

PIONEER POWER SOLUTIONS, INC.  
Form 10-K  
March 14, 2014

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-K**

**(Mark One)**

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

**For the fiscal year ended: December 31, 2013**

**OR**

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

**Commission file number: 001-35212**

**PIONEER POWER SOLUTIONS, INC.**

(Exact name of registrant as specified in its charter)



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. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

As of June 30, 2013, the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the voting and non-voting stock held by non-affiliates of the registrant based on the price at which the common equity was last sold on the OTCQB on such date, was approximately \$7.8 million. For purposes of this computation only, all officers, directors and 10% or greater stockholders of the registrant are deemed to be affiliates.

As of March 14, 2014, 7,172,255 shares of the registrant's common stock were outstanding.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's Proxy Statement for the 2014 Annual Meeting of Stockholders are incorporated herein by reference in Part III of this Annual Report on Form 10-K to the extent stated herein. Such proxy statement will be filed with the Securities and Exchange Commission within 120 days of the registrant's fiscal year ended December 31, 2013.

**PIONEER POWER SOLUTIONS, INC.**

**Form 10-K**

**For the Fiscal Year Ended December 31, 2013**

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## SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

General economic conditions and their effect on demand for electrical equipment, particularly in the commercial construction market, but also in the power generation, industrial production, data center, oil and gas, marine and infrastructure industries.

The effects of fluctuations in sales on our business, revenues, expenses, net income, earnings per share, margins and profitability.

Many of our competitors are better established and have significantly greater resources, and may subsidize their competitive offerings with other products and services, which may make it difficult for us to attract and retain customers.

We depend on Hydro-Quebec Utility Company and Siemens Industry, Inc. for a large portion of our business, and any change in the level of orders from Hydro-Quebec Utility Company or Siemens Industry, Inc., could have a significant impact on our results of operations.

The potential loss or departure of key personnel, including Nathan J. Mazurek, our chairman, president and chief executive officer.

Our ability to expand our business through strategic acquisitions.

Our ability to integrate acquisitions and related businesses.

Our ability to generate internal growth, maintain market acceptance of our existing products and gain acceptance for our new products.

Unanticipated increases in raw material prices or disruptions in supply could increase production costs and adversely affect our profitability.

Restrictive loan covenants and/or our ability to repay or refinance debt under our credit facilities could limit our future financing options and liquidity position and may limit our ability to grow our business.

Our ability to realize revenue reported in our backlog.

Operating margin risk due to competitive pricing and operating efficiencies, supply chain risk, material, labor or overhead cost increases, interest rate risk and commodity risk.

Strikes or labor disputes with our employees may adversely affect our ability to conduct our business.

A majority of our revenue and a significant portion of our expenditures are derived or spent in Canadian dollars. However, we report our financial condition and results of operations in U.S. dollars. As a result, fluctuations between the U.S. dollar and the Canadian dollar will impact the amount of our revenues and earnings.

The impact of geopolitical activity on the economy, changes in government regulations such as income taxes, climate control initiatives, the timing or strength of an economic recovery in our markets and our ability to access capital

markets.

Our chairman controls a majority of our combined voting power, and may have, or may develop in the future, interests that may diverge from yours.

- Future sales of large blocks of our common stock may adversely impact our stock price.
- The liquidity and trading volume of our common stock.

The foregoing does not represent an exhaustive list of matters that may be covered by the forward-looking statements contained herein or risk factors that we are faced with that may cause our actual results to differ from those anticipated in our forward-looking statements. Moreover, new risks regularly emerge and it is not possible for us to predict or articulate all risks we face, nor can we assess the impact of all risks on our business or the extent to which any risk, or combination of risks, may cause actual results to differ from those contained in any forward-looking statements. Except to the extent required by applicable laws or rules, we undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise. You should review carefully the risks and uncertainties described under the heading “Item 1A. Risk Factors” in this Annual Report on Form 10-K for a discussion of the foregoing and other risks that relate to our business and investing in shares of our common stock.

When used herein, unless the context requires otherwise, references to the “Company,” “Pioneer,” “we,” “our” and “us” refer to Pioneer Power Solutions, Inc. and its subsidiaries.

## **PART I**

### **ITEM 1. BUSINESS**

#### **Overview**

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

Our largest customers, which include a number of recognized national and regional utilities, industrial companies and engineering, procurement and construction firms, are located in North America. In addition, we sell our products through hundreds of electrical distributors served by our network of 15 stocking locations throughout the U.S. and Canada. We intend to grow our business, both through acquisitions and internal product development, by increasing the scope of highly-engineered solutions we offer our customers for their specific electrical applications.

#### **Products**

We design, develop, manufacture and sell a wide range of electrical transmission and distribution equipment in two general product categories – electrical transformers and circuit protection and control equipment. Our emphasis within these product categories is to provide custom engineered, manufactured to order equipment, which we estimate currently represents over two-thirds of our revenue. We believe that demand for our custom solutions is driven primarily by end user maintenance programs to repair, replace or retrofit aging equipment, as well as to upgrade or expand their electrical distribution system to accommodate growth and other changes in their operations. The remaining one-third of our consolidated revenue is currently derived from transformers we manufacture primarily to stock and which are used for general purpose applications, primarily in commercial construction.

#### *Overview of Electrical Transformers*

Our liquid-filled and dry-type power, distribution and specialty electrical transformers are magnetic products used in the control and conditioning of electrical current for critical processes. An electric transformer is used to reduce or



increase the voltage of electricity traveling through a wire. This increase or decrease in voltage is accomplished by transferring electric energy from one internal coil or winding to another coil through electromagnetic induction. Electric power generating plants use generator transformers to “step-up,” or increase, voltage that is transferred through power lines in order to transmit the electricity more efficiently and over long distances. When the high voltage electricity nears its final destination, a “step-down” transformer reduces its voltage. A distribution transformer makes a final step-down in voltage to a level usable in businesses and homes.

Transformers are integral to every electrical transmission and distribution system. Electric utilities use transformers for the construction and maintenance of their power networks. Industrial firms use transformers to supply factories with electricity and to distribute power to production machinery. The renewable energy industry uses transformers to connect new sources of electricity generation to the power grid. The construction industry uses transformers for the supply of electricity to new homes and buildings and original equipment manufacturers use custom transformers as a component part of the systems they make.

Our operating subsidiaries distinguish themselves by producing a wide range of engineered-to-order and standard equipment, sold either directly to end users, through engineering and construction firms or through electrical distributors. We serve customers in a variety of industries including electric utilities, industrial customers, information technology companies, commercial construction companies and renewable energy producers.

*Liquid-Filled Transformers*

Our liquid-filled transformer products are manufactured by our Pioneer Transformers Ltd. business unit. Liquid-filled transformers are typically used for applications requiring utility or industrial-level electrical loads, such as in a substation, and are most commonly found in outdoor settings given the risk of leakage and flammable properties of the liquid coolant. We manufacture these products in electrical power ranges from 25 kVA (kilovolt amperes) to 30 MVA (megavolt amperes) and at up to 69 kV (kilovolts) in voltage. In recent years, we have focused primarily on the small power market, generally considered to include transformers between 1 MVA and 10 MVA, as well as on specialty transformers such as network and submersible models used by utilities to ensure reliability of service. We sell these products to electrical utilities, independent power providers, electrical co-ops, industrial companies, commercial users and electric equipment wholesalers. Our primary categories of liquid-filled transformers are as follows:

| <b>Transformer Type</b> | <b>Range of Sizes</b> | <b>Applications</b>                                                                                                                                                                                   |
|-------------------------|-----------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Small and Medium Power  | 300 kVA to 30 MVA     | Power conversion for the utility, industrial and commercial markets, typically found in electrical substations                                                                                        |
| Network                 | 300 kVA to 3.75 MVA   | Subway and vault-type transformers designed to withstand harsh environments and typically used by utilities and municipal power authorities to ensure reliability of service                          |
| Pad-Mount               | 75 kVA to 10 MVA      | Distribution transformers commonly used in underground power or distribution systems and in wind farm power projects                                                                                  |
| Unitized Pad-Mount      | Up to 5 MVA           | Combines pad-mounts with other equipment in a product that can be substituted for conventional unit substations at apartment complexes, shopping centers, hospitals and similar commercial facilities |
| Mini-Pad                | 25 kVA to 167 kVA     | Single phase, low profile pad-mounted distribution transformers for residential and underground distribution                                                                                          |
| Platform-Mount          | 250 kVA to 2.5 MVA    | Single phase units from 250 kVA to 1 MVA, also supplied for substation installation up to 2.5 MVA                                                                                                     |

*Dry-Type Transformers*

Our dry-type transformer products are manufactured by our Jefferson Electric, Inc. and Bemag Transformer Inc. business units. Our product scope includes over 3,500 standard designs for low voltage distribution transformers, equipment which is typically used indoors to provide power to commercial and industrial machines and equipment requiring 50 VA through 1 MVA of power transformation capacity in voltages at or below 600 V (volts). In our medium voltage and power-dry product classes, our range extends to 10 MVA in capacity and from 600 V to 35kV in voltage. Medium voltage and power-dry transformers are used in metropolitan areas and are increasingly being used for industrial applications, such as in mining and oil drilling. They are well-suited to operate in outdoor or harsh environments and in situations where the transformer needs to be installed close to the area where the electricity will ultimately be used. Our primary categories of dry-type transformers are as follows:

| <b>Transformer Type</b>           | <b>Range of Sizes</b> | <b>Applications</b>                                                                                                                                            |
|-----------------------------------|-----------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Medium Voltage                    | 30 kVA to 10 MVA      | Available in standard and custom designs in voltages from 208 to 35,000 volts. Common applications include offshore drilling and mining                        |
| Ventilated Single & Three Phase   | 25 kVA to 100 kVA     | Ventilated transformers designed for general loads, indoors or out, including for lighting, data centers, industrial and commercial applications               |
|                                   | 15 kVA to 1 MVA       |                                                                                                                                                                |
| Encapsulated Single & Three Phase | 50 VA to 50 kVA       | General purpose encapsulated transformers for lighting, industrial and commercial applications. Suitable for indoor or outdoor use                             |
|                                   | 3 kVA to 75 kVA       |                                                                                                                                                                |
| Floor Mount Encapsulated          | 30 kVA to 75 kVA      | For all general loads in rugged environment areas including refineries, factories, chemical plants, marine duty, ship docks and grain mills                    |
| Buck Boost Transformers           | 50 VA to 10 kVA       | Single phase transformers for correcting voltage line drops, landscape lighting, low voltage lighting, international voltage adaptation and motor applications |
| Non-Linear Transformers           | 15 kVA to 300 kVA     | Jefferson Plus™ line of non-linear transformers are designed to meet the load demands caused by computers and other electronic office equipment                |
| Other Transformers                | Various size ranges   | Drive isolation, industrial control and custom designed transformers, lighting ballasts, reactors, filters and associated other parts                          |

### *Overview of Circuit Protection and Control Equipment*

There are many different classes of circuit protection and control equipment, the most common being panelboards, switchboards and switchgear – terms which refer to a system of electrical disconnects, fuses and circuit breakers whose general function is to distribute, monitor and control the flow of electrical energy, while isolating and protecting critical equipment such as transformers, motors and other machinery.

### *Paralleling Switchgear*

Our paralleling switchgear (PSG) products are manufactured by our Pioneer Critical Power Inc. business unit. The primary function of our PSG solutions is to reliably switch the power source to the load, protect and operate the power generation source(s), meter output and provide paralleling and load sharing capability between multiple on-site power sources and the utility grid. Our paralleling switchgear is an integral component to ensuring optimal power generation and electrical distribution system performance, both for primary and backup power installations. These installations typically include data centers, hospitals, industrial facilities, office complexes, remote locations not connected to the power grid and other sites where emergency backup power sources are a necessity to protect operations from the consequences of power outages. Our focus is on larger installations where a single generator is not sufficient or where multiple generator sets may be required to provide system resilience. We believe that our PSG customer solutions represent a scalable, cost-effective and intelligent automation option through their embedded programming and logic to synchronize multiple on-site power sources, and the capability to operate them in concert with the utility feed(s).

