial OEMs is limited. We are solidly positioned to capitalize on the diminishing base of suppliers capable of meeting these increasingly stringent customer expectations. In almost every industrial OEM category, we maintain a supplier relationship with two or more of the largest OEMs in that category.

Our depth of expertise, technical superiority and broad range of product offerings is the underlying basis for our position as a sole source provider of products to a majority of our OEM customers. Our strong customer base, which includes a diversity of customers across industry categories, provides a broad range of opportunities for continued growth.

Our arrangements with our customers, including our relationships with our industrial OEM customers in Asia, generally do not fix, on other than a short term basis with certain limited exceptions, pricing terms or quantities of our power systems to be sold. They also typically do not mandate exclusivity. Purchases are made by customers on a purchase order basis, with pricing of our power systems driven in large part by the volume of power systems

purchased by a particular customer and market-based factors, including the price of raw materials and other components incorporated into our power systems, as well as prices for comparable power systems, if any, offered by our competitors.

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Our largest customers, based upon our consolidated revenues in 2015, included Kohler and Hyster-Yale Materials Handling Group, Inc. (formerly NACCO Materials Handling Group Inc.), of which each represented more than ten percent of our 2015 consolidated net sales. Our relationships with these customers are all pursuant to terms and conditions substantially similar to the arrangements described above, including the manner in which prices are determined. Our largest customers change from time to time as a result of various factors, including prevailing market conditions, our customers' strategies (such as their focus on marketing and sales efforts with respect to products into which our power systems are incorporated as compared to their other products) and our customers' existing inventory of our power systems.

## **Operations and Research and Development**

### ***Design and Engineering / Research and Development***

Our research and development efforts are market driven. Our sales team first meets to identify and define market requirements and trends and then communicates that vision to our engineering and new product development groups. Our engineering and new product development groups then review our existing power system portfolio and develop new solutions that build upon the technology within that portfolio. We maintain in-house design, prototyping, testing and application engineering capability, including specialists in EPA and CARB certification, fuel systems, electronics, cooling systems, mechanical engineering and application engineering. Our design and application engineering expertise and capabilities include expertise in (1) emissions compliance, (2) design and development of standardized and customized products for incorporation into industrial and on-road equipment, (3) three-dimensional solid modeling and finite element analysis, (4) computer-based modeling and testing, (5) rapid OEM product prototyping, (6) industrial OEM product retrofitting and testing and (7) support for application engineering and system integration.

We also rely upon engineering outsourcing relationships for design, development and product testing that allow us to fulfill demands for specialty services and satisfy fluctuating workload requirements. In particular, since 2009, we have used outside engineering relationships to supplement product design, development and testing services as dictated by demands from our industrial OEM customers. We require these third-party engineering service providers to treat all design, development and testing information provided to them as confidential. In addition to these engineering outsourcing relationships, where applicable, we also benefit from the design, development and testing capabilities of our supplier base.

We provide the design, durability testing, validation testing and compliance with other engineering and administrative requirements necessary to meet and obtain EPA and CARB certification for a range of spark-ignited engines. As a result, we provide our OEM customers with emission-certified power systems, without these OEMs having to expend considerable research and development time and resources related to obtaining power system certification. We further provide the tools and services necessary to support revalidation and other EPA and CARB requirements that exist beyond the initial emission compliance requirements. As a result of such revalidation, we become the manufacturer of record, which is the entity that holds the applicable regulatory certifications for a power system, for the emission-certified power system.

We staff our engineering support activities associated with released product and component sourcing programs with dedicated internal engineering personnel, separate from our product and application development engineering team. This allows us to provide committed engineering and technical attention to internal operational support, customer production support and component sourcing activities, thereby helping to buffer the demands placed on our product and application development engineering group. Through such attention and support, we are able to maximize the focus of our product and application development engineering group on current and future design, prototyping, testing and application development activities resulting in shorter design, prototyping and testing cycles for our OEM

customer base.

Our research and development expenditures for our fiscal years 2015, 2014 and 2013 were approximately \$19.1 million, \$14.9 million and \$9.4 million, respectively.

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### ***Manufacturing***

We manufacture and assemble our products at our facilities in suburban Chicago, Illinois, Darien, Wisconsin and Madison Heights, Michigan. We customize our power systems to meet specific requirements of industrial OEM applications and the needs of our industrial OEM customers. We have recently invested in machining equipment to hone and finish our internally designed engine blocks, which are initially cast at a supplier's foundry. We also design and manufacture large, custom engineered integrated electrical power generation systems for both standby and prime power applications. Our production operations encompass all aspects of manufacturing our power systems, which range from fitting a basic engine block with appropriate fuel system components to building a comprehensive power system that includes any combination of cooling systems, electronic systems, air intake systems, fuel systems, housings, power takeoff systems, exhaust systems, hydraulic systems, enclosures, brackets, hoses, tubes and other assembled componentry.

The manufacturing lines in our production facilities are technologically sophisticated and flexible, and we allocate production capacity on our manufacturing lines to accommodate the demand levels and product mix required by our OEM customers. Our manufacturing lines are equipped with display screens, through which our production personnel are able to monitor design and other technological specifications for each product being assembled on the manufacturing line at that time. The information displayed on these screens is supplied from a central server, which is updated in real-time with all current product information. Through this process, we ensure that the product manufacturing and other specifications used by our production personnel represent the most current information available. We have also developed efficient in-line methods to support specialized product testing, as required by a specific customer or product application.

Our engineering and manufacturing systems use sophisticated, paperless, integrated, software-based management and control systems. Our warehouse systems include computerized management systems and high speed infrastructure such as wire guided racking systems and high density automated carousel systems. We use a dynamic, software-driven inventory management system, which allows us to accurately monitor inventory levels for our comprehensive power systems, subsystems and individual components. We also incorporate, within our manufacturing process, software that enables us to identify and deliver components and other parts to our OEM customers.

We focus on safety, quality and on-time delivery in our manufacturing operations. We are 9001-2008 ISO Certified, the highest ISO certification available. The ISO 9000 family of quality management standards, which must be met in order to become ISO certified, is designed to help organizations monitor and improve the quality and delivery of products and/or services to their customers. We also use Six Sigma, a business management strategy designed to minimize variability in manufacturing and business processes, 5S, a workplace organization methodology designed to maximize efficiency and effectiveness, and other disciplines in our goal of continuous improvements in quality and on-time delivery. Structured staff training is a constant priority and includes closed-loop quality monitoring and feedback systems.

### **Supplier Relationships**

#### ***Engine and Component Suppliers***

We have established relationships with suppliers for the engines to be integrated into our comprehensive power systems, the most significant of which are Doosan, Shenyang Aerospace Mitsubishi Motors Engine Manufacturing Co., Ltd. ( SAME ), General Motors and Perkins/Caterpillar. We also source our other power system components from third party suppliers. We coordinate design efforts with suppliers for some of our key components. In addition, we



internally design other parts and components for our products, own the tooling for such parts and components and globally source them from a variety of domestic and global suppliers. Because we design many of our parts and components in-house, we are generally not limited in our choice of suppliers. As such, we are able to select our supplier relationships based upon a supplier's reliability and performance.

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We aggregate our product sourcing efforts across our large and diverse OEM customer base and across industry categories, capitalizing on volume, economies of scale and global supply opportunities. Our OEM customers benefit from the aggregation of our global sourcing, procurement, assembly and packaging services, obtaining cost benefits that they might not obtain if they were to rely on their own internal resources, capabilities and more limited demand requirements. Through this process, industrial OEMs are able to reduce their part numbers and supply base by consolidating their procurement and assembly efforts down to a single part number product supplied by us. We deliver this single assembly to an industrial OEM's production line as an integrated drop-in to the OEM's end product.

***Arrangements with Key Suppliers***

We enter into various arrangements with suppliers from which we source engines and other components which are incorporated into our power systems. These arrangements generally govern the terms and conditions upon which we purchase engines, components and other raw materials for use in our power systems. In general, the prices at which we purchase engines, components and other raw materials are based on market factors, including the prices offered by other suppliers operating in the same market and the prevailing market prices of raw materials. The terms of each of the individual arrangements are negotiated with each supplier on an individual basis, but are generally consistent with typical arrangements between manufacturers and suppliers in our industry.

Under our new expanded distribution agreement with Perkins, we are a distributor of specified Perkins engines within a territory consisting of the states of North Dakota, South Dakota, Minnesota, Wisconsin, Iowa, Michigan, Ohio, Indiana, Illinois, Missouri, Nebraska, Kansas, Pennsylvania, New Jersey, Delaware, Maryland (including Washington, District of Columbia), West Virginia, New Hampshire, Vermont, Massachusetts, Maine, Rhode Island, Connecticut and New York. In exchange for this expanded territory, we are required to purchase from Perkins all of our requirements for the same or similar engines covered by the agreement. As described in further detail below under Sales and Marketing; Value-Added Resellers; Distribution Sales and Marketing; Value-Added Resellers, under the distribution agreement with Perkins, we are also required to establish a service and support network that provides various services to our customers that purchase power systems which use Perkins engines. The initial term of this distribution agreement with Perkins is currently scheduled to expire on December 31, 2017.

We are also party to a supply agreement with Doosan, under which we purchase and distribute, on an exclusive basis, specified Doosan engines within a territory consisting of North and Central America. This supply agreement with Doosan automatically renews annually for successive one-year periods but may be terminated with six months' written notice by either party prior to the end of the then-current term.

Unlike our arrangements with Perkins and Doosan, we do not maintain an exclusive relationship with GM. We receive a pricing package each year (or sometimes more frequently) containing applicable price quotations, as if we operate as an OEM that uses GM engines as a key component of our power systems. Purchases of engines from GM are executed through purchase orders at prices listed in the pricing package under the general terms of sale that GM offers to its OEM customers.

**Sales and Marketing; Value-Added Resellers; Distribution**

***Sales and Marketing; Value Added Resellers***

We employ a direct sales and marketing approach to maintain maximum interface with, and service support for, our OEM customers. This direct interface incorporates our internal technical sales representatives. In Asia, we currently complement our direct OEM relationships with a local, independent sales and product support organization. This local sales and support organization provides the necessary knowledge of local customs and requirements, while also

providing immediate sales assistance and customer support. In general, we engage third

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parties to provide local service and support functions for our power systems sold to our domestic OEM customers on a case by case basis, as necessary. Further, as required by our agreement with Perkins, we have also established a service and support network in our territory, as described under **Supplier Relationships**, which provides various services to our customers that purchase power systems using Perkins engines, including warranty support, servicing of Perkins engines, technical support and parts support (including support for aftermarket parts).

In Europe, we enter into arrangements with third parties, pursuant to which these third parties resell our power systems (in some cases sold with add-on power system components) to European OEM customers. These value-added resellers also provide application and engineering support for these power systems sold in Europe. We currently sell our power systems to value-added resellers in Europe on a similar basis as our sales to our OEM customers. At any particular point in time, we are typically selling our power systems to between one and five value-added resellers in Europe.

### ***Aftermarket Distribution***

Our aftermarket and service parts distribution organization consist of three main sales and distribution programs:

*OEM Customers With an In-House, Spark-Ignited Product Service Parts Program:* For our OEM customers that maintain their own service parts distribution and product support programs, we supply them with the information and component products required to support an effective global OEM customer service parts program.

*OEM Customers Without an In-House, Spark-Ignited Product Service Parts Program:* For our OEM customers that do not maintain their own service parts distribution and product support programs, we maintain a web-based and internal sales-oriented global aftermarket and service parts distribution system for our spark-ignited product and ancillary components. Through this product support program that we provide on behalf of our OEM customers, we capitalize on market opportunities that exist outside of those associated with our OEM customer base.

*Perkins Diesel Service Parts Program:* We provide Perkins diesel service parts through a network of established service and parts organizations located throughout our distributor territory, as described above under **Supplier Relationships**.

### **Intellectual Property**

Our business depends, in substantial part, upon our proprietary technology, processes, know-how and other confidential and proprietary information. In particular, we consider portions of our emission certification process to be confidential and proprietary trade secrets. In addition to putting our OEM customers' engines through initial emission compliance testing, including durability testing, production line testing and field compliance audit testing, we also provide the tools, and perform sophisticated testing and other services, on these engines to comply with EPA and CARB requirements. As a result of the lengthy and technologically sophisticated testing we perform to revalidate these engines, we become the manufacturer of record for the emission-certified power system that is incorporated into our OEM customers' equipment. As the manufacturer of record, we are responsible for compliance with regulations as they relate to our emission-certified power systems (as more fully discussed below under **Government Regulation**). We incur the costs of certification of our power systems, as well as the risk of making sure that these systems remain

compliant. Additionally, we use technologically sophisticated development, testing, launching and other manufacturing processes in connection with the manufacturing of our power systems, as well as in coordinating design efforts with power system component suppliers.

In addition, many of the components we source from our suppliers and which are integrated into our power systems embody proprietary intellectual property of such suppliers. To a limited extent, we also license

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proprietary software, much of which is off the shelf, from third parties for use in our manufacturing processes, and we also license and rely upon third party technology included in our telematics tool. We rely on a combination of trademark, trade secret and other intellectual property laws and various contract rights to protect our proprietary rights, as well as to protect the intellectual property rights of our suppliers and third party licensors. We do not currently own any material patents, but believe that the policies and safeguards we have in place, together with the costs associated with the development, testing, launch and marketing of competitive products, adequately protect our valuable trade secrets and other intellectual property rights.

## **Competition**

We believe we are one of the few providers of comprehensive power systems to the industrial OEM market. However, the market for our products and related services is intensely competitive, subject to rapid change and sensitive to new product and service introductions and changes in technical requirements. Some competitors have longer operating histories, strong name recognition and significant financial and marketing resources. Competition in our markets may become more intense as additional companies enter them and as new technologies are adopted. Generally, we believe that the principal competitive factors for our business include the following:

Completeness and comprehensiveness of power systems;

Range of power systems employing a common technology platform;

Emissions regulation (EPA and CARB) compliance and certification;

Industry leading product and applications engineering;

Ease of installation;

Pricing and cost effectiveness;

Breadth of product offerings, including system power and fuel alternatives;

Ability to tailor power systems to specific customer needs;

Performance and quality; and  
Customer support and service.

We believe that, with our current product lineup and our ongoing research and product development efforts, as well as our global procurement capabilities, we are able to compete effectively based on each of these factors.

Among our competitors are fuel system providers such as Westport Innovations, Inc., Fuel System Solutions and Woodward Governor, Inc. These companies supply engines and engine system componentry into the industrial OEM marketplace. However, we do not believe that any of the other fuel system providers with which we compete are able to provide the single assembly, integrated, comprehensive power systems that our OEM customers demand and that we provide on a cost-effective basis. Further, some of our competitors do not have the internal resources or capabilities to enable them to meet these customer requirements and, in their efforts to compete, sometimes rely upon third party logistic companies to fit and dress engine systems with specific engine parts and components which these competitors are unable to provide themselves. As a result of the changing environment of the marketplace, some fuel system providers have been forced into non-core competency areas and some have exited the marketplace entirely.

Other competitors have been automotive engine companies, but a number have ceased directly supplying power systems to industrial OEMs (although they continue to supply their standard engines and components to producers of power systems for this market). They have left this market primarily because production of emission-compliant and certified industrial engines is not in their core competency area and because the changing regulations create difficulties for them, as engine life spans are short. More generally, we believe that

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the significant costs associated with developing and certifying emission-compliant power systems as applicable regulations change have led some companies to exit our markets and have deterred others from entering them.

## **Government Regulation**

### ***Our Power Systems***

Our power systems are subject to extensive statutory and regulatory requirements that directly or indirectly impose standards governing exhaust emissions, evaporative emissions, Green House Gases ( GHG ) emissions, and noise. Our power systems are subject to compliance with all current regulatory standards imposed by the EPA, state regulatory agencies in the United States, including CARB, and other regulatory agencies around the world. Since our engines are sold into both off-road and on-road markets, we must ensure we are certified to the specific regulations within the applicable statutory segment. Both EPA and CARB have imposed specific regulations on engines used in both off-road equipment and on-road vehicles. These regulations generally serve to restrict exhaust emissions, with a primary focus on oxides of nitrogen, hydrocarbons and carbon monoxide. Exhaust emission regulations for engines used in off-highway industrial equipment vary based upon the use of the equipment into which the engine is incorporated (such as stationary power generation or mobile off-highway industrial equipment), and the type of fuel used to drive the power system. Similarly, on-road regulations from the EPA and CARB focus on the same exhaust constituents, however, GHG s such as CO<sub>2</sub> and methane are also regulated, and are required to demonstrate and certify sophisticated On-Board Diagnostics ( OBD ) monitors that ensure that the vehicle will remain emissions compliant over the useful life of the vehicle. We continue to make significant investments into the necessary intellectual property that supports full compliance of our engines now and into the foreseeable future.

The first EPA emissions regulations adopted for diesel engines, known as Tier 1, applied to diesel engines used in mobile off-highway applications in the U.S., and similar standards for diesel engines, known as Stage I regulations, were implemented thereafter in Europe. The EPA and applicable agencies in Europe have continued to develop emission regulations for diesel engines in the U.S. and Europe, respectively, and have adopted more restrictive standards. The current diesel engine emission requirements in the U.S are known as Tier 4 and are applicable to off-road diesel engines used in industrial equipment. Similarly, Europe has adopted more restrictive standards under its Stage IV regulations. Tier 4 and Stage IV regulations call for reductions in levels of particulate matter and oxides of nitrogen (by approximately 90% from current levels in a majority of power categories under the Tier 4 requirements). The phase-in of Tier 4 regulations commenced for the smallest engines (based on horsepower) at the beginning of 2008, and the final phase-in of Tier 4 regulations for engines of all sizes was completed in 2015. The phase-in of the Stage IV regulations commenced in 2014 and was completed in 2015. Because we do not sell diesel power systems in Europe, only the Tier 4 regulations directly impact any of our power systems. With respect to our power systems that use Perkins/Caterpillar diesel engines, Perkins/Caterpillar is responsible for all testing and manufacturing processes associated with obtaining original emission certification and continued compliance for its diesel engines. We are not responsible for emissions compliance on Perkins/Caterpillar products, and as a result, Perkins/Caterpillar is ultimately responsible for modifications to its engines necessary to meet these, and any future, emissions regulations. The EPA and CARB have similarly adopted regulations to reduce pollutant exhaust emissions for spark-ignited engines used in off-road equipment. In 2004, the EPA fully introduced Tier 1 exhaust emission regulations for mobile off-highway large spark ignited engines to control hydrocarbon, oxides of nitrogen and carbon monoxide following a phase in program that started in 2001. In 2007, the EPA introduced Tier 2 exhaust emission regulations for off-highway large spark ignited engines which further reduced hydrocarbon and oxides of nitrogen emissions by approximately 33% and carbon monoxide emissions by 91% over Tier 1. In 2010, CARB enacted new exhaust emission regulations for off-highway large spark-ignited engines, for California only, that further reduced hydrocarbon and oxides of nitrogen emissions by 68% over EPA Tier 2. In 2008, the EPA finalized and enacted New Source Performance Standards to regulate emission for stationary off-highway spark-ignited engines to control



hydrocarbon, oxides of nitrogen, carbon monoxide and volatile organic compound.

Our entry into the on-road market began in 2013 with the development of our 8.8L power systems targeted for 2015 regulatory standards. In 2014, EPA and CARB certified our new engine as a Model Year 2015

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product for propane and Compressed Natural Gas (CNG) fuels, and in 2015 we launched our first propane fueled engine for on-road application. To assist the adoption of alternative fueled vehicles in the marketplace, the EPA and CARB granted alternative fueled engines an exemption from OBD regulations until 2018. We have leveraged this exemption on our 8.8L certifications to date. Gasoline engines are not exempt from OBD regulations, therefore, we are in the process of full OBD certification for our gasoline 8.8L product. The knowledge gained from this development will be transitioned to our alternative fuel engines for 2018 when the exemption ends. In 2016, the EPA launched new GHG emission regulations. However, we are exempt from these new regulations since we are considered a small business (less than 1000 employees). As we grow, our exemption will sunset and our engines will be enhanced to meet all applicable GHG standards.

The initial and on-going certification requirements vary by power system application. Each application must undergo a series of rigorous and demanding tests to meet compliance with regulatory standards, including useful life, zero hours and durability testing to meet the appropriate regulatory standards.

Once a power system is certified, regulatory agencies impose ongoing compliance requirements on us, which include our testing newly produced power systems on a regular quarterly schedule to ensure ongoing compliance with applicable regulations. In addition, there are field audit requirements, which require the removal of power systems from service at specified stages of their useful lives to perform confirmatory exhaust emissions testing.

All of our emission-certified power systems meet existing exhaust emission standards of the EPA and CARB. Failure to comply with these standards could result in adverse effects on our future financial results.

### ***Our Telematics Tool***

We are also subject to various laws and regulations relating to our telematics tool and connected asset services. Among other things, wireless transceiver products are required to be certified by the Federal Communications Commission and comparable authorities in foreign countries where they are sold. We currently maintain applicable certifications from governmental agencies in each of the jurisdictions in which our telematics tool is required to be so certified.

### ***Our Operations***

Our operations are also subject to numerous federal, state and local laws relating to such matters as safe working conditions, manufacturing practices, environmental protection, fire hazard control and disposal of hazardous or potentially hazardous substances. We may be required to incur significant costs to comply with such laws and regulations in the future. Any failure to comply with these laws or regulations could have a material adverse effect upon our ability to do business.

### **Employees**

As of February 22, 2016, our workforce consisted of approximately 819 persons, including 4 part-time staff. Of this total, approximately 59 persons are individuals whose services we obtain through an arrangement with a professional employer organization and 144 persons are from individuals whose services we obtain through a temporary employment agency.

None of the members of our workforce are represented by a union or covered by a collective bargaining agreement. We believe we have a good relationship with the members of our workforce.



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### **Item 1A. Risk Factors**

*Our business, financial condition and results of operations are subject to various risks, including those described below, which in turn may affect the value of our securities. In addition, other risks not presently known to us or that we currently believe to be immaterial may also adversely affect our business, financial condition, results of operations, cash flows or prospects, perhaps materially. The risks discussed below also include forward-looking statements, and actual results and events may differ substantially from those discussed or highlighted in these forward-looking statements. Before making an investment decision with respect to any of our securities, you should carefully consider the following risks and uncertainties described below and elsewhere in this report. See also Cautionary Note Regarding Forward-Looking Statements.*

### **Risks Related to our Business and our Industry**

***The market for alternative fuel spark-ignited power systems may not continue to develop according to our expectations and, as a result, our business may not grow as planned and our business plan may be adversely affected.***

Our future growth is dependent upon the market for efficient alternative fuel spark-ignited power systems (including natural gas and propane) expanding as a result of our customers and potential customers substituting alternative fuel power systems for diesel power systems. Part of our business plan is dependent on our market forecasts with respect to this expected substitution trend. However, there can be no assurance that we can accurately predict the potential impact of new diesel emission regulations, which we assume will help drive this trend by increasing the cost and product footprint of diesel power systems, nor can we assure that customers or potential customers would substitute natural gas and propane powered power systems for diesel power systems in response to these regulations. In addition, to the extent that diesel power system manufacturers develop the ability to design and produce emission-compliant diesel power systems that they can sell at a lower price and have smaller product footprints than we currently expect, diesel power systems will be more competitive with our alternative fuel power systems, and customers and potential customers may be less likely to substitute alternative fuel power systems for diesel power systems. Furthermore, even if alternative fuel power systems are substituted for diesel power systems, there can be no assurance that our power systems would capture any portion of the potential market increase. If the industrial OEM market generally, or more specifically any of the industrial OEM categories which represent a significant portion of our business or in which we anticipate significant growth opportunities for our power systems, fails to develop or develops more slowly than we anticipate, the growth of our business and our business plan could be materially adversely affected.

***Our 8.8 liter engine block is the first engine block manufactured in-house by our company, and may not be successful.***

We have introduced a newly designed 8.8 liter, fuel flexible engine block that we have internally developed to replace an engine that we previously purchased from a third party engine supplier. This is our first engine produced in-house by us. We may not be successful in obtaining acceptance of this product in the marketplace, particularly given that it is in part the replacement for an engine block produced by a well-known and long-time engine manufacturer. Even if this product is accepted in the marketplace, we do not have sufficient history with this engine to assess whether it will succeed without significant performance issues.

The discovery of any significant problems with these engines, or any of the other engines we develop, could result in recall campaigns, increased warranty costs, potential product liability claims, reputational risk and brand risk. More specifically, sales of our own internally developed engine could lead to significantly higher warranty costs to service this engine if it does not perform to expectations, as we would be unable to rely on a warranty provided by a third-party engine manufacturer. Additionally, any performance issues with our internally developed engine could also

result in increased product liability claims, and we would be unable to rely on any indemnification provided by a third-party engine manufacturer. Potential losses could also arise from other unforeseen issues associated with the internal production of our own base engine block. For additional detail

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regarding the risk of introducing a new product such as our 8.8 liter engine, see New products, including new engines we develop, may not achieve widespread adoption. For additional detail regarding the risk of warranty costs and product liability claims, see We could suffer warranty claims that could materially and adversely affect our business and We could become subject to product liability claims.

### ***We may have difficulty managing the expansion of our operations.***

In order to effectively manage our operations and growth, including growth in the sales of, and services related to, our power systems, we may need to:

scale our internal infrastructure, including establishing additional facilities, while continuing to provide technologically sophisticated power systems on a timely basis;

attract and retain sufficient numbers of talented personnel, including application engineers, customer support staff and production personnel;

continue to enhance our compliance and quality assurance systems; and

continue to improve our operational, financial and management controls and reporting systems and procedures.

Rapid expansion of our operations could place a strain on our senior management team, support teams, manufacturing lines, information technology platforms and other resources. In addition, we may be required to place more reliance on our strategic partners and suppliers, some of whom may not be capable of meeting our production demands in terms of timing, quantity, quality or cost. Difficulties in effectively managing the budgeting, forecasting and other process control issues presented by any rapid expansion could harm our business, prospects, results of operations or financial condition.

### ***We may not succeed with the expansion of our product into the on-road market.***

Our current products have historically been sold and used in the off-road industrial markets. We have announced our intention to expand our product line to on-road markets into which we have not previously sold.

The costs and regulations involved with certifying an engine for on-road applications may be more than expected, which could affect our ability to successfully expand our product line into these markets. Additionally, the stresses and demands on engines and power systems used for on-road applications could result in unexpected issues. Not only are we attempting to expand into markets into which we have not previously sold, we are attempting to do so using our newly designed and internally developed 8.8 liter engine. This unproven engine for on-road applications (and other additional applications) may not gain acceptance as an alternative to proven engines already used in on-road applications, and our company may not generally gain acceptance as a supplier to on-road markets. For additional detail regarding the risks related to our newly developed 8.8 liter engine, see Our 8.8 liter engine block is the first engine block manufactured in-house by our company, and may not be successful.

As we begin to sell into these markets, we may expose ourselves to additional costs associated with on-road engine failures. These costs could be significant, not only if the vehicle into which the engine is installed becomes damaged, but because of the increased potential for injuries or fatalities that could arise from a malfunction or manufacturing defect in an engine used for on-road applications. Finally, we may face significantly increased competition in the on-road markets from competitors with longer operating histories, greater name recognition and greater financial and marketing resources than our current competitors in the off-road industrial markets. For additional detail regarding the competition faced by our company, see We currently face, and will continue to face, significant competition, which could result in a decrease in our revenue.

We have expanded our on-road product line by entering a multi-year supply agreement with General Motors for 4.8-liter and 6.0-liter engines. There is no guarantee that we will be successful in expanding our on-road product line which could have an adverse impact on our on-road supply agreement with General Motors.

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### ***New products, including new engines we develop, may not achieve widespread adoption.***

Our growth may depend on our ability to develop and/or acquire new products, and/or refine our existing products and power system technology, to complement and enhance the breadth of our power system offerings with respect to engine class and the industrial OEM market categories into which we supply our products. We will generally seek to develop or acquire new products, or enhance our existing products and power system technology, if we believe they will provide significant additional revenues and favorable profit margins. However, we cannot know beforehand whether any new or enhanced products will successfully penetrate our target markets. There can be no assurance that newly developed or acquired products will perform as well as we expect, or that such products will gain widespread adoption among our customers.

Additionally, there are greater design and operational risks associated with new products. The inability of our suppliers to produce technologically sophisticated components for our new engines and power systems, the discovery of any product or process defects or failures associated with production of any new products and any related product returns could each have a material adverse effect on our business, financial condition and results of operations. If new products for which we expend significant resources to develop or acquire are not successful, our business could be adversely affected.

### ***Changes in environmental and regulatory policies could hurt the market for our products.***

Our business is affected by government environmental policies, mandates and regulations around the world, most significantly with respect to emission standards in the United States. Examples of such regulations include those that (1) restrict the sale of power systems that do not meet emission standards, (2) impose penalties on sellers of non-compliant power systems, and (3) require the use of more expensive ultra-low sulfur diesel fuel. There can be no assurance that these policies, mandates and regulations will be continued or expanded as assumed in our growth strategy. Incumbent industry participants with a vested interest in gasoline and diesel, many of which have substantially greater resources than we do, may invest significant resources in an effort to influence environmental regulations in ways that delay or repeal requirements for more stringent carbon, particulate matter (a mixture of solid particles and liquid droplets found in the air that contain a variety of chemical components, such as dust, dirt, soot or smoke) and other emissions.

We generally must obtain product certification from both the EPA and CARB to sell our products in the United States. We may attempt to expand sales of our certified power systems to industrial OEMs that sell their products in Europe, which also has stringent emissions requirements. Accordingly, future sales of our product will depend upon their being certified to meet the existing and future air quality and energy standards imposed by the relevant regulatory agencies. While we incur significant research and developments costs to ensure that our products comply with emission standards and meet certification requirements in the regions where our products are sold, we cannot provide assurance that our products will continue to meet these standards. The failure to comply with certification requirements would not only adversely affect future sales but could result in the recall of our products or civil or criminal penalties.

The adoption of new, more stringent and burdensome government emission regulations, whether at the foreign, federal, state, or local level, in markets in which we supply our power systems, may require modification of our emission certification and other manufacturing processes for our power systems. Thus, we might incur unanticipated expenses in meeting future compliance requirements, and may be required to increase our research and product development expenditures. Increases in such costs and expenses could necessitate increases in the prices we charge our OEM customers for our power systems, which could adversely affect demand for them.



***We currently face, and will continue to face, significant competition, which could result in a decrease in our revenue.***

The market for our products and related services is highly competitive, subject to rapid change and sensitive to new product and service introductions and changes in technical requirements. New developments in power system technology may negatively affect the development or sale of some or all of our power systems or make

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our power systems uncompetitive or obsolete. Other companies, some of which have longer operating histories, greater name recognition and greater financial and marketing resources than us, are currently engaged in the development of products and technologies that are similar to, or may be competitive with, certain of our products and power system technologies. If the markets for our products (including particular industrial OEM market categories) grow as we anticipate, competition may intensify, as existing and new competitors identify opportunities in such markets.

We face competition from companies that employ current power system technologies, and may face competition in the future from additional companies as new power system technologies are adopted. Among our competitors are fuel system providers such as Westport Innovations, Inc., Fuel System Solutions and Woodward Governor, Inc., which supply engines and engine system components to the industrial OEM marketplace. Additionally, we may face competition from companies developing technologies such as cleaner diesel engines, bio-diesel, fuel cells, advanced batteries and hybrid battery/internal combustion power systems. We may not be able to incorporate such technologies into our product offerings, or may be required to devote substantial resources to do so. The success of our business depends in large part on our ability to provide single assembly, integrated, comprehensive, technologically sophisticated power systems to our customers. The development or enhancement by our competitors of similar capabilities could adversely affect our business.

### ***Our industrial OEM customers may not continue to outsource their power system needs.***

The purchasers of our power systems are industrial OEMs that manufacture industrial equipment. As a result of the significant resources and expertise required to develop and manufacture emission-certified power systems, these customers have historically chosen to outsource production of power systems to us. Our business depends in significant part on our industrial OEMs continuing to outsource design and production of power systems, power system components and subsystems. However, there can be no assurance that our OEM customers will continue to outsource, or outsource as much of, their power system production in the future. Industrial OEMs that otherwise might use our power systems may instead seek to internalize the production of these power systems and related components. Increased levels of OEM vertical integration could result from a number of factors, such as shifts in our customers business strategies, acquisition by a customer of a power system manufacturer or the emergence of low-cost production opportunities in foreign countries.

### ***We are dependent on certain products and industrial OEM market categories for a significant share of our revenues and profits.***

During fiscal 2015, a significant portion of our revenues were derived from sales of our power systems to be incorporated into equipment used in the power generation and forklift market categories, and we anticipate that sales of power systems in these market categories will continue to represent a significant portion of our revenues for the foreseeable future. We further believe that our growth may depend in a significant part upon our ability to increase sales of our power systems in the material handling and oil and gas market categories, as well as certain other industrial OEM categories. There can be no assurance that the material handling and oil and gas market categories, or any other industrial market category into which we sell our power systems, will grow as quickly or as significantly as we expect (if at all), or that the current, or any future, demand for our power systems in any of these market categories will not decrease.

### ***We are dependent on relationships with our OEM customers and any change in our relationships with any of our key OEM customers could have a material adverse effect on our business and financial results.***

Our power systems are integrated into our OEM customers' equipment for subsequent sales and distribution to end-users of off-highway industrial equipment. Two and three of our customers represented more than 10% of our sales in 2015 and 2013, and 2014, respectively. We do not currently have formal, written agreements with certain of these customers or some of our other largest customers. There can be no assurance that our current material customers, or industrial OEMs in general, will continue manufacturing equipment that uses our power.

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systems or, if they do manufacture such equipment, that the end-users of our OEM customers will choose to purchase products into which our power systems are incorporated. Any integration, design, manufacturing or marketing problems encountered by our OEM customers could adversely affect the demand for our power systems and the ability of our OEM customers to timely pay us amounts due for our products and services. Any change in our relationships with any of our key OEM customers, whether as a result of economic or competitive pressures or otherwise, including any decision by our OEM customers to reduce their commitments to purchase our power systems in favor of competing products, could have a material adverse effect on our business and financial results.

In addition, we may be subject to disputes arising from agreements and other arrangements with our OEM customers. Disputes with our OEM customers could lead to termination of arrangements with our OEM customers and delays in collaborative development or commercialization of power systems that we design for, and supply to, these customers. Moreover, disagreements may arise with our OEM customers over rights to proprietary technology and other intellectual property incorporated in our power systems and our customers' products into which our power systems are integrated. Significant disagreements with our OEM customers could result in costly and time-consuming litigation. Any such conflicts with our OEM customers could negatively impact our relationships, reduce the number of power systems which we supply, and negatively impact our ability to obtain future business, in each case with these and other OEM customers.

***We are dependent on relationships with our material suppliers, and the partial or complete loss of one of these key suppliers, or the failure to find replacement suppliers or manufacturers in a timely manner, could adversely affect our business.***

In addition to our internally produced engines, we source engines from third party suppliers. We have established relationships with these third party engine suppliers and other suppliers from which we source our components for our power systems. We are substantially dependent on our three key engine suppliers, General Motors, Perkins/Caterpillar, SAME and Doosan. Sales of our power systems incorporating engines from General Motors, Perkins/Caterpillar, SAME and Doosan represented approximately 37%, 5%, 14% and 24% of our total sales for fiscal 2015, respectively, and represented approximately 38%, 8%, 14% and 36% of our total sales for fiscal 2014, respectively. If any of these four engine suppliers were to fail to provide engines in a timely manner or to supply engines that meet our quality, quantity or cost requirements, or were to discontinue manufacturing any engines we source from them or providing any such engines to us, and we were unable to obtain substitute sources in a timely manner or on terms acceptable to us, our ability to manufacture our products could be materially adversely affected. In addition, we currently source other important components used in our power systems, such as catalysts, engine controllers, fuel mixers, wiring harnesses, engine sensors and intake manifolds, from a limited number of suppliers. Much of the technology incorporated into these components that we source from a limited number of suppliers is technologically sophisticated, and we do not believe that our competitors have access to some of this sophisticated technology. Our business could be harmed by adverse changes in our relationships with our non-engine component suppliers, or if our competitors gain access to the technology. Further, if our suppliers are unable to provide components to us in a timely manner, or are unable to meet our quality, quantity or cost requirements, we may not in all cases be able to promptly obtain substitute sources. Any extended delay in receiving engines or other critical components could impair our ability to deliver products to our OEM customers.

We do not have formal, written agreements with many of our component suppliers. Most of our non-engine component supply agreements did not extend past the end of 2015. In any event, a component supplier may fail to provide components on a timely basis, or fail to meet our specifications or other requirements for a component, regardless of whether we have a written contract with such supplier.

***We derive a substantial majority of our diesel power systems revenues from our relationships with Perkins and Caterpillar.***

We derive a significant portion of our diesel power systems business from our distribution agreement with Perkins, our packaging and distribution agreements with Caterpillar engine dealers and our association with

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Caterpillar. Our business with Perkins and Caterpillar represented approximately 7% and 10% of our revenues in fiscal 2015 and 2014, respectively. Any material change in our relationships with Perkins and Caterpillar, including the termination of our distribution agreement with Perkins, could have a material adverse effect on our business and financial results.

***The quality and performance of our power systems are, in part, dependent on the quality of their component parts that we obtain from various suppliers, which makes us susceptible to performance issues that could materially and adversely affect our business, reputation and financial results.***

Our power systems are sophisticated and complex, and the success of our power systems is dependent, in part, upon the quality and performance of key components, such as engines, fuel systems, generators, breakers, and complex electrical components and associated software. There can be no assurance that the power system parts and components will not have performance issues from time to time, and the warranties provided by our suppliers may not always cover the potential performance issues. We may face disputes with our suppliers with respect to those performance issues and their warranty obligations, and our customers could claim damages as a result of such performance issues.

If any of the component parts we obtain from our suppliers are defective, we may incur liabilities for warranty claims. The supplier in any such case may not fully compensate us for any such liabilities. We may also be responsible for obtaining replacement parts and incur liability related thereto.

***We maintain a significant investment in inventory, and a decline in our customers' purchases could lead to a decline in our sales and profitability and cause us to accumulate excess inventory.***

We cannot always predict the timing, frequency or size of the future orders of our OEM customers. Our ability to accurately forecast our sales is further complicated by the continuing global economic uncertainty. We maintain significant inventories in an effort to ensure that our OEM customers have a reliable source of supply. If we fail to anticipate the changing needs of our customers and accurately forecast our customer demands, our customers may not continue to place orders with us, and we may accumulate significant inventories of products that we will be unable to sell or return to our suppliers. This may result in a significant decline in the value of our inventory and a decrease in our future gross profit.

***Changes in our product mix could materially and adversely affect our business.***

The margins on our revenues from some of our product and service offerings are higher than the margins on some of our other product and service offerings. In particular, the margins vary between sales of our power systems as compared to sales of our aftermarket parts and components. A decrease in demand for our higher margin products and service offerings, such as our heavy duty power systems, could have a negative impact on our profitability. Our margins can also fluctuate based upon competition, alternative products and services, operating costs and contractual factors. In addition, we may not be able to accurately estimate the margins of some of our new and developing products and services due to our limited operating history with sales of these products. Our new products and services may have lower margins than our current products and services.