### *Low Voltage Panelboards and Switchboards*

Our low voltage electric power distribution panelboards and switchboards are manufactured by our Pioneer CEP business unit in Southern California. Pioneer CEP specializes in quick-turn, manufactured-to-order circuit protection equipment, primarily serving electrical distributors in its region.

## **Business Strategy**

We believe we have established a stable platform from which to develop and grow our business lines, revenues, earnings and shareholder value. We intend to expand rapidly over the next several years through a two-pronged strategy. First, we are focused on internal growth through operating efficiencies, customer focus and our continued migration towards more highly-engineered products and specialized services. We intend to significantly increase the percentage of our sales derived from engineered-to-order products and believe this can be accomplished by targeting

market segments, such as data centers and renewable energy, which have growth characteristics exceeding the norm in our industry. The second element of our growth strategy is to pursue strategic acquisitions that provide us with complementary product and service offerings, new sales channels, end-markets and scalable operations.

*Internal Growth*

We intend to build our revenue and earnings at rates exceeding industry norms by continuing our sales and product mix advancement towards more highly valued, specialized products. We intend to accomplish this goal within our liquid-filled transformer business by emphasizing the sale of more small and medium power, network and subsurface transformers to new and existing utility customers, particularly in the U.S. In 2012, we completed an expansion of our Granby, Quebec facility to increase our manufacturing capacity for these larger and more complex products.

We expect our internal growth objectives for dry-type transformers to be met primarily through the 2011 addition of medium voltage units to our customer offering. During 2012, we purchased the land and building in Farnham, Quebec where these products are manufactured and added 16,000 square feet of production space dedicated entirely to these products. The building expansion is complete and the new production space became fully operational during the fourth quarter of 2013. In addition, we intend to meet our growth objectives by expanding the geographic coverage, productivity and range of products available through our national distribution network, as well as by continuing to expand our direct sales channel with original equipment manufacturers (OEMs) and brand label customers.

### *Acquisitions*

We believe a disciplined acquisition program is a key component to accelerating our growth and we intend to acquire businesses that broaden the range of customer solutions we provide, increase our market share or expand our geographic reach. In addition to transformer and switchgear manufacturers, we also intend to acquire producers and service businesses focused on other technically-advanced, customized, ancillary or complementary products that address market segments where we seek further penetration — such as in data centers, rail transportation, mining, oil drilling and refining, backup power and renewable energy. We operate in a highly fragmented industry that is served by a few global diversified electrical equipment manufacturers and numerous small manufacturing companies that provide niche products and services to various sub-segments of the power transmission and distribution market. We favor candidates that have competencies and business characteristics similar to our own, and those that we expect will benefit from some of the major trends affecting our industry. Our acquisitions since 2010 of Jefferson Electric, Inc., Bemag Transformer Inc., Power Systems Solutions, Inc. and Pico Electrical Equipment, Inc. are examples of the implementation of our acquisition strategy.

### **Our Industry**

The market for electric transmission and distribution (T&D) equipment is large and has grown over the last several decades. According to a May 2013 study by The Freedonia Group, a market research firm, total U.S. demand for electric T&D equipment was \$24.0 billion in 2012 and was distributed by product category as follows: switchgear (54%), transformers (34%), meters (6%) and pole/transmission line hardware (6%). The Freedonia Group forecasts demand to climb 4.8% annually to \$30.4 billion in 2017, as compared to 2.2% annually between 2007 and 2012, driven by rising utilization of renewable energy sources and increasing demand from the industrial and non-utility generator markets.

Most of our business today consists of manufacturing power, distribution and non-utility transformers. Utilities purchase transformers to replace old equipment, maintain system reliability, achieve efficiency improvements and for grid expansion. Demand is also sensitive to overall economic conditions, particularly with respect to the level of industrial production and investment in commercial and residential construction. Other market demand factors include voltage conversion, voltage unit upgrades, electrical equipment failures, higher energy costs, stricter environmental

regulations and investment in sources of renewable and distributed energy generation.

According to the Freedonia Group report, total demand for transformers is forecast to grow from \$8.1 billion in 2012 to approximately \$10.3 billion by 2017. Based on the classes of transformers surveyed by the market research firm, we estimate that our product scope addresses a \$4.7 billion U.S. market (in 2012) which is expected to grow to \$6.1 billion by 2017, or by approximately 5.5% per year. The market for switchgear and related equipment is larger and significantly more complex given the number and classes of products available. We believe that our paralleling switchgear products, which are designed to meet the specific requirements of critical power applications, address annual demand of approximately \$1.0 billion. We believe several of the key industry trends supporting this growth estimate are as follows:

***Aging and Overburdened North American Power Grid*** — The aging and overburdened North American power grid is expected to require significant capital expenditures to upgrade the existing infrastructure over the next several years to maintain adequate levels of reliability and efficiency. According to the North American Electric Reliability Corp. (NERC), Level 5 Transmission Load Relief (TLR) events, which are triggered when power outages are imminent or in progress, grew at a 27% compounded annual growth rate from 2002 to 2012. These events demonstrate the current power grid's inadequate capacity to accommodate all requests for reliable power. Significant capital investment will be required to relieve congestion, meet growing demand, achieve targets for efficiency, emissions and use of renewable sources, and to replace components of the U.S. power grid operating at, near or past their planned service lives.

***Increasing Long-Term Demand for Electricity and Reliable Power*** — The Department of Energy’s Energy Information Administration, or EIA, forecasts that total electricity use in the U.S. will increase by approximately 28% from 2011 to 2040. This increase is driven by anticipated population growth, economic expansion, increasing dependence on computing power throughout the economy and the increased use of electrical devices in the home. In order to meet growing demand for electricity in North America, substantial investment in increased electrical grid capacity and efficiency will be required, as well as the addition of specialized equipment to help ensure the reliability and quality of electricity for critical applications. In response to these challenges, there is an increasing trend among commercial and industrial companies to invest in on-site power sources, both for standby purposes in the event of a catastrophic power outage, or to reduce the amount of electricity they draw from the utility grid during peak periods.

***Growth in Critical Power Applications and the Data Center Market*** — The number of mission-critical facilities, sites where a power disturbance or outage could cause failure of business operations, safety concerns or regulatory non-compliance, continues to grow exponentially worldwide. In the U.S., the single largest driver for demand in critical power applications is the data center market, followed by the health care industry. The amount of information managed by data centers is expected to grow by a factor of 50 over the next decade, according to General Electric, fueling increasing needs for data storage (for corporate data, content delivery, social networking, handheld devices, online retail and gaming) and the information technology evolution (cloud computing and outsourced hosting). The 2013 DatacenterDynamics Industry Census projects that North American investment in data centers will increase 10.4% in 2014 to \$36.2 billion. Much of this growth will be for spending in the electrical sector, including switchgear, uninterruptible power supplies and generators, systems that typically represent over 40% of data center development cost. Coinciding with demand for mission-critical facilities is the need for efficient, reliable primary power to support their essential applications, and for backup generator plants in case the utility feed becomes unavailable. Electricity is the highest operating cost of a data center, a factor supporting investment in on-site alternative energy systems to reduce peak-demand expenses. These systems require paralleling switchgear, such as we provide, operated by hardware embedded with sophisticated programming and logic to synchronize multiple power sources reliably and efficiently.

The market for electrical transmission and distribution equipment is very fragmented due to the range of sizes, voltages and technological standards required by different categories of end users for their specific applications. Many orders are custom-engineered and tend to be time-sensitive since other critical work is frequently being coordinated around the customer’s electrical equipment installation. The vast majority of North American demand for transmission and distribution is satisfied by producers in the U.S. and Canada. According to an industry report by IBISWorld Inc., there are over 2,400 electrical equipment manufacturers in the U.S., of which we believe at least 75 manufacture products similar to ours.

## **Customers**

In 2013, approximately 60% of our sales were to Canadian customers, including many of Canada’s electrical utilities, municipal power systems, large industrial companies, engineering and construction firms and a number of electrical distributors. Another 38% of our sales in 2013 were to U.S. customers, represented in large part by companies involved in commercial construction. The remaining 2% of our sales were to export customers primarily serving the Central and Latin American markets. We sold our electrical transformers to over 1,900 individual customers in 2013



and our twenty five largest customers represented approximately 67% of our consolidated revenue.

We have a significant number of repeat customers and long-standing relationships with engineering, procurement and construction (EPC) firms hired by end-users to select products such as ours. Our customers order from us as their needs may require, and the level of such orders may change significantly from period to period based on changes in the scheduling of their projects or size of their capital budget. Despite these factors causing variability in our revenue, our repeat order frequency has been very consistent from year to year. Approximately 88% of our revenue in 2013 originated from customers who also ordered from us in 2012.

Approximately 19% of our sales in 2013 and 2012 were made to Hydro-Quebec Utility Company, a provincial government-owned utility in the Province of Quebec, Canada. The majority of our sales to Hydro-Quebec Utility Company are made pursuant to a long-term contract for the supply of pad-mount transformers that was renewed in 2010, at which time we were also awarded an additional contract by Hydro-Quebec Utility Company for the supply of submersible transformers. Both contracts had two-year initial terms that expired during the second quarter of 2012, and two one-year extension options at Hydro-Quebec Utility Company's option that provided for a maximum term of four years each. In 2013, Hydro-Quebec Utility Company exercised its last remaining one year extension option, and then requested and received an additional six month extension, thereby extending each contract through September 2014. The contracts set forth the terms, conditions and rights of the parties with respect to the supply of the subject products including ordering and delivery procedures, required technical specifications, minimum performance standards, product pricing and price adjustment mechanisms, terms of payment and rights of termination. The contracts do not require Hydro-Quebec Utility Company to order any minimum quantity of products from us and do not grant us any form of supply exclusivity. Hydro-Quebec Utility Company has been a customer of ours and our predecessors for approximately 45 years, over which time we have been party to consecutive long-term contracts for an uninterrupted period spanning several decades. We believe the status of our business relationship with Hydro-Quebec Utility Company to be good.

In addition, Siemens Industry, Inc. and its affiliated companies accounted for 12% of our consolidated sales in 2013 and 2012, primarily through purchases from our Jefferson Electric, Inc. subsidiary. Our pricing agreement with Siemens Industry, Inc. does not obligate Siemens Industry, Inc. to purchase transformers from us in quantities consistent with the past or at all. While the loss of a significant number of customers would have a material adverse effect on our business, aside from Hydro-Quebec Utility Company and Siemens Industry, Inc., we do not believe that the loss of any specific customer would have a material adverse effect on our business.

### **Marketing, Sales and Distribution**

A substantial portion of the transformers manufactured by us, and most of the switchgear products we offer, are sold directly to customers by our 18 full-time sales personnel and 6 members of our executive management team operating from our office locations in the U.S. and Canada. Our products are also sold through our network of more than 50 independent sales agencies throughout North America that sell primarily to full-line electrical distributors and to maintenance, repair and overhaul organizations. Our direct sales force markets to end users and to third parties, such as original equipment manufacturers and engineering firms that prescribe the specifications and parameters that control the applications of our products.

### **Sales Backlog**

Backlog reflects the amount of revenue we expect to realize upon the shipment of customer orders for our products that are not yet complete or for which work has not yet begun. Our sales backlog as of December 31, 2013 was

approximately \$24.4 million, as compared to \$23.6 million as of December 31, 2012. We anticipate that most of our current backlog will be delivered during 2014. Orders included in our sales backlog are represented by customer purchase orders and contracts that we believe to be firm.

## **Competition**

We experience intense competition from a large number of electrical equipment manufacturers and from distributors of such equipment. The number and size of our competitors varies considerably by product line, with many of our competitors tending to be small, highly specialized or focused on a certain geographic market area or customer. However, several of our competitors have substantially greater financial and technical resources than us, including some of the world's largest electrical products companies. A representative list of our competitors includes ABB Ltd., Carte International, Inc., Eaton Corporation plc, Emerson Electric Company, General Electric Company, Schneider Electric SA, Hammond Power Solutions Inc., Howard Industries, Inc., Partner Technologies, Inc. and Russelectric Inc.

We believe that we compete primarily on the basis of technical support and application expertise, engineering and manufacturing capabilities, equipment rating, quality, scheduling and price. In all our electrical equipment businesses, our objective is to focus our efforts on more specialized, proprietary and complex applications. Accordingly, a critical element to the success of our business is responsiveness and flexibility in providing custom-engineered solutions to satisfy customer needs. We believe that our strongest product niches are in the manufacture and design of small power and distribution electrical transformers, custom-manufactured panelboard and switchboard products and in paralleling switchgear solutions for on-site power applications serving data centers, hospitals and other businesses with critical power needs. As a result of our long-time presence in the industry, we possess a number of special designs and libraries of programming code for our equipment that were engineered and developed specifically for our customers. We believe these factors give us a competitive advantage and that they are a major contributor to our frequency of repeat customer orders and the longevity of our customer relationships.

### **Raw Materials and Suppliers**

The principal raw materials purchased by us are core steel, copper wire, aluminum strip, insulating materials including transformer oil and sheet metal. We also purchase certain electrical components from a variety of suppliers including bushings, switches, fuses, protectors and circuit breakers. These raw materials and components are available from and supplied by numerous sources at competitive prices, although there are more limited sources of supply for electrical core steel and transformer oil. Unanticipated increases in raw material prices or disruptions in supply could increase production costs and adversely affect our profitability. We attempt to minimize the effect on our profit margins of unanticipated changes in the prices of raw materials by including index clauses in our customer contracts that allow us to increase or reduce our prices if the costs of raw materials unexpectedly rise or decrease. Approximately 38% of our annual sales are made pursuant to contracts that contain such index clauses, which, subject to various formulae and limitations, permit us to adjust the final prices we charge. We do not anticipate any significant difficulty in satisfying our raw material requirements on reasonable terms and have not experienced any such difficulty in the past several years. Our largest suppliers during 2013 included Essex Group, Inc., National Material L.P., Three D Metals Canada Inc., Metelec Ltée and Rea Magnet Wire Co. Inc.

### **Employees**

At December 31, 2013, we had 351 employees consisting of 112 salaried staff and 239 hourly workers. We also had five part-time employees. Our hourly employees located at our plant in Farnham, Quebec, Canada are covered by a collective bargaining agreement with a provincial labor union that expired in March 2013. We are negotiating a new labor agreement with our unionized workforce at this location which may take several months to complete. There can be no assurance that we will be successful in obtaining a new labor agreement, or that the terms of any such agreement will be favorable to us. Our hourly employees located at our plant in Granby, Quebec, Canada are covered by a collective bargaining agreement with the United Steel Workers of America Local 9414 that expires in May 2015. The hourly employees located at our manufacturing facility in Reynosa, Mexico are also covered by a collective bargaining agreement with a local labor union that has an indefinite term, subject to annual review and negotiation of key provisions. In addition, certain of our hourly employees located at our manufacturing facility in Santa Fe Springs,

California are covered by a collective bargaining agreement with Local Union 1710 of the International Brotherhood of Electrical Workers, AFL-CIO with an initial term ending in May 2014, with automatic one year renewals thereafter unless terminated earlier by either party for review and negotiation of key provisions. We consider our relationship with our employees to be good.

## **Environmental**

We are subject to numerous environmental laws and regulations concerning, among other areas, air emissions, discharges into waterways and the generation, handling, storing, transportation, treatment and disposal of waste materials. These laws and regulations are constantly changing and it is impossible to predict with accuracy the effect they may have on us in the future. Like many other industrial enterprises, our manufacturing operations entail the risk of noncompliance, which may result in fines, penalties and remediation costs, and there can be no assurance that such costs will be insignificant. To our knowledge, we are in substantial compliance with all federal, state, provincial and local environmental protection provisions, and believe that the future compliance cost should not have a material adverse effect on our capital expenditures, earnings or competitive position. However, legal and regulatory requirements in these areas have been increasing and there can be no assurance that significant costs and liabilities will not be incurred in the future due to regulatory noncompliance.

## Corporate History

We were originally formed in the State of Nevada in 2008. On November 30, 2009, we merged with and into Pioneer Power Solutions, Inc., a Delaware corporation, for the sole purpose of changing our state of incorporation from Nevada to Delaware and changing our name to “Pioneer Power Solutions, Inc.” On September 24, 2013, we completed an underwritten public offering and our common stock began trading on the Nasdaq Capital Market under the symbol PPSI.

## Legal Proceedings

We are not presently a party to any material legal proceedings nor are we aware of any such threatened or pending litigation.

## Available Information

Our corporate website is located at [www.pioneerpowersolutions.com](http://www.pioneerpowersolutions.com). On the investor relations section of our website, we make available, free of charge, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports as soon as reasonably practicable after we electronically file them with or furnish them to the SEC. You may read and copy any materials we file with the SEC at the SEC’s Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. You may obtain information on the operation of the SEC’s Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements and other information regarding issuers, such as us, that file electronically with the SEC at [www.sec.gov](http://www.sec.gov).

We webcast our earnings calls and certain events we participate in with members of the investment community on our investor relations website. Additionally, we provide notifications of news or announcements regarding our financial performance, including SEC filings, investor events and press and earnings releases as part of the investor relations section of our website. Further corporate governance materials, including our Corporate Governance Guidelines, charters of our Board Committees and our Code of Business Ethics and Conduct, are also available under the heading “Corporate Governance” on the investor relations portion of our website. The contents of and the information on or accessible through our corporate website, including the investor relations portion of our website, is not a part of, and is not intended to be incorporated into, this report or any other report or document we file with or furnish to the SEC, and any references to our website are intended to be an inactive textual references only.



## ITEM 1A. RISK FACTORS

*Investing in our common stock involves a high degree of risk. Before investing in our common stock you should carefully consider the following risks, together with the financial and other information contained in this Annual Report on Form 10–K for the year ended December 31, 2013 and our other periodic filings with the Securities and Exchange Commission. Additional risks and uncertainties that we are unaware of may become important factors that affect us. If any of the following events occur, our business, financial conditions and operating results may be materially and adversely affected. In that event, the trading price of our common stock may decline, and you could lose all or part of your investment.*

### **Risks Relating to Our Business and Industry**

*We are vulnerable to economic downturns in the commercial construction market, which may reduce the demand for some of our products and adversely affect our sales, earnings, cash flow or financial condition.*

Portions of our business, in particular those of Jefferson Electric, Inc. and Bemag Transformer Inc., involve sales of our products in connection with commercial and industrial construction. Our sales to this sector are affected by the levels of discretionary business spending. During economic downturns in this sector, the levels of business discretionary spending may decrease. This decrease in spending will likely reduce the demand for some of our products and may adversely affect our sales, earnings, cash flow or financial condition.

The commercial and industrial building and maintenance sectors began to experience a significant decline in 2008. The downturn in these segments contributed to a decline in the demand for our standard distribution transformer products and adversely affected Jefferson Electric, Inc.'s sales and earnings in 2008 through 2010. We cannot predict the timing, duration or severity of another such downturn in these segments which may adversely impact sales, earnings and cash flow.

*Our operating results may vary significantly from quarter to quarter, which makes our operating results difficult to predict and can cause our operating results in any particular period to be less than comparable quarters and expectations from time to time.*

Our quarterly results may fluctuate significantly from quarter to quarter due to a variety of factors, many of which are outside our control and have the potential to materially and adversely affect our results. Factors that affect our operating results include the following:



- the size, timing and terms of sales and orders, especially large customer orders;
- variations caused by customers delaying, deferring or canceling purchase orders or making smaller purchases than expected;
- the timing and volume of work under new agreements;
- the spending patterns of customers;
- customer orders received;
- a change in the mix of our products having different margins;
- a change in the mix of our customers, contracts and business;
- increases in design and manufacturing costs;
- the length of our sales cycles;
- the rates at which customers renew their contracts with us;
- changes in pricing by us or our competitors, or the need to provide discounts to win business;
- a change in the demand or production of our products caused by severe weather conditions;
- our ability to control costs, including operating expenses;
- losses experienced in our operations not otherwise covered by insurance;
- the ability and willingness of customers to pay amounts owed to us;
- the timing of significant investments in the growth of our business, as the revenue and profit we hope to generate from those expenses may lag behind the timing of expenditures;
- costs related to the acquisition and integration of companies or assets;

general economic trends, including changes in equipment spending or national or geopolitical events such as economic crises, wars or incidents of terrorism; and  
future accounting pronouncements and changes in accounting policies.

Accordingly, our operating results in any particular quarter may not be indicative of the results that you can expect for any other quarter or for an entire year.

***Our industry is highly competitive.***

The electrical transmission and distribution equipment industry is highly competitive. Principal competitors in our markets include ABB Ltd., Carte International, Inc., Eaton Corporation plc, Emerson Electric Company, General Electric Company, Hammond Power Solutions Inc., Howard Industries, Inc., Partner Technologies, Inc., Russelectric, Inc. and Schneider Electric SA. Many of these competitors, as well as other companies in the broader electrical equipment manufacturing and service industry where we expect to compete, are significantly larger and have substantially greater resources than we do and are able to achieve greater economies of scale and lower cost structures than us and may, therefore, be able to provide their products and services to customers at lower prices than we are able to. Moreover, our competitors could develop the expertise, experience and resources to offer products that are superior in both price and quality to our products. While we seek to compete by providing more customized, highly-engineered products, there are few technical or other barriers to prevent much larger companies in our industry from putting more emphasis on this same strategy. Similarly, we cannot be certain that we will be able to market our business effectively in the face of competition or to maintain or enhance our competitive position within our industry, maintain our customer base at current levels or increase our customer base. Our inability to manage our business in light of the competitive forces we face could have a material adverse effect on our results of operations.

***Because we currently derive a significant portion of our revenues from two customers, any decrease in orders from these customers could have an adverse effect on our business, financial condition and operating results.***

We depend on Hydro-Quebec Utility Company and Siemens Industry, Inc. for a large portion of our business, and any change in the level of orders from Hydro-Quebec Utility Company or Siemens Industry, Inc., has, in the past, had a significant impact on our results of operations. In particular, Hydro-Quebec Utility Company represented approximately 19% of our net sales in the years ended December 31, 2013 and 2012. In addition, Siemens Industry, Inc. accounted for 12% of our net sales in the years ended December 31, 2013 and 2012, respectively. Our long term supply agreements with Hydro-Quebec Utility Company had an initial term expiring in April 2012, and two one-year extension options, the second of which was exercised by Hydro-Quebec Utility Company in 2013, and which was followed by an additional six month extension option at Hydro-Quebec Utility Company's request, thereby extending our contracts through September 2014. We therefore cannot assure you that Hydro-Quebec Utility Company will continue to purchase transformers from us in quantities consistent with the past or at all. In addition, our pricing agreement with Siemens Industry, Inc. does not obligate Siemens Industry, Inc. to purchase transformers from us in quantities consistent with the past or at all. If either of these customers was to significantly cancel, delay or reduce the

amount of business it does with us for any reason, there would be a material adverse effect on our business, financial condition and operating results.