***Our financial position, results of operations and cash flows have been, and may in the future be, negatively impacted by challenging global economic conditions.***

Challenging global economic conditions, which can have a particularly severe impact on industrial markets, have had, and may in the future have, a material adverse effect on our business. More specifically, such conditions resulted in significantly reduced demand in 2009 for our power systems and other products from our industrial OEM customers,

as those customers faced sharp declines in market demand for their products into which our power systems are incorporated. Our net sales decreased from 2008 to 2009, primarily due to lower power system shipment volumes and aftermarket parts sales resulting from this reduced demand. This sales

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decrease was reflected across our base of customers in all of the OEM categories in which our power systems are used. Difficult market conditions can also cause us to experience pricing pressure, negatively impacting our margins.

Future economic downturns may materially impact our OEM customers, as well as suppliers and other parties with which we do business. Economic conditions that adversely affect our customers may cause them to terminate existing supply agreements or to reduce the volume of power systems they purchase from us in the future. In the case of another economic downturn, we may have significant receivables owing from customers that face liquidity issues. Failure to collect a significant portion of amounts due on those receivables could have a material adverse effect on our results of operations and financial condition. Similarly, with adverse market conditions, our key suppliers from which we source power system components may be unable to provide components to us or extend us credit. Furthermore, we may not be able to successfully anticipate, plan for and respond to changing economic conditions, and our business could be negatively affected.

### ***Fuel price differentials are hard to predict and may have an adverse impact on the demand for our products in the future.***

The prices of various fuel alternatives are subject to fluctuation, based upon many factors, including changes in resource bases, pipeline transportation capacity for natural gas, refining capacity for crude oil and government excise and fuel tax policies. The price differential among various fuel alternatives can impact OEMs and their decisions to buy power systems from us. For example, if fossil fuel prices increase significantly, OEMs may choose to seek power systems powered by electric motors instead of ones that use fossil fuels. Furthermore, if OEMs do decide to purchase power systems from us, relative fuel prices may affect which power systems they purchase from us. The margins on our sale of certain of our power systems are higher than the margins on other power systems that we sell to our OEM customers. See Changes in our product mix could materially and adversely affect our business.

### ***The volatility of oil and gas prices may affect our stock price.***

While our company develops alternative fuel spark-engine power systems for off-road industrial equipment and the 8.8 liter engine for on-road vehicles, we may be affected by the price of oil and gas. The investing public may categorize our stock with other fuel or alternative energy stocks, thus the volatility of the price of oil and gas may affect the price of our stock. In particular, when the price of oil declines, oil becomes a more favorable source of fuel in the short term and alternative fuel and energy producers suffer as a result. This, as with any commodity volatility, will occur from time to time and may adversely affect the price of our stock.

Also, certain of our products are used in the oil and gas industry, primarily in support of operating wells and not exploration activities. At times of severely depressed energy prices, such as have recently occurred, oil and gas producers can and do curtail capital expenditures, sometimes sharply. In addition, oil and gas producers may cease or suspend production at well sites that have or are likely to become unprofitable. As a result, sales of our products could be severely impacted during periods of a prolonged depression in energy prices which could have a material adverse effect on our financial condition and results of operations.

### ***Price increases in some of the key components in our power systems could materially and adversely affect our operating results and cash flows.***

The prices of some of the key components of our power systems are subject to fluctuation due to market forces beyond our control, including changes in the costs of raw materials incorporated into these components. Such price increases occur from time to time due to spot shortages of commodities, increases in labor costs or longer-term shortages due to market forces. In particular, the prices of certain precious metals used in our emissions control



systems fluctuate frequently and often significantly. Substantial increases in the prices of raw materials used in components which we source from our suppliers may result in increased prices charged by our suppliers. If we incur price increases from our suppliers for key components in our power systems, our

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production costs will increase. Given competitive market conditions, we may not be able to pass all or any of those cost increases on to our OEM customers in the form of higher sales prices. To the extent our competitors do not suffer comparable component cost increases to our customers, we may have even greater difficulty passing along price increases and our competitive position may be harmed. As a result, increases in costs of key components may adversely affect our margins and otherwise adversely affect our operating results and cash flows.

***Many of our power systems involve long and variable design and sales cycles, which could have a negative impact on our results of operations for any given quarter or year.***

The design and sales cycle for our customized power systems, from initial contact with our potential OEM customer to the commencement of shipments of our power systems, may be lengthy. Customers generally consider a wide range of issues before making a decision to purchase our power systems. Before an industrial OEM commits to purchase our power systems, they often require a significant technical review, assessment of competitive products and approval at a number of management levels within their organization. During the time our customers are evaluating our products, we may incur substantial sales and marketing, engineering and research and development expenses to customize our power systems to the customer's needs. We may also expend significant management efforts, increase manufacturing capacity, order long-lead-time components or purchase significant amounts of power system components and other inventory prior to receiving an order. Even after this evaluation process, a potential customer may not purchase our products.

***Our existing debt or new debt that we incur could adversely affect our business and growth prospects.***

We are required to meet certain obligations under a credit agreement with Wells Fargo Bank, NA. and an indenture with respect to our 5.50% Senior Notes. Failure or inability to meet such obligations under our current credit agreement, indenture or any new credit facility could materially and adversely affect our business. In addition, our debt obligations could make us more vulnerable to adverse economic and industry conditions and could limit our flexibility in planning for, or reacting to, changes in our business and the industries in which we operate. Our indebtedness, the cash flow needed to satisfy our debt and the covenants contained in current and potential future credit and debt agreements and indenture have important consequences, including:

limiting funds otherwise available for financing our capital expenditures by requiring us to dedicate a portion of our cash flows from operations to the repayment of debt and the interest on this debt;

limiting our ability to incur additional indebtedness;

limiting our ability to capitalize on significant business opportunities, including mergers, acquisitions and other strategic transactions;

placing us at a competitive disadvantage to those of our competitors that are less indebted than we are;

making us more vulnerable to rising interest rates;

and making us more vulnerable in the event of a downturn in our business.

More specifically, pursuant to our current credit agreement with our senior lender, we have agreed to certain financial covenants, including maintaining certain ratios between our adjusted earnings before interest, taxes, depreciation and amortization and our fixed charges. In addition, our current credit agreement places limitations on our ability to make acquisitions of other companies and our current credit agreement and our indenture restrict our ability to incur additional indebtedness. Any failure by us to comply with the financial covenants set forth in our current credit agreement in the future, if not cured or waived, could result in our senior lender accelerating the maturity of our indebtedness or preventing us from accessing availability under our credit facility. If the maturity of our indebtedness is accelerated, we may not have sufficient cash resources to satisfy our debt obligations and we may not be able to continue our operations as planned.

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Furthermore, we may incur substantial additional indebtedness in the future. If new debt or other liabilities are added to our current debt levels, the related risks that we now face, as described above, could intensify.

### ***Our quarterly operating results are subject to variability from quarter to quarter.***

Our quarter-to-quarter and quarter-over-quarter operating results (including our sales, gross profit and net income) and cash flows have been, and in the future may be, impacted by a variety of internal and external events associated with our business operations, many of which are outside of our control. Examples of such events include (1) changes in regulatory emission requirements (which generally occur on January 1 of the year in which they become effective), (2) customer product phase-in/phase-out programs, (3) supplier product (i.e. a specific engine model) phase-in/phase-out programs, (4) changes in pricing by suppliers to us of engines, components and other parts (typically effective January 1 of any year), and (5) changes in our pricing to our customers (typically effective January 1 of any year), which may be related to changes in the pricing by suppliers to us.

In order to mitigate potential availability or pricing issues, customers may adjust their demand requirements from traditional patterns. We may also extend special programs to customers in advance of such events, and we are more likely to offer such programs in our fourth quarter of a year in anticipation of events expected to occur in the first quarter of the next year. The occurrence of any of the events discussed above may result in fluctuations in our operating results (including sales and profitability) and cash flows between and among reporting periods.

### ***If we fail to adequately protect our intellectual property rights, we could lose important proprietary technology, which could materially and adversely affect our business.***

We believe that the success of our business depends, in substantial part, upon our proprietary technology, information, processes and know-how. The unauthorized use of our intellectual property rights and proprietary technology by others could materially harm our business. We do not own any material patents and rely on a combination of trademark and trade secret laws, along with confidentiality agreements, contractual provisions and licensing arrangements, to establish and protect our intellectual property rights. Although certain of our employees have entered into confidentiality agreements with us to protect our proprietary technology and processes, not all of our employees have executed such agreements, nor can we ensure that employees who have executed such agreements will not violate them.

Despite our efforts to protect our intellectual property rights, existing laws afford only limited protection, and our actions may be inadequate to protect our rights or to prevent others from claiming violations of their proprietary rights. Unauthorized third parties may attempt to copy, reverse engineer or otherwise obtain, use or exploit aspects of our products and services, develop similar technology independently, or otherwise obtain and use information that we regard as proprietary. We cannot assure you that our competitors will not independently develop technology similar or superior to our technology or design around our intellectual property.

In addition, the laws of some foreign countries may not protect our proprietary rights as fully or in the same manner as the laws of the United States. In particular, we sell our power systems to industrial OEM customers, and source certain components from suppliers, in China, where commercial laws are relatively underdeveloped compared to other geographic markets into which we sell our products. Protection of intellectual property is limited under Chinese law, and the sale of our products and the local sourcing of components may subject us to an increased risk of infringement or misappropriation of our intellectual property. As a result, we cannot be certain that we will be able to adequately protect our intellectual property rights in China.

We may need to resort to litigation to enforce our intellectual property rights to protect our trade secrets and to determine the validity and scope of other companies' proprietary rights in the future. However, litigation could result in significant costs or in the diversion of financial resources and management's attention. We cannot assure you that any such litigation will be successful or that we will prevail over counterclaims against us.

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In addition, many of the components we source from our suppliers and which are incorporated into our power systems use proprietary intellectual property of our suppliers. We also license or rely upon certain intellectual property from third parties, including the back office software and functionality for our telematics tool, MasterTrak. For a description of MasterTrak, our telematics tool, see Business Our Products and Industry Categories Connected Asset Services. Any of these third parties from which we source our power system components, from which we license intellectual property or on whose intellectual property we rely, may also supply these components (or other components that incorporate the same intellectual property) or license or provide such intellectual property, as applicable, to others, including our competitors, or terminate our access to such intellectual property.

***If we face claims of intellectual property infringement by third parties, we could encounter expensive litigation, be liable for significant damages or incur restrictions on our ability to sell our products and services.***

We cannot be certain that our products, services and power system technologies, including any intellectual property licensed from third parties for use therein or incorporated into components that we source from our suppliers, do not, or in the future will not, infringe or otherwise violate the intellectual property rights of third parties. We are not aware of all of the proprietary technology incorporated into, or used in developing, the components that we source and integrate into our power systems, nor are we familiar with all of the technology included in, or used in developing, products that are competitive with these components. Furthermore, the design, prototyping, testing and engineering capabilities we use to manufacture our power systems are technologically sophisticated, and we consider the processes by which we develop our power systems to be confidential and proprietary trade secrets. To compete in the industrial OEM market, our competitors likely also use proprietary development processes to manufacture their products. Given that neither we nor our competitors make information regarding such manufacturing and development processes available to the public, we cannot know the extent to which there may be any commonality between our respective processes and cannot be certain that we are not infringing on any intellectual property rights of others. In addition, for the above reasons, we cannot assure you that third parties will not claim that we have infringed their intellectual property rights.

We may in the future be subject to infringement claims that may result in litigation. Successful infringement claims against us could result in substantial monetary liability, require us to enter into royalty or licensing arrangements, or otherwise materially disrupt the conduct of our business. In addition, even if we prevail in the defense of any such claims, any such litigation could be time-consuming and expensive to defend or settle, and could result in the diversion of the time and attention of management and of operational resources, which could materially and adversely affect our business. Any potential intellectual property litigation also could force us to do one or more of the following:

stop selling and/or using the specific products and/or services incorporating the allegedly infringing technology and/or stop incorporating the allegedly infringing technology into such products and/or services;

obtain from the owner of the infringed intellectual property right a license to sell and/or use the relevant technology, which license may not be available on commercially reasonable terms, or at all; or

redesign the products and/or services that incorporate the allegedly infringing technology.

***We could suffer warranty claims or be subject to product liability claims, both of which could materially and adversely affect our business.***

From time to time, we may incur liabilities for warranty claims as a result of defective products or components, including claims arising from defective products or components provided by our suppliers that are integrated into our power systems. The provisions we make for warranty accrual may not be sufficient or we may be unable to rely on a warranty provided by a third-party manufacturer, and we may recognize additional expenses as a result of warranty claims in excess of our current expectations. Such warranty claims may

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necessitate a redesign, re-specification, a change in manufacturing processes, and/or recall of our power systems, which could have an adverse impact on our finances and on existing or future sales of our power systems and other products. Even in the absence of any warranty claims, a product deficiency such as a manufacturing defect or a safety issue may necessitate a product recall, which could have an adverse impact on our finances and on existing or future sales.

Our business exposes us to potential product liability claims that are inherent to natural gas, propane, gasoline and diesel, and products that use these fuels. Natural gas, propane and gasoline are flammable and are potentially dangerous products. Any accidents involving our power systems could materially impede widespread market acceptance and demand for our power systems. In addition, we may be subject to a claim by end-users of our OEM customers' products or others alleging that they have suffered property damage, personal injury or death because our power systems or the products of our customers into which our power systems are integrated did not perform adequately. Such a claim could be made whether or not our power systems perform adequately under the circumstances. From time to time, we may be subject to product liability claims in the ordinary course of business, and we carry a limited amount of product liability insurance for this purpose. However, our current insurance policies may not provide sufficient or any coverage for such claims, and we cannot predict whether we will be able to maintain our insurance coverage on commercially acceptable terms.

### ***If we do not properly manage the sales of our products into foreign markets, our business could suffer.***

We have sales and distribution activities in Asia and Europe, where we may lack sufficient expertise, knowledge of local customs or contacts. In Asia, we depend upon an independent sales and support organization to complement our OEM relationships and provide knowledge of local customs and requirements, while also providing immediate sales assistance and customer support. There can be no assurance that we will be able to maintain our current relationship with this independent sales and support organization, or that we will be able to develop effective, similar relationships in foreign markets into which we supply our products in the future.

Growing the market for our products in Asia and other markets outside of the United States may take longer and cost more to develop than we anticipate and is subject to inherent risks, including unexpected changes in government policies, trade barriers restricting our ability to sell our products in those countries, longer payment cycles, exposure to currency fluctuations, and foreign exchange controls that restrict or prohibit repatriation of funds. As a result, if we do not properly manage foreign sales, our business could suffer.

In addition, our foreign sales subject us to numerous stringent U.S. and foreign laws, including the Foreign Corrupt Practices Act (FCPA), and comparable foreign laws and regulations which prohibit improper payments or offers of payments to foreign governments and their officials and political parties by U.S. and other business entities for the purpose of obtaining or retaining business. Safeguards that we may implement to discourage these practices could prove to be ineffective, and violations of the FCPA and other laws may result in severe criminal or civil sanctions, or other liabilities or proceedings against us, including class action lawsuits and enforcement actions from the SEC, Department of Justice and overseas regulators. Any of these factors, or any other international factors, could impair our ability to effectively sell our power systems, or other products or services that we may develop, outside of the U.S.

### ***If our production facilities become inoperable, our business, including our ability to manufacture our power systems, will be harmed.***

We operate our business, including all of our production and manufacturing processes, out of facilities that are located in West Suburban Illinois, Darien, Wisconsin and Madison Heights, Michigan. If damaged, our facilities, our manufacturing lines, the equipment we use to perform our emission certification and other tests and our other business



process systems would be costly to replace and could require substantial time to repair or replace. We are particularly subject to this risk because of the current geographic concentration of our facilities in Wood Dale, Illinois which accounted for over 83% of our fiscal 2015 net sales. Our facilities may be harmed or rendered

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inoperable by natural or man-made disasters, including inclement weather, earthquakes, wildfires, floods, acts of terrorism or other criminal activities, infectious disease outbreaks and power outages, which may render it difficult or impossible for us to efficiently operate our business for some period of time. In addition, such events may temporarily interrupt our ability to receive engines, fuel systems or other components for our power systems from our suppliers and to have access to our various production systems necessary to operate our business. Our insurance covering damage to our properties and the disruption of our business may not be sufficient to cover all of our potential losses and may not continue to be available to us on acceptable terms, or at all.

In the event our facilities are damaged or destroyed, we may need to find another facility into which we can move our operations. Finding a facility that meets the criteria necessary to operate our business would be time-consuming and costly and result in delays in our ability to provide our sophisticated power systems or to provide the same level of quality in our services as we currently provide.

### ***We may be adversely impacted by work stoppages and other labor matters.***

Our workforce consists of full-time and part-time employees, as well as members of our production team whose services we obtain through an arrangement with a professional employer organization. While none of the members of our workforce are currently represented by a union or covered by a collective bargaining agreement, there have been unsuccessful efforts to unionize our manufacturing employees in the past, and there can be no assurance that members of our workforce will not in the future join a union. If our employees organize and join a union in the future, there can be no assurance that future issues with our workforce will be resolved favorably or that we will not encounter future strikes, work stoppages or other types of conflicts with labor unions or our employees. Any of these consequences may have an adverse effect on us or may limit our flexibility in dealing with our workforce.

In addition, many of our suppliers have unionized work forces. Work stoppages or slow-downs experienced by our material suppliers could result in slow-downs or closures at the manufacturing facilities of our suppliers from where our power system components are sourced. If one or more of our key suppliers experience a material work stoppage, it could have a material adverse effect on our operations.

### ***Our business could be adversely affected by increased compensation costs or difficulties in attracting staff for our business including those related to our acquisitions.***

Compensation is a significant component of our operating costs, and we believe talented and hardworking staff are a key part of our success. We devote significant resources to training our staff. Increased compensation costs due to factors like additional taxes or benefit costs, including the requirements of the Patient Protection and Affordable Care Act, as well as competition, increased minimum wage requirements, and other benefit mandates that may be required in the future could adversely impact our operating results. Our success depends in part on our ability to hire, motivate, and retain qualified staff. As we continue to expand, we will need to promote or hire additional staff, and it may be difficult to attract or retain such individuals as a result of these increased compensation and benefit mandates without incurring significant additional costs.

### ***The loss of one or more key members of our senior management, or our inability to attract and retain qualified personnel could harm our business.***

Our success and future growth depends to a significant degree on the skills and continued services of our management team, in particular Gary Winemaster, our Chief Executive Officer and President, Eric Cohen, our Chief Operating Officer and Michael Lewis, our Chief Financial Officer, as well as other members of management and key employees of our affiliates and subsidiaries. The loss of any of our key members of management could inhibit our growth

prospects, limit our acquisition and joint venture opportunities or impede upon our integration of acquired businesses, technologies services or products, including Powertrain Integration, LLC and Professional Power Products, Inc. Our future success also depends in large part on our ability to attract,

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retain and motivate key management, engineering, manufacturing and operating personnel. As we develop additional capabilities, we may require more skilled personnel. Given the highly specialized nature of our power systems, these personnel must be highly skilled and have a sound understanding of our industry, business and our technology. The market for such personnel is highly competitive. As a result, we may not be able to continue to attract and retain the personnel needed to support our business.

***Our products could become subject to additional emissions regulations under the EPA if our headcount exceeds threshold amounts codified under federal regulations in the U. S and the compliance cost and development timing required to support these potential additional regulations could adversely affect or operating results.***

We currently qualify for an exemption for Phase I Greenhouse Gas Emissions under 40 CFR Section 1036.150(d). Failure to qualify for this exemption could have a material adverse effect on our ability to sell our products to some of our largest customers. While we are aware of and are planning to comply with such regulations should the regulations change or if the exemption is no longer available, the cost and development of compliance could adversely affect our operating results.

***Governmental regulation in one or more of the following areas may adversely affect our existing and future operations and financial results, including harming our ability to expand or by increasing our operating costs.***

We are subject to various federal and state laws governing our relationship with and other matters pertaining to our staff, including wage and hour laws, requirements to provide meal and rest periods or other benefits, family leave mandates, requirements regarding working conditions and accommodations to certain employees, citizenship or work authorization and related requirements, insurance and workers' compensation rules and anti-discrimination laws. Complying with these rules can be cumbersome and subjects us to substantial expense. These rules can also expose us to liabilities arising from claims for non-compliance. We could suffer losses from, and we could incur legal costs to defend lawsuits or claims, and the amount of such losses or costs could be significant. In addition, several states and localities in which we operate and the federal government from time to time have enacted minimum wage increases, paid sick leave and mandatory vacation accruals, and similar requirements and such changes, when enacted, could increase our compensation costs and have an adverse impact on our operating results.

We are subject to state and federal immigration laws, and the U.S. Congress and Department of Homeland Security from time to time consider or implement changes to Federal immigration laws, regulations or enforcement programs. Changes in immigration or work authorization laws may increase our obligations for compliance and oversight, which could subject us to additional costs and make our hiring process more cumbersome, or reduce the availability of potential qualified staff. Although we require all workers to provide us with government-specified documentation evidencing their employment eligibility, some of our staff may, without our knowledge, be unauthorized workers. Ineligible staff may subject us to fines or penalties, and we could experience adverse publicity that negatively impacts our business, disrupted operations and difficulty hiring and retaining qualified staff. Claims arising from inadequate documentation of the eligibility of our staff as a result of not fully complying with all recordkeeping obligations of federal and state immigration compliance laws could result in other penalties and costs that could have a material adverse effect our operating results.

We are also audited from time to time for compliance with citizenship or work authorization requirements. Unauthorized staff may subject us to fines or penalties, and if any of our staff are found to be unauthorized our business may be disrupted as we try to replace lost staff with other qualified individuals. On the other hand, in the event we wrongfully reject work authorization documents, or if our compliance procedures are found to have a disparate impact on a protected class, such as a racial minority or based on the citizenship status of applicants, we could be found to be in violation of anti-discrimination laws. We could experience adverse publicity arising from

enforcement activity related to work authorization compliance, anti-discrimination compliance, or both, that negatively impacts our business, adversely impacts our operating results, and may make it more difficult to hire and retain qualified staff.

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*We could be adversely affected by risks associated with acquisitions and joint ventures, including those in the Asian markets.*

From time to time, we may seek to expand our business through investments in, joint ventures with or acquisitions of, complementary businesses, technologies, services or products, subject to our business plans and management's ability to identify, acquire and develop suitable investments or acquisition targets in both new and existing industrial OEM market categories and geographic markets. In certain circumstances, acceptable investments or acquisition targets might not be available. Acquisitions involve a number of risks, including: (1) difficulty in integrating the operations, technologies, products and personnel of an acquired business, including consolidating redundant facilities and infrastructure; (2) potential disruption of our ongoing business and the distraction of management from our day-to-day operations; (3) difficulty entering markets in which we have limited or no prior experience and in which competitors have a stronger market position; (4) difficulty maintaining the quality of services that such acquired companies have historically provided; (5) potential legal and financial responsibility for liabilities of acquired businesses; (6) overpayment for the acquired company or assets or failure to achieve anticipated benefits, such as cost savings and revenue enhancements; (7) increased expenses associated with completing an acquisition and amortizing any acquired intangible assets; (8) challenges in implementing uniform standards, accounting policies, customs, controls, procedures and policies throughout an acquired business; (9) failure to retain, motivate and integrate key management and other employees of the acquired business; and (10) loss of customers and a failure to integrate customer bases.

We may be subject to some or all of the risks and uncertainties described above in connection with our acquisition of Professional Power Products, Inc., particularly because it was the first acquisition we completed, or any of the acquisitions made during 2015. See Note 3, "Acquisitions", to our consolidated financial statements for further details. The economic benefits, cost savings and other synergies that we anticipate as a result of that transaction may not be fully realized or may take longer to realize than we expect. Furthermore, the operating results of these acquisitions may be more volatile and less predictable than those of our core business. In addition, we incurred substantial additional indebtedness to finance the cash purchase price we paid to acquire these operations, reducing our capacity to borrow additional amounts and requiring us to dedicate a greater percentage of our cash flow from operations to payments on our debt, thereby reducing the cash resources available to us to fund capital expenditures, pursue other acquisitions or investments in new technologies and meet general corporate and working capital needs. This increased indebtedness may also limit our flexibility in planning for, and reacting to, changes in or challenges relating to our business and industry.

If we were to pursue future acquisition or investment opportunities, the potential risks could disrupt our ongoing business, result in the loss of key customers or personnel, increase expenses and otherwise have a material adverse effect on our business, results of operations and financial condition. In addition, under the terms of our credit facility, we may be restricted from engaging in certain acquisition transactions. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and capital resources."

In 2012, we entered into a joint venture with another entity for the purpose of manufacturing, assembling and selling certain power systems into the Asian market, and specifically to distribute such power systems from the joint venture's manufacturing facility in China. The facility in China was completed in 2013 and manufacturing is due to commence in the near future. Further, in late 2014, we entered into a joint venture with a worldwide construction and utility equipment manufacturer headquartered in South Korea. The joint venture, equally owned by both companies, will leverage the strengths of each to design, develop, produce, market and distribute industrial gas power systems to the global market. There can be no assurances that the joint ventures will be successful. The formation of the ventures and establishment of the businesses will require significant management and capital resources and there can be no assurances that such resources will be available. Operations at the joint ventures could expose us to risks inherent in such activities, such as protection of our intellectual property, economic and political stability, labor matters, language

and cultural differences, including cultural differences that could be construed as violations of U.S. or other anti-bribery laws; and the need to manage product development, operations and sales activities that are located a long distance from our

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headquarters. The management of new product development activities and the sharing or transfer of technological capabilities to the joint ventures will expose us to risks. In addition, from time to time in the future, our joint venture partners may have economic or business interests or goals that are different from ours. Furthermore, each joint venture will require us to make equity contributions from time to time up to specified amounts. If each joint venture business does not progress according to our plans and anticipated timing, our investment in the joint ventures may not be considered successful.

***Failure to raise additional capital or to generate the significant capital necessary to continue our growth could reduce our ability to compete and could harm our business.***

We may need to raise additional capital in the future, and we may not be able to obtain additional debt or equity financing on favorable terms, if at all. Our current credit facility and our indenture governing our 5.50% Senior Notes contain covenants restricting our ability to enter into additional debt financing. See Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and capital resources—Credit agreement for a description of our credit facility and indenture. We may offer and sell up to \$150,000,000 of common stock, preferred stock, debt securities, depositary shares, warrants, subscription rights, stock purchase contracts and units under a universal shelf registration statement. If we raise additional equity financing, our stockholders may experience significant dilution of their ownership interests, and the per share value of our common stock could decline. Furthermore, if we engage in additional debt financing, the holders of debt would have priority over the holders of common stock, and we may be required to accept terms that restrict our ability to incur additional indebtedness, and take other actions that would otherwise be in the interests of our stockholders and force us to maintain specified liquidity or other ratios. If we need additional capital and cannot raise it on acceptable terms, we may not, among other things, be able to:

continue to expand our research and product development operations and sales and marketing organization;

expand operations both organically and through acquisitions; or

respond to competitive pressures or unanticipated working capital requirements.

***We are and will continue to be subject to foreign laws, rules and regulations as our business expands into these foreign markets and cannot be certain as to our continued compliance and costs related thereto.***

We are subject to, and may become subject to additional, state, federal and international laws and regulations governing our environmental, labor, trade and tax practices. These laws and regulations, particularly those applicable to our international operations, are or may be complex, extensive and subject to change. We will need to ensure that we and our OEM customers and suppliers timely comply with such laws and regulations, which may result in an increase in our operating costs. For example, in August 2012, the Securities and Exchange Commission adopted final rules to implement Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act intended to improve transparency and accountability concerning the supply of minerals originating from the conflict zones of the Democratic Republic of Congo or adjoining countries, which obligates us to conduct a reasonable country of origin inquiry with respect to conflict minerals included in components of products we directly manufacture, contract to manufacture and purchase to include in products. Other legislation has been, and may in the future be, enacted in other locations where we manufacture or sell our products. In addition, climate change and financial reform legislation in the United States is a significant topic of discussion and has generated and may continue to generate federal or other



regulatory responses in the near future. If we or our component suppliers fail to timely comply with applicable legislation, our customers may refuse to purchase our products or we may face increased operating costs as a result of taxes, fines or penalties, which could have a materially adverse effect on our business, financial condition and operating results. In connection with our compliance with such environmental laws and regulations, as well as our compliance with industry environmental initiatives, the standards of business conduct required by some of our customers, and our commitment to sound corporate citizenship in all aspects of our business, we could incur substantial compliance

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and operating costs and be subject to disruptions to our operations and logistics. In addition, if we were found to be in violation of these laws or noncompliant with these initiatives or standards of conduct, we could be subject to governmental fines, liability to our customers and damage to our reputation and corporate brand which could cause our financial condition or operating results to suffer.

***We could become liable for damages resulting from our manufacturing activities.***

The nature of our manufacturing operations exposes us to potential claims and liability for environmental damage, personal injury, loss of life and damage to, or destruction of, property. Our manufacturing operations are subject to numerous laws and regulations that govern environmental protection and human health and safety. These laws and regulations have changed frequently in the past and it is reasonable to expect additional and more stringent changes in the future. Our manufacturing operations may not comply with future laws and regulations, and we may be required to make significant unanticipated capital and operating expenditures to bring our operations within compliance with such regulations. If we fail to comply with applicable environmental laws and regulations, manufacturing guidelines, and workplace safety requirements, governmental authorities may seek to impose fines and penalties on us or to revoke or deny the issuance or renewal of operating permits, and private parties may seek damages from us. Under such circumstances, we could be required to curtail or cease operations, conduct site remediation or other corrective action, or pay substantial damage claims for which we may not have sufficient or any insurance coverage for claims.

***We may have unanticipated tax liabilities that could adversely impact our results of operations and financial condition.***

We are subject to various types of taxes in the U.S., as well as foreign jurisdictions into which we supply our products. The determination of our provision for income taxes and other tax accruals involves various judgments, and therefore the ultimate tax determination is subject to uncertainty. Also, changes in tax laws, regulations, or rules may adversely affect our future reported financial results, may impact the way in which we conduct our business, or may increase the risk of audit by the Internal Revenue Service or other tax authority. In addition, in our normal course of business, we are subject to Internal Revenue Service audit or other audit by state, local and foreign tax authorities. The final determinations of any tax audits in the U.S. or abroad could be materially different from our historical income tax provisions and accruals. If any taxing authority disagrees with the positions taken by us on our tax returns, we could incur additional tax liabilities, including interest and penalties.

***Changes in accounting standards or inaccurate estimates or assumptions in applying accounting policies could adversely affect us.***

Our accounting policies and methods are fundamental to how we record and report our financial condition and results of operations. Some of these policies require use of estimates and assumptions that may affect the reported value of our assets or liabilities and results of operations and are critical because they require management to make difficult, subjective and complex judgments about matters that are inherently uncertain. If those assumptions, estimates or judgments were incorrectly made, we could be required to correct and restate prior-period financial statements.

***The Company has significant goodwill and amortizable intangible assets. An impairment of goodwill or amortizable intangible assets could result in a significant charge to earnings.***

In accordance with generally accepted accounting principles, we test goodwill for impairment at least annually and review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill would also be tested for impairment when factors might indicate that the carrying value may not be recoverable. One such factor may be reduced cash flow estimates. Another factor could

be a sustained decline in our stock price which reduces our market capitalization

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below our book value. We would be required to record a charge in the financial statements during the period in which any impairment of goodwill or amortizable intangible assets is determined.

### ***Impairment charges could have a material adverse effect on the Company's operating results.***

Future events may occur that might adversely affect the reported value of our assets and require impairment charges. Such events may include, but are not limited to, strategic decisions made in response to changes in economic and competitive conditions, the impact of the economic environment on our customer base, a material adverse change in our relationship with significant customers or business partners, or a sustained decline in our stock price.

We evaluate the impact of economic and other developments on the Company. We currently utilize market capitalization to assess the fair value of the Company. If our total market capitalization is below reported consolidated stockholders' equity at a future reporting date and for a sustained period, we would consider this an indicator of potential impairment of goodwill. As a result, we may be required to perform additional impairment tests based on changes in the economic environment and other factors, to corroborate an initial indication of impairment, and such corroboration could result in an impairment charge at that time.

## **Risks Related to the Ownership of our Common Stock**

***We incur significant costs and demands upon management and accounting and finance resources as a result of complying with the laws and regulations affecting public companies; any failure to establish and maintain adequate internal control over financial reporting or to recruit, train and retain necessary accounting and finance personnel could have an adverse effect on our ability to accurately and timely prepare our financial statements.***

As a public operating company, we incur significant administrative, legal, accounting and other burdens and expenses beyond those of a private company, including those associated with corporate governance requirements, public company reporting obligations and NASDAQ listing requirements. In particular, we have needed to enhance and supplement our internal accounting resources with additional accounting and finance personnel with the requisite technical and public company experience and expertise, as well as refine our quarterly and annual financial statement closing process, to enable us to satisfy such reporting obligations.

Furthermore, we are required to comply with Section 404 of the Sarbanes-Oxley Act of 2002, including the auditor attestation requirements of Section 404(b) of the Sarbanes-Oxley Act of 2002. In order to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, we are required to document and test our internal control procedures and prepare annual management assessments of the effectiveness of our internal control over financial reporting. These assessments must include disclosure of identified material weaknesses in our internal control over financial reporting. The existence of one or more material weaknesses could affect the accuracy and timing of our financial reporting. Testing and maintaining internal control over financial reporting involves significant costs and could divert management's attention from other matters that are important to our business. Additionally, we cannot provide any assurances that we will be successful in remediating any deficiencies that may be identified. If we are unable to remediate any such deficiencies or otherwise fail to establish and maintain adequate accounting systems and internal control over financial reporting, or we are unable to continue to recruit, train and retain necessary accounting and finance personnel, we may not be able to accurately and timely prepare our financial statements and otherwise satisfy our public reporting obligations. Any inaccuracies in our financial statements or other public disclosures (in particular if resulting in the need to restate previously filed financial statements), or delays in our making required SEC filings, could have a material adverse effect on the confidence in our financial reporting, our credibility in the marketplace and the trading price of our common stock.

In prior periods, as a smaller reporting company, we were able to take advantage of an exemption from the auditor attestation requirements of Section 404(b) of the Sarbanes-Oxley Act of 2002. As we no longer

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qualify as a smaller reporting company, compliance with these auditor attestation requirements have required additional costs and significant time and resources from our management and finance and accounting personnel. See Item 9A. Controls and Procedures, for Management's Report on Internal Control Over Financial Reporting.

Furthermore, we are now deemed to be an accelerated filer and are subject to time constraints with respect to our financial and public reporting obligations. While we used every effort to plan accordingly for this reporting obligation and NASDAQ listing requirements we cannot be certain that our planning will continue to be effective and timely. The reporting obligations pertain not only to the finance and accounting departments, but impact almost all employees, processes and technology throughout our company.

In addition, our management team must continue to adapt to other requirements of being a public company. We need to devote significant resources to address these public company-associated requirements, including compliance programs and investor relations, as well as our financial reporting obligations. We incur substantial legal and financial compliance costs as a result of complying with these rules and regulations promulgated by the SEC.

### ***Concentration of ownership among our existing executive officers may prevent new investors from influencing significant corporate decisions.***

As of February 22, 2016, Gary Winemaster, our Chairman of the Board, Chief Executive Officer and President, and Kenneth Winemaster, Senior Vice President, beneficially owned in the aggregate approximately 56.29% of our outstanding shares of common stock. On a fully-diluted basis, assuming the exercise of all outstanding warrants and outstanding stock appreciation rights, such individuals beneficially owned in the aggregate approximately 53.68% of our outstanding shares of common stock. As of February 22, 2016, Gary Winemaster alone beneficially owned approximately 36.02% of our outstanding shares of common stock. On a fully diluted basis, assuming the exercise of all outstanding warrants and outstanding stock appreciation rights, Gary Winemaster alone beneficially owned approximately 34.34% of our outstanding shares of common stock.

As a result of Messrs. Winemasters' beneficial ownership of a significant majority of our outstanding shares of common stock, these stockholders can exercise control over matters requiring stockholder approval, including the election of directors, amendment of our articles of incorporation and approval of significant corporate transactions. This control could have the effect of delaying or preventing a change of control of our company or changes in management and will make the approval of certain transactions impossible without the support of these stockholders.

### ***The price of our stock may be volatile and may decline in value.***

The trading price of our common stock may be highly volatile and could be subject to wide fluctuations in response to various factors, including the price of oil and gas or other fuel sources, some of which are beyond our control. The stock market in general has experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of companies with securities traded in those markets. Broad market and industry factors may seriously affect the market price of companies' stock, including ours, regardless of actual operating performance. In addition, in the past, following periods of volatility in the overall market and the market price of a particular company's securities, securities class action litigation has often been instituted against these companies. This litigation, if instituted against us, could result in substantial costs and a diversion of our management's attention and resources.

### ***Future sales by us or our existing stockholders could depress the market price of our common stock.***

Sales of a substantial number of shares of common stock, or the perception that sales could occur, could adversely affect the market price of our common stock. We may offer and sell up to \$150,000,000 of common

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stock, preferred stock, debt securities, depositary shares, warrants, subscription rights, stock purchase contracts and units and certain selling stockholders may offer to sell up to 500,000 shares of common stock under a universal shelf registration. If we or our existing stockholders sell a large number of shares of our common stock, or if we sell additional securities that are convertible into common stock, in the future, the market price of our common stock similarly could decline. Further, even the perception in the public market that we or our existing stockholders might sell shares of common stock could depress the market price of our common stock.

### ***Our actual operating results may differ significantly from our guidance.***

From time to time, we release guidance regarding our future performance that represents our management's estimates as of the date of release. This guidance, which consists of forward-looking statements, is prepared by our management and is qualified by, and subject to, the assumptions and the other information contained or referred to in the release. Our guidance is not prepared with a view toward compliance with published guidelines of the American Institute of Certified Public Accountants, and neither our independent registered public accounting firm nor any other independent expert or outside party compiles or examines the guidance and, accordingly, no such person expresses any opinion or any other form of assurance with respect thereto. Guidance is based upon a number of assumptions and estimates that, while presented with numerical specificity, is inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control and are based upon specific assumptions with respect to future business decisions, some of which will change. The principal reason that we release this data is to provide a basis for our management to discuss our business outlook with analysts and investors. We do not accept any responsibility for any projections or reports published by any such persons. Guidance is necessarily speculative in nature, and it can be expected that some or all of the assumptions of the guidance furnished by us will not materialize or will vary significantly from actual results. Accordingly, our guidance is only an estimate of what management believes is realizable as of the date of release. Actual results will vary from the guidance, and the variations may be material. Investors should also recognize that the reliability of any forecasted financial data diminishes the farther in the future that the data is forecast. In light of the foregoing, investors are urged to put the guidance in context and not to place undue reliance on it. Any failure to successfully implement our operating strategy or the occurrence of any of the events or circumstances set forth in this Annual Report on Form 10-K could result in the actual operating results being different than the guidance, and such differences may be adverse and material.

### ***We have discretion in the use of borrowings under our revolving line of credit and may use them in a manner in which our stockholders would not consider appropriate.***

Our management has broad discretion in the application of the borrowings under our revolving line of credit. Our stockholders may not agree with the manner in which our management chooses to allocate and spend these funds. The failure by our management to apply these funds effectively could have a material adverse effect on our business.