***The departure or loss of key personnel could disrupt our business.***

We depend heavily on the continued efforts of Nathan J. Mazurek, our principal executive officer, and on other senior officers who are responsible for the day-to-day management of our five operating subsidiaries. In addition, we rely on our current electrical and mechanical design engineers, along with trained coil winders, many of whom are important to our operations and would be difficult to replace. We cannot be certain that any of these individuals will continue in their respective capacities for any particular period of time. The departure or loss of key personnel, or the inability to hire and retain qualified employees, could negatively impact our ability to manage our business.

***We may not be able to expand our business through strategic acquisitions, which could decrease our profitability.***

A key element of our strategy is to pursue strategic acquisitions that either expand or complement our business in order to increase revenue and earnings. We may not be able to identify additional attractive acquisition candidates on terms favorable to us or in a timely manner. We may require additional debt or equity financing for future acquisitions, which may not be available on terms favorable to us, if at all. Moreover, we may not be able to integrate any acquired businesses into our business or to operate any acquired businesses profitably. Recently acquired businesses may operate at lower profit margins, which could negatively impact our results of operations. Each of these factors may contribute to our inability to grow our business through strategic acquisitions, which could ultimately result in increased costs without a corresponding increase in revenues, which would result in decreased profitability.

***Any acquisitions that we complete may not perform as planned and could disrupt our business and harm our financial condition and operations.***

In an effort to effectively compete in the specialty electrical equipment manufacturing and service businesses, where increasing competition and industry consolidation prevail, we will seek to acquire complementary businesses in the future. In the event of any future acquisitions, we could:

issue additional securities that would dilute our current stockholders' percentage ownership or provide the purchasers of the additional securities with certain preferences over those of common stockholders, such as dividend or liquidation preferences;

incur debt and assume liabilities; and  
incur large and immediate write-offs of intangible assets, accounts receivable or other assets.

These events could result in significant expenses and decreased revenue, which could adversely affect the market price of our common stock.

In addition, integrating product acquisitions and completing any future acquisitions involve numerous operational and financial risks. These risks include difficulty in assimilating acquired operations, diversion of management's attention, and the potential loss of key employees or customers of acquired operations. Furthermore, companies acquired by us may not generate financial results consistent with our management's plans at the time of acquisition. For example, through transactions completed in June and August 2010, we acquired substantially all the assets and the capital stock of AAER Inc. to form Pioneer Wind Energy Systems Inc., a business that sought to provide project integration solutions, including equipment sales, procurement, after-sales services and financing to community wind and industrial customers. In September 2011, following weak domestic wind energy market conditions, combined with our inability to establish an arrangement, on commercially acceptable terms, with a qualified third party to provide outsourced parts procurement and assembly services, we decided to discontinue this business. On a cumulative basis,

from formation through to the discontinuation of Pioneer Wind Energy Systems Inc., our results from operations were impacted by a cumulative net loss of \$3.0 million.

***If we do not conduct an adequate due diligence investigation of a target business that we acquire, we may be required subsequently to take write downs or write-offs, restructuring, and impairment or other charges that could have a significant negative effect on our financial condition, results of operations and our stock price, which could cause you to lose some or all of your investment.***

As part of our acquisition strategy, we will need to conduct a due diligence investigation of one or more target businesses. Intensive due diligence is time consuming and expensive due to the operations, accounting, finance and legal professionals who must be involved in the due diligence process. We may have limited time to conduct such due diligence. Even if we conduct extensive due diligence on a target business that we acquire, we cannot assure you that this diligence will uncover all material issues relating to a particular target business, or that factors outside of the target business and outside of our control will not later arise. If our diligence fails to identify issues specific to a target business or the environment in which the target business operates, we may be forced to write-down or write-off assets, restructure our operations, or incur impairment or other charges that could result in us reporting losses. Even though these charges may be non-cash items and not have an immediate impact on our liquidity, the fact that we report charges of this nature could contribute to negative market perceptions about us or our common stock. In addition, charges of this nature may cause us to violate net worth or other covenants that we may be subject to as a result of assuming pre-existing debt held by a target business or by virtue of our obtaining post-combination debt financing.

***Our revenue may be adversely affected by fluctuations in currency exchange rates.***

A majority of our revenue and a significant portion of our expenditures are derived or spent in Canadian dollars. However, we report our financial condition and results of operations in U.S. dollars. As a result, fluctuations between the U.S. dollar and the Canadian dollar will impact the amount of our revenues and earnings. For example, if the Canadian dollar appreciates relative to the U.S. dollar, the fluctuation will result in a positive impact on the revenues that we report. However, if the Canadian dollar depreciates relative to the U.S. dollar, there will be a negative impact on the revenues we report due to such fluctuation. It is possible that the impact of currency fluctuations will result in a decrease in reported sales even though we have experienced an increase in sales when reported in the Canadian dollar. Conversely, the impact of currency fluctuations may result in an increase in reported sales despite declining sales when reported in the Canadian dollar. The exchange rate from the U.S. dollar to the Canadian dollar has fluctuated substantially in the past and may continue to do so in the future. Though we may choose to hedge our exposure to foreign currency exchange rate changes in the future, there is no guarantee such hedging, if undertaken, will be successful.

***We may be unable to generate internal growth.***

Our ability to generate internal growth will be affected by, among other factors, our ability to attract new customers, increases or decreases in the number or size of orders received from existing customers, hiring and retaining skilled employees and increasing volume utilizing our existing facilities. Many of the factors affecting our ability to generate internal growth may be beyond our control, and we cannot be certain that our strategies will be implemented with positive results or that we will be able to generate cash flow sufficient to fund our operations and to support internal growth. If we do not achieve internal growth, our results of operations will suffer and we will likely not be able to expand our operations or grow our business.

***Fluctuations in the price and supply of raw materials used to manufacture our products may reduce our profits.***

Our raw material costs represented approximately 59% and 64% of our revenues for the years ended December 31, 2013 and 2012, respectively. The principal raw materials purchased by us are electrical core steel, copper wire, aluminum strip and insulating materials including transformer oil. We also purchase certain electrical components from a variety of suppliers including bushings, switches, fuses and protectors. These raw materials and components are available from, and supplied by, numerous sources at competitive prices, although there are more limited sources of supply for electrical core steel and transformer oil. Unanticipated increases in raw material prices or disruptions in supply could increase production costs and adversely affect our profitability. We cannot provide any assurances that we will not experience difficulties sourcing our raw materials in the future.

***Our Bemag Transformer Inc. subsidiary currently derives a significant portion of its revenues from three electrical distributor groups; any decrease in orders from these distributors could have an adverse effect on Bemag Transformer Inc.'s financial condition and operating results.***

Bemag Transformer Inc. depends on three electrical distributor groups for a large portion of its business, and any change in the level of orders from these distributors, has, in the past, had a significant impact on Bemag Transformer Inc.'s results of operations. Collectively, purchases from these distributor groups represented approximately 52% of Bemag Transformer Inc.'s sales in 2013 and approximately 8% of our sales on a consolidated basis. We expect aggregate sales to these distributor groups to continue to represent less than 10% of our consolidated sales in 2014. Our Bemag Transformer Inc. subsidiary has pricing and rebate agreements with these distributor groups that are negotiated annually and, if the pricing and rebate agreements are modified or not renewed in future periods or are less favorable than those offered by competitors, we cannot assure you that these distributor groups will continue to purchase transformers from us in quantities consistent with the past or at all. If any of these distributor groups were to influence our customers to cancel, significantly delay or reduce the amount of business they do with Bemag Transformer Inc., there could be a material adverse effect on our business, financial condition and operating results. Moreover, although Bemag Transformer Inc. has agreements for the sale of its products through these three distributor groups, these agreements do not obligate the groups to distribute transformers from Bemag Transformer Inc. in quantities consistent with the past or at all. If any of these distributor groups were to become insolvent, our business, financial condition and operating results could also be materially adversely affected.

*We have, and expect to continue to have, credit facilities with restrictive loan covenants that may impact our ability to operate our business and to pursue our business strategies, and our failure to comply with these covenants could result in an acceleration of our indebtedness.*

We will continue to rely on our credit facilities with Bank of Montreal for a significant portion of the working capital to operate our business and execute our strategy. These credit facilities contain certain covenants that restrict our ability to, among other things:

- undergo a change in control;
- incur new indebtedness or other obligations, subject to certain exceptions;
- pay cash dividends;
- create or incur new liens, subject to certain exceptions;
- make new acquisitions or investments in other entities, subject to certain exceptions;
- wind up, liquidate or dissolve our affairs;
- change the nature of our core business;
- alter our capital structure in a manner that would be materially adverse to our lenders; and
- make investments or advancements to affiliated or related companies.

The majority of the liquidity derived from our credit facilities is based on availability determined by a borrowing base. Specifically, the availability of credit is dependent upon eligible receivables, inventory and certain liens. We may not be able to maintain adequate levels of eligible assets to support our required liquidity.

In addition, our credit facilities require us to meet certain financial ratios, including maximum funded debt to EBITDA ratios, funded debt to total capitalization ratios and fixed charge coverage ratios. Our ability to meet these financial provisions may be affected by events beyond our control. If, as or when required, we are unable to repay, refinance or restructure our indebtedness under, or amend the covenants contained in, our credit facilities, our lenders could institute foreclosure proceedings against the assets securing borrowings under those facilities, which would harm our business, financial condition and results of operations.

*The indebtedness under our credit facilities with Bank of Montreal is secured by substantially all of our consolidated assets. As a result of these security interests, such assets would only be available to satisfy claims of our general creditors or to holders of our equity securities if we were to become insolvent to the extent the value of such assets exceeded the amount of our indebtedness and other obligations. In addition, the existence of these security interests may adversely affect our financial flexibility.*

Indebtedness under our credit facilities with Bank of Montreal is secured by a lien on substantially all of our assets. Accordingly, if an event of default were to occur under our credit facilities, Bank of Montreal would have a prior right



to our assets, to the exclusion of our general creditors in the event of our bankruptcy, insolvency, liquidation, or reorganization. In that event, our assets would first be used to repay in full all indebtedness and other obligations secured by them (including all amounts outstanding under our senior secured credit agreement), resulting in all or a portion of our assets being unavailable to satisfy the claims of our unsecured indebtedness. Only after satisfying the claims of our unsecured creditors and our subsidiaries' unsecured creditors would any amount be available for our equity holders. The pledge of these assets and other restrictions may limit our flexibility in raising capital for other purposes. Because substantially all of our assets are pledged under these financing arrangements, our ability to incur additional secured indebtedness or to sell or dispose of assets to raise capital may be impaired, which could have an adverse effect on our financial flexibility.

***We may not be able to fully realize the revenue value reported in our backlog.***

We routinely have a backlog of work to be completed on contracts representing a significant portion of our annual sales. As of December 31, 2013, our order backlog was \$24.4 million. Orders included in our backlog are represented by customer purchase orders and contracts that we believe to be firm. Backlog develops as a result of new business taken, which represents the revenue value of new customer orders received by us during a given period. Backlog consists of customer orders that either (1) have not yet been started or (2) are in progress and are not yet completed. In the latter case, the revenue value reported in backlog is the remaining value associated with work that has not yet been completed. From time to time, customer orders are canceled that appeared to have a high certainty of going forward at the time they were recorded as new business taken. In the event of a customer order cancellation, we may be reimbursed for certain costs but typically have no contractual right to the total revenue reflected in our backlog. In addition to us being unable to recover certain direct costs, canceled customer orders may also result in additional unrecoverable costs due to the resulting underutilization of our assets.