### ***Anti-takeover provisions contained in our certificate of incorporation and bylaws, as well as provisions of Delaware law, could impair a takeover attempt.***

In addition to the concentration of ownership described under **Concentration of ownership** among our existing executive officers and their affiliates may prevent new investors from influencing significant corporate decisions above, which will prevent any attempt to acquire control of our company not supported by these significant stockholders, our certificate of incorporation, bylaws and Delaware law contain provisions which could have the effect of rendering more difficult, delaying or preventing an acquisition deemed undesirable by our board of directors. Our organizational documents, include provisions authorizing blank check preferred stock, which may be issued by our board of directors without stockholder approval and may contain voting, liquidation, dividend and other rights superior to our common stock





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These provisions, alone or together, could delay or prevent hostile takeovers and changes in control or changes in our management. Provisions of Delaware law may also have anti-takeover effects. Any provision of our certificate of incorporation or bylaws or Delaware law that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock.

***Our stockholders may experience significant dilution if future equity offerings are used to fund operations or acquire complementary businesses.***

If we engage in capital raising activities in the future, including issuances of common stock, to fund the growth of our business, our stockholders could experience significant dilution. In addition, securities issued in connection with future financing activities or potential acquisitions may have rights and preferences senior to the rights and preferences of our common stock.

During 2012, we adopted the 2012 Incentive Compensation Plan, which was amended in 2013 to increase the number of shares available for awards pursuant to this plan. The issuance of shares of our common stock upon the exercise of any equity awards granted pursuant to this plan may result in dilution to our stockholders and adversely affect our earnings.

***If securities or industry analysts cease publishing, research or reports about us, our business or our market, or if they change their recommendations regarding our stock adversely, our stock price and trading volume could decline.***

The trading market for our common stock will be influenced by the extent to which industry or securities analysts publish research and reports about us, our business, our market or our competitors and what they publish in those reports. Any analysts that do cover us may make adverse recommendations regarding our stock, adversely change their recommendations from time to time, and/or provide more favorable relative recommendations about our competitors. If any analyst who covers us were to cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline.

***We do not anticipate paying any dividends in the foreseeable future.***

The payment of dividends is currently restricted by our credit agreement with Wells Fargo Bank, N.A. and the indenture governing our 5.50% Senior Notes with a final maturity in 2018. We intend to retain our future earnings to support operations and to finance expansion and, therefore, we do not anticipate paying any cash dividends to holders of our common stock in the foreseeable future. Because we do not anticipate paying dividends in the future, the only opportunity to realize the value of our common stock will likely be through an appreciation in value and a sale of those shares. There is no guarantee that shares of our common stock will appreciate in value or even maintain the price at which a stockholder purchased his, her or its shares.

**Table of Contents****Item 1B. Unresolved Staff Comments.**

Not applicable.

**Item 2. Properties.**

We operate within approximately an aggregate of 818,000 square feet of space in four facilities located in the Chicago, Illinois area, one located in Darien, Wisconsin and one located in Madison Heights, Michigan. The following table lists the location of each of our six facilities materially important to our business (one of which we own, and the others of which are leased by us), that facility's principal use, the approximate square footage of that facility, and the current lease expiration date (to the extent applicable):

| Location                  | Principal Use                                                                                    | Square Footage | Lease Expiration   |
|---------------------------|--------------------------------------------------------------------------------------------------|----------------|--------------------|
| Wood Dale, Illinois       | Research & Development                                                                           | 42,000         | Owned              |
| Darien, Wisconsin         | Company Offices; Finance; Human Resources; Production; Warehousing & Distribution; Sales Support | 134,000        | March 31, 2021     |
| Wood Dale, Illinois       | Executive Offices; Production; Warehousing & Distribution; Sales Support                         | 261,000        | July 31, 2018      |
| Wood Dale, Illinois       | Corporate Offices; Finance; Human Resources; Production Warehousing                              | 116,000        | July 31, 2018      |
| Itasca, Illinois          | Research & Development; Production                                                               | 197,000        | July 31, 2023      |
| Madison Heights, Michigan | Company Offices; Production; Warehousing & Distribution; Sales Support; Finance; Human Resources | 47,000         | September 30, 2016 |

The facilities collectively house our manufacturing operations. As noted above, we have expanded the square footage in which we operate and believe our newly expanded facilities are adequate to meet our current and future needs.

**Item 3. Legal Proceedings.**

From time to time, in the normal course of business, we are a party to various legal proceedings. We do not expect that any currently pending proceedings will have a material adverse effect on our business, results of operations, financial condition or cash flows.

**Item 4. Mine Safety Disclosures.**

Not applicable.

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.**

Our common stock is listed on The NASDAQ Capital Market under the symbol PSIX. The table below sets forth the high and low sale prices per share of our common stock on The NASDAQ Capital Market for the last two fiscal years.

|                                            | <b>High</b> | <b>Low</b> |
|--------------------------------------------|-------------|------------|
| <b>Fiscal Year Ended December 31, 2015</b> |             |            |
| First Quarter                              | \$ 66.61    | \$ 40.83   |
| Second Quarter                             | \$ 69.79    | \$ 49.28   |
| Third Quarter                              | \$ 54.44    | \$ 22.09   |
| Fourth Quarter                             | \$ 28.92    | \$ 16.75   |
| <b>Fiscal Year Ended December 31, 2014</b> |             |            |
| First Quarter                              | \$ 87.40    | \$ 56.53   |
| Second Quarter                             | \$ 88.96    | \$ 66.03   |
| Third Quarter                              | \$ 79.50    | \$ 58.03   |
| Fourth Quarter                             | \$ 74.57    | \$ 43.74   |

As of February 22, 2016, the last reported sale price for our common stock on The NASDAQ Capital Market was \$10.76 per share.

**Holders**

As of February 22, 2016, there were approximately 32 holders of record of our common stock. The actual number of stockholders is significantly greater than this number of record holders and includes stockholders who are beneficial owners but whose shares are held in street name by brokers and other nominees. This number of holders of record also does not include stockholders whose shares may be held in trust by other entities.

**Dividend Policy**

We have not paid any cash dividends on our common stock to date. The payment of dividends is currently restricted by our credit agreement with Wells Fargo Bank, National Association and the indenture governing our 5.50% Senior Notes due 2018. We intend to retain our future earnings to support operations and to finance expansion. See

Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Credit Agreements—below for a further discussion regarding restrictions on the payment of dividends under our credit facility and indenture.

**Securities Authorized for Issuance Under Compensation Plans**

See Item 12, Securities Authorized for Issuance Under Compensation Plans.

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**Performance Graph**

Comparison of the Russell 2000 and our Peer group

The basis of comparison is a \$100 investment at April of 2012 in each of: (i) Power Solutions International, Inc., (ii) our Peer Group (which consists of Westport Innovations, Inc., Fuel Systems Solutions, Inc. and Woodward, Inc.), and (iii) the Russell 2000. The Company believes the companies included in this index provide the most representative sample of enterprises that are in primary lines of business that are similar to Power Solutions International, Inc. The above graph, including the related table is not soliciting material, is not deemed to be filed with the SEC and is not incorporated by reference in any of our filings under the Securities Act or the Securities Exchange Act of 1934 whether made before or after the date hereof and irrespective of any general incorporation language in any such filing.

**Issuer Purchases of Equity Securities**

During the fourth quarter of the year ended December 31, 2015, we did not make any repurchases of equity securities.

**Table of Contents****Item 6. Selected Financial Data.**

|                                                                           | Year ended<br>December<br>31,<br>2015 | Year ended<br>December<br>31,<br>2014 | Year ended<br>December 31,<br>2013 | Year ended<br>December 31,<br>2012 | Year ended<br>December 31,<br>2011 |
|---------------------------------------------------------------------------|---------------------------------------|---------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| <b>Results of operations data</b>                                         |                                       |                                       |                                    |                                    |                                    |
| Net sales                                                                 | \$ 389,446                            | \$ 347,995                            | \$ 237,842                         | \$ 202,342                         | \$ 154,969                         |
| Operating income                                                          | 9,195                                 | 26,044                                | 14,967                             | 12,316                             | 9,805                              |
| Income (loss) before income taxes                                         | 13,890                                | 34,539                                | (14,001)                           | 10,845                             | 6,834                              |
| Net income (loss)                                                         | \$ 14,278                             | \$ 23,726                             | \$ (18,760)                        | \$ 6,702                           | \$ 4,061                           |
| Undistributed earnings                                                    | \$ 14,278                             | \$ 23,726                             | \$ (18,760)                        | \$ 6,702                           | \$ 4,061                           |
| Undistributed earnings allocable to Series A convertible preferred shares | \$                                    | \$                                    | \$                                 | \$                                 | \$ 2,513                           |
| Undistributed earnings allocable to common shares                         | \$ 14,278                             | \$ 23,726                             | \$ (18,760)                        | \$ 6,702                           | \$ 1,548                           |
| <b>Weighted-average common shares outstanding (a)</b>                     |                                       |                                       |                                    |                                    |                                    |
| Basic                                                                     | 10,808,005                            | 10,706,780                            | 9,779,457                          | 9,068,846                          | 3,512,534                          |
| Diluted                                                                   | 11,073,647                            | 11,131,617                            | 9,779,457                          | 9,068,846                          | 3,512,534                          |
| Earnings per share basic Common shares                                    | \$ 1.32                               | \$ 2.22                               | \$ (1.92)                          | \$ 0.74                            | \$ 0.44                            |
| Earnings per share diluted Common shares                                  | \$ 0.45                               | \$ 1.58                               | \$ (1.92)                          | \$ 0.74                            | \$ 0.44                            |
|                                                                           | As of<br>December<br>31,<br>2015      | As of<br>December<br>31,<br>2014      | As of<br>December<br>31,<br>2013   | As of<br>December<br>31,<br>2012   | As of<br>December<br>31,<br>2011   |
| <b>Balance sheet data</b>                                                 |                                       |                                       |                                    |                                    |                                    |
| Total assets (b)                                                          | \$ 359,936                            | \$ 262,637                            | \$ 126,619                         | \$ 90,765                          | \$ 71,083                          |
| Total liabilities                                                         | 253,639                               | 171,838                               | 76,198                             | 68,031                             | 55,759                             |
| Long-term obligations (c)                                                 | 154,377                               | 95,790                                | 43,813                             | 35,367                             | 3,917                              |
| Common stockholders equity                                                | 106,297                               | 90,799                                | 50,421                             | 22,734                             | 15,324                             |

- (a) On July 16, 2013, the Company closed an underwritten public offering of 2,005,000 shares of its common stock at a price to the public of \$35.00 per share. The Company sold 1,050,000 shares of its common stock, and certain selling stockholders, sold 955,000 shares of common stock in the offering. The proceeds to the Company, net of the underwriter's fees and expenses, were \$34,530,000 before deducting offering expenses of approximately \$514,000 paid by the Company. The Company did not receive any proceeds from the sale of the shares by the selling stockholders.

- (b) During 2015 and 2014, the Company made four acquisitions collectively. Refer to Note 3, Acquisitions to the consolidated financial statements, for a further discussion of these acquisitions.
- (c) Prior to 2012, the Company's revolving line of credit was required to be classified as a current liability on its consolidated balance sheet. The revolving line of credit was classified as a long-term obligation as of December 31, 2012 and thereafter on the Company's consolidated balance sheet. Accordingly, the long-term obligation amount reported herein as of December 31, 2011 excludes the revolving line of credit. The revolving line of credit was \$97,299,000, \$78,030,000, \$17,933,000, \$30,942,000 and \$19,666,000 as of December 31, 2015, 2014, 2013, 2012 and 2011, respectively. On April 24, 2015, the Company entered into a purchase agreement with certain institutional investors for a private sale of an aggregate amount of \$55.0 million of the Company's unsecured 5.50% Senior Notes. The sale closed on April 29, 2015. In connection with the issuance of the Senior Notes, the Company entered into an indenture agreement dated April 29,

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2015, by and among the Company, The Bank of New York Mellon, as Trustee, and the Company's subsidiaries as guarantors. The Company received net proceeds of \$53,483,000 after financing costs of \$1,517,000. Refer to Note 8, Debt to the consolidated financial statements, for a further discussion of this long-term obligation.



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### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. Management's Discussion and Analysis of**

#### **Financial Condition and Results of Operations**

*The following discussion and analysis includes forward-looking statements about our business, financial condition and results of operations, including discussions about management's expectations for our business. These statements represent projections, beliefs and expectations based on current circumstances and conditions and in light of recent events and trends, and you should not construe these statements either as assurances of performance or as promises of a given course of action. Instead, various known and unknown factors are likely to cause our actual performance and management's actions to vary, and the results of these variances may be both material and adverse. A description of material factors known to us that may cause our results to vary, or may cause management to deviate from its current plans and expectations, is set forth under Risk Factors. See Cautionary Note Regarding Forward-Looking Statements. The following discussion should also be read in conjunction with our financial statements and the related notes included in this report.*

#### **Overview**

#### **Organization**

We design, manufacture, distribute and support power systems and large custom-engineered integrated electrical power generation systems for industrial OEMs across a broad range of industries including stationary electricity power generation, oil and gas, material handling, aerial work platforms, industrial sweepers, arbor, welding, airport ground support, turf, agricultural, construction and irrigation. We also develop and deliver power systems aimed at on-road markets including medium duty fleets, delivery trucks, school buses and garbage trucks. Our engineering personnel design and test power system solutions and components supporting those solutions. We operate as one business and geographic operating segment. Accordingly, the following discussion is based upon this presentation.

#### *Net sales*

We generate revenues and cash primarily from the sale of off-highway industrial power systems and aftermarket parts to industrial OEMs and power systems to on-road markets. Our products and services are sold predominantly to customers throughout North America, as well as, to customers located throughout the Pacific Rim and Europe. Net sales are derived from gross sales less sales returns and/or sales discounts.

#### *Cost of sales*

We manufacture and assemble our products at our primary facilities in suburban Chicago, Illinois, Darien, Wisconsin and Madison Heights, Michigan. Materials used to manufacture and assemble our power systems account for the most significant component of our costs. Our cost of sales includes, labor, freight, depreciation and other inventoriable costs such as allocated overhead. Additionally, we also include the costs to procure materials and service our products as components of our cost of sales.

#### *Operating expenses*

Operating expenses include research & development and engineering, selling and service and general and administrative expenses. Research & development and engineering expense includes both internal personnel costs and expenses associated with outsourced third party engineering relationships. Research & development and engineering

activities are staff intensive. Costs incurred primarily consist of salaries and benefits for professional engineers, materials used in the development of new products and applications, and amounts paid to

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third parties under contractual engineering agreements. Research & development and engineering staff focus on advanced product development, application design, customer product support and other engineering related activities. Our advanced product development and application design staff primarily focus on current and future product design, prototyping, testing and application development activities. Our customer product support group provides dedicated engineering and technical attention to customer production support, including a direct communication link with our internal operations.

Selling and service expense represents the costs of our sales team, an aftermarket sales group and certain costs associated with field service and support of our products. We utilize a direct sales and marketing approach to maintain maximum customer interface and service support. Salaries and benefits, together with expenses associated with travel, account for the majority of the costs in this category.

General and administrative expense principally represents costs of our corporate office and personnel that provide management, accounting, finance, human resources, information systems and related services which support the organization. In addition to salaries and benefits, costs include public company expenses, consulting and professional services fees, insurance premiums, banking fees and other general facility and administrative support costs.

Amortization expense principally represents costs associated with the amortization of certain acquisition-related intangible assets.

### *Other (income) expense*

Other (income) expense includes interest expense on our revolving line of credit and other obligations upon which we pay interest, changes in the valuation of the warrants issued in the private placement that closed on April 29, 2011, and other pre-tax transactions. The change in the valuation of our private placement warrants liability is based upon fluctuations in the market price of our common stock which can vary significantly from period to period. Other (income) expense may also include other non-operating expenses from time to time, such as a loss on debt extinguishment, valuation adjustments associated with acquisition activity, and other matters which are not otherwise considered operating income or expense.

## **2015 Significant developments**

### *5.50% Senior Notes Due 2018*

On April 24, 2015, we entered into a purchase agreement with certain institutional investors for a private sale of an aggregate amount of \$55.0 million in unsecured 5.50% Senior Notes. The sale closed on April 29, 2015. In connection with the issuance of the Senior Notes, we entered into an indenture agreement dated April 29, 2015, by and among us, The Bank of New York Mellon, as Trustee, and our subsidiaries as guarantors. We received net proceeds of \$53,483,000 after financing costs of \$1,517,000. The Senior Notes are unsecured debt of our Company and are effectively subordinated to our existing and future secured debt including the obligation under our revolving line of credit. The Senior Notes have a final maturity date of May 1, 2018, subject to earlier mandatory repurchase, under certain circumstances, as more fully described below under, *Credit Agreements, 5.50% Senior Notes Due 2018* .

### *Acquisition of Powertrain Integration, LLC*

On May 4, 2015, we entered into an Asset Purchase Agreement ( APA ) with Powertrain Integration, LLC ( Powertrain ) and its owners, to acquire the assets of Powertrain. Powertrain provides on-road powertrain solutions, including systems, components and services for niche OEM automakers and fleets. Powertrain also specializes in

alternative-fuel as well as gasoline and diesel systems and offers design, engineering, testing and production capabilities to deliver one-stop vehicle integration. The acquisition was completed on May 19, 2015. The cash consideration paid, net of working capital adjustments totaled \$20,776,000. We also recorded an initial

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liability of \$8,200,000 as of the date of acquisition representing the contingent consideration associated with the Base Earn-out Payment and Additional Earn-out Payment for a provisional aggregate purchase price of \$28,976,000. As of December 31, 2015, the Base Earn-out Payment and The Additional Earn-out Payment were finalized at \$8,248,000. The additional liability was recorded as an adjustment within Other (income) expense within our consolidated statement of operations for the year ended December 31, 2015.

We have accounted for this acquisition as a business combination in accordance with ASC 805, *Business Combinations*, and as such, the excess of the purchase price over the fair values assigned to the assets acquired and liabilities assumed was allocated to goodwill. The acquisition of Powertrain has been accounted for as a purchase of assets for income tax purposes. Accordingly, the financial and income tax bases of the assets and liabilities were assumed to be the same at the date of acquisition, and therefore, a provision for deferred income tax was not recorded in connection with the purchase price allocation, and the excess of the purchase price over the fair value of the assets acquired is expected to be deductible for income tax purposes. Refer to Note 3, *Acquisitions* to our consolidated financial statements, for a further discussion of the acquisition. The acquisition was funded by the proceeds received from the issuance of the 5.50% Senior Notes described in Note 8, *Debt*, to our consolidated financial statements.

*Acquisition of Bi-Phase Technologies, LLC*

On May 1, 2015, we acquired all of the membership interests in Bi-Phase Technologies, LLC, a Minnesota limited liability company ( *Bi-Phase* ) and wholly-owned subsidiary of TPB, Inc., a Minnesota corporation. Bi-Phase is engaged in the design and manufacture of liquid propane electronic fuel injection systems to allow for the conversion of vehicles from gasoline to propane. The purchase price was \$3,500,000 plus certain working capital, assumption of certain liabilities and Earn-out Payments as defined in the Membership Interest Purchase Agreement. The cash paid was \$3,885,000 which represented the purchase price of \$3,500,000 plus an adjustment for working capital. We also recorded a contingent consideration liability of \$540,000, representing an estimate of the Earn-out Payments expected to be payable in connection with the acquisition of Bi-Phase. This contingent consideration, payable to TPB, Inc., is based upon sales of Bi-Phase fuel systems over a period of three to five years. Accordingly, the aggregate purchase price approximated \$4,425,000.

We have accounted for this acquisition as a business combination in accordance with ASC 805, *Business Combinations*, and as such, the excess of the purchase price over the fair values assigned to the assets acquired and liabilities assumed was allocated to goodwill. The acquisition of Bi-Phase was accounted for as a purchase of assets for income tax purposes. Accordingly, the financial and income tax bases of the assets and liabilities were assumed to be the same at the date of acquisition, and a provision for deferred income tax was not recorded in connection with the purchase price allocation. The excess of the purchase price over the fair value of the assets acquired is expected to be deductible for income tax purposes. Refer to Note 3, *Acquisitions* to our consolidated financial statements, for a further discussion of the acquisition. The acquisition was funded by the proceeds received from the issuance of the 5.50% Senior Notes described in Note 8, *Debt*, to our consolidated financial statements.

*Acquisition of Bucks*

On March 18, 2015, we acquired all of the membership interests in Bucks Acquisition Company, LLC ( *Bucks* ) from UE Powertrain d/b/a Bucks Engines and United Holdings, LLC, for cash of \$9,735,000. Bucks is a manufacturer of alternative-fuel engines for industrial markets and was formerly a product line of United Engines, LLC. Bucks supplies a range of alternative-fuel engines that run on natural gas, propane and liquid propane gas fuels. Bucks targets an extensive range of industrial applications, including irrigation, gas compression, oil production, industrial equipment, power generation, mobile equipment, wind turbines, and re-power applications.



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We have accounted for this acquisition as a business combination in accordance with ASC 805, *Business Combinations*, and as such, the excess of the purchase price over the fair values assigned to the assets acquired and liabilities assumed was allocated to goodwill. The acquisition of Buck's was accounted for as a purchase of assets for income tax purposes. Accordingly, the financial and income tax bases of the assets and liabilities were assumed to be the same at the date of acquisition, and a provision for deferred income tax was not recorded in connection with the purchase price allocation. The excess of the purchase price over the fair value of the assets acquired is expected to be deductible for income tax purposes. Refer to Note 3, *Acquisitions* to our consolidated financial statements, for a further discussion of the acquisition.

### *Amended credit agreement*

On April 29, 2015, we entered into an amendment with Wells Fargo Bank, National Association, for the purpose of facilitating the issuance of 5.50% Senior Notes, as described above, and this amendment also provides for the earlier maturity of our revolving credit agreement to insure that the revolving line of credit will come due before the Senior Notes are payable. The Amended Wells Credit Agreement will become due 75 days prior to the earliest date that a Special Mandatory Purchase Date (as defined in the Indenture agreement) may occur or 90 days prior to the final maturity date of the Senior Notes, all as described in the Indenture agreement below under, *Credit agreements*.

### *Retirement of Chief Financial Officer*

On October 5, 2015, we announced the retirement of our Chief Financial Officer, effective October 19, 2015. Our new Chief Financial Officer, Michael Lewis, joined us effective October 19, 2015 as our new Chief Financial Officer. As contemplated by Mr. Lewis' Executive Employment Agreement, he was granted a stock appreciation right pursuant to the 2012 Incentive Compensation Plan, as amended. The award of the SAR was approved by the Compensation Committee of the Board of Directors and the terms of the SAR are set forth in a Stock Appreciation Rights Agreement, dated as of October 19, 2015 (the Grant Date). The SAR provides for the right to receive, upon exercise, shares of the Company's common stock, par value \$0.001 per share, based upon the appreciation in market value (determined as provided in the Stock Appreciation Rights Agreement) of the shares of our common stock covered by the SAR above a strike price of \$24.41 per share. The SAR covers an aggregate of 60,000 shares of our common stock and is to be settled only in whole shares of our common stock. It will vest ratably and become exercisable with respect to one fourth of the covered shares beginning on the third anniversary of the Grant Date.

## **2014 Significant developments**

### *Acquisition of Professional Power Products, Inc.*

On April 1, 2014, we acquired Professional Power Products, Inc. (3PI), a designer and manufacturer of large, custom engineered integrated electrical power generation systems serving the global diesel and natural gas power generation markets. We acquired all of the issued and outstanding stock of 3PI for an initial cash purchase price of approximately \$45.4 million, including cash acquired of approximately \$1.3 million, and agreed to pay additional consideration of between \$5.0 million and \$15.0 million in shares of our common stock, valued at \$76.02 per share (i.e., between 65,772 and 197,316 shares), based upon, and following the final determination in accordance with the Stock Purchase Agreement of, the 2014 3PI EBITDA (as defined in the Stock Purchase Agreement). As of the date of acquisition, this consideration was valued at \$8.9 million, and accordingly the total consideration payable for 3PI was valued at \$54.3 million and subsequently adjusted to \$54.5 million under the terms of the Stock Purchase Agreement. The consideration payable in shares of the company's common stock consisted of (i) fixed consideration (65,772 shares of

our common stock) and (ii) contingent consideration (i.e., between 65,772 shares and 131,544 shares of our common stock). The Stock Purchase Agreement included a



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provision by and among us and the sellers to treat the purchase of the 3PI stock as an acquisition of assets for income tax purposes. As of December 31, 2014, 3PI's EBITDA was less than the minimum amount as defined in the Stock Purchase Agreement and as a result, the liability arising from the contingent consideration of \$3,840,000 was reversed into income in the year ended December 31, 2014.

*Amended credit agreement and term loan*

To facilitate the acquisition of 3PI, on April 1, 2014, we entered into an amended credit agreement with Wells Fargo Bank, National Association to increase our revolving line of credit from \$75.0 million to \$90.0 million and added a secured \$5.0 million term loan, among other things. See Note 8, *Debt*, to our consolidated financial statements and below under *Credit agreements* for further detail relating to the financing associated with the acquisition. On September 30, 2014 and again on February 11, 2015, we further amended our \$90.0 million credit facility with Wells Fargo Bank, National Association to increase our revolving line of credit facility to \$100.0 million and \$125.0 million, respectively. See *Liquidity and Capital Resources* *Credit Agreements* for further discussion of the credit agreement with Wells Fargo Bank, National Association.

**Factors affecting comparability**

We have set forth below selected factors that we believe have had, or can be expected to have, a significant effect on the comparability of recent or future results of operations:

*5.50% Senior Notes due 2018*

As discussed above, we entered into a purchase agreement for a private sale of an aggregate amount of \$55.0 million in unsecured 5.50% Senior Notes. We received net proceeds of \$53,483,000 after financing costs of \$1,517,000. As a result, interest expense related to the Senior Notes included in *Interest expense* was \$2,379,000 for the year ended December 31, 2015 as compared to none in the comparable periods in 2014 and 2013.

*Acquisitions*

Our consolidated financial statements for the year ended December 31, 2015, include the results of operations of the three acquisitions which we completed during 2015, Powertrain, Bi-Phase and Buck's. The cash paid for the acquisition of these businesses was \$34,396,000 for the year ended December 31, 2015. In addition to the receivables and inventories acquired, we also recognized amortizable intangible assets of \$14,540,000, \$700,000 and \$600,000 for customer relationships, developed technology and backlog, respectively, plus goodwill of \$17,720,000 in connection with these acquisitions.

On April 1, 2014, we acquired Professional Power Products, Inc. As a result of this acquisition, the consolidated results of operations for the year ended December 31, 2015 include 3PI for the entire year while the consolidated results of operations for the year ended December 31, 2014 do not include any operating results attributable to 3PI for the first quarter of 2014 or any of 2013.

See Note 3, *Acquisitions* to our consolidated financial statements for a further discussion of our acquisitions during 2015 and 2014.

*Acquisition expenses*

We incurred total transaction costs, including due diligence expenses related to acquisition activities of \$526,000, excluding lease termination expenses discussed below, for the year ended December 31, 2015, respectively, all of which was recognized as an expense classified within general and administrative expense. We

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incurred \$811,000 of such costs related to acquisitions in 2014 all of which was recognized as an expense within general and administrative expense for the year ended December 31, 2014. We did not incur any such costs related to acquisitions for the year ended December 31, 2013.

In connection with the acquisition of Bi-Phase and Bucks we assumed the lease obligations of the facilities in which these entities operated. During 2015, we exited these facilities. However, the leases are on-going beyond December 31, 2015. As such, lease termination expenses relating to such leases of \$543,000 were included in general and administrative expense in our 2015 consolidated results of operations.

### *Joint venture with South Korean manufacturer*

We entered into a joint venture with a construction and utility equipment manufacturer headquartered in Incheon, South Korea for the purpose of designing, developing, manufacturing, marketing and selling specific engines throughout the global markets except North America and South Korea. We and our joint venture partner each have a 50% equity interest in the joint venture. In connection with this agreement, we were required to contribute \$1,000,000 to the joint venture which payment was made during the second quarter of 2015. We expect to account for the results of the joint venture as an equity investment in our consolidated financial statements.

### *Balance sheet classification of deferred taxes*

In November 2015, the FASB issued final guidance that requires companies to classify all deferred tax assets and liabilities as noncurrent on the consolidated balance sheet instead of separating deferred taxes into current and noncurrent amounts. Although the standard is effective for financial statements issued for annual periods beginning after December 15, 2016 and interim periods within those annual periods, we elected the early adoption provision of this standard as of the year ended December 31, 2015, and have prospectively classified all deferred tax assets and liabilities as noncurrent on our consolidated balance sheet as of that date in accordance with the standard. Prior year's balances were not required to be retrospectively adjusted.

### *Amended credit agreement and term loan*

As noted above, to facilitate the acquisition of 3PI, on April 1, 2014, we entered into an amended credit agreement with Wells Fargo Bank, National Association. As a result of the amendment, we had greater borrowings outstanding under our revolving credit facility in 2014 as compared to 2013. We secured a \$5.0 million term loan on April 1, 2014 also to facilitate the acquisition of 3PI. This term loan was repaid from a portion of the proceeds received from the 5.50% Senior Notes in 2015. We did not have any term loan as of December 31, 2015 or 2013.

### *Private placement warrants*

Our year-to-year and year-over-year results can be impacted by our private placement warrants liability. The change in estimated fair value of the liability associated with the private placement warrants is primarily attributable to fluctuations in the value of our common stock during a period. Our consolidated results of operations included \$9,299,000 of income in 2015, \$6,169,000 of income in 2014 and \$28,031,000 of expense in 2013 all related to the change in the estimated fair value of the private placement warrants during each period.

### *Stock-based and other executive compensation*

On October 19, 2015, as contemplated by his Executive Employment Agreement, our Chief Financial Officer was granted a stock appreciation right pursuant to the 2012 Incentive Compensation Plan, as amended. This SAR covers

an aggregate of 60,000 shares of our common stock and is to be settled only in whole shares of

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our common stock. It vests ratably and becomes exercisable with respect to one fourth of the covered shares beginning on the third anniversary of the grant date. SAR expense initially recognized was \$37,000 for the year ended December 31, 2015 in connection with this SAR grant.

On June 6, 2012, we granted a SAR award to our Chief Operating Officer. This SAR covers an aggregate 543,872 shares of our common stock and is also to be settled only in whole shares of our common stock. This SAR was originally scheduled to vest ratably on June 6, 2013, 2014 and 2015. On June 5, 2015, we and the COO agreed to defer the vesting of the remaining unvested portion of the SAR granted for 30 days until July 6, 2015 pursuant to an amendment to the initial SAR. On July 6, 2015, we and the COO entered into a SAR and Bonus Agreement which amended the SAR by extending the vesting period applicable to the remaining unvested portion of the SAR. The unvested portion covers 181,290 underlying shares of the our common stock which, prior to the amendment, would have vested on June 6, 2015. The amendment extended the vesting of these shares to June 6, 2017 with respect to 100,000 underlying shares of the our common stock and to June 6, 2019 with respect to the remaining 81,290 shares of underlying Company common stock (in each case subject to forfeiture upon termination of employment by the Company for Cause (as defined in the SAR and Bonus Agreement)). The SAR and Bonus Agreement also provides the COO with an annual bonus in the amount of \$250,000 for each of calendar years 2016, 2017, 2018 and 2019 as long as the conditions of the SAR agreement are met and subject to forfeiture under certain circumstances enumerated in the SAR agreement. We determined that the fair value attributable to the extension of the vesting period approximated \$333,000 which will be recognized through the final vesting date of June 6, 2019. Including the effect of this amendment in 2015, SAR expense attributable to this grant was \$197,000, \$329,000 and \$907,000 for the years ended December 31, 2015, 2014 and 2013, respectively. In consideration for this extension, the amendment also provides the Chief Operating Officer with an annual bonus in the amount of \$250,000 for each of calendar years 2016, 2017, 2018 and 2019.

In addition, late in the second quarter of 2013 and at times since that date, we granted restricted stock awards under our 2012 Incentive Compensation Plan to certain of our employees. As a result of such awards and the vesting thereof, stock compensation expense recognized was \$989,000, \$925,000 and \$361,000 for the years ended December 31, 2015, 2014 and 2013, respectively.

On July 31, 2013, our Board, upon recommendation of the Compensation Committee, adopted an amendment to increase the number of shares of common stock available for issuance under our 2012 Incentive Compensation Plan by 700,000 shares, which amendment was approved by our stockholders on August 28, 2013. We expect to make additional share-based awards to our directors, officers and other employees and possibly to consultants, and if we do, we will incur additional non-cash, stock-based compensation expenses related to such awards.

### *Loss on debt extinguishment*

We recognized a loss on debt extinguishment of \$270,000 in the year ended December 31, 2013, due to the write-off of remaining unamortized loan fees associated with our prior credit facility. No such item was present for the year ended December 31, 2015 or 2014.

### *Underwritten public offering*

During 2013, we closed an underwritten public offering of 2,005,000 shares of our common stock at a price to the public of \$35.00 per share. We sold 1,050,000 shares of our common stock, and certain selling stockholders sold 955,000 shares of common stock, in the offering. We received proceeds, net of underwriters' fees and expenses, of approximately \$34,530,000 before deducting offering expenses of approximately \$514,000. We did not receive any proceeds from the sale of the shares by the selling stockholders.



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### *Significant sales growth*

Our year-over-year sales growth directly correlates with various other aspects of our consolidated financial statements. Our significant sales growth also resulted in higher accounts receivable balances, inventory balances and related reserves for such balances. Our sales growth also required a correlated increase in our costs and capital required in order to support and sustain the significant growth achieved.

### *Other events affecting sales and profitability comparisons*

Our year-to-year and year-over-year operating results (including our sales, gross profit and net (loss) income) and cash flows can be impacted by a variety of internal and external events associated with our business operations. Examples of such events include (1) changes in regulatory emission requirements (which generally occur on January 1 of the year in which they become effective), (2) customer product phase-in/phase-out programs, (3) supplier product (e.g., a specific engine model) phase-in/phase-out programs, (4) changes in pricing by suppliers to us of engines, components and other parts (typically effective January 1 of any year), and (5) changes in our pricing to our customers (typically effective January 1 of any year), which may be related to changes in the pricing by suppliers to us. In order to mitigate potential availability or pricing issues, customers may adjust their demand requirements from traditional patterns. We may also extend special programs to customers in advance of such events, and we are more likely to offer such programs in our fourth quarter of a year in anticipation of events expected to occur in the first quarter of the next year. The occurrence of any of the events discussed above may result in fluctuations in our operating results (including sales and profitability) and cash flows between and among reporting periods.

## **Results of operations**

### ***Year ended December 31, 2015 compared with the year ended December 31, 2014***

#### *Net sales*

Our net sales increased \$41,451,000 (11.9%) to \$389,446,000 in the year ended December 31, 2015 compared to \$347,995,000 for the same period of 2014. Our sales increased \$55.7 million attributable to incremental sales from businesses acquired. This increase was offset by a \$14.2 million decrease in organic sales principally due to volume year over year.

#### *Gross profit*

Our gross profit decreased \$4,211,000 (6.3%) to \$62,834,000 for the year ended December 31, 2015, from \$67,045,000 in the comparable period of 2014. Although net sales of our large custom-engineered power generation systems included approximately \$2.3 million of additional sales of these systems in 2015 as compared to 2014, our gross profit arising from the sales of such systems decreased approximately \$3.7 million year over year due to current competitive pricing for such products as well as general production inefficiencies associated with these systems. In addition, our gross profit decreased due to a shift in the product mix of our power systems primarily due to the oil and gas end markets into which our higher end products are sold, combined with higher production spending and production inefficiencies. As a percentage of net sales, gross margin was 16.1% for the year ended December 31, 2015, compared to 19.3% for the same period in 2014.

#### *Research & development and engineering*

Research & development and engineering expense increased \$4,781,000 (28.3%) to \$21,681,000 in the year ended December 31, 2015, as compared to \$16,900,000 for the same period in 2014. Approximately \$1,934,000 of the increase was a result of the research & development and engineering expense attributable to the activities of our recent acquisitions in 2015.



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Excluding the expenses of our recently acquired businesses, research & development and engineering expense increased approximately \$2,847,000 in the year ended December 31, 2015, as compared to the same period in 2014. Wages and benefits increased \$1,554,000 as we increased headcount while consulting and outside services, including product testing, increased \$876,000 to support activities related to development of new engines and pursuing on-road applications for our products, among other things. The remaining net increase in other research & development and engineering expense was \$417,000 of which none of the individual components was individually significant as compared to the same period in 2014. As a percentage of net sales, research & development and engineering expense increased to 5.6% in the year ended December 31, 2015, as compared to 4.9% for the same period in 2014.

### *Selling and service*

Selling and service expense increased \$1,972,000 (20.4%) to \$11,658,000 in the year ended December 31, 2015, from \$9,686,000 in the comparable period of 2014. The increase was principally a result of the incremental selling and service expense attributable to the activities of our acquisitions which totaled \$2,057,000 in 2015 and \$1,123,000 in 2014, an increase of \$934,000 year over year.

Excluding the incremental expenses attributable to our acquisitions, selling and service expense increased approximately \$1,038,000 in the year ended December 31, 2015, as compared to the same period in 2014. Wages and benefits increased \$469,000 in the year ended December 31, 2015, as compared to the same period in 2014 as we have increased our staff to pursue growth opportunities. Bad debt expense increased \$222,000 as we increased our allowance for doubtful accounts and other selling and service expenses accounted for the remaining net increase of \$347,000 period over period, of which none of the components was individually significant. As a percentage of net sales, selling and service expenses increased to 3.0% in the year ended December 31, 2015, compared to 2.8% for the same period in 2014.

### *General and administrative*

General and administrative expense, increased \$2,316,000 (17.3%) to \$15,718,000 in the year ended December 31, 2015, from \$13,402,000 in 2014. Of this increase, \$1,367,000 was attributable to general and administrative expenses of our acquired businesses. In addition, we incurred an incremental \$258,000 of due diligence and related transaction expenses including lease termination expenses relating to these acquisitions in the year ended December 31, 2015 as compared to 2014.

Excluding the expenses attributable to our acquired businesses and transaction related expenses, general and administrative expenses increased \$691,000 in the year ended December 31, 2015 as compared to the same period in 2014. Placement fees increased approximately \$509,000 year over year as we replaced certain senior management positions and added other senior positions within the organization. Legal fees increased \$339,000 in the year ended December 31, 2015 as compared to 2014 arising from various litigation matters in which we are engaged. Other consulting and professional expenses and insurance expense also increased approximately \$430,000 and \$234,000, respectively, year over year, primarily attributable to the growth in our business. These increases were partially offset by lower expenses for wages and benefits expense of \$1,191,000 principally attributable to a decrease in variable compensation expenses in 2015. The remaining individual expense components resulted in a net increase in general and administrative expense of \$370,000 of which none of the individual components was individually significant in the year ended December 31, 2015 as compared to the same period in 2014. As a percentage of net sales, general and administrative expenses increased to 4.0% in the year ended December 31, 2015, compared to 3.9% for the same period in 2014.