***We are subject to pricing pressure from our larger customers.***

We face significant pricing pressures in all of our business segments from our larger customers, including Hydro-Quebec Utility Company and Siemens Industry, Inc. Because of their purchasing size, our larger customers can influence market participants to compete on price terms. Such customers also use their buying power to negotiate lower prices. If we are not able to offset pricing reductions resulting from these pressures by improved operating efficiencies and reduced expenditures, those price reductions may have an adverse impact on our financial results.

***Deterioration in the credit quality of several major customers could have a material adverse effect on our operating results and financial condition.***

A significant asset included in our working capital is accounts receivable from customers. If customers responsible for a significant amount of accounts receivable become insolvent or are otherwise unable to pay for products and services, or become unwilling or unable to make payments in a timely manner, our operating results and financial condition could be adversely affected. A significant deterioration in the economy could have an adverse effect on the servicing of these accounts receivable, which could result in longer payment cycles, increased collection costs and defaults in excess of management's expectations. Deterioration in the credit quality of Hydro-Quebec Utility Company, Siemens Industry, Inc. or of any other major customers could have a material adverse effect on our operating results and financial condition.

***We rely on third parties for key elements of our business whose operations are outside our control.***

We rely on arrangements with third party shippers and carriers such as independent shipping companies for timely delivery of our products to our customers. As a result, we may be subject to carrier disruptions and increased costs due to factors that are beyond our control, including labor strikes, inclement weather, natural disasters and rapidly increasing fuel costs. If the services of any of these third parties become unsatisfactory, we may experience delays in meeting our customers' product demands and we may not be able to find a suitable replacement on a timely basis or on commercially reasonable terms. Any failure to deliver products to our customers in a timely and accurate manner may damage our reputation and could cause us to lose customers.

We also utilize third party distributors and manufacturer's representatives to sell, install and service certain of our products. While we are selective in whom we choose to represent us, it is difficult for us to ensure that our distributors and manufacturer's representatives consistently act in accordance with the standards we set for them. To the extent any of our end-customers have negative experiences with any of our distributors or manufacturer's representatives, it could reflect poorly on us and damage our reputation, thereby negatively impacting our financial results.

***We may face impairment charges if economic environments in which our business operates and key economic and business assumptions substantially change.***

Assessment of the potential impairment of property, plant and equipment, goodwill and other identifiable intangible assets is an integral part of our normal ongoing review of operations. Testing for potential impairment of long-lived assets is dependent on numerous assumptions and reflects our best estimates at a particular point in time, which may vary from testing date to testing date. The economic environments in which our businesses operate and key economic and business assumptions with respect to projected product selling prices and materials costs, market growth and inflation rates, can significantly affect the outcome of impairment tests. Estimates based on these assumptions may differ significantly from actual results. Changes in factors and assumptions used in assessing potential impairments can have a significant impact on both the existence and magnitude of impairments, as well as the time at which such impairments are recognized. Future changes in the economic environment and the economic outlook for the assets being evaluated could also result in additional impairment charges. Any significant asset impairments would adversely impact our financial results.

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

Our ability to maintain our productivity and profitability will be limited by our ability to employ, train and retain skilled personnel necessary to meet our requirements. We may experience shortages of qualified personnel. We cannot be certain that we will be able to maintain an adequate skilled labor force necessary to operate efficiently and to support our growth strategy or that our labor expenses will not increase as a result of a shortage in the supply of skilled personnel. Labor shortages, increased labor costs or loss of our most skilled workers could impair our ability to deliver on time to our customers (thereby creating a risk that we lose our customers to competition) and would inhibit our ability to maintain our business or grow our revenues, and may adversely impact our profitability.

***Our business operations are dependent upon our ability to engage in successful collective bargaining with our unionized workforce.***

Approximately 65% of our workforce is unionized. Our current collective bargaining agreements with our unionized workforces in Canada expire in May 2015, in the case of Pioneer Transformers Ltd., and in the case of Bemag Transformer Inc., expired in March 2013. We are in the process of negotiating a new collective bargaining agreement with our unionized workforce at Bemag Transformer Inc. which may take several months to complete. There can be no assurance we will be successful in this effort. We have similar labor agreements with our unionized workforce in Reynosa, Mexico that has an indefinite term, subject to annual review and negotiation of key provisions. In addition, certain of our hourly employees located at our manufacturing facility in Santa Fe Springs, California are covered by a collective bargaining agreement with Local Union 1710 of the International Brotherhood of Electrical Workers, AFL-CIO with an initial term ending in May 2014, with automatic one year renewals thereafter unless terminated earlier by either party for review and negotiation of key provisions. If we are unable to renew our collective bargaining agreements, or if additional segments of our workforce become unionized, we may be subject to work interruptions or stoppages. Strikes or labor disputes with our employees may adversely affect our ability to conduct our business.

***Deploying a new enterprise resource planning system could interfere with our business or operations and could adversely impact our financial position, results of operations and cash flows.***

We are in the process of deploying a new enterprise resource planning, or ERP, system. This project requires significant investment of capital and human resources, the re-engineering of many processes of our business and the attention of many employees who would otherwise be focused on other aspects of our business. Any disruptions, delays or deficiencies in the design and integration of the new ERP system could result in potentially much higher costs than we had anticipated and could adversely affect our ability to develop and commercialize products, provide services, fulfill contractual obligations, file reports with the Securities Exchange Commission in a timely manner and/or otherwise operate our business, or otherwise impact our controls environment. Any of these consequences could have an adverse effect on our results of operations and financial condition.

*We are subject to the risks of owning real property .*

We own real property, including the land and buildings at two of our manufacturing locations. The ownership of real property subjects us to risks, including: the possibility of environmental contamination and the costs associated with fixing any environmental problems and the risk of damages resulting from such contamination; adverse changes in the value of the property due to interest rate changes, changes in the neighborhood in which the property is located or other factors; ongoing maintenance expenses and costs of improvements; the possible need for structural improvements in order to comply with zoning, seismic, disability act or other requirements; and possible disputes with neighboring owners or others.

***Our risk management activities may leave us exposed to unidentified or unanticipated risks.***

Although we maintain insurance policies for our business, these policies contain deductibles and limits of coverage. We estimate our liabilities for known claims and unpaid claims and expenses based on information available as well as projections for claims incurred but not reported. However, insurance liabilities are difficult to estimate due to various factors and we may be unable to effectively anticipate or measure potential risks to our company. If we suffer unexpected or uncovered losses, any of our insurance policies or programs are terminated for any reason or are not effective in mitigating our risks, we may incur losses that are not covered by our insurance policies or that exceed our accruals or that exceed our coverage limits and could adversely impact our consolidated results of operations, cash flows and financial position.

***Regulatory, environmental, monetary and other governmental policies could have a material adverse effect on our profitability.***

We are subject to international, federal, provincial, state and local laws and regulations governing environmental matters, including emissions to air, discharge to waters and the generation and handling of waste. We are also subject to laws relating to occupational health and safety. The operation of manufacturing plants involves a high level of susceptibility in these areas, and there is no assurance that we will not incur material environmental or occupational health and safety liabilities in the future. Moreover, expectations of remediation expenses could be affected by, and potentially significant expenditures could be required to comply with, environmental regulations and health and safety laws that may be adopted or imposed in the future. Future remediation technology advances could adversely impact expectations of remediation expenses.

***Future litigation could impact our financial results and condition.***

Our business, results of operations and financial condition could be affected by significant future litigation or claims adverse to us. Types of potential litigation cases include product liability, contract, employment-related, labor relations, personal injury or property damage, intellectual property, stockholder claims and claims arising from any injury or damage to persons, property or the environment from hazardous substances used, generated or disposed of in the conduct of our business.

***Our international operations subject us to additional risks, which risks and costs may differ in each country in which we do business and may cause our profitability to decline.***

Most of our products are manufactured at our facilities in Canada and Mexico, and we depend on a number of suppliers for raw materials and component parts that are located outside of the U.S., including Asia and Western Europe. We generate a significant portion of our revenue from our operations in Canada and currently derive most of our revenue in the U.S. from products we manufacture in Mexico. Our international operations are subject to a variety of risks that we do not face in the U.S., and that we may face only to a limited degree in Canada, including:

- building and managing highly experienced foreign workforces and overseeing and ensuring the performance of foreign subcontractors;
- increased travel, infrastructure and legal and compliance costs associated with multiple international locations; additional withholding taxes or other taxes on our foreign income, and tariffs or other restrictions on foreign trade or investment;
- imposition of, or unexpected adverse changes in, foreign laws or regulatory requirements, many of which differ from those in the U.S.;
- changes in foreign currency exchange rates, principally fluctuations in the Canadian dollar and Mexican peso;
- longer payment cycles for sales in some foreign countries and potential difficulties in enforcing contracts and collecting accounts receivable;
- difficulties in repatriating overseas earnings;
- general economic conditions in the countries in which we operate; and
- political unrest, civil disturbances, corruption, crime, war, incidents of terrorism, or responses to such events.

We may be unable to maintain policies and strategies that will be effective in managing these risks in each country where we do business. Our failure to manage these risks could cause us to fail to reap our investments in these markets and could harm our international operations, reduce our international sales and increase our costs, thus adversely affecting our international and overall business, financial condition and operating results.

***Market disruptions caused by domestic or international financial crises could affect our ability to meet our liquidity needs at a reasonable cost and our ability to meet long-term commitments, which could adversely affect our financial condition and results of operations.***

We rely on credit facilities with our lenders, amongst other avenues, to satisfy our liquidity needs. Disruptions in the domestic or international credit markets or deterioration of the banking industry's financial condition (such as occurred beginning in 2008), may discourage or prevent our lenders and other lenders from meeting their existing lending commitments, extending the terms of such commitments or agreeing to new commitments, such as for acquisitions or to refinance existing credit facilities. Market disruptions may also limit our ability to issue debt securities in the capital markets. We can provide no assurances that our lenders or any other lenders we may have will meet their existing commitments or that we will be able to access the credit markets in the future on terms acceptable to us or at all.

Longer term disruptions in the domestic or international capital and credit markets as a result of uncertainty, reduced financing alternatives or failures of significant financial institutions could adversely affect our access to the liquidity needed for our business. Any disruption could require us to take measures to conserve cash until the market stabilizes or until alternative financing can be arranged. Such measures could include deferring capital expenditures and reducing other discretionary expenditures. Market disruptions could cause a broad economic downturn that may lead to increased incidence of customers' failure to pay for services delivered, which could adversely affect our financial condition, results of operations and cash flow.

Capital market disruptions could result in increased costs related to variable rate debt. As a result, continuation of market disruptions could increase our interest expense and adversely impact our results of operations. Disruption in the capital markets and its actual or perceived effects on particular businesses and the greater economy also adversely affects the value of the investments held within our pension plans. Significant declines in the value of the investments held within our pension plans may require us to increase contributions to those plans in order to meet future funding requirements if the actual asset returns do not recover these declines in value in the foreseeable future. These trends may also adversely impact our results of operations, net cash flows and financial positions, including our stockholders' equity.

## **Risks Relating to Our Organization**



***Our common stock is listed on the Nasdaq Capital Market, and we take advantage of the “controlled company” exemption to the corporate governance rules for NASDAQ-listed companies. As a controlled Company, our common stock may be less attractive to some investors or otherwise harm our stock price.***

Because we qualify as a “controlled company” under the corporate governance rules for NASDAQ-listed companies, we are not required to have a majority of our board of directors be independent, nor are we required to have a compensation committee or an independent nominating function. In light of our status as a controlled company, our board of directors has determined not to have a majority of independent directors or an independent nominating or compensation committee and to have the full board of directors be directly responsible for compensation matters and for nominating members of our board. Accordingly, should the interests of our controlling stockholder differ from those of other stockholders, the other stockholders may not have the same protections afforded to stockholders of companies that are subject to all the corporate governance rules for NASDAQ-listed companies. Our status as a controlled company could make our common stock less attractive to some investors or otherwise harm our stock price.