### *Amortization of intangible assets*

Amortization expense increased \$3,569,000 to \$4,582,000 in the year ended December 31, 2015, from \$1,013,000 in the comparable period of 2014. As a result of acquisitions in 2015, we recognized amortizable

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intangible assets relating to customer relationships and developed technology of \$14,540,000 and \$700,000, respectively. The amortization of these intangible assets, along with intangible assets recognized and attributable to the acquisition of 3PI in 2014 gave rise to the increase in amortization expense in 2015 over 2014. Specifically, amortization expense attributable to customer relationships and trade names and trademarks arising from the acquisition of 3PI increased \$2,203,000 in 2015 as compared to 2014. The remaining increase of \$1,366,000 was attributable to the amortization of these newly acquired intangible assets. As a percentage of net sales, amortization of intangible assets expense increased to 1.2% in the year ended December 31, 2015, compared to 0.3% for the same period in 2014.

*Other (income) expense*

Interest expense increased \$2,996,000 to \$4,327,000 in the year ended December 31, 2015, as compared to \$1,331,000 for the same period in 2014. Interest expense attributable to the 5.50% Senior Notes was \$2,379,000, including \$337,000 of amortization of debt issuance costs in the year ended December 31, 2015, as compared to none for the same period in 2014. The remaining \$617,000 increase in interest expense was principally attributable to an increase in the overall average amount outstanding on our revolving line of credit during the year ended December 31, 2015, as compared to the same period in 2014. Our average borrowings outstanding were approximately \$96.5 million during 2015 as compared to approximately \$62.1 million during 2014. Including only our revolving line of credit and our term loan which was paid in full on April 29, 2015, our weighted average borrowing rate was 1.80% for the year ended December 31, 2015 as compared to 1.86% for the same period in 2014.

Our results in the year ended December 31, 2015 included \$48,000 of expense arising from an increase in the valuation of a contingent consideration liability as compared to \$3,840,000 of income for the same period in 2014. The contingent consideration expense of \$48,000 in the year ended December 31, 2015 was attributable our acquisition of Powertrain in 2015. The contingent consideration payable was based upon Powertrain achieving certain sales targets for the full year 2015 plus additional consideration as defined in the asset purchase agreement. The change in the contingent consideration represents the change in the liability from the Powertrain date of acquisition to December 31, 2015. The accounting guidance requires changes in contingent consideration that is accounted for as a liability to be recognized in the results of operations when such changes occur.

In 2014, we recognized a non-cash gain of \$3,840,000 arising from a decrease in the contingent consideration liability attributable to our acquisition of 3PI. The total consideration for the acquisition of 3PI was payable in cash and shares of our common stock. A portion of the fixed consideration and all of the contingent consideration was payable in shares of our common stock. The actual amount of shares of our common stock that was payable to the former owners of 3PI was based upon financial performance measures set forth in the stock purchase agreement related to the 3PI acquisition. The valuation of the contingent consideration was based upon certain factors, including the price of our common stock, as defined in the stock purchase agreement, and 3PI's projected performance for 2014 and was recognized as a \$3,840,000 liability on our balance sheet as of April 1, 2014, the date of acquisition. The performance measurement period upon which the contingent liability was based ended on December 31, 2014. As a result of 3PI not achieving the financial performance measures set forth in the stock purchase agreement, the entire contingent consideration obligation was reversed, which resulted in a \$3,840,000 non-cash gain recognized in our financial statements for the year ended December 31, 2014.

Private placement warrant (income) expense was income of \$9,299,000 in the year ended December 31, 2015, as compared to income of \$6,169,000 for the same period in 2014. We are required to recognize changes in the estimated fair value of unexercised private placement warrants in our consolidated statement of operations. The change in estimated fair value of the private placement warrants was attributable to fluctuations in the trading price of our common stock at each balance sheet date.

*Income tax expense*

Our income tax expense decreased \$11,201,000 to an income tax benefit of \$388,000 in the year ended December 31, 2015, as compared to income tax expense of \$10,813,000 for the same period in 2014. Our pre-tax

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book income decreased \$20,649,000 to \$13,890,000 in the year ended December 31, 2015 as compared to 2014. Excluding the change in the valuation of our private placement warrants, a non-taxable transaction, our pre-tax book income decreased \$23,779,000 to \$4,591,000 in the year ended December 31, 2015 as compared to the 2014. The lower pre-tax book income in 2015 combined with an increase in research tax credits recognized in 2015 as compared to 2014 were the principal drivers resulting in the decrease in income tax expense from 2014 to an income tax benefit in 2015. As a result of recognizing an income tax benefit with pre-tax book income, our income tax rate was not a meaningful presentation for the year ended December 31, 2015. Our reported income tax rate was 31.3% for the year ended December 31, 2014. Excluding the impact of the change in the valuation of our private placement warrants, our income tax rate was not a meaningful presentation for the year ended December 31, 2015 and was 38.1% for the year ended December 31, 2014.

### ***Year ended December 31, 2014 compared with the year ended December 31, 2013***

#### ***Net sales***

Our net sales increased \$110,153,000 (46.3%) to \$347,995,000 in the year ended December 31, 2014 compared to \$237,842,000 for the year ended December 31, 2013. Organic sales growth accounted for \$89.7 million or approximately 81.4% of the increase in sales and the remaining increase was primarily attributable to sales by 3PI, our recently acquired subsidiary. An increase in sales volume (as opposed to price increases) accounted for approximately \$84.0 million of the \$89.7 million increase in organic sales in the year ended December 31, 2014 as compared to the same period in 2013. Of the total organic growth of \$89.7 million, our power systems and related sales increased approximately \$82.0 million, and our aftermarket parts sales accounted for the remaining \$7.7 million increase. The sales increase was primarily driven by increased demand for our heavy duty power systems.

#### ***Gross profit***

Our gross profit increased \$22,519,000 (50.6%) to \$67,045,000 for the year ended December 31, 2014, from \$44,526,000 in the comparable period of 2013. Our gross profit increased primarily due to the previously discussed increase in sales volumes. As a percentage of net sales, gross margin was 19.3% for the year ended December 31, 2014, compared to 18.7% for the same period in 2013. The higher gross margin during 2014 was principally attributable to an increase in sales of our heavy duty power systems.

#### ***Research & development and engineering***

Research & development and engineering expense increased \$6,461,000 (61.9%) to \$16,900,000 in the year ended December 31, 2014, as compared to \$10,439,000 for the same period in 2013. Wages and benefits increased \$3,645,000 as we increased headcount to support product development activities, including development of new engines and pursuing on-road applications for our products, among other things. Materials and related expenses pertaining to the development of our research and development projects increased \$1,645,000 in the year ended December 31, 2014 as compared to the same period in 2013 and consulting and professional fees incurred to support the furtherance of such projects also increased \$532,000 year over year. The remaining net increase in other research & development and engineering expense was \$639,000 and principally related to travel costs, emission certification expenses, and expendable supplies in support of our research and development and engineering activities. As a percentage of net sales, research & development and engineering expense increased to 4.9% in the year ended December 31, 2014, as compared to 4.4% for the same period in 2013.

#### ***Selling and service***

Selling and service expenses increased \$2,141,000 (28.4%) to \$9,686,000 in the year ended December 31, 2014, from \$7,545,000 in the comparable period of 2013. The increase was principally a result of the incremental selling and service expense attributable to 3PI which was \$1,123,000 in the year ended December 31, 2014 and

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none in the comparable period in 2013. Wages and benefits increased \$776,000 in the year ended December 31, 2014, as compared to the same period in 2013 as we have increased our staff to pursue growth opportunities. In addition, consulting and professional fees accounted for the remaining net increase of \$242,000 year over year. As a percentage of net sales, selling and service expenses decreased to 2.8% in the year ended December 31, 2014, compared to 3.2% for the same period in 2013.

*General and administrative*

General and administrative expenses increased \$1,827,000 (15.8%) to \$13,402,000 in the year ended December 31, 2014, from \$11,575,000 in the comparable period of 2013. The increase was primarily attributable to the general and administrative expense of 3PI, which was \$1,296,000 in the year ended December 31, 2014 and none in 2013. In addition, we incurred \$811,000 of transaction expenses in connection with the acquisition of 3PI in the year ended December 31, 2014 as compared to none for the same period in 2013. Compensation and benefits increased \$374,000 in the year ended December 31, 2014 as compared to the same period in 2013. This increase was primarily attributable to the addition of staff to support our growth and also included expenses incurred in connection with our incentive and performance compensation. The remaining other expenses decreased approximately \$654,000 in the year ended December 31, 2014 as compared to the same period in 2013. As a percentage of net sales, general and administrative expenses, excluding transaction expenses, decreased to 3.9% in the year ended December 31, 2014, from 4.9% for the same period in 2013.

*Amortization of intangible assets*

Amortization expense increased to \$1,013,000 in the year ended December 31, 2014, as compared to none for the same period in 2013. In the year ended December 31, 2014, all of the amortization expense of \$1,013,000 was attributable to the amortization of intangible assets to which a value was ascribed in connection with the acquisition of 3PI. As a percentage of net sales, amortization of intangible assets expense was 0.3% in the year ended December 31, 2014.

*Other (income) expense*

Interest expense increased \$674,000 (102.6%) to \$1,331,000 in the year ended December 31, 2014, as compared to \$657,000 for the same period in 2013. The increase in interest expense was attributable to an increase in borrowings outstanding on our revolving line of credit and interest on the \$5.0 million of term loan that we obtained on April 1, 2014, both of which were used to finance our acquisition of 3PI. Our average borrowings outstanding were approximately \$62.1 million during the year ended December 31, 2014 as compared to approximately \$21.8 million during the year ended December 31, 2013. Including only our revolving line of credit and our term loan, our weighted average borrowing rate was 1.86% for the year ended December 31, 2014 as compared to 2.21% for the same period in 2013.

Private placement warrant (income) expense was income of \$6,169,000 in the year ended December 31, 2014, as compared to expense of \$28,031,000 for the same period in 2013. We are required to recognize changes in the estimated fair value of unexercised private placement warrants in our consolidated statement of operations. The change in estimated fair value of the private placement warrants was attributable to fluctuations in the trading price of our common stock at each balance sheet date.

In 2014, we recognized a non-cash gain of \$3,840,000 arising from a decrease in the contingent consideration liability attributable to our acquisition of 3PI as more fully described above. The value of the contingent consideration liability decreased as a result of 3PI not achieving the expected financial performance measures set forth in the stock purchase

agreement which resulted in this non-cash gain recognized in our financial statements for the year ended December 31, 2014.



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### *Income tax expense*

Our income tax expense increased \$6,054,000 to \$10,813,000 in the year ended December 31, 2014, as compared to \$4,759,000 for the same period in 2013. Our effective income tax rate was 31.3% for the year ended December 31, 2014. As we reported a loss before incomes taxes in 2013, an effective income tax rate is not a meaningful calculation in the year ended December 31, 2013.

Excluding the change in the valuation of our private placement warrants from our statements of operations as described above, our effective income tax rates would have been 38.1% and 33.9% for the years ended December 31, 2014 and 2013, respectively. The remaining differential in these income tax rates was principally attributable to the impact of the research tax credits recognized. Our income tax expense in 2013 was favorably impacted by the recognition of the federal research tax credit for 2013 as well as 2012. We recognized the federal research tax credits for both years in 2013 because the enactment of the legislation providing the federal research tax credits for 2012 was not signed into law until January 2, 2013, and generally accepted accounting principles prohibit retroactive application of tax law changes. Although the amount of the federal research tax credit recognized in 2014 increased over 2013, the tax credit decreased as a percentage of income before tax due to the increase in our pre-tax income year over year.

### **Liquidity and capital resources**

Our cash requirements are dependent upon a variety of factors, foremost of which is the execution of our strategic plan. We expect to continue to devote substantial capital resources to running our business. Our primary sources of liquidity have been and are expected to continue to be cash flows from operations, principally collections of customer accounts receivable, and borrowing capacity under our credit facility. During 2015, we issued \$55.0 million in 5.50% Senior Notes for which we received \$53,483,000 after financing fees. These 5.50% Senior Notes are described below under Credit agreements. Effective February 11, 2015, we amended our \$100.0 million credit facility with Wells Fargo Bank, National Association to increase our revolving line of credit facility to \$125.0 million. We had previously amended our credit facility on September 30, 2014 to \$100.0 million and prior to that on April 1, 2014 to \$90.0 million from \$75.0 million. Also on April 1, 2014, we secured a \$5.0 million term loan. The term loan and credit agreement are further described below under Credit agreements. The increase in our credit facility effective April 1, 2014 and the proceeds from the term loan were used to finance our acquisition of 3PI. We had previously increased our liquidity in the third quarter of 2013 through a public offering in which we sold 1,050,000 shares of our common stock at \$35.00 per share that resulted in net proceeds to us of approximately \$34.3 million after underwriters fees and expenses associated with the sale of these shares.

Although we believe we have or can access sufficient liquidity to fund our operations as needed, there can be no assurances such funding will be consistently available to us on terms that are attractive or at all. Our ability to access additional funding as and when needed, our ability to timely refinance and/or replace our outstanding debt securities and credit facilities on acceptable terms, and our cost of funding will depend upon numerous factors including, but not limited to, the health and vibrancy of the financial markets, our financial performance, and the performance of our specific industry and other macro-economic factors in general. Our access to liquidity within a chosen funding mechanism is based on numerous factors, including the following: strength and quality of our assets, the continuation of our existing customer relationships and our development of new customer relationships; market acceptance of our existing and future products; the success of our product development and commercialization efforts and the costs associated with those efforts; and the costs associated with any future acquisitions, joint ventures or other strategic transactions. Accordingly, we may evaluate and pursue various financing alternatives determined advantageous to us at any particular point in time, including a larger credit facility, additional or replacement debt financing and/or additional equity financing as needed.

As of December 31, 2015, we had working capital of \$153,413,000 compared to \$114,955,000 as of December 31, 2014. Our working capital increase of \$38,458,000 was attributable primarily to a \$36,444,000 increase in our net inventory from December 31, 2014, principally resulting from continued growth in our

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business and inventories acquired with our recent acquisitions. Accounts receivable, net increased \$22,625,000 year over year as a result of the increase in sales we have experienced and timing of payments. Also, as of December 31, 2015, we recognized a \$5,230,000 receivable representing an amount due from the U.S. Department of the Treasury as a result of an anticipated refund attributable to our 2015 federal income tax filing. Additionally, accrued compensation and benefits decreased \$1,974,000 principally as a result of a decrease in our discretionary compensation liability year over year and our income taxes payable decreased \$779,000 due to an overall decrease in our consolidated operating results year over year. Finally, our working capital also increased due to a \$1,667,000 decrease in the current portion of long-term debt which was paid off during 2015 from a portion of the proceeds received on the 5.50% Senior Notes arising in 2015 and our cash on hand increased by \$1,884,000 year over year.

The increases to working capital were partially offset by a \$15,201,000 increase in accounts payable arising from the timing of payments to suppliers and a \$12,433,000 increase in other accrued liabilities, principally attributable to an \$8,248,000 increase attributable to acquisition consideration payable to the former owners of Powertrain Integration, which we acquired during 2015. Working capital also decreased \$3,998,000 due to a decrease in our current deferred income tax asset arising from the consolidation of our deferred income tax accounts into a single balance sheet caption within non-current assets on our balance sheet as of December 31, 2015. See Note 2, Recently issued accounting pronouncements, to our consolidated financial statements for a discussion of this change in the presentation of the deferred income tax balances. We also realized a \$513,000 decrease in our prepaid and other current assets year over year.

A limited number of our customers have payment terms which may extend up to 150 days. As of December 31, 2015 and December 31, 2014, our trade receivables included \$8.0 million and \$11.2 million, respectively, of trade receivables which represented aggregate customer account balances subject to these terms. Of these amounts, \$3.7 million and \$7.5 million at December 31, 2015 and December 31, 2014, respectively, represented the portion of the balance outstanding with these extended trade terms. Under our revolving line of credit, which funds our working capital as needed, these receivables represent eligible collateral on the same basis as our other trade receivables and remain eligible as collateral upon which we may borrow up to their extended due date of 150 days.

***Cash flows for the year ended December 31, 2015******Operating activities***

Net income and changes in working capital are the primary drivers of our cash flows from operations. For the year ended December 31, 2015, we used \$23,049,000 to fund our operations.

In the year ended December 31, 2015, we had net income of \$14,278,000 and non-cash adjustments totaling \$4,618,000, resulting in cash generated from operations of \$18,896,000 before considering changes in our operating assets and liabilities. Our non-cash adjustments favorably affecting our cash from operations in the year ended December 31, 2015, primarily included (i) \$9,671,000 of depreciation and amortization, (ii) \$1,186,000 of share-based compensation expense, (iii) \$945,000 of inventory provisions, (iv) \$641,000 of receivable allowances, (v) \$538,000 of amortization expense recognized for the step-up valuation of certain inventory acquired through acquisitions, and (vi) \$454,000 of non-cash interest expense. These increases were partially offset by a non-cash gain of \$9,299,000 derived from an adjustment to the fair value of our private placement warrants in the year ended December 31, 2015. The remaining other non-cash adjustments totaled \$482,000, none of which was individually significant.

Cash generated of \$18,896,000 from our net income adjusted for non-cash items was offset by \$41,945,000 of cash used by operating assets and liabilities in the year ended December 31, 2015. Our inventories increased \$27,336,000 as we built up our inventory, including strategic engine block purchases, and we realized an increase in our inventory

due to our recent acquisitions. Our trade receivables increased by \$20,526,000 as sales increased in the year ended December 31, 2015, as compared to the year ended December 31, 2014. In addition, income tax

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receivable and prepaid expenses and other assets increased \$5,230,000 and \$83,000, respectively since December 31, 2014. Partially offsetting these increases was an \$8,160,000 increase in accounts payable, principally attributable to the build-up of our inventory, along with a \$3,195,000 increase in accrued compensation and benefits and other accrued liabilities. Our other non-current liabilities increased \$654,000 which were offset by a decrease of \$779,000 in our income taxes payable since December 31, 2014.

*Investing activities*

Net cash used in investing activities was \$43,570,000 in the year ended December 31, 2015. Cash used for acquisitions of Powertrain, Bucks and Bi-Phase discussed above totaled \$34,396,000 in the year ended December 31, 2015. The property and equipment additions accounted for \$8,174,000 of cash used in the year ended December 31, 2015 for equipment as well as the build-out of a new and significantly larger facility to support our research and development activities. In addition, we contributed \$1,000,000 representing an equity investment in a joint venture with a construction and utility equipment manufacturer headquartered in Incheon, South Korea.

*Financing activities*

We generated \$68,503,000 of cash from financing activities in the year ended December 31, 2015. As discussed above, we issued unsecured 5.50% Senior Notes for which we received proceeds of \$55,000,000 before financing fees of \$1,517,000. In addition, we generated cash of \$19,269,000 from net borrowings under our revolving line of credit in the year ended December 31, 2015. We also realized 65,000 from the exercise of private placement warrants held by our investors and we also realized \$65,000 in from compensation costs deductible only for income tax purposes and arising from the issuance of our common stock under our 2012 Incentive Compensation Plan. These increases were partially offset by the \$4,028,000 repayment of a term loan with an initial principal balance of \$5,000,000 that was originally secured on April 1, 2014 as well as the payment of \$351,000 in withholding taxes for the net settlement of share-based awards which vested in the year ended December 31, 2015.

***Cash flows for the year ended December 31, 2014****Operating activities*

For the year ended December 31, 2014, we used \$15,685,000 to fund our operations.

In the year ended December 31, 2014, we had net income of \$23,726,000 and non-cash adjustments totaling \$1,090,000, resulting in cash generated from operations of \$22,636,000 before considering changes in our operating assets and liabilities. Our non-cash adjustments favorably affecting our cash from operations in the year ended December 31, 2014 primarily included (i) \$4,709,000 of depreciation and amortization, (ii) \$1,254,000 of share-based compensation expense, (iii) \$1,011,000 of deferred income taxes, (iv) \$679,000 of reserves for inventory, (v) \$482,000 of expense recognized for the step-up valuation of certain inventory acquired in our acquisition of 3PI, and (vi) other adjustments of \$784,000. These favorable adjustments were partially offset by; (i) a \$6,169,000 decrease in the fair value of the private placement warrants liability arising from a decrease in the market value of our common stock, and (ii) a \$3,840,000 decrease in the valuation of contingent consideration liability since April 1, 2014, and recorded in connection with our acquisition of 3PI, which decrease was primarily driven by 3PI not achieving the financial performance measures set forth in the stock purchase agreement.

Cash generated of \$22,636,000 from our net income (as adjusted for non-cash items) was offset by \$38,321,000 of cash used by operating assets and liabilities in the year ended December 31, 2014. Our sales growth resulted in a \$35,225,000 increase in accounts receivable in the year ended December 31, 2014. Our inventories increased

\$34,125,000 as we built up our inventory to support current and future period sales. Prepaid expenses and other assets also increased \$4,492,000 principally attributable to investments in our growth.

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Partially offsetting these increases was a \$34,140,000 increase in accounts payable, principally attributable to the build-up of our inventory. The remaining components driving the increase in cash used was a net decrease in other liabilities totaling \$1,381,000 in the year ended December 31, 2014.

### *Investing activities*

Net cash used in investing activities was \$51,713,000 in the year ended December 31, 2014. As discussed previously, we acquired 3PI on April 1, 2014 in a taxable transaction. We initially paid \$44,122,000 for 3PI, net of cash acquired. Property and equipment additions accounted for \$7,239,000 in the year ended December 31, 2014, and we also contributed an additional investment of \$350,000 to our joint venture in China. In December 2012, we entered into a joint venture with MAT Holdings, Inc. for the purpose of manufacturing, assembling and selling certain engines into the Asian market. The joint venture initially provided for an investment of \$1.2 million from each joint venture partner, of which \$500,000 was contributed during 2013, for a total investment to date of \$850,000.

### *Financing activities*

We generated approximately \$67,653,000 of cash from financing activities for the year ended December 31, 2014. We generated cash from \$60,097,000 in net borrowings under our revolving line of credit in the year ended December 31, 2014. In addition, we secured a term loan of \$5,000,000 and received proceeds of \$1,425,000 from the exercise of private placement warrants for shares of our common stock. We also realized an income tax benefit of \$2,704,000 from compensation costs deductible only for income tax purposes and arising from the issuance of our common stock under our 2012 Incentive Compensation Plan.

Offsetting these proceeds were (i) \$972,000 for the installment payments due on our term loan, (ii) \$430,000 in the payment of withholding taxes for the net settlement of share-based awards which vested in the year ended December 31, 2014, and (iii) \$171,000 of financing fees paid in connection with the amendment of our credit facility with Wells Fargo Bank, N.A. as further discussed below under *Credit agreement*.

### ***Cash flows for the year ended December 31, 2013***

#### *Operating activities*

For the year ended December 31, 2013, we used \$12,435,000 to fund our operations.

We had a reported net loss of \$18,760,000, which, after adjustment for non-cash items of \$31,654,000, resulted in net cash generated of \$12,894,000 before considering changes in our operating assets and liabilities. Our non-cash adjustments in the year ended December 31, 2013, primarily included expenses of (i) \$28,031,000 arising from a change in the valuation of our private placement warrants, (ii) \$1,568,000 of depreciation and amortization expense, (iii) \$1,268,000 of share-based compensation expense and (iv) \$649,000 in provisions for inventory. Non-cash adjustments also included \$270,000 arising from the loss on debt extinguishment arising from the write-off of unamortized loan financing fees as a result of the replacement of our prior credit facility.

The net loss adjusted for non-cash expenses of \$12,894,000 was offset by \$25,329,000 of cash used in operating activities in the year ended December 31, 2013, principally arising from increases in inventories and accounts receivable. Our inventories increased \$16,667,000 to support our growth and as a result of making strategic engine block purchases during 2013. Our accounts receivable increased \$5,410,000 arising from higher year over year sales and, more specifically, higher fourth quarter sales in 2013 as compared to the same period in 2012. Further increasing our operating cash used in 2013 was a \$3,687,000 reduction in trade accounts payable as a result of payments to

suppliers. We also incurred increases in prepaid expenses and other assets of \$1,849,000 which also contributed to the increase in cash used. These increases were partially offset by a \$2,763,000 increase in accrued liabilities representing obligations incurred for which we had not yet remitted payment. We also had \$479,000 of net other increases which also contributed to the use of cash from operations.



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### *Investing activities*

Net cash used in investing activities was \$6,514,000 in the year ended December 31, 2013, of which \$6,007,000 related primarily to the acquisition of property and equipment, and \$500,000 related to our initial investment in a joint venture in China.

### *Financing activities*

We generated \$24,712,000 of cash from financing activities for the year ended December 31, 2013.

We generated \$36,750,000 of gross proceeds, prior to \$2,734,000 of transaction fees (classified in *Cash paid for financing and transaction fees* in our consolidated statement of cash flows), from the completion of a public offering of our common stock in July 2013, and we generated \$4,412,000 of cash from the exercise of private placement warrants by our investors. We also realized an income tax benefit of \$1,642,000 from compensation costs deductible only for income tax purposes and arising from the issuance of our common stock under our 2012 Incentive Compensation Plan.

We replaced our existing credit facility with BMO Harris Bank, N.A. on June 28, 2013 with another credit facility from Wells Fargo Bank, National Association, as more fully discussed in *Credit agreements* below. We repaid \$38,945,000 representing the outstanding principal balance on the BMO Harris Bank, N.A. facility through an initial advance from the Wells Fargo Bank, National Association, credit facility of \$38,995,000. We incurred \$286,000 in financing fees in connection with our new credit facility, which are included in *Cash paid for financing and transaction fees* in our consolidated statement of cash flows.

Partially offsetting the cash generated were net repayments under our credit facilities of \$13,059,000 in the year ended December 31, 2013 principally due to a paydown of our revolving line of credit from a portion of the proceeds generated from the public offering discussed above. In addition, we used \$2,063,000 in cash as payment of withholding taxes on behalf of our Chief Operating Officer in connection with his exercise of a portion of shares received under a Stock Appreciation Rights plan that we have with him, and we withheld shares upon such exercise to satisfy his withholding tax obligations.

### *Credit agreements*

#### *Wells Fargo Bank, National Association credit agreement*

On June 28, 2013, we entered into a \$75.0 million credit agreement with Wells Fargo Bank, National Association, which replaced our prior \$50.0 million credit agreement with BMO Harris Bank N.A. The Wells Credit Agreement enabled us to borrow under a revolving line of credit secured by substantially all of our tangible and intangible assets (other than real property). The Wells Credit Agreement (a) provided an initial maximum \$75.0 million revolving line of credit to us, which, at our request and subject to the terms of the Wells Credit Agreement, could have been increased up to \$100.0 million during the term of the Wells Credit Agreement; (b) bore interest at the Wells Fargo Bank's prime rate plus an applicable margin ranging from 0% to 0.50%; or at our option, all or a portion of the revolving line of credit could have been designated to bear interest at LIBOR plus an applicable margin ranging from 1.50% to 2.00%; (c) had an unused line fee of 0.25% and (d) required us to report our fixed charge coverage ratio, when our Availability (as defined in the Wells Credit Agreement) was less than the Threshold Amount (as defined in the Wells Credit Agreement), and to continue to report our fixed charge coverage ratio until the date that Availability, for a period of 60 consecutive days, was greater than or equal to the Threshold Amount. We were required to meet a minimum monthly fixed charge coverage ratio of not less than 1.0 to 1.0, the testing of which commenced on the last

day of the month prior to the date on which our Availability (as defined in the Wells Credit Agreement) was less than the Threshold Amount. The Threshold Amount was defined in the Wells Credit Agreement as the greater of (i) \$9,375,000 or (ii) 12.5% of the maximum revolver amount of \$75.0 million or as it may be increased during the term of the Wells Credit Agreement up to \$100.0 million.

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On April 1, 2014, the Wells Credit Agreement was amended ( Amended Wells Credit Agreement ) to increase our revolving line of credit from \$75.0 million to \$90.0 million. The Amended Wells Credit Agreement (a) bears interest at the Wells Fargo Bank's prime rate plus an applicable margin ranging from 0% to 0.5%; or at our option, all or a portion of the revolving line of credit can be designated to bear interest at LIBOR plus an applicable margin ranging from 1.50% to 2.00%; (b) has an unused line fee of 0.25%; (c) requires us to report our fixed charge coverage ratio and leverage ratio as described below and; (d) includes a \$5.0 million term loan arrangement with Wells Fargo Bank; and (e) includes a letter of credit sub-facility of the revolving line of credit. The principal amount of the \$5.0 million term loan was payable in 36 monthly equal installments with the first payment due on June 1, 2014, and bore interest at LIBOR plus 4.5%. Effective April 1, 2014 and during the period in which the term loan was outstanding, we were subject to a fixed charge coverage ratio covenant and a debt leverage ratio covenant. We were required to maintain a fixed charge coverage ratio of at least 1.20 to 1.00 and our debt leverage ratio could not exceed 4.0 to 1.0 during the period in which the term loan was outstanding. We used borrowings under the expanded revolving line of credit well as the proceeds from the term loan to finance our acquisition of 3PI which was consummated on April 1, 2014 as described in Note 3, Acquisitions , to the consolidated financial statements included herein. The term loan was subsequently paid in full on April 29, 2015. In connection with the repayment of the term loan on April 29, 2015, the Company's minimum monthly fixed charge coverage ratio reverted back to 1.0 to 1.0, the testing of which commences on the last day of the month prior to the date on which the Company's Availability is less than the Threshold Amount.

On September 30, 2014 and again on February 11, 2015, we further amended our credit facility with Wells Fargo Bank, National Association, to increase our revolving line of credit facility to \$100.0 million and \$125.0 million, respectively (collectively with the Amended Wells Credit Agreement, the Amended Wells Credit Agreement II ). The Amended Wells Credit Agreement II was scheduled to mature on June 28, 2018.

Other than the above mentioned amendments, the terms and conditions of the Amended Wells Credit Agreement II are substantially similar to our predecessor Wells Fargo Bank credit agreements. Under the Amended Wells Credit Agreement II, the amount that we may borrow is limited to the lesser of (i) the maximum available amount and (ii) borrowing base. The borrowing base is calculated as a percentage of our eligible accounts receivable and eligible inventory plus a defined amount based upon certain of our fixed assets (all as defined in the Amended Wells Credit Agreement II). The Amended Wells Credit Agreement II also contains customary covenants and restrictions applicable to us, including agreements to provide financial information, comply with laws, pay taxes and maintain insurance, restrictions on the incurrence of certain indebtedness, guarantees and liens, restrictions on mergers, acquisitions and certain dispositions of assets, and restrictions on the payment of dividends and distributions. The revolving line of credit is secured by substantially all of our tangible and intangible assets (other than real property).

On April 29, 2015, we entered into an amended credit facility ( Amended Wells Credit Agreement III ) for the purpose of facilitating the issuance of the 5.50% Senior Notes (the Senior Notes ), as described below, and this amendment provided for the earlier maturity of the Amended Wells Credit Agreement III to insure that the Amended Wells Credit Agreement III will come due before the Senior Notes are payable as described below. While the Senior Notes are outstanding, the Amended Wells Credit Agreement III will become due 75 days prior to the earliest date that a Special Mandatory Purchase Date may occur or 90 days prior to the final maturity date of the Senior Notes, all as described in the Indenture agreement below. Accordingly, under the above terms, the Amended Wells Credit Agreement III will become due no earlier than March 15, 2017, but no later than January 31, 2018.

*Outstanding borrowings under the credit agreement*

As of December 31, 2015, \$97.0 million of our outstanding borrowings under its revolving line of credit bore interest at the LIBOR rate, plus an applicable margin. The weighted average interest rate on these borrowings was 1.84% as of December 31, 2015. The remaining outstanding balance of \$299,000 as of December 31, 2015 had been designated to

bear interest at the prime rate, plus an applicable margin, which equaled 3.50% with the applicable margin included. The unused and available revolving line of credit balance was \$27.1 million at December 31, 2015. Our term loan was repaid on April 29, 2015.

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As of December 31, 2014, \$71.0 million of our outstanding borrowings under its revolving line of credit bore interest at the LIBOR rate, plus an applicable margin. The weighted average interest rate on these borrowings was 1.66% as of December 31, 2014. The remaining outstanding balance of \$7.0 million as of December 31, 2014 had been designated to bear interest at the prime rate, plus an applicable margin, which equaled 3.25% with the applicable margin included. The unused and available revolving line of credit balance was \$21.2 million at December 31, 2014. As of December 31, 2014, we had approximately \$4,028,000 outstanding under the term loan, which bore interest at LIBOR plus 4.50%, which equaled 4.67% with the applicable margin included.

*5.50% Senior Notes Due 2018*

On April 24, 2015, we entered into a purchase agreement with certain institutional investors for a private sale of an aggregate amount of \$55.0 million in our unsecured 5.50% Senior Notes. The sale closed on April 29, 2015. In connection with the issuance of the Senior Notes, we entered into an indenture agreement ( *Indenture* ) dated April 29, 2015, by and among us, The Bank of New York Mellon, as Trustee, and our subsidiaries as guarantors. We received net proceeds of \$53,483,000 after financing costs of \$1,517,000. The Senior Notes are unsecured debt of our Company and are effectively subordinated to our existing and future secured debt including the debt in connection with the Amended Wells Credit Agreement III. The Senior Notes have a final maturity date of May 1, 2018, provided that a mandatory offer by us to purchase the Senior Notes must be made on or prior to May 1, 2017 in the event we cannot or do not certify compliance with certain financial covenants as more fully described below. In that event, the date of purchase will be no earlier than May 30, 2017.

We may redeem the Senior Notes in whole or in part at any time on or after May 1, 2016, at our option following redemption prices (expressed as percentages of the principal amount), together with accrued and unpaid interest to the date of redemption:

| <b>Redemption date</b>               | <b>Redemption price</b> |
|--------------------------------------|-------------------------|
| May 1, 2016 through October 31, 2016 | 101.0%                  |
| November 1, 2016 and thereafter      | 100.0%                  |

At any time prior to May 1, 2016, we may redeem up to 35% of the Senior Notes with the net cash proceeds of certain equity offerings specified in the Indenture at a redemption price of 105.5% of the principal amount of the Senior Notes, together with accrued and unpaid interest to the date of redemption, but only if at least 65% of the original aggregate principal amount of the Senior Notes would remain outstanding following such redemption. In addition, prior to May 1, 2016, we may redeem the Senior Notes in whole or in part at a redemption price equal to 101.0% of the principal amount plus (i) accrued and unpaid interest to the redemption date and (ii) an Applicable Premium (as defined in the Indenture) that is intended as a *make-whole* to May 1, 2016.

The Senior Notes have a Special Mandatory Purchase Date as described in the Indenture and summarized as follows. Upon the occurrence of the earlier of (I) March 15, 2017, if the Trustee has not received on or within five days prior to such date an officer's certificate stating that (i) our pro forma consolidated EBITDA (as defined in the Indenture) is at least equal to or greater than \$35.0 million for the most recent four full fiscal quarters for which financial statements are available as of such date and (ii) our consolidated pro forma ratio of consolidated EBITDA to fixed charges (as defined in the Indenture) is at least equal to or greater than 3.25 to 1.0 for the most recent four full fiscal quarters for which financial statements are available as of such date or (II) the date on which we notify the Trustee in writing (which date may be at any time on or after March 1, 2017 but on or prior to March 15, 2017) that we cannot or will not deliver such officer's certificate, then, unless we have given on or prior to March 15, 2017 a notice of redemption of all of the Senior Notes, we will make a mandatory offer to purchase all of the Senior Notes at a purchase price of

100.0% of the principal amount plus accrued and unpaid interest, if any, to the date of purchase in accordance with the procedures set forth in the Indenture.

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The Indenture contains covenants that, among other things, limit or restrict our ability and the ability of our subsidiaries to incur additional debt, prepay subordinated indebtedness, pay dividends or make other distributions on capital stock, redeem or repurchase capital stock, make investments and restricted payments, enter into transactions with affiliates, sell assets, create liens on assets to secure debt, or effect a consolidation or merger or to sell all, or substantially all, of our assets, in each case subject to certain qualifications and exceptions set forth in the Indenture. The Indenture also provides for customary events of default (subject in certain cases to customer grace and cure periods), which include nonpayment, breach of covenants in the Indenture, payment defaults or acceleration of other indebtedness, and certain events of bankruptcy and insolvency. Generally, if an event of default occurs, the Trustee or holders of at least 25.0% in principal amount of the then outstanding Senior Notes may declare the principal of and accrued but unpaid interest on all Senior Notes to be due and payable.

Interest on the Senior Notes accrues at a rate of 5.50% per annum and is payable semi-annually in arrears on May 1 and November 1 of each year, commencing on November 1, 2015.

**Contractual obligations**

The following table sets forth a summary of the Company's contractual obligations as of December 31, 2015:

| (in thousands)                          | Total             | Payments due by period |                  |                 |                      |
|-----------------------------------------|-------------------|------------------------|------------------|-----------------|----------------------|
|                                         |                   | Less than 1<br>year    | 1-3<br>years     | 3-5 years       | More than 5<br>years |
| <b>Contractual obligations</b>          |                   |                        |                  |                 |                      |
| Debt (1)                                | \$ 55,000         | \$                     | \$ 55,000        | \$              | \$                   |
| Interest payments on long-term debt (1) | 7,562             | 3,025                  | 4,537            |                 |                      |
| Operating leases (2)                    | 18,822            | 4,771                  | 7,399            | 3,605           | 3,047                |
| Purchase obligations (3)                | 61,162            | 61,162                 |                  |                 |                      |
| Other tax liabilities (4)               |                   |                        |                  |                 |                      |
| Other long-term liabilities (5)         | 350               | 350                    |                  |                 |                      |
| <b>Total contractual obligations</b>    | <b>\$ 142,896</b> | <b>\$ 69,308</b>       | <b>\$ 66,936</b> | <b>\$ 3,605</b> | <b>\$ 3,047</b>      |

- (1) See Note 8, Debt, in the Notes to Consolidated Financial Statements for additional information on the Company's debt. Debt refers to future cash principal payments. The Company has excluded the future debt and interest cash payments associated with its revolving line of credit balance of \$97,299,292 as of December 31, 2015. The revolving line of credit will become due no earlier than March 15, 2017 but no later than January 31, 2018.
- (2) See Note 9, Leases, in the Notes to Consolidated Financial Statements for additional information on the Company's operating leases.
- (3) Purchase obligations represent agreements with suppliers at the end of 2015 for raw materials and other product as part of the normal course of business.
- (4) Represents the expected cash obligations related to the Company's liability for uncertain income tax positions. As of December 31, 2015, the Company's total liability for uncertain tax positions including interest was \$1,055,000. Due to the high degree of uncertainty regarding the timing of potential future cash outflows associated with these liabilities, the Company was unable to make a reasonably reliable estimate of the amount and period in which these remaining liabilities might be paid.

- (5) See Note 14, Commitments and contingencies, in the notes to the Consolidated Financial Statements for additional information related to the Company's commitments associated with its joint ventures.

**Off-balance sheet arrangements**

We do not have any material off-balance sheet arrangements (as defined in Item 303(a) (4) of Regulation S-K).



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### **Critical accounting policies and estimates**

The discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States ( GAAP ). The preparation of these financial statements in accordance with GAAP requires us to make estimates, assumptions and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, assumptions and judgments, including those related to revenue recognition, bad debts, inventories, warranties, private placement warrants and income taxes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities and our revenue recognition. Actual results may differ from these estimates under different assumptions or conditions.