***Delaware law and our corporate charter and bylaws contain anti-takeover provisions that could delay or discourage takeover attempts that stockholders may consider favorable.***

Our board of directors is authorized to issue shares of preferred stock in one or more series and to fix the voting powers, preferences and other rights and limitations of the preferred stock. Accordingly, we may issue shares of preferred stock with a preference over our common stock with respect to dividends or distributions on liquidation or dissolution, or that may otherwise adversely affect the voting or other rights of the holders of common stock. Issuances of preferred stock, depending upon the rights, preferences and designations of the preferred stock, may have the effect of delaying, deterring or preventing a change of control, even if that change of control might benefit our stockholders. In addition, we are subject to Section 203 of the Delaware General Corporation Law. Section 203 generally prohibits a public Delaware corporation from engaging in a “business combination” with an “interested stockholder” for a period of three years after the date of the transaction in which the person became an interested stockholder, unless (i) prior to the date of the transaction, the board of directors of the corporation approved either the business combination or the transaction which resulted in the stockholder becoming an interested stockholder; (ii) the interested stockholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced, excluding for purposes of determining the number of shares outstanding (a) shares owned by persons who are directors and also officers and (b) shares owned by employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer; or (iii) on or subsequent to the date of the transaction, the business combination is approved by the board and authorized at an annual or special meeting of stockholders, and not by written consent, by the affirmative vote of at least 66 2/3% of the outstanding voting stock which is not owned by the interested stockholder.

Section 203 could delay or prohibit mergers or other takeover or change in control attempts with respect to us and, accordingly, may discourage attempts to acquire us even though such a transaction may offer our stockholders the opportunity to sell their stock at a price above the prevailing market price.

***Your ability to influence corporate decisions may be limited because Provident Pioneer Partners, L.P. owns a controlling percentage of our common stock.***

Provident Pioneer Partners, L.P., which is controlled by Nathan J. Mazurek, our chief executive officer, president and chairman of the board of directors, beneficially owns approximately 64.7% of our outstanding common stock. As a result of this stock ownership, Provident Pioneer Partners, L.P. and Mr. Mazurek can control all matters submitted to our stockholders for approval, including the election of directors and approval of any merger, consolidation or sale of all or substantially all of our assets. This concentration of voting power could delay or prevent an acquisition of our company on terms that other stockholders may desire. In addition, as the interests of Provident Pioneer Partners, L.P. and our minority stockholders may not always be the same, this large concentration of voting power may lead to stockholder votes that are inconsistent with the best interests of our minority stockholders or the best interest of us as a whole.

Furthermore, pursuant to the terms of our credit agreement with Bank of Montreal, Chicago Branch, we are restricted from, among other things, entering into merger agreements or agreements for the sale of any or all of our assets outside the course of ordinary business. As such, even if certain corporate transactions may be approved by our stockholders, Bank of Montreal, Chicago Branch, as the lender under our credit agreement, has final authority to approve or reject certain of our transactions. This could lead to us not being able to effect certain transactions that may be in the best interests of our stockholders or our business.

***We are subject to financial reporting and other requirements for which our accounting, internal audit and other management systems and resources may not be adequately prepared.***

We are subject to reporting and other obligations under the Securities Exchange Act of 1934, as amended, including the requirements of Section 404 of the Sarbanes-Oxley Act. Section 404 requires us to conduct an annual management assessment of the effectiveness of our internal controls over financial reporting. These reporting and other obligations place significant demands on our management, administrative, operational, internal audit and accounting resources. Any failure to maintain effective internal controls could have a material adverse effect on our business, operating results and stock price.

In addition, our internal controls will also include those of any company or business that we may acquire in the future. Acquired companies or businesses are likely to have different standards, controls, contracts, procedures and policies, making it more difficult to implement and harmonize company-wide financial, accounting, information and other systems. As a result, our internal controls may become more complex and we may require significantly more resources to ensure they remain effective. Failure to implement required new or improved controls, or difficulties encountered in their implementation, either in our existing business or in businesses that we may acquire, could harm our operating results or cause us to fail to meet our reporting obligations.

### **Risks Relating to our Common Stock**

*There has been a limited market for our common stock and we cannot ensure investors that an active market for our common stock will be sustained.*

There has been limited trading in our common stock and there can be no assurance that an active trading market in our common stock will be maintained. Due to the illiquidity of our common stock, the market price may not accurately reflect our relative value. There can be no assurance that an active market for our shares of common stock will develop in the future. Because our common stock is so thinly traded, even limited trading in our shares has in the past, and might in the future, lead to dramatic fluctuations in share price and investors may not be able to liquidate their investment in us at all or at a price that reflects the value of the business.

While our common stock became listed on the Nasdaq Capital Market as of September 2013, we cannot assure you that we will maintain compliance with all of the requirements for our common stock to remain listed. Additionally, there can be no assurance that trading of our common stock on such market will be sustained or desirable.

*Our stock price may be volatile, which could result in substantial losses for investors.*

The market price of our common stock is highly volatile and could fluctuate widely in response to various factors, many of which are beyond our control, including the following:

- technological innovations or new products and services by us or our competitors;
- additions or departures of key personnel, including Nathan J. Mazurek, our chairman, president and chief executive officer;
- sales of our common stock, including management shares;
- limited availability of freely-tradable “unrestricted” shares of our common stock to satisfy purchase orders and demand;

our ability to execute our business plan;  
operating results that fall below expectations;  
loss of any strategic relationship;  
industry developments;  
economic and other external factors;  
our ability to manage the costs of maintaining adequate internal financial controls and procedures in connection with the acquisition of additional businesses;  
period-to-period fluctuations in our financial results; and  
announcements of acquisitions.

In addition, the securities markets have from time to time experienced significant price and volume fluctuations that are unrelated to the operating performance of particular companies. These market fluctuations may also significantly affect the market price of our common stock.

*Offers or availability for sale of a substantial number of shares of our common stock may cause the price of our common stock to decline.*

Sales of a significant number of shares of our common stock in the public market could harm the market price of our common stock and make it more difficult for us to raise funds through future offerings of common stock. Our stockholders and the holders of our options and warrants may sell substantial amounts of our common stock in the public market. The availability of these shares of our common stock for resale in the public market has the potential to cause the supply of our common stock to exceed investor demand, thereby decreasing the price of our common stock.

In addition, the fact that our stockholders, option holders and warrant holders can sell substantial amounts of our common stock in the public market, whether or not sales have occurred or are occurring, could make it more difficult for us to raise additional financing through the sale of equity or equity-related securities in the future at a time and price that we deem reasonable or appropriate.

***We do not expect to pay cash dividends in the future. As a result, any return on investment may be limited to the value of our common stock.***

We do not anticipate paying cash dividends on our common stock in the foreseeable future. The payment of dividends on our common stock will depend on our earnings, financial condition and other business and economic factors as our board of directors may consider relevant. In addition, our credit agreement with Bank of Montreal, Chicago Branch restricts our ability to pay cash dividends. If we do not pay dividends, our common stock may be less valuable because a return on your investment will only occur if our stock price appreciates.

***If securities or industry analysts do not publish research or publish inaccurate or unfavorable research about our business, our stock price and trading volume could decline.***

The trading market for our common stock will depend in part on the research and reports that securities or industry analysts publish about us or our business. We do not currently have research coverage by securities and industry analysts and you should not invest in our common stock in anticipation that we will obtain such coverage. If we obtain securities or industry analyst coverage and if one or more of the analysts who covers us downgrades our stock or publishes inaccurate or unfavorable research about our business, our stock price would likely decline. If one or more of these analysts ceases coverage of us or fails to publish reports on us regularly, demand for our stock could decrease, which could cause our stock price and trading volume to decline.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

Not applicable.

**ITEM 2. PROPERTIES**

| Location                     | Description                                          | Approximate<br>Square<br>Footage | Owned or<br>Lease<br>Expiration Date |
|------------------------------|------------------------------------------------------|----------------------------------|--------------------------------------|
| Granby, Quebec               | Manufacturing and administration                     | 50,000                           | Owned                                |
| Farnham, Quebec              | Manufacturing and administration                     | 69,000                           | Owned                                |
| Reynosa, Mexico              | Manufacturing                                        | 52,000                           | March 2016                           |
| Brooklyn Park, Minnesota     | Manufacturing, sales, engineering and administration | 16,000                           | March 2016                           |
| Santa Fe Springs, California | Manufacturing, sales, engineering and administration | 40,000                           | August 2018                          |
| Pharr, Texas                 | Distribution warehouse                               | 22,000                           | August 2015                          |
| Franklin, Wisconsin          | Sales, marketing, engineering and administration     | 5,000                            | December 2018                        |
| Mississauga, Ontario         | Sales and engineering                                | 1,400                            | July 2016                            |
| Fort Lee, New Jersey         | Corporate management and sales office                | 1,200                            | July 2015                            |

We believe our manufacturing and distribution facilities are well maintained, in proper condition to operate at higher than current levels and are adequately insured. We do not anticipate significant difficulty in renewing or extending existing leases as they expire, or in replacing them with equivalent facilities or office locations. Of the owned properties, both are subject to encumbrances with a bank, in amounts that we do not believe are material to our operations.

**ITEM 3. LEGAL PROCEEDINGS.**

We are not presently a party to any material legal proceedings nor are we aware of any such threatened or pending litigation.

**ITEM 4. MINE SAFETY DISCLOSURES.**

Not applicable.

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**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our common stock has been listed on the Nasdaq Capital Market since September 19, 2013. Prior to that time, it was quoted on the OTCQB. The following table sets forth the high and low bid and sales prices for our common stock for the periods indicated, as reported by the OTCQB and the Nasdaq Capital Market, respectively. The quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not represent actual transactions.

| <b>Fiscal Year</b> | <b>Period</b>                    | <b>High</b> | <b>Low</b> |
|--------------------|----------------------------------|-------------|------------|
| 2012               | First Quarter Ended March 31     | 4.50        | 2.00       |
|                    | Second Quarter Ended June 30     | 5.00        | 2.00       |
|                    | Third Quarter Ended September 30 | 5.51        | 4.55       |
|                    | Fourth Quarter Ended December 31 | 6.50        | 5.51       |
| 2013               | First Quarter Ended March 31     | 5.60        | 5.60       |
|                    | Second Quarter Ended June 30     | 6.30        | 5.75       |
|                    | Third Quarter Ended September 30 | 8.98        | 4.55       |
|                    | Fourth Quarter Ended December 31 | 10.43       | 7.55       |

The last reported sales price of our common stock on the Nasdaq Capital Market on March 13, 2014, was \$8.89 per share. As of March 13, 2014, there were 10 holders of record of our common stock. Such number of record holders does not include additional stockholders whose shares are held in street or nominee name by banks, brokerage firms or other institutions on their behalf.

We have not declared or paid cash dividends on our common stock during the two most recent fiscal years, and we do not intend to pay any cash dividends on our common stock during the foreseeable future. Rather, we intend to retain future earnings (if any) to fund the operation and expansion of our business and for general corporate purposes. Subject to legal and contractual limits, our board of directors will make any decision as to whether to pay dividends in the future. In addition, our credit agreement with Bank of Montreal, Chicago Branch, dated June 28, 2013, restricts our ability to pay cash dividends.

**ITEM 6. SELECTED FINANCIAL DATA.**

Not applicable.