#### *Revenue recognition*

We recognize revenue upon transfer of title and risk of loss to the customer, which is typically when products are shipped, provided there is persuasive evidence of an arrangement, the sales price is fixed or determinable and management believes collectability is reasonably assured. As of December 31, 2015 and 2014, we had recognized revenue associated with approximately \$21.4 million and \$3.2 million, respectively, of undelivered product. We anticipate the collection of any unpaid balances during 2016. We did not enter into any bill and hold arrangements during 2013.

We classify shipping and handling charges billed to customers as revenue. Shipping and handling costs paid to others are classified as a component of cost of sales when incurred.

#### *Allowance for doubtful accounts*

The carrying amount of accounts receivable is reduced by a valuation allowance that reflects our management's best estimate of the amounts that will not be collected. Our management specifically reviews all past due accounts receivable balances and, based on historical experience and an assessment of current creditworthiness, estimates the portion, if any, of the balance that will not be collected.

#### *Inventories*

Our inventories consist primarily of engines and parts. Engines are valued at the lower of cost plus estimated freight-in, as determined by specific serial number identification, or market value. Parts are valued at the lower of cost (first-in, first out) or market value.

We write down inventory for an estimated amount equal to the difference between the cost of the inventory and the estimated realizable value. Additionally, an inventory reserve is provided for based upon our estimation of future demand for the quantity of inventory on hand. In determining an estimate of future demand, multiple factors are taken into consideration including (i) customer purchase orders and customer forecasted demand; (ii) historical sales/usage for each inventory item; and (iii) utilization within a current or anticipated future power system. These factors are primarily based upon quantifiable information and therefore, we have not experienced significant differences in inventory valuation due to variances in our estimation of future demand. We estimate that, in 2015, a 10% variance between the estimated net realizable value of such inventory and its actual realizable amount would have a less than \$94,000 effect on our cost of goods sold and the value of our inventory.

*Goodwill and other intangibles*

Goodwill represents the excess of purchase price and related costs over the values assigned to the net tangible and identifiable intangible assets of businesses acquired. In accordance with ASC 350, *Intangibles – Goodwill and Other Intangibles*, goodwill is not amortized, but instead is tested for impairment annually, or more frequently if circumstances indicate a possible impairment may exist. Absent any interim indicators of impairment, we will test for goodwill impairment on a specified date of each year, October 1.

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In accordance with ASC 350, *Intangibles – Goodwill and Other Intangibles*, we amortize our intangible assets with finite lives over their respective estimated useful lives and will review for impairment whenever impairment indicators exist. Our intangible assets consist of backlog, customer relationships and trade names and trademarks.

### *Warranty programs*

We offer a standard limited warranty on the workmanship of our products that in most cases covers defects for a defined period. Warranties for certified emission products are mandated by the EPA and/or the CARB and are longer than our standard warranty on certain emission related products. Our products also carry limited warranties from suppliers. Costs related to supplier warranty claims are borne by the supplier; our warranties apply only to the modifications we make to supplier base products. We estimate and record a liability, and related charge to income, for our warranty program at the time products are sold to customers. Our estimates are based on historical experience and reflect management's best estimates of expected costs at the time products are sold. We make adjustments to our estimates in the period in which it is determined that actual costs may differ from our initial or previous estimates. In 2015, we estimate that, a 10% change in the amount of historical warranty expense would have increased our warranty liability and related costs by approximately \$43,000.

### *Private Placement Warrants*

Our private placement warrants are accounted for as a liability, in accordance with ASC 480, *Distinguishing Liabilities from Equity*. ASC 480 states that, if an entity must or could settle an instrument by issuing a variable number of its own shares, and, as in this case, the obligation's monetary value is based solely or predominantly on variations in the fair value of the company's equity shares, but moves in the opposite direction, then the obligation to issue shares is to be recorded as a liability at the inception of the arrangement, and is adjusted with subsequent changes in the fair value of the underlying stock. Our private placement warrants were measured at fair value under ASC Topic 820, *Fair Value Measurements and Disclosures of the Accounting Standards Codification*. Our liability for the private placement warrants is measured at fair value based on unobservable inputs, and thus is considered a Level 3 financial instrument. In 2015, if all other assumptions are held constant, we estimate that, the recorded liability of the private placement warrants would increase or decrease by an immaterial amount due to a 10% change in the enterprise value of our company based on the Black-Scholes option pricing model.

### *Equity-based compensation*

Our equity-based compensation expense for awards granted to employees for service is accounted for over the service period based on the grant date fair value. Furthermore, the stock appreciation right granted is accounted for as equity, in accordance with ASC 718, *Compensation – Stock Compensation*.

### *Income taxes*

We account for income taxes under the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date.

We record net deferred tax assets to the extent we believe the assets will more likely than not be realized. In making such a determination, we consider all available positive and negative evidence, including future reversals of existing

taxable temporary differences, projected future taxable income, tax-planning strategies, and results of recent operations. As of December 31, 2015, and 2014, we had not recorded a tax asset valuation allowance.

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We record uncertain tax positions in accordance with ASC 740, *Income Taxes*, on the basis of a two-step process whereby (1) we determine whether it is more likely than not that the tax positions will be sustained based on the technical merits of the position and (2) for those tax positions that meet the more-likely-than-not recognition threshold, we recognize the largest amount of tax benefit that is greater than 50 percent likely to be realized upon ultimate settlement with the related tax authority. As of December 31, 2015 and 2014, we had unrecognized tax benefits of \$1,055,000 and \$740,000, respectively, for uncertain tax positions.

### **Impact of recently issued accounting standards**

We evaluate the pronouncements of authoritative accounting organizations, including the Financial Accounting Standards Board (FASB), to determine the impact of new pronouncements on GAAP and our consolidated financial statements. In May of 2014, the FASB and International Accounting Standards Board jointly issued a final standard on revenue recognition which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. This standard will supersede most current revenue recognition guidance. Under the new standard, entities are required to identify the following within a contract with a customer: the separate performance obligations in the contract; the transaction price; allocation of the transaction price to the separate performance obligations in the contract; and the appropriate amount of revenue to be recognized when (or as) the entity satisfies each performance obligation. Entities have the option of using either retrospective transition or a modified approach in applying the new standard. On July 9, 2015, the FASB voted to issue a final Accounting Standards Update (ASU) that defers for one year the effective date of the new revenue standard and allows early adoption as of the original effective date (i.e., annual reporting periods beginning after December 15, 2016, including interim reporting periods within those annual periods). After reviewing and discussing the feedback received, the Board decided to adopt the standard as originally proposed. Thus, the anticipated final ASU will be effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2017. We are currently evaluating the approach to use to apply the new standard and the impact that the adoption of the new standard will have on our consolidated financial statements.

In April of 2015, the FASB issued guidance to simplify the presentation of debt issuance costs. This new guidance requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. Although the standard is effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years, as permitted under the standard, we chose to early adopt this guidance as of June 30, 2015, and have therefore presented the debt issuance costs associated with the issuance of our 5.50% Senior Notes as a direct deduction from the carrying value of the liability as of December 31, 2015. Refer to Note 8, *Debt* for further details related to the issuance of our 5.50% Senior Notes.

In July 2015, the FASB issued final guidance to simplify the subsequent measurement of inventories by replacing the lower of cost or market test with a lower of cost and net realizable value test. The guidance applies to inventories for which cost is determined by methods other than LIFO and the retail inventory method. The amendment is to be applied prospectively and is effective for fiscal years, and the interim periods within those years, beginning after December 15, 2016, with early adoption permitted. We are currently evaluating the impact of adopting this ASC amendment, but do not expect it will have a significant effect on our consolidated financial statements.

In November 2015, the FASB issued final guidance that requires companies to classify all deferred tax assets and liabilities as noncurrent on the consolidated balance sheet instead of separating deferred taxes into current and noncurrent amounts. Although the standard is effective for the Company for financial statements issued for annual periods beginning after December 15, 2016 and interim periods within those annual periods, we elected the early adoption provision of this standard as of the year ended December 31, 2015, and have prospectively classified all

deferred tax assets and liabilities as noncurrent on our consolidated balance sheet in accordance with the standard. Prior year's balances were not required to be retrospectively adjusted.

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There were no additional new accounting pronouncements or guidance that have been issued or adopted by authoritative accounting organizations during the year ended December 31, 2015, that are expected to have a significant effect on our consolidated financial statements.

### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

The Company is exposed to changes in interest rates primarily due to its outstanding balances under the Amended Wells Credit Agreement III. If interest rates were to fluctuate, there is a risk that any outstanding balance would be impacted by the prevailing rate, which may further impact our ability to repay the outstanding balance. A one percentage point increase or decrease in interest rates would increase or decrease our interest expense by approximately \$973,000 annually based on our revolving line of credit outstanding as of December 31, 2015. Our 5.50% Senior Notes outstanding as of December 31, 2015 are fixed and not subject to changes in interest rates.

For a discussion of our liability for the Private Placement Warrants, see Note 7, Fair value of financial instruments, to the consolidated financial statements.

### **Item 8. Financial Statements and Supplementary Data.**

See Index to Financial Statements and Financial Statement Schedule on page F-1.

### **Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.**

None.

### **Item 9A. Controls and Procedures.**

#### **Disclosure Controls and Procedures**

We maintain a system of disclosure controls and procedures that is designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934, as amended (the Exchange Act) is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such that information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

As of the end of the period covered by this report and pursuant to Rule 13a-15(b) of the Exchange Act, our management, including the Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness and design of our disclosure controls and procedures (as that term is defined in Rule 13a-15(b) of the Exchange Act). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective, as of the end of the period covered under this report.

### **Management's Report on Internal Control Over Financial Reporting**

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act. Internal control over financial reporting is a process designed by, or under the supervision of the Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, and effected by our board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements for external purposes in accordance with United States generally accepted accounting principles ( U.S. GAAP ). Internal control over financial reporting includes those policies and procedures that:

Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect our transactions and dispositions of assets.



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Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP and that our receipts and expenditures are made in accordance with authorization of our management and our board of directors.

Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on our consolidated financial statements.

Under the supervision of our Chief Executive Officer and Chief Financial Officer, our management conducted an assessment of the effectiveness of our internal control over financial reporting as of December 31, 2015, based on criteria established in the framework in the Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ). Our evaluation of internal controls over financial reporting did not include the internal controls of Powertrain Integration (Powertrain), which we acquired in 2015. The aggregate amount of total assets and net sales of Powertrain in our consolidated financial statements as of and for the year ended December 31, 2015 was \$41.3 million and \$44.2 million, respectively. Based on this assessment, our management has concluded that as of December 31, 2015, our internal control over financial reporting was effective based on those criteria. Management reviewed the results of its assessment with our Audit Committee. The effectiveness of our internal control over financial reporting as of December 31, 2015 has been reviewed by RSM US LLP, an independent registered public accounting firm, as stated in its attestation report which is included in this Annual Report on Form 10-K.

## **Changes In Internal Control Over Financial Reporting**

There have been no changes in our internal control over financial reporting during the quarter ended December 31, 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **Inherent Limitations on the Effectiveness of Controls**

Our management does not expect that our disclosure controls and procedures or our internal controls will prevent or detect all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in a cost-effective control system, no controls can provide absolute assurance that misstatements due to error or fraud will not occur, and no evaluation of any such controls can provide absolute assurance that control issues and instances of fraud, if any, within our company have been detected.

These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies and procedures.

## **Item 9B. Other Information.**

Not applicable.



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**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance**

Our Board of Directors adopted a Code of Ethics for Principal and Senior Financial Officers that applies to senior officers, including our principal executive officer, principal financial officer, and principal accounting officer. A copy of the code is posted on our investor relations section of our website at [www.psiengines.com](http://www.psiengines.com). Information contained on the website is not incorporated by reference in, or considered to be a part of, this document.

Additional information required by this Item is incorporated herein by reference to our proxy statement for the annual meeting of stockholders to be filed pursuant to Regulation 14A within 120 days after our fiscal year-end of December 31, 2015.

**Item 11. Executive Compensation**

Incorporated herein by reference from the proxy statement for the annual meeting of stockholders to be filed pursuant to Regulation 14A within 120 days after our fiscal year-end of December 31, 2015.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

Incorporated herein by reference from the proxy statement for the annual meeting of stockholders to be filed pursuant to Regulation 14A within 120 days after our fiscal year-end of December 31, 2015.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

Incorporated herein by reference from the proxy statement for the annual meeting of stockholders to be filed pursuant to Regulation 14A within 120 days after our fiscal year-end of December 31, 2015.

**Item 14. Principal Accountant Fees and Services**

Incorporated herein by reference from the proxy statement for the annual meeting of stockholders to be filed pursuant to Regulation 14A within 120 days after our fiscal year-end of December 31, 2015.

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**PART IV**

**Item 15. Exhibits, Financial Statement Schedules.**

**15(a) Consolidated Financial Statements and Schedules**

The following financial statements are filed as a part of this report.

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Consolidated Statements of Changes In Stockholders' Equity for the years ended December 31, 2015, 2014 and 2013

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders

Power Solutions International, Inc.

We have audited the accompanying consolidated balance sheets of Power Solutions International, Inc. and subsidiaries as of December 31, 2015 and 2014, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2015. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Power Solutions International, Inc. and subsidiaries as of December 31, 2015 and 2014, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2015, in conformity with U.S. generally accepted accounting principles.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Power Solutions International, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated February 26, 2016 expressed an unqualified opinion on the effectiveness of Power Solution International Inc.'s internal control over financial reporting.

/s/ RSM US LLP

Chicago, Illinois

February 26, 2016

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### **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders

Power Solutions International, Inc.

We have audited Power Solutions International, Inc.'s internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. Power Solutions International, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting appearing under Item 9A. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

As described in Management's Report on Internal Control Over Financial Reporting appearing under Item 9A, management has excluded Powertrain Integration, LLC from its assessment of internal control over financial reporting as of December 31, 2015, because it was acquired by the Company in a purchase business combination in the second quarter of 2015. We have also excluded Powertrain Integration, LLC from our audit of internal control over financial reporting. Powertrain Integration, LLC is a wholly owned subsidiary whose total assets and net income represent approximately 11% and 18%, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 2015.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (a) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (b) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (c) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Power Solutions International, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Power Solutions International, Inc. and subsidiaries as of December 31, 2015 and 2014, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2015 and our report dated February 26, 2016, expressed an unqualified opinion.

/s/ RSM US LLP

Chicago, Illinois

February 26, 2016





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POWER SOLUTIONS INTERNATIONAL, INC.

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31,

| (Dollar amounts in thousands, except per share amounts)                                                                                                                                                                                         | 2015              | 2014              |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------|-------------------|
| <b>ASSETS</b>                                                                                                                                                                                                                                   |                   |                   |
| Current assets                                                                                                                                                                                                                                  |                   |                   |
| Cash                                                                                                                                                                                                                                            | \$ 8,445          | \$ 6,561          |
| Accounts receivable, net                                                                                                                                                                                                                        | 104,365           | 81,740            |
| Income tax receivable                                                                                                                                                                                                                           | 5,230             |                   |
| Inventories, net                                                                                                                                                                                                                                | 130,347           | 93,903            |
| Prepaid expenses and other current assets                                                                                                                                                                                                       | 4,288             | 4,801             |
| Deferred income taxes                                                                                                                                                                                                                           |                   | 3,998             |
| <b>Total current assets</b>                                                                                                                                                                                                                     | <b>252,675</b>    | <b>191,003</b>    |
| Property, plant & equipment, net                                                                                                                                                                                                                | 26,001            | 20,892            |
| Intangible assets, net                                                                                                                                                                                                                          | 31,745            | 21,392            |
| Goodwill                                                                                                                                                                                                                                        | 41,466            | 23,546            |
| Deferred income tax asset                                                                                                                                                                                                                       | 819               |                   |
| Other noncurrent assets                                                                                                                                                                                                                         | 7,230             | 5,804             |
| <b>TOTAL ASSETS</b>                                                                                                                                                                                                                             | <b>\$ 359,936</b> | <b>\$ 262,637</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                                                                                                                                                                                     |                   |                   |
| Current liabilities                                                                                                                                                                                                                             |                   |                   |
| Accounts payable                                                                                                                                                                                                                                | \$ 76,078         | \$ 60,877         |
| Income taxes payable                                                                                                                                                                                                                            |                   | 779               |
| Accrued compensation and benefits                                                                                                                                                                                                               | 4,009             | 5,983             |
| Current maturities of long-term debt                                                                                                                                                                                                            |                   | 1,667             |
| Other accrued liabilities                                                                                                                                                                                                                       | 19,175            | 6,742             |
| <b>Total current liabilities</b>                                                                                                                                                                                                                | <b>99,262</b>     | <b>76,048</b>     |
| Long-term obligations                                                                                                                                                                                                                           |                   |                   |
| Revolving line of credit                                                                                                                                                                                                                        | 97,299            | 78,030            |
| Deferred income taxes                                                                                                                                                                                                                           |                   | 3,241             |
| Private placement warrants                                                                                                                                                                                                                      | 1,482             | 11,036            |
| Long-term debt, less current maturities, net                                                                                                                                                                                                    | 53,820            | 2,361             |
| Other noncurrent liabilities                                                                                                                                                                                                                    | 1,776             | 1,122             |
| <b>TOTAL LIABILITIES</b>                                                                                                                                                                                                                        | <b>253,639</b>    | <b>171,838</b>    |
| <b>COMMITMENTS AND CONTINGENCIES</b>                                                                                                                                                                                                            |                   |                   |
| <b>STOCKHOLDERS' EQUITY</b>                                                                                                                                                                                                                     |                   |                   |
| Series A convertible preferred stock \$0.001 par value. Authorized: 114,000 shares. Issued and outstanding: -0-shares at December 31, 2015 and 2014.                                                                                            |                   |                   |
| Common stock \$0.001 par value. Authorized: 50,000,000 shares. Issued: 11,583,831 and 11,562,209 shares at December 31, 2015 and 2014, respectively. Outstanding: 10,752,906 and 10,731,284 shares at December 31, 2015 and 2014, respectively. | 12                | 12                |
| Additional paid-in-capital                                                                                                                                                                                                                      | 75,179            | 73,959            |
| Retained earnings                                                                                                                                                                                                                               | 35,356            | 21,078            |
| Treasury stock, at cost, 830,925 shares at December 31, 2015 and 2014.                                                                                                                                                                          | (4,250)           | (4,250)           |

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|                                           |            |            |
|-------------------------------------------|------------|------------|
| TOTAL STOCKHOLDERS EQUITY                 | 106,297    | 90,799     |
| TOTAL LIABILITIES AND STOCKHOLDERS EQUITY | \$ 359,936 | \$ 262,637 |

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

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POWER SOLUTIONS INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31,

|                                                         |            |            |             |
|---------------------------------------------------------|------------|------------|-------------|
| (Dollar amounts in thousands, except per share amounts) | 2015       | 2014       | 2013        |
| Net sales                                               | \$ 389,446 | \$ 347,995 | \$ 237,842  |
| Cost of sales                                           | 326,612    | 280,950    | 193,316     |
| Gross profit                                            | 62,834     | 67,045     | 44,526      |
| Operating expenses:                                     |            |            |             |
| Research & development and engineering                  | 21,681     | 16,900     | 10,439      |
| Selling and service                                     | 11,658     | 9,686      | 7,545       |
| General and administrative                              | 15,718     | 13,402     | 11,575      |
| Amortization of intangible assets                       | 4,582      | 1,013      |             |
| Total operating expenses                                | 53,639     | 41,001     | 29,559      |
| Operating income                                        | 9,195      | 26,044     | 14,967      |
| Other (income) expense:                                 |            |            |             |
| Interest expense                                        | 4,327      | 1,331      | 657         |
| Contingent consideration                                | 48         | (3,840)    |             |
| Private placement warrant (income) expense              | (9,299)    | (6,169)    | 28,031      |
| Loss on debt extinguishment                             |            |            | 270         |
| Other expense, net                                      | 229        | 183        | 10          |
| Total other (income) expense                            | (4,695)    | (8,495)    | 28,968      |
| Income (loss) before income taxes                       | 13,890     | 34,539     | (14,001)    |
| Income tax (benefit) provision                          | (388)      | 10,813     | 4,759       |
| Net income (loss)                                       | \$ 14,278  | \$ 23,726  | \$ (18,760) |
| Weighted-average common shares outstanding:             |            |            |             |
| Basic                                                   | 10,808,005 | 10,706,780 | 9,779,457   |
| Diluted                                                 | 11,073,647 | 11,131,617 | 9,779,457   |
| Earnings (loss) per common share                        |            |            |             |
| Basic                                                   | \$ 1.32    | \$ 2.22    | \$ (1.92)   |
| Diluted                                                 | \$ 0.45    | \$ 1.58    | \$ (1.92)   |

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

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POWER SOLUTIONS INTERNATIONAL, INC.

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

|                                                                          | Preferred<br>stock | Common<br>stock | Additional<br>paid-in<br>capital | Treasury<br>stock | Retained<br>earnings<br>(accumulated<br>deficit) | Total<br>stockholders<br>equity |
|--------------------------------------------------------------------------|--------------------|-----------------|----------------------------------|-------------------|--------------------------------------------------|---------------------------------|
| (Dollar amounts in thousands)                                            |                    |                 |                                  |                   |                                                  |                                 |
| Balance at December 31, 2012                                             | \$                 | \$ 10           | \$ 10,862                        | \$ (4,250)        | \$ 16,112                                        | \$ 22,734                       |
| Net loss                                                                 |                    |                 |                                  |                   | (18,760)                                         | (18,760)                        |
| Net proceeds from stock offering                                         |                    | 1               | 34,015                           |                   |                                                  | 34,016                          |
| Share-based compensation expense                                         |                    |                 | 1,268                            |                   |                                                  | 1,268                           |
| Payment of withholding taxes for net settlement of<br>share-based awards |                    |                 | (2,063)                          |                   |                                                  | (2,063)                         |
| Excess tax benefit from exercise of share-based awards                   |                    |                 | 1,642                            |                   |                                                  | 1,642                           |
| Exercise of private placement warrants                                   |                    |                 | 11,584                           |                   |                                                  | 11,584                          |
| Balance at December 31, 2013                                             |                    | 11              | 57,308                           | (4,250)           | (2,648)                                          | 50,421                          |
| Net income                                                               |                    |                 |                                  |                   | 23,726                                           | 23,726                          |
| Acquisition consideration                                                |                    |                 | 5,060                            |                   |                                                  | 5,060                           |
| Tax effect of acquisition consideration                                  |                    |                 | (681)                            |                   |                                                  | (681)                           |
| Share-based compensation expense                                         |                    |                 | 1,254                            |                   |                                                  | 1,254                           |
| Payment of withholding taxes for net settlement of<br>share-based awards |                    |                 | (430)                            |                   |                                                  | (430)                           |
| Excess tax benefit from exercise of share-based awards                   |                    |                 | 2,704                            |                   |                                                  | 2,704                           |
| Exercise of private placement warrants                                   |                    | 1               | 8,744                            |                   |                                                  | 8,745                           |
| Balance at December 31, 2014                                             |                    | 12              | 73,959                           | (4,250)           | 21,078                                           | 90,799                          |
| Net income                                                               |                    |                 |                                  |                   | 14,278                                           | 14,278                          |
| Share-based compensation expense                                         |                    |                 | 1,186                            |                   |                                                  | 1,186                           |
| Payment of withholding taxes for net settlement of<br>share-based awards |                    |                 | (351)                            |                   |                                                  | (351)                           |
| Excess tax benefit from exercise of share-based awards                   |                    |                 | 65                               |                   |                                                  | 65                              |
| Exercise of private placement warrants                                   |                    |                 | 320                              |                   |                                                  | 320                             |
| Balance at December 31, 2015                                             | \$                 | \$ 12           | \$ 75,179                        | \$ (4,250)        | \$ 35,356                                        | \$ 106,297                      |

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

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POWER SOLUTIONS INTERNATIONAL, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31,

| (Dollar amounts in thousands)                                                                      | 2015      | 2014      | 2013        |
|----------------------------------------------------------------------------------------------------|-----------|-----------|-------------|
| Cash flows from operating activities                                                               |           |           |             |
| Net income (loss)                                                                                  | \$ 14,278 | \$ 23,726 | \$ (18,760) |
| Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities: |           |           |             |
| Depreciation                                                                                       | 4,347     | 2,562     | 1,528       |
| Amortization                                                                                       | 5,324     | 2,147     | 40          |
| Deferred income taxes                                                                              | (62)      | 1,011     | (467)       |
| Non-cash interest expense                                                                          | 454       | 87        | 64          |
| Share-based compensation expense                                                                   | 1,186     | 1,254     | 1,268       |
| Increase in accounts receivable allowances                                                         | 641       | 204       | 160         |
| Increase in inventory reserves                                                                     | 945       | 679       | 649         |
| Amortization of inventory step up to fair value                                                    | 538       | 482       |             |
| (Decrease) increase in valuation of private placement warrants liability                           | (9,299)   | (6,169)   | 28,031      |
| Increase (decrease) in valuation of contingent consideration liability                             | 48        | (3,840)   |             |
| Loss on investment in joint ventures                                                               | 229       | 209       | 39          |
| Loss on disposal of assets                                                                         | 267       | 284       | 72          |
| Loss on debt extinguishment                                                                        |           |           | 270         |
| (Increase) decrease in operating assets, net of effects of business combinations:                  |           |           |             |
| Accounts receivable                                                                                | (20,526)  | (35,225)  | (5,410)     |
| Income tax receivable                                                                              | (5,230)   |           |             |
| Inventories                                                                                        | (27,336)  | (34,125)  | (16,667)    |
| Prepaid expenses and other assets                                                                  | (83)      | (4,492)   | (1,849)     |
| Increase (decrease) in operating liabilities, net of effects of business combinations:             |           |           |             |
| Accounts payable                                                                                   | 8,160     | 34,140    | (3,687)     |
| Accrued compensation and benefits and other accrued liabilities                                    | 3,195     | 667       | 2,763       |
| Income taxes payable                                                                               | (779)     | 585       | (445)       |
| Other noncurrent liabilities                                                                       | 654       | 129       | (34)        |
| Net cash used in operating activities                                                              | (23,049)  | (15,685)  | (12,435)    |
| Cash flows from investing activities                                                               |           |           |             |
| Purchases of property, plant & equipment                                                           | (8,174)   | (7,239)   | (6,007)     |
| Business combinations, net of cash acquired                                                        | (34,396)  | (44,122)  |             |
| Investment in joint ventures                                                                       | (1,000)   | (350)     | (500)       |
| Increase in cash surrender value of life insurance                                                 |           | (2)       | (7)         |
| Net cash used in investing activities                                                              | (43,570)  | (51,713)  | (6,514)     |
| Cash flows from financing activities                                                               |           |           |             |
| Proceeds from stock offering                                                                       |           |           | 36,750      |
| Initial proceeds from borrowings under revolving line of credit                                    |           |           | 38,995      |
| Advances from revolving line of credit noncurrent obligation                                       | 93,628    | 82,402    | 74,841      |
| Repayments of revolving line of credit noncurrent obligation                                       | (74,359)  | (22,305)  | (87,900)    |
| Repayment of prior revolving line of credit                                                        |           |           | (38,945)    |
| Proceeds from exercise of private placement warrants                                               | 65        | 1,425     | 4,412       |
| Proceeds from long-term debt                                                                       | 55,000    | 5,000     |             |
| Payments on long-term debt                                                                         | (4,028)   | (972)     |             |
| Payment of withholding taxes from net settlement of share-based awards                             | (351)     | (430)     | (2,063)     |
| Excess tax benefit from exercise of share-based awards                                             | 65        | 2,704     | 1,642       |
| Cash paid for financing and transaction fees                                                       | (1,517)   | (171)     | (3,020)     |
| Net cash provided by financing activities                                                          | 68,503    | 67,653    | 24,712      |

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|                                                    |           |           |          |
|----------------------------------------------------|-----------|-----------|----------|
| Increase in cash                                   | 1,884     | 255       | 5,763    |
| Cash at beginning of the year                      | 6,561     | 6,306     | 543      |
| Cash at end of the year                            | \$ 8,445  | \$ 6,561  | \$ 6,306 |
| Supplemental disclosures of cash flow information  |           |           |          |
| Cash paid for interest                             | \$ 3,380  | \$ 1,153  | \$ 660   |
| Cash paid for income taxes                         | \$ 7,125  | \$ 5,333  | \$ 4,869 |
| Supplemental disclosures of non-cash transactions  |           |           |          |
| Unpaid property, plant & equipment                 | \$ 891    | \$ 799    | \$ 1,552 |
| Fair value of private placement warrants exercised | \$ 255    | \$ 7,320  | \$ 7,172 |
| Supplemental disclosures of business acquisition   |           |           |          |
| Fair value of assets acquired                      | \$ 50,165 | \$ 60,104 | \$       |
| Less liabilities assumed                           | (7,029)   | (5,805)   |          |
| Net assets acquired                                | 43,136    | 54,299    |          |
| Less contingent consideration                      | (8,740)   |           |          |
| Less shares expected to be issued                  |           | (8,900)   |          |
| Less cash acquired                                 |           | (1,277)   |          |
| Business combinations, net of cash acquired        | \$ 34,396 | \$ 44,122 | \$       |

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

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POWER SOLUTIONS INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular dollar amounts in thousands, except per share amounts)

### **1. Description of the company and summary of significant accounting policies**

#### ***Description of the company and nature of business operations***

##### ***Nature of business operations***

Power Solutions International, Inc., a Delaware corporation ( "Power Solutions International", "PSI" or the "Company" ) is a global producer and distributor of a broad range of high performance, certified low emission power systems, including alternative fuel power systems for original equipment manufacturers of off-highway industrial equipment ( "industrial OEMs" ) and certain on-road vehicles and large custom-engineered integrated electrical power generation systems. The Company's customers include large, industry-leading and/or multinational organizations. The Company's products and services are sold predominantly to customers throughout North America, as well as to customers located throughout the Pacific Rim and Europe. The Company operates as one business and geographic operating segment.

The Company's power systems are highly engineered, comprehensive systems which, through its technologically sophisticated development and manufacturing processes, including its in-house design, prototyping, testing and engineering capabilities and its analysis and determination of the specific components to be integrated into a given power system (driven in large part by emission standards and cost restrictions required, or desired, to be met), allow the Company to provide its customers with power systems customized to meet specific industrial OEM application requirements, other technical specifications of customers, and requirements imposed by environmental regulatory bodies. The Company's power system configurations range from a basic engine integrated with appropriate fuel system components to completely packaged power systems that include any combination of cooling systems, electronic systems, air intake systems, fuel systems, housings, power takeoff systems, exhaust systems, hydraulic systems, enclosures, brackets, hoses, tubes and other assembled componentry. The Company purchases engines from third party suppliers and produces internally-designed engines, all of which are then integrated into the Company's power systems. Of the other components that the Company integrates into its power systems, a substantial portion consist of internally designed components and components for which the Company coordinates significant design efforts with third party suppliers, with the remainder consisting largely of parts that are sourced off-the-shelf from third party suppliers. Some of the key components (including purchased engines) embody proprietary intellectual property of the Company's suppliers. As a result of its design and manufacturing capabilities, the Company is able to provide its customers with a comprehensive power system which can be incorporated, using a single part number, directly into a customer's specified application. Capitalizing on its expertise in developing and manufacturing emission-certified power systems and its access to the latest power system technologies, the Company believes that it is able to provide complete "green" power systems to industrial OEMs at a low cost and with fast design turnaround. In addition to the certified products described above, the Company sells diesel, gasoline and non-certified power systems and aftermarket components.

##### ***Basis of presentation***

The consolidated financial statements of Power Solutions International, Inc. present information in accordance with generally accepted accounting principles in the U.S. ( "GAAP" ), have been prepared pursuant to the rules and regulations of the SEC and, in the opinion of management present fairly the consolidated financial position, results of operations and cash flows of the Company and its wholly-owned subsidiaries for the periods presented.

**Table of Contents*****Reclassification***

Certain amounts recorded in the prior period consolidated financial statements presented have been reclassified to conform to the current period financial statement presentation. These reclassifications had no effect on previously reported results of operations.

***Principles of consolidation***

The consolidated financial statements presented herein include the accounts of Power Solutions International, Inc. and its direct and indirect wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

***Use of estimates***

The preparation of consolidated financial statements in conformity with GAAP requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could materially differ from those estimates.

***Revenue recognition***

The Company recognizes revenue upon transfer of title and risk of loss to the customer, which is typically when products are shipped, provided there is persuasive evidence of an arrangement, the sales price is fixed or determinable and management believes collectability is reasonably assured. As of December 31, 2015 and December 31, 2014, the Company had recognized revenue associated with approximately \$21.4 million and \$3.2 million of undelivered product, respectively. In certain circumstances, the Company recognizes revenue before delivery has occurred. In such circumstances, among other things, risk of ownership has passed to the buyer, the buyer has made a written fixed commitment to purchase the finished goods, the buyer has requested the finished goods be held for future delivery as scheduled and designated by them, and no additional performance obligations exist by the Company. The Company anticipates the collection of any unpaid balances during 2016. The Company did not enter into any bill and hold arrangements during 2013.

The Company classifies shipping and handling charges billed to customers as revenue. Shipping and handling costs paid to others are classified as a component of cost of sales when incurred.

***Accounts receivable and allowance for doubtful accounts***

Accounts receivable are due under normal trade terms generally requiring payment within 30 to 45 days from the invoice date. A limited number of customers have terms which may extend up to 150 days from the invoice date. The carrying amount of accounts receivable is reduced by a valuation allowance that reflects management's best estimate of the amounts that will not be collected. Management specifically reviews all past due accounts receivable balances and, based on historical experience and an assessment of current creditworthiness, estimates the portion, if any, of the balance that will not be collected.

The activity in the Company's allowance for doubtful accounts as of December 31, was as follows:

|                                 | 2015   | 2014   |
|---------------------------------|--------|--------|
| Balance at beginning of year    | \$ 652 | \$ 452 |
| Charged to expense              | 641    | 204    |
| (Write-offs), net of recoveries | (356)  | (4)    |
| Balance at end of year          | \$ 937 | \$ 652 |



**Table of Contents*****Inventories, net***

Inventories consist primarily of engines and parts. Engines are valued at the lower of cost, plus estimated freight-in, or market value. Parts are valued at the lower of cost (first-in, first-out) or market value. When necessary, the Company writes down inventory for an estimated amount equal to the difference between the cost of the inventory and the estimated realizable value. Additionally, an inventory allowance is provided based upon the Company's estimation of future demand for the quantity of inventory on hand. In determining an estimate of future demand, multiple factors are taken into consideration, including, but not limited to: (i) customer purchase orders and customer forecasted demand; (ii) historical sales/usage for each inventory item; and (iii) utilization within a current or anticipated future power system.

Inventories consisted of the following as of December 31:

|                     | 2015       | 2014      |
|---------------------|------------|-----------|
| Raw materials       | \$ 104,433 | \$ 87,133 |
| Work in process     | 6,401      | 1,752     |
| Finished goods      | 21,853     | 6,777     |
| Total inventories   | 132,687    | 95,662    |
| Inventory allowance | (2,340)    | (1,759)   |
| Inventories, net    | \$ 130,347 | \$ 93,903 |

The activity in the Company's inventory allowance as of December 31 was as follows:

|                              | 2015     | 2014     |
|------------------------------|----------|----------|
| Balance at beginning of year | \$ 1,759 | \$ 1,510 |
| Charged to expense           | 945      | 679      |
| Write-offs                   | (364)    | (430)    |
| Balance at end of year       | \$ 2,340 | \$ 1,759 |

***Long-lived assets***

Long-lived assets, such as property, plant and equipment and land, are evaluated for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. If such review indicates that the carrying amount of long-lived assets is not recoverable, the carrying amount of such assets is reduced to fair value. There were no adjustments to the carrying values of long-lived assets during the years ended December 31, 2015 or 2014.

***Goodwill and other intangibles***

Goodwill represents the excess of purchase price and related costs over the values assigned to the net tangible and identifiable intangible assets of businesses acquired. In accordance with ASC 350, *Intangibles – Goodwill and Other Intangibles*, goodwill is not amortized, but instead is tested for impairment annually, or more frequently if circumstances indicate a possible impairment may exist. Absent any interim indicators of impairment, the Company tests for goodwill impairment on a specified date of each year, October 1.

In accordance with ASC 350, *Intangibles – Goodwill and Other Intangibles*, the Company amortizes its intangible assets with finite lives using an accelerated method over their respective estimated useful lives and will review for impairment whenever impairment indicators exist. The Company's intangible assets consist of backlog, customer relationships, developed technology and trade names and trademarks.

**Table of Contents****Warranty costs**

The Company offers a standard limited warranty on the workmanship of certain of its products that in most cases covers defects for a defined period. Warranties for certified emission products are mandated by the Environmental Protection Agency ( EPA ) and/or the California Air Resources Board ( CARB ) and are longer than the Company's standard warranty on certain emission related products. The Company's products also carry limited warranties from suppliers. Costs related to supplier warranty claims are borne by the supplier; the Company's warranties apply only to the modifications made to supplier base products. The Company's management estimates and records a liability, and related charge to income, for the warranty program at the time products are sold to customers. Estimates are based on historical experience and reflect management's best estimates of expected costs at the time products are sold. The Company makes adjustments to estimates in the period in which it is determined that actual costs may differ from initial or previous estimates.

The activity in the Company's warranty liability as of December 31 was as follows:

|                              | 2015     | 2014     |
|------------------------------|----------|----------|
| Balance at beginning of year | \$ 3,094 | \$ 1,274 |
| Acquisitions                 | 631      | 1,600    |
| Charged to expense           | 428      | 2,020    |
| Payments                     | (1,726)  | (1,800)  |
| Balance at end of year       | \$ 2,427 | \$ 3,094 |

**Other accrued liabilities**

Other accrued liabilities consisted of the following as of December 31:

|                        | 2015      | 2014     |
|------------------------|-----------|----------|
| Due to former owners   | \$ 8,788  | \$       |
| Warranty               | 2,427     | 3,094    |
| Customer deposits      | 3,606     | 385      |
| Other                  | 4,354     | 3,263    |
| Balance at end of year | \$ 19,175 | \$ 6,742 |

**Private placement warrants**

The Company's private placement warrants are accounted for as a liability, in accordance with ASC 480-10-25-14, *Distinguishing Liabilities from Equity*. ASC 480-10-25-14 states that, if an entity must or could settle an instrument by issuing a variable number of its own shares, and, as in this case, the obligation's monetary value is based solely or predominantly on variations in the fair value of the company's equity shares, but moves in the opposite direction, then the obligation to issue shares is to be recorded as a liability at the inception of the arrangement, and is adjusted with subsequent changes in the fair value of the underlying stock. The effect of the change in value of the obligation is reflected as

Private placement warrant (income) expense in the Company's consolidated statements of operations. See Note 7, Fair value of financial instruments, for detail describing the valuation approach for the Private Placement Warrants.

**Research & development and engineering costs**

The Company expenses research & development and engineering costs when incurred. Research & development costs classified within research & development and engineering expenses in the consolidated statements of operations, consist primarily of wages, materials, testing and consulting related to the development of new engines, parts and applications relating to the alternative fuel market across all markets with an emphasis on the industrial and on-road markets. These costs approximated \$19.1 million, \$14.9 million and \$9.4 million for the years ended December 31, 2015, 2014, and 2013, respectively.

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### ***Share-based compensation***

The Company accounts for share-based compensation expense for awards granted to employees for service over the service period based on the grant date fair value.

### ***Fair value of financial instruments***

The Company's financial instruments include accounts receivable, accounts payable, revolving line of credit, term debt and private placement warrants. The carrying amounts of accounts receivable and accounts payable approximate fair value because of their short-term nature. The carrying value of the revolving line of credit and term debt approximate fair value because the interest rates fluctuate with market interest rates or the fixed rates are based on current rates offered to the Company for debt with similar terms and maturities. Based upon the Company's current credit agreement with Wells Fargo Bank, National Association, using the Company's balances and interest rates as of December 31, 2015, and holding other variables constant, an increase by a factor of 10 of the interest rates for the next 12 month period charged by the bank to the Company would decrease the Company's pre-tax earnings and cash flow by approximately \$179,000. The fair value of the private placement warrants is described below in Note 7, Fair value of financial instruments.

### ***Self-funded insurance***

The Company is self-insured for certain costs of its employee benefit plans, although the Company obtains third-party insurance coverage to limit its exposure. The Company maintains a stop-loss insurance policy with individual and aggregate stop-loss coverage.

### ***Income taxes***

The Company accounts for income taxes under the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date.

The Company records net deferred tax assets to the extent it believes these assets will more likely than not be realized. In making such a determination, the Company considers all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax-planning strategies, and results of recent operations. As of December 31, 2015 and 2014, the Company had not recorded a deferred tax asset valuation allowance.

The Company records uncertain tax positions in accordance with ASC 740, *Income Taxes*, on the basis of a two-step process whereby (1) it determines whether it is more likely than not that the tax positions will be sustained based on the technical merits of the position and (2) for those tax positions that meet the more-likely-than-not recognition threshold, the Company recognizes the largest amount of tax benefit that is greater than 50 percent likely to be realized upon ultimate settlement with the related tax authority. As of December 31, 2015 and 2014, the Company had an unrecognized tax benefit of \$1,055,000 and \$740,000, respectively, for uncertain tax positions including interest and penalties. The Company recognizes interest and penalties related to unrecognized tax benefits in income tax expense.

### ***Concentrations***

The Company generally maintains cash balances in various accounts at one financial institution in the Midwest. As of December 31, 2015 and 2014, the Company maintained cash in a non-interest bearing account at

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a financial institution. At December 31, 2015 and 2014, cash accounts were insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000 per institution and per depositor. The Company's cash balances exceeded the FDIC maximum insured amounts in both 2015 and 2014.

The Company is exposed to potential credit risks associated with its accounts receivable. The Company performs ongoing credit evaluations of its customers and generally does not require collateral on its accounts receivable. For certain non-U.S. trade receivables, the Company obtains trade credit insurance or requires letters of credit for those non-U.S. accounts for which trade credit insurance is not available or is insufficient. The Company has not experienced significant credit-related losses to date.

Three customers ( Customer A , Customer B and Customer C ) individually accounted for more than 10% of the Company's sales during one or more years from 2013 through 2015. Customer A represented 12%, 11% and 16% of consolidated net sales in 2015, 2014 and 2013, respectively. Customer B represented 16% and 11% of consolidated net sales in 2015 and 2014, respectively, and less than 10% of consolidated net sales in 2013. Customer C represented less than 10% of consolidated net sales in 2015 and 2013, respectively, and 11% of consolidated net sales in 2014.

Five customers ( Customer A, Customer B, Customer C, all referred to above, Customer D and Customer E ) individually accounted for more than 10% of consolidated accounts receivable at December 31, 2015 or 2014. At December 31, 2015 and December 31, 2014, Customer A represented 13% of consolidated accounts receivable and less than 10% of consolidated accounts receivable, respectively. At December 31, 2015 and 2014, Customer B represented less than 10% of consolidated accounts receivable and 14% of consolidated accounts receivable, respectively. At December 31, 2015 and 2014, Customer C represented less than 10% of consolidated accounts receivable and 17% of consolidated accounts receivable, respectively. At December 31, 2015 and 2014, Customer D represented less than 10% of consolidated accounts receivable and 11% of consolidated accounts receivable, respectively. Customer E represented 14% and 11% of consolidated accounts receivable in 2015 and 2014, respectively.

Two suppliers ( Supplier A and Supplier B ) individually accounted for more than 10% of the Company's purchases during the years from 2013 through 2015. Supplier A accounted for 21%, 15% and 30% of the Company's purchases in 2015, 2014 and 2013, respectively. Supplier B accounted for 11%, 27% and 15% of the Company's purchases in 2015, 2014 and 2013, respectively.

## **2. Recently issued accounting pronouncements**

The Company evaluates the pronouncements of authoritative accounting organizations, including the Financial Accounting Standards Board (FASB), to determine the impact of new pronouncements on GAAP and the Company. In May of 2014, the FASB and International Accounting Standards Board jointly issued a final standard on revenue recognition which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. This standard will supersede most current revenue recognition guidance. Under the new standard, entities are required to identify the following within a contract with a customer: the separate performance obligations in the contract; the transaction price; allocation of the transaction price to the separate performance obligations in the contract; and the appropriate amount of revenue to be recognized when (or as) the entity satisfies each performance obligation. Entities have the option of using either retrospective transition or a modified approach in applying the new standard. On July 9, 2015, the FASB voted to issue a final Accounting Standards Update (ASU) that defers for one year the effective date of the new revenue standard and allows early adoption as of the original effective date (i.e., annual reporting periods beginning after December 15, 2016, including interim reporting periods within those annual periods). After reviewing and discussing the feedback received, the FASB decided to adopt the standard as originally proposed. Thus, the anticipated final ASU will be effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2017. The Company is currently evaluating the approach it will use to apply the new standard and the impact that the adoption of the new standard will have on the Company's consolidated financial statements.

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In April of 2015, the FASB issued guidance to simplify the presentation of debt issuance costs. This new guidance requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. Although the standard is effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years, as permitted under the standard, the Company chose to early adopt this guidance as of June 30, 2015, and has therefore presented the debt issuance costs associated with the issuance of its 5.50% Senior Notes as a direct deduction from the carrying value of the liability as of December 31, 2015. Refer to Note 8, Debt for further details related to the issuance of the Company's 5.50% Senior Notes.

In July 2015, the FASB issued final guidance to simplify the subsequent measurement of inventories by replacing the lower of cost or market test with a lower of cost and net realizable value test. The guidance applies to inventories for which cost is determined by methods other than LIFO and the retail inventory method. The amendment is to be applied prospectively and is effective for fiscal years, and the interim periods within those years, beginning after December 15, 2016, with early adoption permitted. The Company is currently evaluating the impact of adopting this ASC amendment, but does not expect it will have a significant effect on the Company's consolidated financial statements.

In November 2015, the FASB issued final guidance that requires companies to classify all deferred tax assets and liabilities as noncurrent on the consolidated balance sheet instead of separating deferred taxes into current and noncurrent amounts. Although the standard is effective for the Company for financial statements issued for annual periods beginning after December 15, 2016 and interim periods within those annual periods, the Company chose the early adoption provision of this standard as of the year ended December 31, 2015, and has prospectively classified all deferred tax assets and liabilities as noncurrent on its consolidated balance sheet in accordance with the standard. Prior year's balances were not required to be retrospectively adjusted.

There were no additional new accounting pronouncements or guidance that have been issued or adopted by authoritative accounting organizations during the year ended December 31, 2015, that are expected to have a significant effect on the Company's consolidated financial statements.

### **3. Acquisitions**

When appropriate, the Company accounts for business combinations in accordance with ASC 805, *Business Combinations*, and, as such, assets acquired and liabilities assumed are recorded at their respective fair values. The excess of the acquisition consideration over the fair value of tangible and intangible assets acquired and liabilities assumed, if any, is then allocated to goodwill. Any goodwill ultimately recorded is generally attributable to one or more values ascribed to geographic expansion of product sales, manufacturing and other synergies of the combined businesses.

The estimated fair values of assets acquired and liabilities assumed are based on the information that was available through the date of the most recent balance sheet, and are provisional, until the Company has completed the required analysis of fair values to be assigned to the assets acquired and liabilities assumed. The ultimate determination of fair values assigned to the assets acquired and liabilities assumed requires management to make significant assumptions and estimates. The more significant assumptions include estimating future cash flows and developing appropriate discount rates. These estimates and assumptions of the fair value allocation are subject to change upon the finalization of all valuation analyses. When required, independent valuation specialists conduct valuations to assist management of the Company in determining the estimated fair values of trade receivables, inventory, machinery and equipment, intangible assets and liabilities assumed, including contingent consideration. The determination of these estimated fair values, the assets' useful lives and the amortization and depreciation methods are subject to finalization of the work performed by the independent valuation specialists. Fair value measurements can be highly subjective, and the reasonable application of measurement principles may result in a range of alternative estimates using the same facts and circumstances. The final allocation could be materially different from the preliminary allocation recorded in the Company's consolidated balance sheet. However, the Company's management is ultimately responsible for the values

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assigned. Although the final determinations may result in asset fair values that are materially different from the preliminary estimates of the amounts included in the Company's consolidated financial statements until the Company has finalized its analysis, the Company believes that the fair values ultimately assigned to the assets acquired and liabilities assumed will not materially differ from amounts initially recorded in the Company's consolidated financial statements.

The consolidated financial statements as of and for the years ended December 31, 2015 and 2014, include the assets, liabilities and operating results of each acquired business since the date of each respective acquisition. There were no such business combinations during the year ended December 31, 2013.

### *Acquisition of Powertrain Integration, LLC*

On May 4, 2015, the Company entered into an Asset Purchase Agreement ( APA ) with Powertrain Integration, LLC ( Powertrain ) and its owners to acquire the assets of Powertrain. The acquisition closed on May 19, 2015 ( Powertrain Date of Acquisition ). Powertrain provides on-road powertrain solutions, including systems, components and services for niche OEM automakers and fleets. Powertrain specializes in alternative-fuel as well as gasoline and diesel systems and offers design, engineering, testing and production capabilities to deliver one-stop vehicle integration. At closing, the Company paid cash of \$20,873,000 representing the initial cash consideration adjusted for estimated working capital. Subsequently, the Company recorded a \$97,000 favorable final working capital adjustment that reduced the cash paid to \$20,776,000. The purchase price was subject to further adjustments for assumed liabilities, and contingent consideration consisting of a Base Earn-out Payment and Additional Earn-out Payment, all as described in the APA. The contingent consideration attributable to the Base Earn-out was based upon the 2015 full year net sales of Powertrain and the Additional Earn-out Payment was defined as the greater of a 5.0% per annum return on the Base Earn-out Payment and the incremental growth of the Company's stock price since the acquisition was announced as determined in accordance with the formula defined in the APA. The Base Earn-out Payment and the Additional Earn-out Payment were initially determined using a Modified Black-Scholes call option model because the inputs to determine these amounts were unobservable and thus considered a Level 3 financial instrument. The resultant initial contingent consideration of \$8,200,000 and the cash paid at closing along with the final working capital adjustment resulted in a purchase price of \$28,976,000 subject to the final determination of the contingent consideration.

As of December 31, 2015, the final Base Earn-out and Additional Earn-out Payment were finalized and the contingent consideration was adjusted to \$8,248,000. The additional liability was recorded as an adjustment within Other (income) expense within the Company's statement of operations for the year ended December 31, 2015.

Under the terms of the APA, the Base Earn-out and the Additional Earn-out payments are expected to be paid in cash during 2016.

The Company accounted for this acquisition as a business combination in accordance with ASC 805, *Business Combinations*, and as such, the excess of the purchase price over the fair values assigned to the assets acquired and liabilities assumed was provisionally allocated to goodwill at the Powertrain Date of Acquisition and deemed final as of December 31, 2015. The Company has treated the acquisition of Powertrain as a purchase of assets for income tax purposes. Accordingly, the financial and income tax bases of the assets and liabilities have been assumed to be the same at the Powertrain Date of Acquisition, and therefore, a provision for deferred income tax was not recorded in connection with the purchase price allocation. Additionally, any excess of the purchase price over the fair value of the assets acquired is expected to be deductible for income tax purposes. The acquisition was funded by certain proceeds received from the issuance of the 5.50% Senior Notes described in Note 8, Debt .

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The purchase price for this acquisition had been provisionally allocated as of May 19, 2015, and deemed final as of December 31, 2015, to the assets acquired and liabilities assumed based on their estimated fair values as follows:

|                                           | May 19, 2015<br>(As initially<br>reported) | Measurement<br>period<br>adjustment | May 19, 2015<br>(As adjusted) |
|-------------------------------------------|--------------------------------------------|-------------------------------------|-------------------------------|
| <b>Assets acquired:</b>                   |                                            |                                     |                               |
| Accounts receivable                       | \$ 4,942                                   | \$ (11)                             | \$ 4,931                      |
| Inventories                               | 1,890                                      |                                     | 1,890                         |
| Prepaid expenses and other current assets | 23                                         |                                     | 23                            |
| Property, plant & equipment               | 315                                        | (1)                                 | 314                           |
| Other non-current assets                  | 24                                         |                                     | 24                            |
| <b>Total tangible assets</b>              | <b>7,194</b>                               | <b>(12)</b>                         | <b>7,182</b>                  |
| <b>Intangible assets:</b>                 |                                            |                                     |                               |
| Intangible assets                         | 13,600                                     |                                     | 13,600                        |
| Goodwill                                  | 14,471                                     | 506                                 | 14,977                        |
| <b>Total assets acquired</b>              | <b>35,265</b>                              | <b>494</b>                          | <b>35,759</b>                 |
| <b>Liabilities assumed:</b>               |                                            |                                     |                               |
| Accounts payable                          | 5,951                                      |                                     | 5,951                         |
| Accrued liabilities                       | 241                                        | 591                                 | 832                           |
| <b>Total liabilities assumed</b>          | <b>6,192</b>                               | <b>591</b>                          | <b>6,783</b>                  |
| <b>Net assets acquired</b>                | <b>\$ 29,073</b>                           | <b>\$ (97)</b>                      | <b>\$ 28,976</b>              |

|                                             |           |
|---------------------------------------------|-----------|
| Cash paid at Powertrain Date of Acquisition | \$ 20,873 |
| Contingent consideration                    | 8,200     |
| Working capital adjustment                  | (97)      |

Aggregate consideration \$ 28,976

The above estimated fair values of assets acquired and liabilities assumed were initially provisional, but deemed final as of December 31, 2015. There are inherent uncertainties and management judgment required in these determinations. The fair value measurements of certain assets acquired and liabilities assumed were based on valuations involving significant unobservable inputs that are Level 3 inputs in the fair value hierarchy. The Company believes that these inputs provided a reasonable basis for estimating the fair values and has finalized these amounts as of December 31, 2015. Except as discussed below, the assets acquired and the liabilities assumed were stated at their estimated fair values at the Powertrain Date of Acquisition.

The fair value of accounts receivable acquired was adjusted for amounts known or highly likely to be uncollectible based upon an assessment of known facts and circumstances as of the Powertrain Date of Acquisition and additional information arising subsequent to the Powertrain Date of Acquisition with respect to these known facts and circumstances.

The inventory acquired was revalued to its fair value. While the cost of raw materials generally approximated fair value, the value of finished goods inventory was stepped up by \$22,000, representing the estimated selling price of that inventory less the sum of costs to complete and a reasonable allowance for the Company's selling efforts, thereby reducing the margin on certain acquired inventory sold. The Company recognized all of this stepped up inventory value within cost of sales in the year ended December 31, 2015.





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The identifiable intangible assets as a result of the acquisition are amortized over their respective estimated useful lives as follows:

|                                             | Asset<br>amount  | Estimated<br>life |
|---------------------------------------------|------------------|-------------------|
| Backlog                                     | \$ 600           | 3 months          |
| Customer relationships                      | 13,000           | 12 years          |
| <b>Total identifiable intangible assets</b> | <b>\$ 13,600</b> |                   |

The weighted average useful life of the intangibles identified above is approximately 11.5 years. The fair value of backlog and customer relationships was derived using the multi-period excess earnings method.

The fair value of property, plant and equipment was based upon the acquisition costs of assets acquired as of the Powertrain Date of Acquisition adjusted for any known facts and circumstances necessary to approximate fair value.

Goodwill largely consists of geographic expansion of product sales, manufacturing and other synergies of the combined companies, and the value of the assembled workforce.

The accounts payable and accrued liabilities assumed were based on their book values which approximated their fair values at the Powertrain Date of Acquisition. Subsequent to the Powertrain Date of Acquisition, the accrued liabilities were further adjusted by \$591,000 primarily related to additional warranty reserves to more accurately reflect the liabilities assumed as of that date.

The following supplemental unaudited pro forma information presents the financial results as if the Powertrain transaction had occurred on January 1, 2014 as follows:

|                             | Year ended<br>(unaudited) |                      |
|-----------------------------|---------------------------|----------------------|
|                             | December 31,<br>2015      | December 31,<br>2014 |
| Net sales                   | \$ 402,718                | \$ 400,585           |
| Net income                  | 14,868                    | \$ 26,320            |
| Earnings per share, basic   | \$ 1.38                   | \$ 2.46              |
| Earnings per share, diluted | \$ 0.50                   | \$ 1.81              |

The pro forma information presented above is for information purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had taken place at an earlier date, nor are these results necessarily indicative of future consolidated results of operations of the Company.

*Acquisition of Bi-Phase Technologies, LLC*

On May 1, 2015 ( Bi-Phase Date of Acquisition ), the Company acquired all of the membership interests in Bi-Phase Technologies, LLC, a Minnesota limited liability company ( Bi-Phase ) and wholly-owned subsidiary of TPB, Inc., a Minnesota corporation. Bi-Phase is engaged in the design and manufacture of liquid propane electronic fuel injection systems to allow for the conversion of vehicles from gasoline to propane. The initial purchase price was approximately \$3.5 million in cash plus certain working capital adjustments, assumption of certain liabilities and Earn-out Payments as defined in the Membership Interest Purchase Agreement. The cash paid at the Bi-Phase Date of Acquisition was \$3,619,000 including estimated working capital. Subsequently, the Company paid an additional \$266,000 representing the final working capital adjustment for total cash consideration of \$3,885,000 before the contingent consideration. The Company also recorded a contingent consideration liability of \$540,000 representing an estimate of the Earn-out Payments expected to be payable in connection with the acquisition of Bi-Phase. This contingent consideration, payable to TPB, Inc., is based upon



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certain sales of Bi-Phase fuel systems over a period of three to five years. Accordingly, the aggregate purchase price approximated \$4,425,000 as of December 31, 2015.

The Company accounted for this acquisition as a business combination in accordance with ASC 805, *Business Combinations*, and as such, the excess of the purchase price over the fair values assigned to the assets acquired and liabilities assumed was initially provisionally allocated to goodwill at the Bi-Phase Date of Acquisition and then deemed final as of December 31, 2015. The Company has treated the acquisition of Bi-Phase as a purchase of assets for income tax purposes. Accordingly, the financial and income tax bases of the assets and liabilities have been assumed to be the same at the Bi-Phase Date of Acquisition, and therefore, a provision for deferred income tax was not recorded in connection with the purchase price allocation. Additionally, any excess of the purchase price over the fair value of the assets acquired is expected to be deductible for income tax purposes. The acquisition was funded by the proceeds received from the issuance of the 5.50% Senior Notes described in Note 8, Debt.

The purchase price for this acquisition had been provisionally allocated at the Bi-Phase Date of Acquisition, and deemed final as of December 31, 2015, to the assets acquired and liabilities assumed based on their estimated fair values as follows:

|                                                          | May 1, 2015 (Bi-Phase<br>Date of Acquisition) |
|----------------------------------------------------------|-----------------------------------------------|
| Assets acquired:                                         |                                               |
| Accounts receivable                                      | \$ 212                                        |
| Inventories                                              | 2,103                                         |
| Prepaid expenses                                         | 4                                             |
| Property, plant & equipment                              | 113                                           |
| Other assets                                             | 162                                           |
| <b>Total tangible assets</b>                             | <b>2,594</b>                                  |
| Intangible assets:                                       |                                               |
| Intangible assets                                        | 860                                           |
| Goodwill                                                 | 1,217                                         |
| <b>Total assets acquired</b>                             | <b>4,671</b>                                  |
| Liabilities assumed:                                     |                                               |
| Accounts payable                                         | 199                                           |
| Accrued liabilities                                      | 47                                            |
| <b>Total liabilities assumed</b>                         | <b>246</b>                                    |
| <b>Net assets acquired</b>                               | <b>\$ 4,425</b>                               |
| <b>Initial cash paid at Bi-Phase Date of Acquisition</b> | <b>\$ 3,619</b>                               |
| Contingent consideration                                 | 540                                           |
| Working capital adjustment                               | 266                                           |
| <b>Aggregate consideration</b>                           | <b>\$ 4,425</b>                               |

The fair value measurements of certain assets acquired and liabilities assumed were based on valuations involving significant unobservable inputs that are Level 3 inputs in the fair value hierarchy. There are inherent uncertainties and management judgment required in these determinations. The Company believes that these inputs provided a reasonable basis for estimating the fair values and has finalized these amounts as of December 31, 2015. Except as discussed below, the assets acquired and the liabilities assumed were stated at their estimated fair values at the Bi-Phase Date of Acquisition.



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The fair value of accounts receivable acquired was adjusted for amounts known or highly likely to be uncollectible based upon an assessment of known facts and circumstances as of the Bi-Phase Date of Acquisition and additional information arising subsequent to that date with respect to these known facts and circumstances.

The inventory acquired was revalued to its fair value. While the cost of raw materials generally approximated fair value, the value of finished goods inventory was stepped up by \$226,000, representing the estimated selling price of that inventory less the sum of costs to complete and a reasonable allowance for the Company's selling efforts, thereby reducing the margin on certain acquired inventory sold. The Company recognized all of this stepped up inventory value within cost of sales in the year ended December 31, 2015.

The identifiable intangible assets as a result of the acquisition are amortized over their respective estimated useful lives as follows:

|                                             | Asset<br>amount | Estimated<br>life |
|---------------------------------------------|-----------------|-------------------|
| Developed technology                        | \$ 700          | 7 years           |
| Customer relationships                      | 160             | 15 years          |
| <b>Total identifiable intangible assets</b> | <b>\$ 860</b>   |                   |

The weighted average useful life of the intangibles identified above is approximately 8.5 years. The fair value of developed technology and customer relationships was derived using the relief from royalty method and the multi-period excess earnings method, respectively.

The fair value of property, plant and equipment was based upon the acquisition costs of assets acquired as of the Bi-Phase Date of Acquisition adjusted for any known facts and circumstances necessary to approximate fair value.

Goodwill largely consists of geographic expansion of product sales, manufacturing and other synergies of the combined companies, and the value of the assembled workforce.

*Acquisition of Buck's Acquisition Company, LLC*

On March 18, 2015 (Buck's Date of Acquisition), the Company acquired all of the membership interests in Buck's Acquisition Company, LLC, (Buck's) from UE Powertrain d/b/a Buck's Engines and United Holdings, LLC, for an initial cash purchase price of approximately \$9,735,000, subject to certain adjustments as defined by the purchase agreement. Buck's is a manufacturer of alternative-fuel engines for industrial markets and was formerly a product line of United Engines, LLC. Buck's supplies a range of alternative-fuel engines that run on natural gas, propane and liquid propane gas fuels. Buck's targets an extensive range of industrial applications, including irrigation, gas compression, oil production, industrial equipment, power generation, mobile equipment, wind turbines, and re-power applications. The acquisition of Buck's was accounted for as a business combination in accordance with ASC 805, *Business Combinations*, and as such, the excess of the purchase price over the fair values assigned to the assets acquired and liabilities assumed had been provisionally allocated to goodwill at the Buck's Date of Acquisition and deemed final as of December 31, 2015. The Company treated the acquisition of Buck's as a purchase of assets for income tax purposes. Accordingly, the financial and income tax bases of the assets and liabilities have been assumed to be the same at the Buck's Date of Acquisition, and therefore, a provision for deferred income tax was not recorded in connection with the purchase price allocation. Any excess of the purchase price over the fair value of the assets acquired is expected to be deductible for income tax purposes. The acquisition of Buck's was funded through the Company's revolving line of credit.

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The purchase price for this acquisition had been provisionally allocated at the Bucks Date of Acquisition, and deemed final as of December 31, 2015, to the assets acquired and liabilities assumed based on their estimated fair values as follows:

|                             | March 18, 2015<br>(Buck s Date of Acquisition) |       |
|-----------------------------|------------------------------------------------|-------|
| Assets acquired:            |                                                |       |
| Inventories                 | \$                                             | 6,598 |
| Property, plant & equipment |                                                | 231   |
| Total tangible assets       |                                                | 6,829 |
| Intangible assets:          |                                                |       |
| Intangible assets           |                                                | 1,380 |
| Goodwill                    |                                                | 1,526 |
| Total assets acquired       | \$                                             | 9,735 |

The fair value measurements of certain assets acquired were based on valuations involving significant unobservable inputs that are Level 3 inputs in the fair value hierarchy. There are inherent uncertainties and management judgment required in these determinations. The Company believes that these inputs provided a reasonable basis for estimating the fair values and has finalized these amounts as of December 31, 2015. Except as discussed below, the assets acquired and the liabilities assumed were stated at their estimated fair values at acquisition.

The inventory acquired was revalued to its fair value. While the cost of raw materials generally approximated fair value, the value of finished goods inventory was stepped up by \$290,000, representing the estimated selling price of that inventory less the sum of costs to complete and a reasonable allowance for the Company s selling efforts, thereby reducing the margin on certain acquired inventory sold. The Company recognized all of this stepped up inventory value within cost of sales in the year ended December 31, 2015.

The identifiable intangible asset as a result of the acquisition is amortized over its respective estimated useful life as follows:

|                        | Asset amount | Estimated life |
|------------------------|--------------|----------------|
| Customer relationships | \$ 1,380     | 10 years       |

The fair value of customer relationships was derived using the multi-period excess earnings method.

The fair value of property, plant and equipment was based upon the acquisition costs of assets acquired as of the Buck s Date of Acquisition adjusted for any known facts and circumstances necessary to approximate fair value.

Goodwill largely consists of geographic expansion of product sales, manufacturing and other synergies of the combined companies, and the value of the assembled workforce.

The consolidated financial statements as of and for the years ended December 31, 2015 and 2014, include the assets, liabilities and operating results of each acquired business since the date of each respective acquisition. There were no such business combinations during the year ended December 31, 2013.

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### *Acquisition of Professional Power Products, Inc.*

On April 1, 2014 ( Date of Acquisition ), the Company acquired Professional Power Products, Inc. ( 3PI ), pursuant to a stock purchase agreement with Carl L. Trent and Kenneth C. Trent (collectively the Trents ) and CKT Holdings Inc., a Wisconsin corporation owned by the Trents. 3PI is a designer and manufacturer of large, custom engineered integrated electrical power generation systems serving the global diesel and natural gas power generation markets. The Company treated the acquisition of 3PI as a purchase of assets for income tax purposes. The acquisition of 3PI was financed through the Company's revolving line of credit and from proceeds received from a secured term loan.

On the Date of Acquisition, the Company acquired all of the issued and outstanding stock of 3PI, an Illinois corporation and wholly-owned subsidiary of CKT Holdings Inc., for cash of \$45.4 million, including cash acquired of \$1.3 million, and agreed to pay to the sellers additional consideration of between \$5,000,000 and \$15,000,000 in shares of the Company's common stock, valued at \$76.02 per share (i.e., between 65,772 and 197,316 shares), based upon, and following the final determination in accordance with the Stock Purchase Agreement of, the 3PI EBITDA (as defined in the Stock Purchase Agreement). As of the Date of Acquisition, this consideration was valued at \$8.9 million, and accordingly the total consideration payable for 3PI was valued at \$54.3 million. The consideration payable in shares of the Company's common stock consisted of (i) fixed consideration and (ii) contingent consideration. The Stock Purchase Agreement included a provision by and among the Company, Shareholders and Seller to treat the purchase of the 3PI stock as an acquisition of assets for income tax purposes.

The fixed portion of the consideration, representing 65,772 shares of the Company's common stock valued at \$5,060,000 at the Date of Acquisition was classified as a component of equity in the Company's consolidated balance sheet as of December 31, 2014. The fixed portion of the consideration was not subject to revaluation adjustment for financial reporting purposes. The contingent portion of the consideration (i.e., the earn-out consideration) was up to 131,544 shares of the Company's common stock (i.e., the difference between the maximum number of shares issuable of 197,316 and the fixed number of shares issuable of 65,772). The earn-out portion of consideration was initially valued at \$3,840,000 as of the Date of Acquisition and recognized as a liability on the Company's consolidated balance sheet. The measurement period for determining the amount of contingent consideration ultimately payable to the sellers was based upon the 2014 full calendar-year performance of 3PI as defined in the Stock Purchase Agreement. The minimum threshold for payout of the earn-out consideration was not met as of December 31, 2014. Accordingly, the Company reversed the liability that had been recorded and recognized a gain of \$3,840,000 which amount has been classified as Other income in the Company's consolidated results of operations for the year ended December 31, 2014.

The Company incurred total transaction costs related to the acquisition of approximately \$811,000, all of which was recognized and classified within general and administration expense in the Company's consolidated statements of operations in 2014. To facilitate the transaction, the Company entered into an amended and restated credit agreement with Wells Fargo Bank, N.A. on April 1, 2014, to increase its revolving line of credit and secured a \$5.0 million term loan to finance this acquisition. Refer to Note 8, Debt for a further description of these obligations.



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The acquisition of 3PI was accounted for as a business combination in accordance with ASC 805, *Business Combinations*, and, as such, assets acquired and liabilities assumed were recorded at their respective fair values. The purchase price for this acquisition allocated to the assets acquired and liabilities assumed based on their estimated fair values was as follows:

|                                           | April 1, 2014<br>(As initially<br>reported) | Measurement<br>period<br>adjustment | April 1, 2014<br>(As adjusted) |
|-------------------------------------------|---------------------------------------------|-------------------------------------|--------------------------------|
| <b>Assets acquired:</b>                   |                                             |                                     |                                |
| Cash                                      | \$ 1,277                                    | \$                                  | \$ 1,277                       |
| Accounts receivable                       | 3,989                                       |                                     | 3,989                          |
| Inventories                               | 5,073                                       | (120)                               | 4,953                          |
| Prepaid expenses and other current assets | 243                                         |                                     | 243                            |
| Property, plant & equipment               | 2,596                                       |                                     | 2,596                          |
| <b>Total tangible assets</b>              | <b>13,178</b>                               | <b>(120)</b>                        | <b>13,058</b>                  |
| <b>Intangible assets:</b>                 |                                             |                                     |                                |
| Intangible assets                         | 23,500                                      |                                     | 23,500                         |
| Goodwill                                  | 22,372                                      | 1,174                               | 23,546                         |
| <b>Total assets acquired</b>              | <b>59,050</b>                               | <b>1,054</b>                        | <b>60,104</b>                  |
| <b>Liabilities assumed:</b>               |                                             |                                     |                                |
| Accounts payable                          | 1,494                                       |                                     | 1,494                          |
| Accrued liabilities                       | 3,257                                       | 1,054                               | 4,311                          |
| <b>Total liabilities assumed</b>          | <b>4,751</b>                                | <b>1,054</b>                        | <b>5,805</b>                   |
| <b>Net assets acquired</b>                | <b>\$ 54,299</b>                            | <b>\$</b>                           | <b>\$ 54,299</b>               |

The following table provides a summary of the initial consideration for 3PI:

|                                                                                           |                  |
|-------------------------------------------------------------------------------------------|------------------|
| Fair value of assets acquired                                                             | \$ 60,104        |
| Less liabilities assumed                                                                  | (5,805)          |
| <b>Net assets acquired</b>                                                                | <b>54,299</b>    |
| Less value of shares of Company common stock expected to be issued at date of acquisition | (8,900)          |
| Less cash acquired                                                                        | (1,277)          |
| <b>Cash paid</b>                                                                          | <b>\$ 44,122</b> |

The above estimated fair values of assets acquired and liabilities assumed were based on known information as of April 1, 2014, were provisionally allocated to the assets acquired and liabilities assumed and deemed final as of December 31, 2014. There are inherent uncertainties and management judgment required in these determinations. The fair value measurements of the assets acquired and liabilities assumed were based on valuations involving significant unobservable inputs, or Level 3 in the fair value hierarchy. The Company believes that this information provides a reasonable basis for estimating the fair values. Except as discussed below, the assets acquired and the liabilities assumed were stated at their estimated fair values at the Date of Acquisition.

The fair value of accounts receivable acquired was adjusted for amounts known or highly likely to be uncollectible based upon an assessment of known facts and circumstances as of the Date of Acquisition and additional information arising subsequent to the Date of Acquisition with

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respect to these known facts and circumstances. The gross amount of accounts receivable acquired was approximately \$4,332,000 of which \$343,000 is expected to be uncollectible.

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The inventory acquired was revalued to its fair value. While the cost of raw materials generally approximates fair value, the value of work in process and finished goods inventory was stepped up by \$482,000, representing the estimated selling price of that inventory less the sum of costs to complete and a reasonable allowance for the Company's selling efforts. This stepped up inventory value was recognized within the Company's cost of sales during 2014. Subsequent to the Date of Acquisition, the inventory was further adjusted by approximately \$120,000, reflecting the value of the inventory acquired as of April 1, 2014.

See Note 6, Goodwill and other intangibles, for detail describing the intangible assets acquired and the amortization period based on the estimated useful lives of the intangible assets. The fair value of backlog and customer relationships was derived using the multi-period excess earnings method. The fair value of the trade names and trademarks was derived using the relief from royalty method.

The fair value of property, plant and equipment was based upon an appraisal of these assets or the acquisition costs of assets acquired immediately prior to the Date of Acquisition.

Goodwill largely consists of geographic expansion of product sales, manufacturing and other synergies of the combined companies, and the value of the assembled workforce.

The accounts payable and accrued liabilities assumed were based on their book values which approximated their fair values at the Date of Acquisition. Subsequent to the Date of Acquisition, the accrued liabilities were further adjusted by \$1,054,000.

During the year ended December 31, 2014, the Company's liability for the contingent consideration associated with the acquisition was measured at fair value based on unobservable inputs, and was thus, considered a Level 3 financial instrument. The fair value of the liability determined by this analysis was primarily driven by the Company's expectations of achieving the performance measures required by the Stock Purchase Agreement, the resulting shares expected to be issued, and the share price of the Company's common stock. The expected performance metrics and resulting shares expected to be issued were estimated based on a Monte Carlo simulation model considering actual and forecasted results over the measurement period. For the year ended December 31, 2014, the Company recognized income of \$3,840,000 due to a decrease in the estimated fair value of the Company's contingent consideration liability. This valuation adjustment was recorded as Contingent consideration in the Company's consolidated statements of operations for the year ended December 31, 2014. As of December 31, 2014, the Company's contingent consideration liability was determined to be zero.

As a result of the provisions within the Stock Purchase Agreement, the Company treated the acquisition of 3PI as a purchase of assets for income tax purposes. Accordingly, the financial and income tax bases of the assets and liabilities were initially the same at the Date of Acquisition. The write-off of the earn-out portion of the contingent consideration and the difference in the book and tax basis of the fixed portion of the consideration resulted in a lower amount of goodwill that is deductible by the Company for income tax purposes. Accordingly, the Company recognized deferred income tax liabilities arising from these differences which amounted to \$1,570,000 and \$681,000, respectively. The \$1,570,000 was recognized in the Company's income tax expense while the \$681,000 was recognized as an adjustment to the Company's additional paid-in-capital as of and for the year ended December 31, 2014. The total amount of goodwill that is expected to be deductible for income tax purposes was approximately \$18.0 million at December 31, 2014.

The assets, liabilities, and operating results of 3PI have been included in the Company's consolidated financial statements from the Date of Acquisition to December 31, 2014. 3PI's sales, net of intercompany sales, included in the Company's operating results from the Date of Acquisition to December 31, 2014 were \$20.4 million and 3PI reported an operating loss of approximately \$2.0 million for the same period. Amortization expense related to identifiable intangible assets associated with the acquisition, further described in Note 6, Goodwill and other intangibles, and included in the consolidated financial statements, approximated \$2,108,000 from the Date of Acquisition through December 31, 2014 and was included in the aforementioned loss from operations.

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The following supplemental unaudited pro forma information presents the financial results as if the 3PI transaction had occurred on January 1, 2013 as follows:

|                                    | Year ended<br>(unaudited) |                      |
|------------------------------------|---------------------------|----------------------|
|                                    | December 31,<br>2014      | December 31,<br>2013 |
| Net sales                          | \$ 353,175                | \$ 278,117           |
| Net (loss) income                  | \$ 23,671                 | \$ (16,557)          |
| (Loss) earnings per share, basic   | \$ 2.21                   | \$ (1.69)            |
| (Loss) earnings per share, diluted | \$ 1.57                   | \$ (1.69)            |

The historical operating results of 3PI included in the proforma information above was adjusted to exclude certain non-recurring expenses, principally transaction expenses which amount approximated \$3,474,000 in 2014 and none in 2013.

The pro forma information presented above is for information purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had taken place at an earlier date, nor are these results necessarily indicative of future consolidated results of operations of the Company.

*Transaction fees and expenses*

The Company incurred total transaction costs related to its acquisition activities of \$526,000, excluding lease termination expenses associated with the Buck's and Bi-Phase facilities, for the year ended December 31, 2015, respectively, all of which was recognized as an operating expense and classified within general and administrative expenses in the Company's consolidated statements of operations. The Company incurred total transaction costs related to the 3PI acquisition of \$811,000 in the year ended December 31, 2014.

**4. Earnings per share**

The Company computes earnings (loss) per share by applying the guidance stated in ASC 260, *Earnings per Share*. The treasury stock method has been used to compute earnings (loss) per share. The Company has issued warrants ( Private Placement Warrants ) that represent the right to purchase shares of the Company's common stock, stock appreciation rights ( SAR ), and restricted stock, all of which have been evaluated for their potentially dilutive effect under the treasury stock method. Refer to Note 11, *Stockholders' equity* for a further description of the Private Placement Warrants and Note 10, *2012 Incentive compensation plan* for a further description of the SAR and restricted stock.

The computations of basic and diluted earnings (loss) per share as of December 31, 2015, 2014 and 2013, were as follows:

|                                                                                               | 2015       | 2014       | 2013        |
|-----------------------------------------------------------------------------------------------|------------|------------|-------------|
| <b>Numerator:</b>                                                                             |            |            |             |
| Net income (loss)                                                                             | \$ 14,278  | \$ 23,726  | \$ (18,760) |
| Change in the value of Private Placement Warrants                                             | (9,299)    | (6,169)    |             |
|                                                                                               | \$ 4,979   | \$ 17,557  | \$ (18,760) |
| <b>Denominator:</b>                                                                           |            |            |             |
| Weighted average common shares outstanding-basic                                              | 10,808,005 | 10,706,780 | 9,779,457   |
| Incremental shares from assumed exercise of Private Placement Warrants, SAR, restricted stock | 265,642    | 424,837    |             |
| Weighted average common shares outstanding-diluted                                            | 11,073,647 | 11,131,617 | 9,779,457   |
| <b>Earnings (loss) per share of common stock - basic and diluted:</b>                         |            |            |             |
| Earnings (loss) per share of common stock - basic                                             | \$ 1.32    | \$ 2.22    | \$ (1.92)   |

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|                                           |         |    |      |    |      |    |        |
|-------------------------------------------|---------|----|------|----|------|----|--------|
| Earnings (loss) per share of common stock | diluted | \$ | 0.45 | \$ | 1.58 | \$ | (1.92) |
|-------------------------------------------|---------|----|------|----|------|----|--------|

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As of December 31, 2015, SARs were excluded from the diluted EPS calculation because they have an anti-dilutive effect under the treasury stock method. As of December 31, 2013, due to the loss reported in the consolidated statements of operating results, any potentially issuable shares of Company common stock associated with the Private Placement Warrants, SAR and restricted stock granted were not included in the dilutive EPS calculation. These potential shares were excluded from the diluted EPS calculation because they have an anti-dilutive effect under the treasury stock method.