## **ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*You should read the following discussion and analysis of our financial condition and results of operations together with our financial statements and related notes appearing elsewhere in this prospectus. In addition to historical financial information, the following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to these differences include those discussed below and elsewhere in this prospectus, particularly in the sections entitled "Risk Factors" and "Cautionary Note Regarding Forward-Looking Statements."*

### **Overview and Recent Events**

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

On March 6, 2013, through our wholly-owned subsidiary Pioneer Critical Power Inc., we acquired substantially all of the assets and assumed certain liabilities of Power Systems Solutions, Inc., a Minneapolis-based provider of paralleling switchgear and engine generator controls used in on-site backup power and distributed generation applications.

On June 28, 2013, we, together with our wholly-owned subsidiaries, Pioneer Critical Power Inc. and Jefferson Electric, Inc., entered into a credit agreement with Bank of Montreal, Chicago Branch, pursuant to which Bank of Montreal, Chicago Branch made available to us (i) a \$10.0 million demand revolving credit facility that, among other things, paid off all amounts outstanding under the Loan and Security Agreement between Jefferson Electric, Inc. and Johnson Bank, and (ii) a \$6.0 million term loan facility to be used by us and our subsidiaries to finance certain permitted acquisitions. Our obligations under this credit agreement are guaranteed by our U.S. subsidiaries. The terms of this credit agreement are described below in greater detail under "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources – Credit Facilities and Long-Term Debt – United States Credit Facilities."

In addition, on June 28, 2013, our wholly-owned subsidiaries Pioneer Electrogroup Canada Inc., Pioneer Transformers Ltd. and Bemag Transformer Inc. entered into an amended and restated letter loan agreement with Bank of Montreal that amended and restated the existing letter loan agreement between the parties and provided for, among other things, an additional six months to borrow any amounts not already drawn from our \$10.0 million Canadian term loan

facility. We also entered into a guaranty agreement to guarantee the obligations under the amended and restated letter loan agreement.

On August 19, 2013, we hired all the employees and acquired all the machinery and equipment, certain inventory assets and all of the intellectual property of Pico Electrical Equipment, Inc. and Pico Metal Products, Inc. to form Pioneer CEP, a Los-Angeles-based manufacturer of electrical switchboards, panelboards and custom electrical enclosures.

On September 24, 2013, we completed an underwritten public offering of 1,265,000 shares of our common stock at a gross sales price of \$7.00 per share, resulting in net proceeds to us of approximately \$7.9 million, after deducting underwriting discounts and commissions and other offering expenses.

On January 1, 2014, we completed an internal legal reorganization whereby all of our Canadian subsidiaries were amalgamated into Pioneer Electrogrouop Canada Inc.

## Foreign Currency Exchange Rates

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

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

|               | 2013<br>Consolidated |                                   |            | 2012<br>Consolidated |                                   |            |
|---------------|----------------------|-----------------------------------|------------|----------------------|-----------------------------------|------------|
|               | Balance Sheet        | Earnings and Comprehensive Income | Cumulative | Balance Sheet        | Earnings and Comprehensive Income | Cumulative |
| Quarter Ended | End of Period        | Average                           | Average    | End of Period        | Average                           | Average    |
| March 31      | \$0.9843             | \$ 0.9912                         | \$ 0.9912  | \$1.0025             | \$ 0.9988                         | \$ 0.9988  |
| June 30       | \$0.9508             | \$ 0.9771                         | \$ 0.9842  | \$0.9822             | \$ 0.9899                         | \$ 0.9943  |
| September 30  | \$0.9706             | \$ 0.9629                         | \$ 0.9769  | \$1.0171             | \$ 1.0052                         | \$ 0.9979  |
| December 31   | \$0.9402             | \$ 0.9526                         | \$ 0.9708  | \$1.0051             | \$ 1.0088                         | \$ 1.0006  |

## Critical Accounting Policies

*Use of Estimates.* The preparation of financial statements in accordance with generally accepted accounting principles in the U.S. requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The financial statements include estimates based on currently available information and our judgment as to the outcome of future conditions and circumstances. Significant estimates in these financial statements include pension expense, inventory provisions, useful lives and impairment of long-lived assets, warranty accruals, income tax determination, stock-based compensation, allowance for doubtful accounts and estimates related to purchase price allocation. Changes in the status of certain facts or circumstances could result in material changes to the estimates used in the preparation of the financial statements and actual results

could differ from the estimates and assumptions.

### Changes in Accounting Principles

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

No significant changes in accounting principles were adopted during 2012 and 2013.

### Results of Operations

#### *Year Ended December 31, 2013 Compared to the Year Ended December 31, 2012*

*Revenue.* The following table represents our revenues by major product category for the periods indicated (in thousands, except percentages):

|                                        | Year Ended<br>December 31, |          | %      |   |
|----------------------------------------|----------------------------|----------|--------|---|
|                                        | 2013                       | 2012     | Change |   |
| Electrical transformers                |                            |          |        |   |
| Liquid-filled                          | \$44,991                   | \$38,363 | 17.3   | % |
| Dry-type                               | 41,348                     | 45,597   | -9.3   | % |
|                                        | 86,339                     | 83,960   | 2.8    | % |
| Circuit protection & control equipment | 1,823                      | -        | -      |   |
| Total revenue                          | \$88,162                   | \$83,960 | 5.0    | % |

For the year ended December 31, 2013, our consolidated revenue increased by \$4.2 million, or 5.0%, to \$88.2 million, up from \$84.0 million during the year ended December 31, 2012. Approximately \$2.4 million of the revenue increase was derived from transformer sales, reflecting year-over-year growth in our liquid-filled transformer products (+17.3%) offset by lower sales of our dry-type transformer products (-9.3%). On a combined basis, these respective changes correspond to 2.8% overall organic growth in our revenue during the year ended December 31, 2013. The remaining \$1.8 million increase in our revenue during 2013, as compared to 2012, resulted from our recently acquired businesses, Pioneer Critical Power and Pioneer CEP.

In 2013, sales to distributors and to engineering, procurement and construction, or EPC, firms grew by approximately 5%, representing 49% of our consolidated revenue in 2013 and 2012. Distributors typically purchase standard-type products from us and resell them in connection with commercial construction projects. EPC firms usually seek a custom manufactured solution to address the specific requirements of their client's electrical application. In both cases, because our customer is an intermediary, the exact nature and end market in which our products are being used is not always known to us. Our sales to these customer classes in the U.S. were down nearly 1%, reflecting a slower pace of commercial construction and the lack of any new expansion in our supply arrangement with a key customer that benefited us during 2012. Our Canadian distributor and EPC firm sales grew by approximately 10%, led by increased sales activity with EPC firms for large oil and gas projects, offset by weaker demand for catalogue products due to a slowdown in the construction market.

Sales to utilities in 2013 grew by approximately 15%, representing 35% of our consolidated revenue as compared to 32% in 2012. Our utility sales benefitted from strong order increases by many of our perennial customers in Canada, where sales grew approximately 10%. Sales to new and existing U.S. utility customers were up substantially in 2013, but still represented less than 5% of our consolidated revenue. Sales to commercial and industrial customers declined by approximately 10% in 2013, representing 16% of our consolidated revenue as compared to 18% in 2012. In any one period, our commercial and industrial revenue is usually derived from a concentrated group of customers and is tied to several large projects which by their nature are non-recurring. The net decrease in our commercial and industrial revenue was driven by a lower volume of industrial project revenue, particularly in the mining sector, as compared to 2012, offset by an increase in commercial project revenue for critical power applications. Critical power projects, principally for data centers, comprised approximately 70% of our sales of circuit protection and control equipment in 2013.

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

|                          | Year Ended           |          | %    | % |
|--------------------------|----------------------|----------|------|---|
|                          | December 31,<br>2013 | 2012     |      |   |
| Cost of sales            | \$50,434             | \$47,791 | 5.5  | % |
| Gross profit             | \$21,817             | \$18,940 | 15.2 | % |
| Gross margin percentage: |                      |          |      |   |

|                                        |      |   |      |   |     |   |
|----------------------------------------|------|---|------|---|-----|---|
| Electrical transformers                | 24.8 | % | 22.6 | % | 2.2 | % |
| Circuit protection & control equipment | 24.2 | % | -    |   | -   |   |
| Consolidated                           | 24.7 | % | 22.6 | % | 2.1 | % |

For the year ended December 31, 2013, our gross margin percentage increased to 24.7% of revenues, compared to 22.6% during the year ended December 31, 2012. The 2.1% increase in our gross margin resulted from a shift in our sales mix towards liquid-filled transformers and switchgear products which represented approximately 53% of consolidated sales during 2013, as compared to only 46% in 2012. We generally achieve higher gross margins from the sale of these engineered-to-order products than we do from the sale of our dry-type transformers, a large portion of which consists of catalogue designs sold on a wholesale basis through our distribution network. By contrast, the majority of our liquid-filled transformer and switchgear sales are on a direct-to-end-user basis and manufactured to the specifications of the application which generally warrants a higher gross margin percentage.



During the year ended December 31, 2013, our blended transformer gross margin increased to 24.8%, reflecting increases of 2.4% and 0.9%, respectively, in our liquid-filled and dry-type transformer product line categories. Our 24.2% gross margin on sales of circuit protection and control equipment through Pioneer Critical Power and Pioneer CEP, businesses we acquired during 2013, had minimal effect on our overall gross margin during 2013.

*Selling, General and Administrative Expense.* For the year ended December 31, 2013, selling, general and administrative expense increased by approximately \$1.5 million, or 11.7%, to \$14.7 million, as compared to \$13.2 million during the year ended December 31, 2012. The increase in our selling, general and administrative expense was primarily due to \$1.1 million of incremental expense related to new businesses acquired during 2013, as well as to an increase in our corporate general and administrative expenses. As a percentage of our consolidated revenue, selling, general and administrative expense increased to 16.7% in 2013, as compared to 15.7% in 2012.

*Foreign Exchange (Gain) Loss.* For the year ended December 31, 2013, approximately 60% of our consolidated operating revenues were denominated in Canadian dollars, and the majority of our expenses were denominated and disbursed in U.S. dollars. We have not historically engaged in currency hedging activities. Fluctuations in foreign currency exchange rates between the time we initiate and then settle transactions with our customers and suppliers can have an impact on our operating results. For the year ended December 31, 2013, we recorded a gain of \$0.1 million due to currency fluctuations, compared to a gain of approximately \$0.2 million during the year ended December 31, 2012.

*Interest Expense.* For the year ended December 31, 2013, our interest expense was approximately \$0.8 million, as compared to \$0.9 million for the year ended December 31, 2012. The decrease in our interest expense was due to lower average borrowings outstanding under our credit facilities during 2013, as compared to 2012. The aggregate outstanding balance of our total debt decreased by \$7.0 million during the year ended December 31, 2013, primarily as a result of the application of the net proceeds from our public offering of common stock to repay indebtedness during the third quarter.

*Other Expense.* For the year ended December 31, 2013, our other non-operating expense of \$428,000 consisted of approximately \$332,000 for professional fees and costs incurred in connection with acquisitions, and the remainder resulted primarily from a reduction in force affecting our dry-type transformer business during the second quarter. The 2012 other expense of \$92,000 consisted of a deposit we forfeited in connection with a proposed debt financing transaction, as well as professional fees incurred in connection with the post-closing requirements of our 2011 acquisition.

*Provision for Income Taxes.* Our provision reflects an effective tax rate on earnings from continuing operations of 11.5% in 2013 compared to 35.2% in 2012. The decrease in our effective tax rate during 2013 primarily reflects the recognition of a \$1.0 million income tax benefit during the fourth quarter resulting from the amalgamation of our Canadian subsidiaries into one corporation. These entities included our discontinued wind energy equipment business,

whose accumulated tax losses will now be available for use by our continuing electrical equipment businesses in Canada. Excluding the impact of this benefit, our effective income tax rate would have been 28.6%. In 2012, our effective income tax rate included the impact of a one-time write-off of a \$0.4 million deferred tax asset resulting from an intercompany asset transfer between our subsidiaries. Without the effect of this non-cash charge, our effective tax rate would have been 26.9% during the year ended December 31, 2012. Most of our taxable income is derived in Canada where we are subject to lower corporate tax rates relative to our U.S. operations.