**5. Property, plant and equipment, net**

The components of property, plant and equipment as of December 31, were as follows:

|                                        | 2015      | 2014      |
|----------------------------------------|-----------|-----------|
| Land                                   | \$ 260    | \$ 260    |
| Building and improvements              | 8,189     | 5,015     |
| Office furniture and equipment         | 4,675     | 3,705     |
| Tooling and equipment                  | 21,381    | 13,736    |
| Transportation equipment               | 560       | 525       |
| Construction in progress               | 3,011     | 6,056     |
| Property, plant and equipment, at cost | 38,076    | 29,297    |
| Accumulated depreciation               | (12,075)  | (8,405)   |
| Property, plant and equipment, net     | \$ 26,001 | \$ 20,892 |

Property, plant and equipment are recorded at cost or fair value when acquired in a business combination. The Company computes depreciation using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the shorter of the assets useful economic lives or the period from the date the assets are placed in service to the end of the lease term including renewal periods that are considered by the Company to be reasonably assured of being exercised. Depreciation expense totaled \$4,347,000, \$2,562,000 and \$1,528,000, for the years ended December 31, 2015, 2014 and 2013, respectively.

Repairs and maintenance costs are charged directly to expense as incurred. Major renewals or replacements that substantially extend the useful life of an asset are capitalized and depreciated.

Estimated useful lives by major asset category are as follows:

|                                | Life (in years)                                                                                                                          |
|--------------------------------|------------------------------------------------------------------------------------------------------------------------------------------|
| Building and improvements      | Lesser of (i) 39 years,<br>(ii) expected useful life of<br>improvement or (iii) life of<br>lease (including<br>likely extension thereof) |
| Tooling and equipment          | Up to 10 years                                                                                                                           |
| Office furniture and equipment | 3 10                                                                                                                                     |
| Transportation equipment       | 3 5                                                                                                                                      |

**6. Goodwill and other intangibles**

Goodwill is not amortized, but is reviewed annually or more frequently if indicators arise, for impairment. The Company's evaluation of goodwill impairment involves first assessing qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit, as defined below, is less than its carrying amount. The Company may bypass this qualitative assessment, or determine that based on its qualitative assessment considering the totality of events and circumstances (including macroeconomic factors, industry and market considerations, current and projected financial performance, a sustained decrease in share price, or other



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factors), that additional impairment analysis is necessary. This additional analysis involves comparing the Company's market capitalization relative to the carrying value of its equity and other factors deemed appropriate by management annually, as of October 1. However, actual fair values that could be realized in a transaction may differ from those used to evaluate the potential impairment of goodwill.

Goodwill was evaluated for impairment at the reporting unit level, which was defined as the operating segment level. At December 31, 2015 and 2014, goodwill recorded on the Company's consolidated balance sheet was \$41,466,000 and \$23,546,000, respectively. The Company's fair value measurement test, performed annually as of October 1, revealed no indications of impairment as of the respective balance sheet dates.

The activity in the Company's goodwill as of December 31 was as follows:

|                              | 2015      | 2014      |
|------------------------------|-----------|-----------|
| Balance at beginning of year | \$ 23,546 | \$        |
| Acquisitions                 | 17,920    | 23,546    |
| Balance at end of year       | \$ 41,466 | \$ 23,546 |

Management reviews other intangible assets, which include backlog, customer relationships, developed technology and trade names and trademarks, for impairment when events or changes in circumstances indicate the carrying amount of the asset may not be recoverable. In the event that impairment indicators exist, a further analysis is performed and if the sum of the expected undiscounted future cash flows resulting from the use of the asset were less than the carrying amount of the asset, an impairment loss equal to the excess of the asset's carrying value over its fair value would be recorded. Management considers historical experience and all available information at the time the estimates of future cash flows are made, however, the actual cash values that could be realized may differ from those that are estimated. For the year ended December 31, 2015 and 2014, there were no indications of impairment.

Amortization expense was classified as follows in the Company's consolidated statements of operations for the years ended December 31:

|                    | 2015     | 2014     | 2013  |
|--------------------|----------|----------|-------|
| Cost of sales      | \$ 742   | \$ 1,134 | \$ 40 |
| Operating expenses | 4,582    | 1,013    |       |
|                    | \$ 5,324 | \$ 2,147 | \$ 40 |

The tables below show the amortization period and intangible asset cost by intangible asset as of December 31, 2015 and December 31, 2014 and the accumulated amortization and net intangible asset value in total for all those intangible assets that related to the Company's acquisitions, for the related period. Refer to Note 3, "Acquisitions" for a further discussion of these acquisitions.

| Description of intangible  | Amortization period | Gross amount | 2015<br>Accumulated amortization | Net amount |
|----------------------------|---------------------|--------------|----------------------------------|------------|
| Backlog                    | 18 months           | \$ 1,800     | \$ (1,800)                       | \$         |
| Customer relationships     | 13 years            | 34,940       | (5,129)                          | 29,811     |
| Developed technology       | 7 years             | 700          | (113)                            | 587        |
| Trade names and trademarks | 13 years            | 1,700        | (353)                            | 1,347      |
| Total                      |                     | \$ 39,140    | \$ (7,395)                       | \$ 31,745  |



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| Description of intangible  | Amortization period | Gross amount | 2014<br>Accumulated amortization | Net amount |
|----------------------------|---------------------|--------------|----------------------------------|------------|
| Backlog                    | 18 months           | \$ 1,200     | \$ (1,095)                       | \$ 105     |
| Customer relationships     | 13 years            | 20,600       | (926)                            | 19,674     |
| Trade names and trademarks | 13 years            | 1,700        | (87)                             | 1,613      |
| Total                      |                     | \$ 23,500    | \$ (2,108)                       | \$ 21,392  |

The weighted average useful life of those intangibles acquired and included in the table above was approximately 13 years as of December 31, 2015 and 2014.

The table below shows the estimated future amortization expense for intangible assets:

| Year       | Estimated amortization expense |
|------------|--------------------------------|
| 2016       | \$ 5,714                       |
| 2017       | 4,837                          |
| 2018       | 4,182                          |
| 2019       | 3,638                          |
| 2020       | 3,053                          |
| Thereafter | 10,321                         |
| Total      | \$ 31,745                      |

**7. Fair value of financial instruments**

As of December 31, 2015, and December 31, 2014, the Company measured its financial assets and liabilities under the amended ASC 820, *Fair Value Measurements and Disclosures of the Accounting Standards Codification*, which defines fair value as the price that would be received to sell an asset or paid to transfer a liability (i.e., exit price) in an orderly transaction between market participants at the measurement date. It also establishes a three-level valuation hierarchy for disclosures of fair value measurement as follows:

Level 1 quoted prices in active markets for identical assets or liabilities;

Level 2 other significant observable inputs for the assets or liabilities through corroborations with market data at the measurement date; and

Level 3 significant unobservable inputs that reflect management's best estimate of what market participants would use to price the assets or liabilities at the measurement date.

***Private placement warrants liability***

As of December 31, 2015 and December 31, 2014, the Company's liability for Private Placement Warrants was measured at fair value under ASC 820. The Company's liability for the Private Placement Warrants is measured at fair value based on unobservable inputs, and thus is considered a Level 3 financial instrument. The Company analyzes financial instruments with features of both liabilities and equity under ASC 480, *Distinguishing Liabilities from Equity* and ASC 815, *Derivatives and Hedging*.

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As of December 31, 2015 and 2014, the Company estimated the fair value of its Private Placement Warrants with a publicly traded stock pricing approach using the Black-Scholes option pricing model. The inputs of the Black-Scholes option pricing model as of December 31, were as follows:

|                                            | December 31,<br>2015 | December 31,<br>2014 |
|--------------------------------------------|----------------------|----------------------|
| Market value of the Company's common stock | \$ 18.25             | \$ 51.61             |
| Exercise price                             | \$ 13.00             | \$ 13.00             |
| Risk-free interest rate                    | 0.12%                | 0.39%                |
| Estimated price volatility                 | 55.00%               | 55.00%               |
| Contractual term                           | 0.33 years           | 1.33 years           |
| Dividend yield                             |                      |                      |

The market value of the Company's common stock was based on its closing price on December 31, 2015 and December 31, 2014, the date of each valuation. The volatility factors noted above represented the upper end of the range of implied volatility of publicly traded call options of benchmark companies. If all other assumptions were held constant, a 10% change in the market value of the Company's common stock as of December 31, 2015, would have an immaterial effect on the recorded liability of the Private Placement Warrants.

The following table summarizes the change in the estimated fair value of the Company's Private Placement Warrants liability Level 3 financial instrument as of December 31:

|                                                     | 2015      | 2014      |
|-----------------------------------------------------|-----------|-----------|
| Balance at beginning of year                        | \$ 11,036 | \$ 24,525 |
| Fair value of private placement warrants exercised  | (255)     | (7,320)   |
| Decrease in the value of private placement warrants | (9,299)   | (6,169)   |
| Balance at end of year                              | \$ 1,482  | \$ 11,036 |

For the years ended December 31, 2015, 2014 and 2013, the Company recognized income of \$9,299,000, \$6,169,000 and expense of \$28,031,000, respectively. This was due to a decrease in the estimated fair value of the Company's Private Placement Warrants in 2015 and 2014 and an increase in fair value of the Private Placement Warrants in 2013. This income and expense was recorded as Private placement warrant (income) expense in the Company's consolidated statements of operations for the respective periods.

***Financial liabilities measured at fair value***

The following table summarizes fair value measurements by level as of December 31, 2015, for the Company's level 3 financial liabilities measured at fair value on a recurring basis:

|                                      | Level 1 | Level 2 | Level 3  |
|--------------------------------------|---------|---------|----------|
| Private placement warrants liability |         |         | \$ 1,482 |

The following table summarizes fair value measurement by level as of December 31, 2014, for the Company's level 3 financial liability measured at fair value on a recurring basis:

|                                      | Level 1 | Level 2 | Level 3   |
|--------------------------------------|---------|---------|-----------|
| Private placement warrants liability |         |         | \$ 11,036 |

***Financial assets and liabilities not measured at fair value***

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As of December 31, 2015 and December 31, 2014, the Company's revolving line of credit and term debt, including accrued interest, recorded on the consolidated balance sheets were carried at cost. The carrying value of the revolving line of credit and term debt approximated fair value because the interest rates fluctuate with market interest rates or the fixed rates approximate current rates offered to the Company for debt with similar terms and maturities,

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and the Company's credit profile had not changed significantly since the origination of these financial liabilities. Under ASC 825, Financial Instruments, these financial liabilities were defined as Level 2 in the three-level valuation hierarchy, as the inputs to their valuation are market observable. The carrying value of cash, accounts receivable, inventories, prepaid expenses and other current assets, accounts payable and other accrued liabilities approximated fair value because of their short maturities.

### **8. Debt**

#### ***Revolving line of credit and term debt***

On June 28, 2013, the Company entered into a credit agreement with Wells Fargo Bank, National Association (the "Wells Credit Agreement"), which replaced its prior credit agreement with BMO Harris Bank N.A. The Wells Credit Agreement enabled the Company to borrow under a revolving line of credit secured by substantially all of the Company's tangible and intangible assets (other than real property). The Wells Credit Agreement (a) provided an initial maximum \$75.0 million revolving line of credit to the Company, which, at the Company's request and subject to the terms of the Wells Credit Agreement, could have been increased up to \$100.0 million during the term of the Wells Credit Agreement; (b) bore interest at the Wells Fargo Bank's prime rate plus an applicable margin ranging from 0% to 0.50%; or at the Company's option, all or a portion of the revolving line of credit could have been designated to bear interest at LIBOR plus an applicable margin ranging from 1.50% to 2.00%; (c) had an unused line fee of 0.25% and (d) required the Company to report its fixed charge coverage ratio, when its Availability (as defined in the Wells Credit Agreement) was less than the Threshold Amount (as defined in the Wells Credit Agreement) and to continue to report its fixed charge coverage ratio until the date that Availability for a period of 60 consecutive days, was greater than or equal to the Threshold Amount. The Company was required to meet a minimum monthly fixed charge coverage ratio of not less than 1.0 to 1.0, the testing of which commenced on the last day of the month prior to the date on which its Availability was less than the Threshold Amount. The Threshold Amount was defined in the Wells Credit Agreement as the greater of (i) \$9,375,000 or (ii) 12.5% of the maximum revolver amount of \$75.0 million or as it may have been increased during the term of the Wells Credit Agreement up to \$100.0 million.

On April 1, 2014, the Wells Credit Agreement was amended (the "Amended Wells Credit Agreement") to increase the Company's revolving line of credit from \$75.0 million to \$90.0 million. The Amended Wells Credit Agreement (a) bears interest at the Wells Fargo Bank's prime rate plus an applicable margin ranging from 0% to 0.5%; or at the Company's option, all or a portion of the revolving line of credit can be designated to bear interest at LIBOR plus an applicable margin ranging from 1.50% to 2.00%; (b) has an unused line fee of 0.25%; (c) requires the Company to report its fixed charge coverage ratio and leverage ratio as described below; (d) includes a \$5.0 million term loan arrangement with Wells Fargo Bank; and (e) includes a letter of credit sub-facility of the revolving line of credit. The principal amount of the \$5.0 million term loan was payable in 36 equal monthly installments with the first payment due on June 1, 2014, plus interest at LIBOR plus 4.50%. Effective April 1, 2014 and during the period in which the term loan was outstanding, the Company was subject to a fixed charge coverage ratio covenant and a debt leverage ratio covenant. The Company was required to maintain a fixed charge coverage ratio of at least 1.20 to 1.00 and the Company's debt leverage ratio could not exceed 4.0 to 1.0 during the period in which the term loan was outstanding. At the time, the Company used borrowings under this expanded revolving line of credit as well as the proceeds from the term loan to finance the acquisition of 3PI which was consummated on April 1, 2014 as described in Note 3, "Acquisitions." The term loan was subsequently paid in full on April 29, 2015. In connection with the repayment of the term loan on April 29, 2015, the Company's minimum monthly fixed charge coverage ratio reverted back to 1.0 to 1.0, the testing of which commences on the last day of the month prior to the date on which the Company's Availability is less than the Threshold Amount.

On September 30, 2014 and again on February 11, 2015, the Company further amended its credit facility with Wells Fargo Bank, National Association, to increase its revolving line of credit facility to \$100.0 million and \$125.0 million, respectively (collectively with the Amended Wells Credit Agreement, the "Amended Wells Credit Agreement II"). The Amended Wells Credit Agreement II was scheduled to mature on June 28, 2018.

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Other than the above-mentioned amendments, the terms and conditions of the Amended Wells Credit Agreement and Amended Wells Credit Agreement II are substantially similar to the Wells Credit Agreement. Under the Amended Wells Credit Agreement and Amended Wells Credit Agreement II, the amount that the Company may borrow is limited to the lesser of (i) the maximum available amount and (ii) borrowing base. The borrowing base is calculated as a percentage of the Company's eligible accounts receivable and eligible inventory, plus a defined amount based upon certain of the Company's fixed assets (all as defined in the Amended Wells Credit Agreement and Amended Wells Credit Agreement II). The Amended Wells Credit Agreement and Amended Wells Credit Agreement II also contain customary covenants and restrictions applicable to the Company, including agreements to provide financial information, comply with laws, pay taxes and maintain insurance, restrictions on the incurrence of certain indebtedness, guarantees and liens, restrictions on mergers, acquisitions and certain dispositions of assets, and restrictions on the payment of dividends and distributions. The revolving line of credit is secured by substantially all of the Company's tangible and intangible assets (other than real property).

On April 29, 2015, the Company entered into an amended credit facility ( Amended Wells Credit Agreement III ) for the purpose of facilitating the issuance of the 5.50% Senior Notes (the Senior Notes ), as described below, and this amendment provided for the earlier maturity of the Amended Wells Credit Agreement III to insure that the Amended Wells Credit Agreement III will come due before the Senior Notes are payable as described below. While the Senior Notes are outstanding, the Amended Wells Credit Agreement III will become due 75 days prior to the earliest date that a Special Mandatory Purchase Date may occur or 90 days prior to the final maturity date of the Senior Notes, all as described in the Indenture agreement below. Accordingly, under the above terms, the Amended Wells Credit Agreement III will become due no earlier than March 15, 2017, but no later than January 31, 2018.

As of December 31, 2015, \$97.0 million of the Company's outstanding borrowings under its revolving line of credit bore interest at the LIBOR rate, plus an applicable margin. The weighted average interest rate on these borrowings was 1.84% as of December 31, 2015. The remaining outstanding balance of \$299,000 as of December 31, 2015 had been designated to bear interest at the prime rate, plus an applicable margin, which equaled 3.50% with the applicable margin included. The unused and available revolving line of credit balance was \$27.1 million at December 31, 2015. The Company's term loan was repaid on April 29, 2015.

As of December 31, 2014, \$71.0 million of the Company's outstanding borrowings under its revolving line of credit bore interest at the LIBOR rate, plus an applicable margin. The weighted average interest rate on these borrowings was 1.66% as of December 31, 2014. The remaining outstanding balance of \$7.0 million as of December 31, 2014 had been designated to bear interest at the prime rate, plus an applicable margin, which equaled 3.25% with the applicable margin included. The unused and available revolving line of credit balance was \$21.2 million at December 31, 2014. As of December 31, 2014, the Company had approximately \$4,028,000 outstanding under the term loan, which bore interest at LIBOR plus 4.50%, which equaled 4.67% with the applicable margin included.

### ***5.50% Senior Notes***

On April 24, 2015, the Company entered into a purchase agreement with certain institutional investors for a private sale of an aggregate amount of \$55.0 million of the Company's unsecured 5.50% Senior Notes. The sale closed on April 29, 2015. In connection with the issuance of the Senior Notes, the Company entered into an indenture agreement ( Indenture ) dated April 29, 2015, by and among the Company, The Bank of New York Mellon, as Trustee, and the Company's subsidiaries as guarantors. The Company received net proceeds of \$53,483,000 after financing costs of \$1,517,000. As discussed previously, in Note 2, Recently issued accounting pronouncements , in accordance with the guidance issued to simplify the presentation of debt issuance costs, the Company has presented issuance costs associated with its 5.50% Senior Notes as a direct deduction from the carrying value of the obligation on the Company's consolidated balance sheet as of December 31, 2015. As of December 31, 2015, the balance outstanding on the 5.50% Senior Notes was \$53,820,000 net of unamortized financing fees.

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The Senior Notes are unsecured debt of the Company and are effectively subordinated to the Company's existing and future secured debt including the debt in connection with the Amended Wells Credit Agreement III. The Senior Notes have a final maturity date of May 1, 2018, provided that a mandatory offer by the Company to purchase the Senior Notes must be made on or prior to May 1, 2017 in the event the Company cannot or does not certify compliance with certain financial covenants as more fully described below. In that event, the date of purchase will be no earlier than May 30, 2017.

The Company may redeem the Senior Notes in whole or in part at any time on or after May 1, 2016, at the option of the Company at the following redemption prices (expressed as percentages of the principal amount), together with accrued and unpaid interest to the date of redemption:

| Redemption date                      | Redemption price |
|--------------------------------------|------------------|
| May 1, 2016 through October 31, 2016 | 101.0%           |
| November 1, 2016 and thereafter      | 100.0%           |

At any time prior to May 1, 2016, the Company may redeem up to 35% of the Senior Notes with the net cash proceeds of certain equity offerings specified in the Indenture at a redemption price of 105.5% of the principal amount of the Senior Notes, together with accrued and unpaid interest to the date of redemption, but only if at least 65% of the original aggregate principal amount of the Senior Notes would remain outstanding following such redemption. In addition, prior to May 1, 2016, the Company may redeem the Senior Notes in whole or in part at a redemption price equal to 101.0% of the principal amount plus (i) accrued and unpaid interest to the redemption date and (ii) an Applicable Premium (as defined in the Indenture) that is intended as a "make-whole" to May 1, 2016.

The Senior Notes have a Special Mandatory Purchase Date as described in the Indenture and summarized as follows. Upon the occurrence of the earlier of (I) March 15, 2017, if the Trustee has not received on or within five days prior to such date an officer's certificate stating that (i) the Company's pro forma consolidated EBITDA (as defined in the Indenture) is at least equal to or greater than \$35.0 million for the most recent four full fiscal quarters for which financial statements are available as of such date and (ii) the Company's consolidated pro forma ratio of consolidated EBITDA to fixed charges (as defined in the Indenture) is at least equal to or greater than 3.25 to 1.0 for the most recent four full fiscal quarters for which financial statements are available as of such date or (II) the date on which the Company notifies the Trustee in writing (which date may be at any time on or after March 1, 2017 but on or prior to March 15, 2017) that the Company cannot or will not deliver such officer's certificate, then, unless the Company has given on or prior to March 15, 2017 a notice of redemption of all of the Senior Notes, the Company will make a mandatory offer to purchase all of the Senior Notes at a purchase price of 100.0% of the principal amount plus accrued and unpaid interest, if any, to the date of purchase in accordance with the procedures set forth in the Indenture.

The Indenture contains covenants that, among other things, limit or restrict the ability of the Company and its subsidiaries to incur additional debt, prepay subordinated indebtedness, pay dividends or make other distributions on capital stock, redeem or repurchase capital stock, make investments and restricted payments, enter into transactions with affiliates, sell assets, create liens on assets to secure debt, or effect a consolidation or merger or to sell all, or substantially all, of the Company's assets, in each case subject to certain qualifications and exceptions set forth in the Indenture. The Indenture also provides for customary events of default (subject in certain cases to customary grace and cure periods), which include nonpayment, breach of covenants in the Indenture, payment defaults or acceleration of other indebtedness, and certain events of bankruptcy and insolvency. Generally, if an event of default occurs, the Trustee or holders of at least 25.0% in principal amount of the then outstanding Senior Notes may declare the principal of and accrued but unpaid interest on all Senior Notes to be due and payable.

Interest on the Senior Notes accrues at a rate of 5.50% per annum and is payable semi-annually in arrears on May 1 and November 1 of each year, commencing on November 1, 2015. As of December 31, 2015, the accrued, but unpaid interest on the Senior Notes was \$513,000.

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The Company leases certain buildings and equipment under various noncancelable operating lease agreements that contain renewal provisions. Rent expense under these leases approximated \$4,377,000, \$3,314,000 and \$2,693,000 for the years ended December 31, 2015, 2014 and 2013, respectively.

The future minimum lease payments due under operating leases as of December 31, 2015, were as follows:

|            |                  |
|------------|------------------|
| 2016       | \$ 4,771         |
| 2017       | 4,192            |
| 2018       | 3,207            |
| 2019       | 1,918            |
| 2020       | 1,687            |
| Thereafter | 3,047            |
|            | <b>\$ 18,822</b> |

**10. 2012 Incentive compensation plan**

On May 30, 2012, the Board of Directors of the Company approved and adopted the Company's 2012 Incentive Compensation Plan (the "2012 Plan"), and the 2012 Plan was approved by a majority of the Company's stockholders at the Company's annual meeting held on August 29, 2012. The 2012 Plan is administered by the Compensation Committee of the Board of Directors, which consists only of independent, non-employee directors.

The 2012 Plan is a broad-based plan which allows for a variety of different types of awards, including (but not limited to) non-qualified stock options, incentive stock options, SAR, restricted stock, deferred stock and performance units, to be made to the Company's executive officers, employees, consultants and directors. The 2012 Plan is intended to assist the Company in attracting and retaining exceptionally qualified employees, consultants and directors to support the sustained progress, growth and profitability of the Company.

Of the Company's 1,530,925 shares initially made available and reserved for awards under the 2012 Plan, 790,865 shares have been granted under various awards as described below, and as of December 31, 2015, the Company had 740,060 shares of common stock available for future issuance under the 2012 Plan.

***SAR award agreements***

SAR awards are accounted for as equity, in accordance with ASC 718, *Compensation - Stock Compensation*, which states that options or similar instruments on shares shall be classified as liabilities if either the underlying shares are classified as liabilities or the entity can be required under any circumstance to settle the option or similar instrument by transferring cash or other assets. The Company's underlying shares are classified as equity, and under the terms of the SAR Award Agreement, the Company must settle the exercised portion of the SAR in shares of the Company's common stock. As such, the Company has accounted for the SAR as equity.

ASC 718, *Compensation - Stock Compensation*, was utilized in order to estimate the fair value of the SAR. The term "fair value" has been defined in Note 7, "Fair value of financial instruments." ASC 718 requires an entity to measure the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award as of the grant date. That cost is then recognized over the period during which an employee is required to provide service in exchange for the award. The Company has computed compensation expense by applying the guidance stated in ASC 718, on a straight-line basis over the requisite service period for each separately vesting portion of the award as if the award was, in-substance, multiple awards.

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The Compensation Committee of the Board of Directors approved, and the Company granted the following SAR awards:

| Award Description | Grant Date       | Recipient                       | Award          | Exercise Price | Expiration       |
|-------------------|------------------|---------------------------------|----------------|----------------|------------------|
| SAR I             | June 6, 2012     | Chief Operating Officer ( COO ) | 543,872 shares | \$22.07        | June 6, 2022     |
| SAR II            | October 19, 2015 | Chief Financial Officer ( CFO ) | 60,000 shares  | \$24.41        | October 19, 2025 |

SAR awards entitle the recipients to receive, upon any exercise, a number of shares of the Company's common stock equal to (i) the number of shares for which the SAR is being exercised multiplied by the value of one share of the Company's common stock on the date of exercise (determined as provided in the SAR Award Agreement), (ii) less the number of shares for which the SAR is being exercised multiplied by the applicable exercise price, (iii) divided by the value of one share of the Company's common stock on the date of exercise (determined as provided in the SAR Award Agreement). The exercised SAR is to be settled only in whole shares of the Company's common stock, and the value of any fractional share of the Company's common stock will be forfeited.

**SAR I**

The assumptions used for the measurement of the expense for SAR I included an expected term of 6.0 years, a risk-free interest rate of 0.92%, an anticipated volatility factor of 55.0% and a zero dividend yield. The resulting valuation as of the SAR I grant date was discounted by 15%, reflecting an assessment of the then trading activity of the Company's common stock (and by extension SAR I). The suggested value from the Black Scholes method reflected a fully marketable security that was not burdened by limited marketability; however, at that time, the Company's common stock (and by extension SAR I) did not have regular trading activity. Therefore, the Company considered it necessary to incorporate a discount to reflect the limited liquidity associated the SAR I. This approach was consistent with that utilized to value the Company's Private Placement Warrants at that time. The resulting fair value of SAR I was \$3.31 per underlying share. The compensation expense for this SAR I was initially determined to approximate \$1.8 million which amount was recognized from the grant date through June 6, 2015.

On June 5, 2015, the Company and the COO agreed to defer the vesting of the remaining unvested portion of the SAR I granted for 30 days until July 6, 2015 pursuant to an amendment to the initial SAR I. On July 6, 2015, the Company and COO entered into a SAR and Bonus Agreement which amended SAR I by extending the vesting period applicable to the remaining unvested portion of SAR I. The unvested portion covers 181,290 underlying shares of the Company's common stock which, prior to the amendment, would have vested on June 6, 2015. The amendment extended the vesting of these shares to June 6, 2017 with respect to 100,000 underlying shares of the Company's common stock and to June 6, 2019 with respect to the remaining 81,290 shares of underlying Company common stock (in each case subject to forfeiture upon termination of employment by the Company for Cause (as defined in the SAR and Bonus Agreement)). The SAR and Bonus Agreement also provides the COO with an annual bonus in the amount of \$250,000 for each of calendar years 2016, 2017, 2018 and 2019 as long as the conditions of the SAR I agreement are met and subject to forfeiture under certain circumstances enumerated in the SAR I agreement.

The extension of the vesting period described above resulted in an additional expense attributable to the fair value of the unrecognized compensation expense of the SAR I and was estimated at \$333,000 using the Black-Scholes option pricing model. The inputs of the Black-Scholes option pricing model included the fair value of the Company's common stock, exercise price, risk-free interest rate, estimated price volatility, term and dividend yield as follows: a fair value of \$51.14, an exercise price of \$22.07, a risk-free interest rate of 1.53%, an expected term of 4.9 years, an anticipated volatility factor of 50.0% and a zero dividend yield. The resulting fair value of the extension was \$1.54 per underlying share.



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This additional expense will be recognized during the remaining vesting period through June 6, 2019. Including the amendment discussed above, the total SAR I expense is expected to be approximately \$2,133,000 from initial grant through the final vesting date in 2019. As of December 31, 2015, there was approximately \$259,000 of total unrecognized compensation expense related to the SAR I.

In the years ended December 31, 2015, 2014 and 2013, the Company recognized approximately \$160,000, \$329,000 and \$907,000, respectively, of compensation expense in connection with SAR I. During the year ended December 31, 2014, a portion of the shares that vested on June 6, 2014 were exercised. During the year ended December 31, 2013, the portion of shares that vested on June 6, 2013 were fully exercised. The impact of this transaction on the Company's issued capital is described in Note 11, Stockholders' equity.

**SAR II**

The assumptions used for the measurement of the expense for SAR II included fair value of the Company's common stock of \$24.41, an exercise price of \$24.41, an expected term of 7.25 years, a risk-free interest rate of 1.76%, an anticipated volatility factor of 50.0% and a zero dividend yield. The resulting fair value of SAR II was \$12.96 per underlying share. SAR II vests ratably and becomes exercisable with respect to one-fourth of the covered shares annually beginning on the third anniversary of the SAR II grant date.

In the year ended December 31, 2015, the Company initially recognized approximately \$37,000, of compensation expense in connection with SAR II, and no similar expense in 2014 or 2013. As of December 31, 2015, there was approximately \$740,000 of total unrecognized compensation expense related to the SAR II granted under the 2012 Plan. As of December 31, 2015, the weighted-average period over which the unrecognized compensation cost is expected to be recognized is approximately 6.0 years.

**Restricted stock awards**

The Compensation Committee of the Board of Directors approved, and the Company granted, shares of Company restricted stock (Restricted Stock) to various employees pursuant to the 2012 Plan and subject in each case to a Restricted Stock Award Agreement (Restricted Stock Award Agreement). Restricted stock activity consisted of the following for the years ended December 31:

|                   | Shares   | Weighted Average Grant Date<br>Fair Value |
|-------------------|----------|-------------------------------------------|
| December 31, 2013 | 162,993  | \$ 39.29                                  |
| Granted           | 23,000   | 71.47                                     |
| Forfeited         | (12,000) | 60.44                                     |
| Vested            | (19,742) | 41.89                                     |
| December 31, 2014 | 154,251  | \$ 42.18                                  |
| Granted           | 1,000    | 28.48                                     |
| Forfeited         | (800)    | 65.51                                     |
| Vested            | (24,207) | 42.63                                     |
| December 31, 2015 | 130,244  | \$ 41.77                                  |

There was no Restricted Stock activity prior to December 31, 2013 with the exception of the initial 162,993 share grant. These shares of Restricted Stock vest in various increments and periods over a maximum of ten years from the date the stock was granted as defined under the applicable Restricted Stock Award Agreement. In the years ended December 31, 2015, 2014 and 2013, the Company recognized approximately \$989,000, \$925,000 and \$361,000, respectively, of compensation expense in connection with the Restricted Stock granted under the 2012 Plan. The fair value of restricted stock that vested during 2015 and 2014 was approximately \$1,101,000 and \$1,408,000, respectively. As of December 31, 2015, there was approximately \$4,882,000 of total unrecognized compensation expense related to the Restricted Stock granted under the 2012 Plan. As of December 31, 2015, the weighted-average period over which the unrecognized compensation cost is expected to be recognized is approximately 6.0 years.

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### **11. Stockholders' equity**

The statements of changes in stockholders' equity for the years ended December 31, 2015, 2014 and 2013, present the changes giving effect to the Company's common stock issued, stock compensation activity and Private Placement Warrant exercises, each of which is described below.

#### ***Common stock***

The Company has authorized 50,000,000 shares of common stock with a par value of \$0.001 per share. At December 31, 2015, 11,583,831 shares of Company common stock were issued and 10,752,906 shares of Company's common stock were outstanding. At December 31, 2014, 11,562,209 shares of Company common stock were issued and 10,731,284 shares of Company's common stock were outstanding. Each holder of a share of the Company's common stock is entitled to one vote per share held on each matter to be considered by holders of the Company's common stock. Holders of the Company's common stock are entitled to receive ratably such dividends, if any, as may be declared by the Company's board of directors. The Company's current policy is to retain earnings for operations and growth. Upon any liquidation, dissolution or winding-up of the Company, the holders of the Company's common stock are entitled to share ratably in all assets available for distribution, after payment of, or provision for, all liabilities and the preferences of any then outstanding shares of Company preferred stock. The holders of the Company's common stock have no preemptive, subscription, redemption or conversion rights.

#### ***Series A Convertible preferred stock***

The Company has authorized 114,000 shares of Series A Convertible preferred stock with a par value of \$0.001 per share. At December 31, 2015 and 2014, no shares of Series A Convertible preferred stock of the Company were issued or outstanding.

#### ***SAR exercise for shares of Company common stock***

During the year ended December 31, 2014, 120,000 of the 181,291 shares of common stock underlying SAR I which vested on June 6, 2014, were exercised in two tranches. As a result of these exercises the Company issued a total of 85,903 shares of the Company's common stock. In connection with these exercises, the excess of the underlying value of the common stock issued over the amount recognized as compensation expense in the Company's financial statements resulted in an amount that was deductible for income tax purposes. As such, the Company realized an income tax benefit of \$2,427,000 for this incremental amount, which was recorded as a reduction in the Company's income tax liability and an increase in additional paid-in-capital during the year ended December 31, 2014. As of December 31, 2014, there were 61,291 unexercised shares under the SAR that vested on June 6, 2014.

On August 15, 2013, 181,291 shares of common stock underlying SAR I, which vested on June 6, 2013 were exercised. Upon such exercise, the Company initially issued 96,504 shares of the Company's common stock. Under the terms of the plan, at the option of the recipient, the Company then withheld 42,314 of the shares issued to satisfy the recipient's income tax obligations. The cash equivalent of the shares withheld was \$2,063,000, representing the recipient's income tax withholding obligation that was remitted by the Company to the applicable taxing authorities. The payment of the income tax withholding obligation was recorded as a reduction in additional paid-in-capital during the year ended December 31, 2013. The Company realized an income tax benefit of \$1,642,000 for the excess of the underlying value of the common stock issued over the amount recognized as compensation expense in the Company's financial statements that was recorded as a reduction in the Company's income tax liability and an increase in additional paid-in-capital during the year ended December 31, 2013.

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### ***Restricted stock vesting for shares of Company common stock***

For the years ended December 31, 2015 and 2014, various individuals vested in shares of the Company's common stock under the Restricted Stock Award Agreement resulting in the net issuance of 16,622 shares and 13,909 shares, respectively. Under the terms of the 2012 Plan, at the option of certain of those vested restricted stock participants, the Company withheld shares issued to satisfy the income tax obligations of these recipients. The cash equivalent of the aggregate number of shares withheld was \$351,000 and \$430,000 for the years ended December 31, 2015 and 2014, respectively, representing the income tax withholding obligations of the recipients, and such amounts were remitted by the Company to the applicable taxing authorities. The payments of the income tax withholding obligations were recorded as a reduction in additional paid-in-capital as of December 31, 2015 and 2014.

In connection with the vesting and issuance of shares of the Company's common stock under the 2012 Plan, other than the shares of common stock issued in connection with the SAR, the excess of the underlying value of the common stock issued over the amount recognized as compensation expense in the Company's financial statements resulted in costs that are deductible for income tax purposes. As such, the Company realized an income tax benefit of \$65,000 and \$277,000 for this incremental amount which was recorded as a reduction in the Company's income tax liability and an increase in additional paid-in-capital as of and for the years ended December 31, 2015 and 2014, respectively.

### ***Private placement warrants***

In connection with a private placement ( "Private Placement" ) on April 29, 2011, investors in the Private Placement received Company preferred stock (which subsequently converted to shares of Company common stock) and Private Placement Warrants. The Private Placement Warrants represented the right to purchase a total of 750,002 shares of the Company's common stock at an exercise price of \$13.00 per share, subject to further adjustment for non-cash dividends, distributions, stock splits or other reorganizations or reclassifications of the Company's common stock. The Private Placement Warrants are also subject to full ratchet anti-dilution protection whereby, upon the issuance (or deemed issuance) of shares of the Company's common stock at a price below the then-current exercise price of the Private Placement Warrants, subject to specified exceptions, the exercise price of the Private Placement Warrants will be reduced to the effective price of the Company's common stock so issued (or deemed to be issued). The Private Placement Warrants will expire on April 29, 2016.

At any time beginning six months after the closing of the Private Placement at which the Company is required to register the shares issuable upon exercise of the Private Placement Warrants pursuant to the registration rights agreement entered into in connection with the Private Placement, but such shares may not be freely sold to the public, the Private Placement Warrants may be "cashlessly" exercised by their holders. In such circumstances, the warrant holders may "cashlessly" exercise the Private Placement Warrants by causing the Company to withhold a number of shares of its common stock otherwise issuable upon such exercise having a value, based upon the market price of the Company's common stock (such market price as defined in the purchase agreement for the Private Placement), equal to the aggregate exercise price associated with such exercise. In other words, in such circumstances, the exercise of the Private Placement Warrants will occur without any cash being paid by the holders of the Private Placement Warrants. Because the shares issuable upon exercise of the Private Placement Warrants are currently available for resale pursuant to effective registration statements filed by the Company with the SEC, the Private Placement Warrants may not be "cashlessly" exercised at this time. The Private Placement Warrants further include a requirement that, the Company will keep reserved out of the authorized and unissued shares of its common stock sufficient shares to provide for the exercise of the Private Placement Warrants.

The Company's Private Placement Warrants are accounted for as a liability, in accordance with ASC 480, *Distinguishing Liabilities from Equity*. ASC 480 states that, if an entity must or could settle an instrument by issuing a variable number of its own shares, and, as in this case, the obligation's monetary value is based solely or predominantly on variations in the fair value of the company's equity shares, but moves in the opposite

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direction, then the obligation to issue shares is to be recorded as a liability at the inception of the arrangement, and is adjusted with subsequent changes in the fair value of the underlying stock. The effect of the change in value of the obligation is reflected as Private placement warrant (income) expense in the Company's consolidated statements of operations.

The Company was formerly known as Format, Inc. (Format). On April 29, 2011, Format consummated a reverse acquisition transaction with The W Group, Inc. and its subsidiaries (The W Group) (Reverse Recapitalization), and in connection with this transaction, Format changed its corporate name to Power Solutions International, Inc. The Private Placement Warrants issued had an estimated fair value of \$2,887,000 at the closing of the Reverse Recapitalization transaction and the Private Placement on April 29, 2011, determined based upon an agreed-upon exercise price of the Private Placement Warrants; the purchase price for (value of) the Company's preferred stock and Private Placement Warrants, in the aggregate as agreed upon with the investors in the Private Placement; an assessment of an appropriate risk-free interest rate of 2.1%, an anticipated volatility factor of 50.0%, and a zero percent dividend yield, all incorporated into a valuation using the Black-Scholes option pricing model. The Company determined that the five-year Treasury Bond yield was a reasonable assumption for a risk-free rate, and that an appropriate volatility rate would represent the upper end of the range of implied volatility of publicly traded call options of benchmark companies, which reflects the mid-range of their historical volatility. The Company's past history of not paying dividends and management's intentions to continue such a dividend policy resulted in a zero dividend yield assumption. The five-year term of the Private Placement Warrants, the stated warrant exercise price of \$13.00 per share (as adjusted for a reverse split), when the Private Placement Warrants became exercisable, and the Company's common stock valuation of \$10.08 per share (as adjusted for a reverse split), when the Private Placement Warrants became exercisable, comprise the balance of the inputs into the Black-Scholes pricing model for the warrant valuation.

See Note 7, Fair value of financial instruments, for detail describing the valuation approach for the Private Placement Warrants.

During the years ended December 31, 2015, 2014 and 2013, portions of the Private Placement Warrants were exercised, resulting in the issuance of 5,000 shares, 109,585 shares and 339,410 shares of Company common stock, respectively.

As of December 31, 2015 and 2014, 282,257 shares and 287,257 shares of Company common stock, respectively, remained reserved for the exercise of the Private Placement Warrants, in accordance with the terms of the purchase agreement for the Private Placement.

### ***Treasury stock***

The Company and Gary S. Winemaster, the Company's Chief Executive Officer and President, and Chairman of the Board of Directors of the Company, entered into a Stock Purchase Agreement, pursuant to which, on October 31, 2011, the Company purchased from Mr. Winemaster 830,925 shares of Company common stock for \$4.25 million, or \$5.11 per share. These shares were returned to the Company's treasury as authorized and issued, but not outstanding, shares of common stock of the Company.

### ***Underwritten public offering***

On July 16, 2013, the Company closed an underwritten public offering of 2,005,000 shares of its common stock at a price to the public of \$35.00 per share. The Company sold 1,050,000 shares of its common stock, and certain selling stockholders, sold 955,000 shares of common stock in the offering. The proceeds to the Company, net of the underwriter's fees and expenses, were \$34,530,000 before deducting offering expenses of approximately \$514,000 paid by the Company. The Company did not receive any proceeds from the sale of the shares by the selling stockholders.

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### ***Registration rights agreement***

In connection with the Private Placement, the Company entered into a Registration Rights Agreement (the "Private Placement Registration Rights Agreement") with the investors in the Private Placement and Roth Capital Partners, LLC, pursuant to which it agreed to file a registration statement on Form S-1, with the SEC, covering the resale of Registrable Securities (as defined below) (which includes the shares of the Company's common stock that were issuable upon conversion of shares of the Company's preferred stock originally issued in the Private Placement and shares of the Company's common stock issuable upon exercise of the Private Placement Warrants and shares of the Company's common stock that were issuable upon exercise of the Roth Warrant), on or before the date which is 30 days after the closing date of the Private Placement, and to use its commercially reasonable efforts to have such registration statement declared effective by the SEC as soon as practicable. The Company further agreed, within 30 days after it becomes eligible to use a registration statement on Form S-3 to register the Registrable Securities for resale, to file a registration statement on Form S-3 covering the Registrable Securities. On June 27, 2013, within 30 days after the Company became eligible to use a registration statement on Form S-3, in accordance with the Private Placement Registration Rights Agreement, it filed a registration statement on Form S-3 (as a post-effective amendment to the registration statement on Form S-1) covering the Registrable Securities, which was declared effective on June 27, 2013.

The Company is obligated to maintain the effectiveness of the registration statement until the earliest of (1) the first date on which all Registrable Securities covered by such registration statement have been sold, (2) the first date on which all Registrable Securities covered by such registration statement may be sold without restriction pursuant to Rule 144 or (3) the first date on which none of the securities included in the registration statement constitute Registrable Securities.

Pursuant to the Private Placement Registration Rights Agreement, the holders of Registrable Securities are also entitled to certain piggyback registration rights if the Registrable Securities are not covered by one or more effective registration statements. As of December 31, 2013, and as of the time of the closing of the public offering on July 16, 2013, all of the Registrable Securities were covered by an effective registration statement. Registrable Securities, as contemplated by the Private Placement Registration Rights Agreement, means certain shares of the Company's common stock, including those shares that were issuable upon conversion of shares of Company preferred stock issued in the Private Placement and shares of the Company's common stock issuable upon exercise of the Private Placement Warrants and the shares of the Company's common stock that were issued upon exercise of the Roth Warrant; provided, that, any such share shall cease to be a Registrable Security upon (A) sale pursuant to the registration statement or Rule 144 under the Securities Act, (B) such share becoming eligible for sale without restriction by the selling securityholder holding such security pursuant to Rule 144 under the Securities Act or (C) such share otherwise becoming eligible for sale without restriction pursuant to Section 4(1) of the Securities Act, provided that, any restrictive legend on any certificate or other instrument representing such shares has been removed or there has been delivered to the transfer agent for such shares irrevocable documentation (including any necessary legal opinion) to the effect that, upon submission by the applicable selling securityholder of the certificate or instrument representing such security, any such restrictive legend shall be removed.

In connection with the consummation of the Reverse Recapitalization, the Company also entered into a registration rights agreement with the former stockholders of The W Group, Inc., pursuant to which it agreed to provide to such persons certain piggyback registration rights with respect to shares of the Company's capital stock, including shares issuable upon exercise, conversion or exchange of securities, held by such persons at any time on or after the closing of the Reverse Recapitalization. The piggyback registration rights under this registration rights agreement are subject to customary cutbacks and are junior to the piggyback registration rights granted to investors in the Private Placement and to Roth pursuant to the Private Placement Registration Rights Agreement.

**Table of Contents****Universal shelf registration**

The Company has a universal shelf registration pursuant to which the Company may offer, issue and sell, from time to time, in one or more offerings, up to \$150,000,000 of common stock, preferred stock, debt securities, depositary shares, warrants, subscription rights, stock purchase contracts and units, and certain selling stockholders may offer and sell, from time to time, in one or more offerings, up to 500,000 shares of common stock.

**12. Income taxes**

The expense (benefit) for income taxes for the years ended December 31, was as follows:

|                                | 2015     | 2014      | 2013     |
|--------------------------------|----------|-----------|----------|
| Current tax expense (benefit)  |          |           |          |
| Federal                        | \$ (446) | \$ 5,650  | \$ 2,629 |
| State                          | 55       | 1,448     | 955      |
|                                | (391)    | 7,098     | 3,584    |
| Deferred tax expense (benefit) |          |           |          |
| Federal                        | 345      | 3,050     | 967      |
| State                          | (342)    | 665       | 208      |
|                                | 3        | 3,715     | 1,175    |
| Total tax (benefit) expense    | \$ (388) | \$ 10,813 | \$ 4,759 |

A reconciliation between the Company's effective tax rate on income from continuing operations and the statutory tax rate for the years ended December 31, was as follows:

|                                                           | 2015     |         | 2014      |         | 2013       |         |
|-----------------------------------------------------------|----------|---------|-----------|---------|------------|---------|
|                                                           | Amount   | Percent | Amount    | Percent | Amount     | Percent |
| Income tax expense (benefit) at federal statutory rate    | \$ 4,862 | 35.0%   | \$ 12,089 | 35.0%   | \$ (4,760) | 34.0%   |
| State income tax, net of federal benefit                  | 178      | 1.3     | 1,403     | 4.0     | 848        | (6.1)   |
| Non-deductible private placement warrant (income)/expense | (3,255)  | (23.4)  | (2,159)   | (6.2)   | 9,531      | (68.0)  |
| Domestic production activity                              |          |         | (295)     | (0.9)   | (376)      | 2.7     |
| Research tax credits                                      | (2,437)  | (17.6)  | (1,001)   | (2.9)   | (1,054)    | 7.5     |
| Tax reserve reassessment                                  | 315      | 2.3     | 170       | 0.5     | 570        | (4.1)   |
| Other, net                                                | (51)     | (0.4)   | 606       | 1.8     |            |         |
| Income tax expense (benefit)                              | \$ (388) | (2.8)%  | \$ 10,813 | 31.3%   | \$ 4,759   | (34.0)% |

The Company recognized pretax income of \$13,890,000 which included \$9,299,000 of permanently excludable income associated with the change in the valuation of the Company's Private Placement Warrants for the year ended December 31, 2015. Excluding this income, the Company's pre-tax income was \$4,591,000 for the year ended December 31, 2015. The Company also recognized \$6,169,000 of income in the year ended December 31, 2014, due to the change in the valuation of the Private Placement Warrants. Excluding this income the Company's pretax income was \$28,370,000 for the year ended December 31, 2014. The Company recognized expense of \$28,031,000 in the year ended December 31, 2013, due to the change in the valuation of the Private Placement Warrants. Excluding this expense, the Company's pre-tax income was \$14,030,000 for the year ended December 31, 2013. Excluding the impact of the change in the valuation of the Private Placement Warrants, the Company's effective income tax rates would have been (8.5)%, 38.1% and 33.9% for the years ended December 31, 2015, 2014, and 2013, respectively.



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The Company's income tax expense for the year ended December 31, 2015, decreased principally due to the lower taxable income realized in 2015 as compared with 2014. On December 18, 2015, Protecting Americans from Tax Hikes Act of 2015 ( PATH Act ) was signed into law making the research tax credit permanent. The Company's income tax expense for the year ended December 31, 2015 was favorably affected by the recognition of federal tax credits for 2015. Partially offsetting the increase in income tax expense for the year ended December 31, 2014 were research tax credits recorded in 2014, net of unrecognized tax benefits, arising from the one year extension of the federal research tax credit as well as continuing state research tax credits. The Company's income tax expense recognized in 2013 was favorably affected by the recognition of federal research tax credits for 2012 and 2013. On January 2, 2013, the American Taxpayer Relief Act of 2012 ( Act ) was signed into law. Some of the provisions of the Act were retroactive to January 1, 2012, including the Research and Experimentation Credit, which, at the time, was extended through the end of 2013. Because a change in tax law is accounted for in the period of enactment, certain provisions of the Act benefiting the Company's 2012 federal taxes, including R&D credit, were not recognized in the Company's financial results until 2013. As the Act was signed into law in 2013, this federal research tax credit for the year ended December 31, 2012 of \$413,000, along with the federal research tax credit estimated for 2013 of \$641,000, were recorded in the Company's financial results in the year ended December 31, 2013.

The Company generates research tax credits as a result of its research & development activities which reduce the Company's effective income tax rate. In general, these credits are general business credits and may be carried forward up to 20 years to be offset against future taxable income.

Changes in tax laws and rates may affect recorded deferred tax assets and liabilities and our effective tax rate in the future.

Components of the deferred income tax assets and liabilities consisted of the following as of December 31:

|                                    | 2015     | 2014     |
|------------------------------------|----------|----------|
| Deferred tax assets                |          |          |
| Inventory                          | \$ 2,861 | \$ 2,143 |
| Allowances and bad debts           | 398      | 280      |
| Accrued warranty                   | 778      | 1,022    |
| Accrued wages and benefits         | 627      | 553      |
| Stock compensation                 | 488      | 391      |
| Other                              | 515      | 8        |
| Total deferred tax assets          | 5,667    | 4,397    |
| Deferred tax liabilities           |          |          |
| Intangibles                        | (944)    | (1,810)  |
| Tax depreciation in excess of book | (3,904)  | (1,830)  |
| Total deferred tax liabilities     | (4,848)  | (3,640)  |
| Net deferred tax assets            | \$ 819   | \$ 757   |

The Company's net deferred tax assets and liabilities are presented as follows in the Company's consolidated balance sheets as of December 31:

|                                                   | 2015   | 2014     |
|---------------------------------------------------|--------|----------|
| Current deferred tax assets, net                  | \$ 819 | \$ 3,998 |
| Non-current deferred tax asset/(liabilities), net | 819    | (3,241)  |
| Net deferred tax assets                           | \$ 819 | \$ 757   |



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In November 2015, the FASB issued final guidance that requires companies to classify all deferred tax assets and liabilities as noncurrent on the consolidated balance sheet instead of separating deferred taxes into current and noncurrent amounts. Although the standard is effective for the Company for financial statements issued for annual periods beginning after December 15, 2016 and interim periods within those annual periods, the Company chose the early adoption provision of this standard as of the year ended December 31, 2015, and has prospectively classified all deferred tax assets and liabilities as noncurrent on its consolidated balance sheet in accordance with the standard. Prior year's balances were not required to be retrospectively adjusted. The adoption of this guidance had no impact on the Company's consolidated results of income.

In preparing the Company's consolidated financial statements, management has assessed the likelihood that its deferred income tax assets will be realized from future taxable income. In evaluating the ability to recover its deferred income tax assets, management considers all available evidence, positive and negative; including the Company's operating results, ongoing tax planning and forecasts of future taxable income on a jurisdiction by jurisdiction basis. A valuation allowance is established if it is determined that it is more likely than not that some portion or all of the net deferred income tax assets will not be realized. Management exercises significant judgment in determining the Company's provisions for income taxes, its deferred income tax assets and liabilities and its future taxable income for purposes of assessing its ability to utilize any future tax benefit from its deferred income tax assets.

Although management believes that its tax estimates are reasonable, the ultimate tax determination involves significant judgments that could become subject to audit by tax authorities in the ordinary course of business. As of each reporting date management considers new evidence, both positive and negative, that could impact management's view with regards to future realization of deferred tax assets. As of December 31, 2015, management believes that it is more likely than not that all of the Company's deferred income tax assets will be realized and no valuation allowance is required on its US deferred tax assets.

The Company recognizes interest and penalties related to unrecognized tax benefits in income tax expense. As of December 31, 2015 and 2014, the amount accrued for interest and penalties was not material to the Company's financial statements.

The change in unrecognized tax benefits excluding interest and penalties for the years ended December 31, 2015 and 2014 were as follows:

|                                                              | 2015     | 2014   |
|--------------------------------------------------------------|----------|--------|
| Balance at beginning of year                                 | \$ 723   | \$ 555 |
| Additions based on tax positions related to the current year | 261      | 255    |
| Additions/(Reductions) for tax positions of prior years      | 44       | (87)   |
| Balance at end of year                                       | \$ 1,028 | \$ 723 |

As of December 31, 2015, management of the Company believes the liability for unrecognized tax benefits, excluding interest and penalties, could decrease by approximately \$141,000 in 2016 due to lapses in the statute of limitations. Due to the various jurisdictions in which the Company files tax returns, it is possible that there could be other significant changes in the amount of unrecognized tax benefits in 2016, but the amount cannot be estimated.

**13. Defined contribution plan**

The Company sponsors two retirement savings plans for employees meeting certain eligibility requirements. Under both plans, participants may choose from various investment options and can contribute an amount of their eligible compensation annually as defined by the applicable plan document, subject to Internal Revenue Code limitations.

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The Power Great Lakes, Inc. Employees (401k) Profit Sharing Plan is funded by participant contributions and discretionary Company contributions. The Company made no discretionary contributions to this plan during 2015, 2014 or 2013. The Power Great Lakes, Inc. Employees (401k) Profit Sharing Plan was amended in 2013, to enable employees to invest in a fund which exclusively invests in the Company's stock.

The Professional Power Products, Inc. (401k) Retirement Plan is funded by participant contributions and Company matching contributions, as defined by the plan document. The Company contributed approximately \$98,000 and \$91,000 to this plan during 2015 and 2014, respectively.

The Powertrain Integration LLC (401k) Plan is funded by participant contributions and discretionary Company contributions. The Company made no discretionary contributions to this plan during 2015.

## **14. Commitments and contingencies**

The Company is involved in various legal proceedings from time to time arising in the normal course of doing business. The Company is required to record a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated; however, based upon a review of information currently available to the Company regarding the potential impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to the legal proceedings in which the Company is currently involved, the resolution of these legal proceedings, either individually or in the aggregate, is not expected to have a material effect on the Company's consolidated results of operations, financial condition or cash flows.

On December 7, 2012, the Company entered into a joint venture with another entity for the purpose of manufacturing, assembling and selling certain engines into the Asian markets. In connection with this agreement, the Company has committed up to \$1.2 million toward the joint venture of which \$850,000 had been contributed since inception as of December 31, 2015. On December 9, 2014, the Company signed an agreement to enter into a joint venture with a construction and utility equipment manufacturer headquartered in Incheon, South Korea. In connection with this agreement, the Company committed to contribute up to \$1.0 million which was contributed to the joint venture during the year ended December 31, 2015.

## **15. Related party transactions**

In connection with the acquisition of 3PI, the Company entered into a lease agreement effective April 1, 2014, with a limited liability company in which one of the former owners of 3PI is the sole member. The lease is for the land, buildings and certain equipment located at 3PI's facilities in Darien, Wisconsin. The initial term of the lease is for seven years through March 31, 2021 and the initial annual base rent is \$480,000 annually which is payable in equal monthly installments. The base rent is subject to annual increases as defined in the lease agreement. In the year ended December 31, 2015 and 2014, the Company recognized expense of \$480,000 and \$360,000, respectively, in connection with this lease. See Note 3, "Acquisitions" for further discussion of the acquisition. The former 3PI owner is no longer employed by the Company and is no longer a related-party.

On April 28, 2011, Gary Winemaster, Chief Executive Officer, and Thomas Somodi, who previously served as the Company's Chief Strategy Officer and Chief Financial Officer entered into a purchase and sale agreement which was subsequently amended on October 31, 2011, whereby Mr. Winemaster agreed to purchase all of Mr. Somodi's shares of preferred and common stock in The W Group.

Pursuant to the terms of the purchase and sale agreement, as amended, Mr. Winemaster had the right to elect to make a payment to Mr. Somodi equal to the product of the number of shares Mr. Winemaster would otherwise be required to deliver to Mr. Somodi upon achievement of a common stock value threshold, multiplied by the applicable threshold price. The first common stock value threshold was achieved on or about March 27, 2013, the second common stock value threshold was achieved on or about May 7, 2013, and the third common stock value threshold was achieved on or about May 28, 2013. On June 24, 2013, Mr. Somodi transferred to the Company his right to receive shares or a cash payment from Mr. Winemaster as a result of the achievement of the first common

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stock value threshold, in exchange for a cash payment by the Company to Mr. Somodi of \$2.5 million. Mr. Winemaster contemporaneously paid the Company \$2.5 million in full satisfaction of Mr. Winemaster's obligations to the Company as a result of the achievement of the first common stock value threshold. On August 5, 2013, Mr. Somodi again transferred to the Company his right to receive shares or a cash payment from Mr. Winemaster as a result of the achievement of the second common stock value threshold, in exchange for a cash payment by the Company to Mr. Somodi of \$3.75 million. Mr. Winemaster contemporaneously paid the Company \$3.75 million in full satisfaction of Mr. Winemaster's obligations to the Company as a result of the achievement of the second common stock value threshold. On August 26, 2013, Mr. Somodi transferred to the Company his right to receive shares or a cash payment from Mr. Winemaster as a result of the achievement of the third common stock value threshold, in exchange for a cash payment by the Company to Mr. Somodi of \$3.0 million. Mr. Winemaster contemporaneously paid the Company \$3.0 million in full satisfaction of Mr. Winemaster's obligations to the Company as a result of the achievement of the third common stock value threshold. These transactions were all approved by the Audit Committee prior to being entered into and consummated.

During the years ended December 31, 2015, 2014 and 2013, the Company incurred fees for tax return and other consulting services with a professional services firm that is affiliated with a stockholder and member of the board of directors. Fees incurred during 2015, 2014 and 2013, were \$43,000, \$62,000 and \$127,000, respectively.

**16. Unaudited quarterly financial data**

Set forth below are the unaudited quarterly financial data for the fiscal years ended December 31, 2015 and 2014:

| For the quarters ended              | March 31   | June 30   | September 30 | December 31 |
|-------------------------------------|------------|-----------|--------------|-------------|
| <b>2015</b>                         |            |           |              |             |
| Net sales                           | \$ 86,139  | \$ 94,629 | \$ 112,008   | \$ 96,670   |
| Cost of sales                       | 69,682     | 77,255    | 96,700       | 82,975      |
| Gross profit                        | 16,457     | 17,374    | 15,308       | 13,695      |
| Operating expenses                  | 12,387     | 12,899    | 13,920       | 14,433      |
| Operating income (loss)             | 4,070      | 4,475     | 1,388        | (738)       |
| Other (income) expense              | 4,142      | (1,731)   | (7,255)      | 149         |
| Income (loss) before income taxes   | (72)       | 6,206     | 8,643        | (887)       |
| Income tax provision (benefit)      | 1,384      | 1,285     | (466)        | (2,591)     |
| Net income (loss)                   | \$ (1,456) | \$ 4,921  | \$ 9,109     | \$ 1,704    |
| Net income (loss) per common share: |            |           |              |             |
| Basic                               | \$ (0.13)  | \$ 0.46   | \$ 0.84      | \$ 0.16     |
| Diluted                             | \$ (0.13)  | \$ 0.18   | \$ 0.03      | \$ 0.04     |

| For the quarters ended     | March 31  | June 30   | September 30 | December 31 |
|----------------------------|-----------|-----------|--------------|-------------|
| <b>2014</b>                |           |           |              |             |
| Net sales                  | \$ 66,735 | \$ 83,378 | \$ 93,972    | \$ 103,910  |
| Cost of sales              | 54,805    | 67,982    | 75,344       | 82,819      |
| Gross profit               | 11,930    | 15,396    | 18,628       | 21,091      |
| Operating expenses         | 8,409     | 9,503     | 11,109       | 11,980      |
| Operating income           | 3,521     | 5,893     | 7,519        | 9,111       |
| Other (income)             | (111)     | (240)     | (3,625)      | (4,519)     |
| Income before income taxes | 3,632     | 6,133     | 11,144       | 13,630      |

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|                              |          |          |          |           |
|------------------------------|----------|----------|----------|-----------|
| Income tax provision         | 1,258    | 2,250    | 3,996    | 3,309     |
| Net income                   | \$ 2,374 | \$ 3,883 | \$ 7,148 | \$ 10,321 |
| Net income per common share: |          |          |          |           |
| Basic                        | \$ 0.23  | \$ 0.37  | \$ 0.66  | \$ 0.96   |
| Diluted                      | \$ 0.19  | \$ 0.34  | \$ 0.56  | \$ 0.48   |

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**EXHIBITS**

**INDEX TO EXHIBITS**

Exhibit

| Number | Exhibit Description                                                                                                                                                                                                                                                                                                                                                  |
|--------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 2.1    | Agreement and Plan of Merger between Format, Inc., PSI Merger Sub, Inc. and The W Group, Inc. (incorporated by reference from Exhibit 2.1 to the registrant's Current Report on Form 8-K, dated April 29, 2011, filed with the Commission May 5, 2011).                                                                                                              |
| 2.2    | Stock Purchase Agreement, dated as of April 1, 2014, by and among Power Solutions International, Inc., Carl L. Trent, Kenneth C. Trent and CKT Holdings, Inc. (incorporated by reference from Exhibit 10.1 to the registrant's Current Report on Form 8-K, dated April 1, 2014, filed with the Commission on April 2, 2014).                                         |
| 3.1    | Certificate of Incorporation of Power Solutions International, Inc., a Delaware corporation, originally filed with the Secretary of State of the State of Delaware on August 12, 2011 (incorporated by reference from Exhibit 3.4 to Amendment No. 2 to the registrant's Registration Statement on Form S-1, Registration No. 333-174543, filed August 19, 2011).    |
| 3.2    | Amended and Restated Bylaws of Power Solutions International, Inc., dated August 13, 2015 (incorporated by reference from Exhibit 3.1 to the registrant's Current Report on Form 8-K dated August 13, 2015 and filed with the Commission on August 18, 2015).                                                                                                        |
| 4.1    | Purchase Agreement, dated April 29, 2011, among Format, Inc. and the investors in the private placement (incorporated by reference from Exhibit 10.4 to Amendment No. 3 to the registrant's Current Report on Form 8-K, dated April 29, 2011, filed with the Commission May 5, 2011).                                                                                |
| 4.2    | Form of Warrant, dated April 29, 2011, issued by Power Solutions International, Inc. to the investors in the private placement (incorporated by reference from Exhibit 10.6 to the registrant's Current Report on Form 8-K, dated April 29, 2011, filed with the Commission May 5, 2011).                                                                            |
| 4.3    | Registration Rights Agreement, dated as of April 29, 2011, among Power Solutions International, Inc., the investors in the private placement and ROTH Capital Partners, LLC (incorporated by reference from Exhibit 10.9 to the registrant's Current Report on Form 8-K, dated April 29, 2011, filed with the Commission May 5, 2011).                               |
| 4.4    | Registration Rights Agreement, dated as of April 29, 2011, among Power Solutions International, Inc. and Gary Winemaster, Kenneth Winemaster and Thomas Somodi (incorporated by reference from Exhibit 10.10 to the registrant's Current Report on Form 8-K, as amended, dated April 29, 2011).                                                                      |
| 4.5    | Indenture dated as of April 29, 2015 by and among Power Solutions International, Inc., The Bank of New York Mellon, as Trustee, and the Guarantors party thereto, including form of 5.50% Senior Notes due 2018 (incorporated by reference from Exhibit 10.1 to the registrant's Current Report on Form 8-K, dated and filed with the Commission on April 29, 2015). |
| 4.6    | First Supplemental Indenture dated as of November 2, 2015 to Indenture dated as of April 29, 2015 by and among Power Solutions International, Inc., The Bank of New York Mellon, as Trustee, and the Guarantors party thereto.                                                                                                                                       |

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- 10.1 Industrial Building Lease, dated as of February 28, 2012, between Power Great Lakes, Inc. and Centerpoint Properties Trust (incorporated by reference from Exhibit 10.1 to the registrant's Current Report on Form 8-K, dated February 28, 2012, filed with the Commission March 2, 2012).
- 10.2 Industrial Building Lease, dated as of March 13, 2012, between Power Great Lakes, Inc. and Centerpoint Properties Trust (incorporated by reference from Exhibit 10.1 to the registrant's Current Report on Form 8-K, dated March 13, 2012, filed with the Commission March 16, 2012).

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Exhibit

| Number | Exhibit Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
|--------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.3*  | Employment Agreement, dated as of June 6, 2012, between Power Solutions International, Inc. and Eric A. Cohen (incorporated by reference from Exhibit 10.1 to the registrant's Current Report on Form 8-K, dated June 6, 2012, filed with the Commission June 7, 2012).                                                                                                                                                                                                                                                                                                                                                                        |
| 10.4*  | Stock Appreciation Rights Agreement, dated as of June 6, 2012, by and between Power Solutions International, Inc. and Eric Cohen (incorporated by reference to Exhibit 10.2 to the registrant's Current Report on Form 8-K, dated June 6, 2012, filed with the Commission on June 7, 2012).                                                                                                                                                                                                                                                                                                                                                    |
| 10.5*  | Power Solutions International, Inc. 2012 Incentive Compensation Plan (incorporated by reference to Exhibit 10.3 to the registrant's Current Report on Form 8-K, dated June 6, 2012, filed with the Commission on June 7, 2012).                                                                                                                                                                                                                                                                                                                                                                                                                |
| 10.6*  | Amendment No. 1 to the Power Solutions International, Inc. 2012 Incentive Compensation Plan (incorporated by reference from Appendix A to the registrant's Proxy Statement on Form DEF 14A, dated August 1, 2013, filed with the Commission on August 2, 2013).                                                                                                                                                                                                                                                                                                                                                                                |
| 10.7*  | Form of Restricted Stock Agreement by and between Power Solutions International, Inc. and each eligible employee (incorporated by reference from Exhibit 10.1 to the Company's Current Report on Form 8-K, dated June 17, 2013, filed with the Commission on June 20, 2013).                                                                                                                                                                                                                                                                                                                                                                   |
| 10.8   | Credit Agreement, dated as of June 28, 2013, by and among Wells Fargo, N.A. as agent for itself and other lenders party thereto, each of the lenders party thereto, Power Solutions International, Inc., The W Group, Inc., Power Solutions, Inc., Power Great Lakes, Inc., Auto Manufacturing, Inc., Torque Power Source Parts, Inc., Power Properties, L.L.C., Power Production, Inc., Power Global Solutions, Inc., PSI International, LLC and XISync LLC, and related documents (incorporated by reference from Exhibit 10.1 to the Company's Current Report on Form 8-K, dated June 28, 2013, filed with the Commission on July 2, 2013). |
| 10.9   | Security Agreement dated as of June 28, 2013 by and among Wells Fargo, N.A. as agent for itself and other lenders party thereto, each of the lenders party thereto, Power Solutions International, Inc., The W Group, Inc., Power Solutions, Inc., Power Great Lakes, Inc., Auto Manufacturing, Inc., Torque Power Source Parts, Inc., Power Properties, L.L.C., Power Production, Inc., Power Global Solutions, Inc., PSI International, LLC and XISync LLC, and related documents (incorporated by reference from Exhibit 10.2 to the Company's Current Report on Form 8-K, dated June 28, 2013, filed with the Commission on July 2, 2013). |
| 10.10* | Indemnification Agreement by and between Power Solutions International, Inc. and certain Indemnitees (incorporated by reference from Exhibit 10.1 to the registrant's Current Report on Form 8-K, dated January 7, 2014, filed with the Commission on January 9, 2014).                                                                                                                                                                                                                                                                                                                                                                        |
| 10.11  | Amended and Restated Lease Agreement, dated as of April 1, 2014, by and between Professional Power Products, Inc. and 448 W. Madison, LLC. (incorporated by reference from Exhibit 10.2 to the registrant's Current Report on Form 8-K, dated April 1, 2014, filed with the Commission on April 2, 2014).                                                                                                                                                                                                                                                                                                                                      |
| 10.12  | Amended and Restated Credit Agreement, dated as of April 1, 2014, by and among Wells Fargo Bank, N.A. as agent for itself and other lenders party thereto, each of the lenders party thereto, Power Solutions International, Inc., The W Group, Inc., Power Solutions, Inc., Power Great Lakes, Inc., Auto Manufacturing, Inc., Torque Power Source Parts, Inc., Power Properties, L.L.C., Power Production,                                                                                                                                                                                                                                   |

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Inc., Power Global Solutions, Inc., PSI International, LLC, XISync LLC and Professional Power Products, Inc., and related documents (incorporated by reference from Exhibit 10.3 to the registrant's Current Report on Form 8-K, dated April 1, 2014, filed with the Commission on April 2, 2014).

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Exhibit

| Number | Exhibit Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
|--------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.13  | Joinder to Guaranty and Security Agreement, dated as of April 1, 2014, by and among Wells Fargo Bank, N.A. as agent for itself and the other lenders party thereto, Power Solutions International, Inc., The W Group, Inc., Power Solutions, Inc., Power Great Lakes, Inc., Auto Manufacturing, Inc., Torque Power Source Parts, Inc., Power Properties, L.L.C., Power Production, Inc., Power Global Solutions, Inc., PSI International, LLC, XISync LLC and Professional Power Products, Inc., joining Professional Power Products, Inc. as a party thereto (incorporated by reference from Exhibit 10.4 to the registrant's Current Report on Form 8-K, dated April 1, 2014, filed with the Commission on April 2, 2014).                                                |
| 10.14  | Addendum dated as of July 31, 2014, to Supply Agreement dated December 11, 2007, by and between PSI International, LLC and Doosan Infracore Co., Ltd., as amended (incorporated by reference from Exhibit 10.1 to the registrant's Current Report on Form 8-K, dated August 6, 2014).                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
| 10.15  | First Amendment to Amended and Restated Credit Agreement, dated as of April 1, 2014, and amended as of September 30, 2014 by and among Wells Fargo Bank, N.A. as agent for itself and other lenders party thereto, each of the lenders party thereto, Power Solutions International, Inc., The W Group, Inc., Power Solutions, Inc., Power Great Lakes, Inc., Auto Manufacturing, Inc., Torque Power Source Parts, Inc., Power Properties, L.L.C., Power Production, Inc., Power Global Solutions, Inc., PSI International, LLC, XISync LLC and Professional Power Products, Inc., and related documents (incorporated by reference from Exhibit 10.1 to the registrant's Current Report on Form 8-K, dated September 30, 2014).                                            |
| 10.16  | Lease Agreement, dated as of October 1, 2014, by and between Power Solutions International, Inc. and Hamilton Lakes Commerce Center #4 Limited Partnership (incorporated by reference from Exhibit 10.2 to the registrant's Current Report on Form 8-K, dated September 30, 2014).                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |
| 10.17  | Second Amendment to the Amended and Restated Credit Agreement, dated as of April 1, 2014, and amended as of September 30, 2014, and further amended February 11, 2015 by and among Wells Fargo Bank, N.A. as agent for itself and other lenders party thereto, each of the lenders party thereto, Power Solutions International, Inc., The W Group, Inc., Power Solutions, Inc., Power Great Lakes, Inc., Auto Manufacturing, Inc., Torque Power Source Parts, Inc., Power Properties, L.L.C., Power Production, Inc., Power Global Solutions, Inc., PSI International, LLC, XISync LLC and Professional Power Products, Inc., and related documents (incorporated by reference from Exhibit 10.1 to the registrant's Current Report on Form 8-K, dated February 17, 2015). |
| 10.18  | Distributor Agreement effective January 1, 2015 by and between Perkins Engines Company Limited and Power Solutions International, Inc. (incorporated by reference from Exhibit 10.1 to the registrant's Current Report on Form 8-K, dated February 26, 2015).                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
| 10.19  | Third Amendment, dated April 29, 2015, to the Amended and Restated Credit Agreement, dated as of April 1, 2014, by and among Wells Fargo Bank, National Association, as agent for itself and other lenders party thereto, each of the lenders party thereto, Power Solutions International, Inc., The W Group, Inc., Power Solutions, Inc., Power Great Lakes, Inc., Auto Manufacturing, Inc., Torque Power Source Parts, Inc., Power Properties, L.L.C., Power Production, Inc., Power Global Solutions, Inc., PSI International, LLC, XISync LLC and Professional Power Products, Inc. (incorporated by reference from Exhibit 10.2 to the registrant's Current Report on Form 8-K, dated and filed with the Commission on April 29, 2015).                               |
| 10.20  | Asset Purchase Agreement dated May 4, 2015 by and among Power Solutions International, Inc., Powertrain Integration Acquisition, LLC, as the Buyer and Powertrain Integration, LLC and its principals, as Seller (incorporated by reference from Exhibit 10.1 to the registrant's Current Report on Form 8-K,                                                                                                                                                                                                                                                                                                                                                                                                                                                               |

dated and filed with the Commission on May 6, 2015).

- 10.21\* SAR and Bonus Agreement, dated as of July 6, 2015, by and between Power Solutions International, Inc. and Eric A. Cohen (incorporated by reference from Exhibit 10.1 to the registrant's Current Report on Form 8-K, dated and filed with the Commission on July 8, 2015).

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### Exhibit

| Number  | Exhibit Description                                                                                                                                                                                                                                                                                                                                                                                                        |
|---------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.22*  | Cooperation and Transition Agreement, dated October 4, 2015, by and between Power Solutions International, Inc. and Daniel P. Gorey (incorporated by reference from Exhibit 10.1 to the registrant's Current Report on Form 8-K dated and filed with the Commission on October 6, 2015).                                                                                                                                   |
| 10.23*  | Executive Employment Agreement, dated October 2, 2015, by and between Power Solutions International, Inc. and Michael P. Lewis (incorporated by reference from Exhibit 10.2 to the registrant's Current Report on Form 8-K dated and filed with the Commission on October 6, 2015).                                                                                                                                        |
| 10.24*  | Stock Appreciation Rights Agreement, dated October 19, 2015, by and between Power Solutions International, Inc. and Michael P. Lewis (incorporated by reference from Exhibit 10.1 to the registrant's Current Report on Form 8-K dated and filed with the Commission on October 22, 2015).                                                                                                                                 |
| 10.25   | Joinder to Amended and Restated Credit Agreement, dated November 2, 2015, by and among Wells Fargo Bank, National Association, as agent for itself and other lenders party thereto, each of the lenders party thereto, Power Solutions International, Inc., and Professional Power Products, Inc. and the original borrowers, Powertrain Integration Acquisition, LLC and Bi-Phase Technologies, LLC as the new borrowers. |
| 21.1    | Subsidiaries of Power Solutions International, Inc.                                                                                                                                                                                                                                                                                                                                                                        |
| 23.1    | Consent of RSM US LLP                                                                                                                                                                                                                                                                                                                                                                                                      |
| 31.1    | Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a)                                                                                                                                                                                                                                                                                                                                           |
| 31.2    | Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a)                                                                                                                                                                                                                                                                                                                                           |
| 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.INS | XBRL Instance Document.                                                                                                                                                                                                                                                                                                                                                                                                    |
| 101.SCH | XBRL Taxonomy Extension Schema Document.                                                                                                                                                                                                                                                                                                                                                                                   |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document.                                                                                                                                                                                                                                                                                                                                                                     |
| 101.LAB | XBRL Taxonomy Extension Labels Linkbase Document.                                                                                                                                                                                                                                                                                                                                                                          |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document.                                                                                                                                                                                                                                                                                                                                                                    |
| 101.DEF | XBRL Taxonomy Definition Linkbase Document.                                                                                                                                                                                                                                                                                                                                                                                |

\* Indicates management contract or compensatory plan or arrangement  
Exhibits and schedules omitted pursuant to Item 601(b)(2) of Regulation S-K. The registrant agrees to furnish a supplemental copy of an omitted exhibit or schedule to the SEC upon request.  
Confidential treatment has been requested with respect to certain portions of this exhibit. Omitted portions have been separately filed with the Securities and Exchange Commission.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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, on the 26th day of February 2016.

POWER SOLUTIONS INTERNATIONAL,  
INC.

By: /s/ Michael P. Lewis  
**Michael P. Lewis**  
**Chief Financial Officer**

**(Principal Financial and Accounting  
Officer)**

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on the 26th day of February 2016.

| <b>Signature</b>          | <b>Titles</b>                                            |
|---------------------------|----------------------------------------------------------|
| /s/ GARY S. WINEMASTER    | Chief Executive Officer (principal executive officer),   |
| <b>Gary S. Winemaster</b> | President and Director                                   |
| /s/ MICHAEL P. LEWIS      | Chief Financial Officer (principal financial officer and |
| <b>Michael P. Lewis</b>   | principal accounting officer)                            |
| /s/ KENNETH W. LANDINI    | Director                                                 |
| <b>Kenneth W. Landini</b> |                                                          |
| /s/ JAY J. HANSEN         | Director                                                 |
| <b>Jay J. Hansen</b>      |                                                          |
| /s/ ELLEN R. HOFFING      | Director                                                 |
| <b>Ellen R. Hoffing</b>   |                                                          |
| /s/ MARY E. VOGT          | Director                                                 |
| <b>Mary E. Vogt</b>       |                                                          |