*Earnings from Continuing Operations.* We generated net earnings from continuing operations of \$5.3 million for the year ended December 31, 2013, as compared to \$3.2 million during the year ended December 31, 2012. In 2013, our earnings from continuing operations per basic and diluted share was \$0.84, as compared to \$0.54 during the year ended December 31, 2012. Due to the public offering of our common stock in September 2013, we had approximately 0.4 million additional weighted average shares outstanding during the year, as compared to 2012. Our earnings from continuing operations benefitted from a higher gross margin on increased sales, combined with lower interest and tax expense as compared to the prior year. Partially offsetting these increases in our earnings from continuing operations were higher selling, general and administrative expenses, as well as costs incurred in connection with acquisitions.

*Backlog.* Our order backlog at December 31, 2013 was \$24.4 million, as compared to \$21.4 million at September 30, 2013 and \$23.6 million at December 31, 2012. Approximately 75% of our current backlog is comprised of orders for liquid-filled transformers, with the remainder consisting of dry-type transformers (16%) and circuit protection and control equipment (9%). Our backlog is based on orders expected to be delivered in the future, most of which is expected to occur during 2014.

## **Liquidity and Capital Resources**

*General.* At December 31, 2013, we had cash and cash equivalents of approximately \$0.4 million and total debt outstanding of \$10.1 million. We have historically met our cash needs through a combination of cash flows from operating activities and bank borrowings under our revolving credit facilities. Our cash requirements are generally for operating activities, debt repayment, capital improvements and acquisitions. We believe that working capital, borrowing capacity available under our credit facilities and funds generated from operations should be sufficient to finance our cash requirements for anticipated operating activities, capital improvements and principal repayments of debt through at least the next twelve months.

*Cash Provided by (Used in) Operating Activities.* Cash provided by our operating activities was approximately \$3.0 million during the year ended December 31, 2013, compared to cash provided by our operating activities of \$2.4 million during the year ended December 31, 2012. The principal elements of cash provided by operating activities during 2013 were \$5.3 million of earnings from continuing operations, \$1.8 million of non-cash expenses consisting of depreciation, amortization and stock-based compensation and \$0.4 million of unrealized losses related to currency translation included in our net earnings. These sources of cash during the period were partially offset by \$2.4 million of cash used for working capital and \$2.1 million related to deferred taxes and pension costs.

*Cash Provided by (Used in) Investing Activities.* Cash used in investing activities during the year ended December 31, 2013 was approximately \$4.3 million, as compared to \$2.4 million during the year ended December 31, 2012. During 2013, our cash used in investing activities increased by approximately \$1.8 million for the expansion of our Canadian dry-type transformer manufacturing facility. In addition, during 2013 we used approximately \$1.6 million of cash to finance acquisitions. Our uses of cash in investing activities during 2012 included \$1.5 million for the purchase and beginning stages of expansion of our Canadian dry-type transformer manufacturing facility, and a \$0.3 million loan we made to the developer of a renewable energy project for the purpose of securing a purchase order for our transformers. Additions to our property, plant and equipment in the ordinary course of business were approximately \$0.9 million and \$0.5 million, respectively, during the years ended December 31, 2013 and 2012.

*Cash Provided by (Used in) Financing Activities.* Cash provided by our financing activities was \$1.4 million during the year ended December 31, 2013, as compared to cash used in our financing activities of approximately \$1.0 million during the year ended December 31, 2012. During 2013, our cash provided by financing activities included approximately \$7.9 million of net proceeds from a public offering of 1,265,000 shares of our common stock, offset by

\$4.3 million of cash used to reduce borrowings outstanding under our revolving credit facilities and net principal payments of approximately \$2.1 million on our long-term debt. During 2012, increases in our long-term debt provided cash of approximately \$2.5 million and we used cash of \$3.5 million to reduce borrowings under our revolving credit facilities and make made principal repayments on our long-term.

*Working Capital.* As of December 31, 2013, we had net working capital of \$13.8 million, including \$0.4 million of cash and equivalents, compared to net working capital of \$6.9 million, including \$0.5 million of cash and equivalents at December 31, 2012. Our current assets were approximately 2.1 times our current liabilities at December 31, 2013, as compared to 1.3 times at December 31, 2012. At December 31, 2013 and 2012, we had \$8.7 million and \$4.7 million, respectively, of available and unused borrowing capacity from our revolving credit facilities, without taking into account cash and equivalents on hand. However, the availability of this capacity under our revolving credit facilities is subject to restrictions on the use of proceeds and is dependent upon our ability to satisfy certain financial and operating covenants, including financial ratios.

## Credit Facilities and Long-Term Debt

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

Our Canadian Facilities, as amended, provide for up to \$23.0 million Canadian dollars (“CAD”) (approximately \$21.6 million expressed in U.S. dollars) consisting of a \$10.0 million CAD demand revolving credit facility (“Facility A”) to finance ongoing operations, a \$2.0 million CAD term credit facility (“Facility B”) that financed a plant expansion, a \$10.0 million CAD term credit facility (“Facility C”) that financed a business acquisition and the purchase and expansion of its manufacturing facilities, a \$50,000 CAD Corporate MasterCard credit facility and a \$1.0 million CAD foreign exchange settlement risk facility.

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

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

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

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

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

As of December 31, 2013, we had approximately \$9.0 million in U.S. dollar equivalents outstanding under our Canadian Facilities and were in compliance with our financial covenant requirements. Our borrowings consisted of approximately \$0.8 million outstanding under Facility A, \$1.2 million outstanding under Facility B and \$7.0 million outstanding under Facility C.

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

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

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

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

Our obligations under the U.S. Facilities are guaranteed by all our wholly-owned U.S. subsidiaries. In addition, we and our wholly-owned U.S. subsidiaries granted a security interest in substantially all of our assets, including 65% of the shares of Pioneer Electroup Canada Inc. held by us, to secure our obligations for borrowed money under the U.S. Facilities.

As of December 31, 2013, we had no borrowings outstanding under the U.S. Facilities and were in compliance with its financial covenant requirements.

*Nexus Promissory Note.* On July 25, 2012, Nexus Magneticos de Mexico, S. de R.L. de C.V., a subsidiary of Jefferson Electric, Inc., entered into a \$1.7 million term loan agreement with GE CF Mexico, S.A. de C.V. The term loan from GE CF Mexico, S.A. de C.V. is payable in 60 consecutive monthly installments and bears interest, payable monthly, at a rate of 6.93% per annum. In December 2013, we elected to make a \$250,000 advance payment against the Nexus Promissory Note. We provided a guaranty to GE CF Mexico, S.A. de C.V. of all of Nexus Magneticos de Mexico, S. de R.L. de C.V.'s obligations under the term loan agreement. During the fourth quarter of 2013, we prepaid \$250,000 of the term loan and as of December 31, 2013, there was approximately \$0.8 million outstanding.

*Pico Promissory Note.* On August 19, 2013, in connection with the acquisition of certain assets from Pico Electrical Equipment, Inc. and Pico Metal Products, Inc., our Pioneer CEP subsidiary issued a \$455,000 non-interest bearing promissory note to the sellers of the assets. The promissory note is payable in six installments of principal ending on June 19, 2014. In addition, we also entered into a guaranty agreement to guarantee the obligations of Pioneer CEP under the promissory note. As of December 31, 2013, there was \$250,000 of principal remaining to be paid on the promissory note.

*Capital Lease Obligations.* As of December 31, 2013, the last of our remaining capital lease obligations had been repaid in full.

### **Capital Expenditures**

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



## **Factors That May Affect Future Operations**

We believe that our future operating results will continue to be subject to quarterly variations based upon a wide variety of factors, including the cyclical nature of the electrical equipment industry and the markets for our products and services. Our operating results could also be impacted by a weakening of the Canadian dollar, changing customer requirements and exposure to fluctuations in prices of important raw supplies, such as copper, steel and aluminum. We attempt to minimize increases resulting from fluctuations in supply costs through the inclusion of escalation clauses with respect to commodities in our customer contracts. In addition to these measures, we attempt to recover other cost increases through improvements to our manufacturing efficiency and through increases in prices where competitively feasible. Lastly, other economic conditions we cannot foresee may affect customer demand. We predominately sell to customers in the utility, industrial production and commercial construction markets. Accordingly, changes in the condition of any of our customers may have a greater impact than if our sales were more evenly distributed between different end markets. For a further discussion of factors that may affect future operating results see the sections entitled “Risk Factors” and “Cautionary Note Regarding Forward-Looking Statements.”

## **Off Balance Sheet Transactions and Related Matters**

We have no off-balance sheet transactions, arrangements, obligations (including contingent obligations), or other relationships with unconsolidated entities or other persons that have, or may have, a material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

## **New Accounting Pronouncements**

The information required by this Item is provided in “Note 2. Summary of Significant Accounting Policies” to our audited financial statements for the year ended December 31, 2013 included in this prospectus.

## **Recent Accounting Pronouncements**

**Testing Indefinite-Lived Intangible Assets for Impairment** – In July 2012, the FASB issued ASU No. 2012-02, Intangibles—Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment. This standard, which amends the guidance on testing indefinite-lived intangible assets, other than goodwill, for impairment, provides companies with the option to first perform a qualitative assessment before performing the two-step quantitative impairment test. If the company determines, on the basis of qualitative factors, that the fair value of the

indefinite-lived intangible asset is more likely than not to exceed its carrying amount, then the company would not need to perform the two-step quantitative impairment test. This standard does not revise the requirement to test indefinite-lived intangible assets annually for impairment. This standard became effective for the us on a prospective basis commencing January 1, 2013. The adoption of this standard had no effect on our financial position or results of operations.

**Presentation of Unrecognized Tax Benefit** – In July 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit when a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. This standard requires an entity to present unrecognized tax benefits as a reduction to deferred tax assets when a net operating loss carryforward, similar tax loss or a tax credit carryforward exists, with limited exceptions. This standard is effective for fiscal years beginning on or after December 15, 2013, and for interim periods within those fiscal years. We are currently assessing the potential impact of ASU No. 2013-11 on our financial statements.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Not Applicable.

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**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

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## **Report of Independent Registered Public Accounting Firm**

To the Shareholders and Board of Directors of

### **Pioneer Power Solutions, Inc.**

We have audited the accompanying consolidated balance sheets of Pioneer Power Solutions, Inc. as at December 31, 2013 and 2012 and the related consolidated statements of earnings, comprehensive income, shareholders' equity and cash flows for the years then ended. 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 audit.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). These standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also 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, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2013 and 2012 and the results of its operations, comprehensive income and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States.

*Richter LLP (Signed)*

### **Chartered Professional Accountants**

Montreal, Canada

March 14, 2014

<sup>1</sup> CPA auditor, CA, public accountancy permit No. A106063

**T. 514.934.3400**

**Richter LLP**

**1981 McGill College Montréal, Toronto**

**Mtl (Qc) H3A 0G6**

**[www.richter.ca](http://www.richter.ca)**

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**PIONEER POWER SOLUTIONS, INC.****Consolidated Statements of Earnings****(In thousands, except per share data)**

|                                                         | Year Ended<br>December 31, |          |
|---------------------------------------------------------|----------------------------|----------|
|                                                         | 2013                       | 2012     |
| Revenues                                                | \$88,162                   | \$83,960 |
| Cost of goods sold                                      | 66,392                     | 65,020   |
| Gross profit                                            | 21,770                     | 18,940   |
| Operating expenses                                      |                            |          |
| Selling, general and administrative                     | 14,719                     | 13,181   |
| Foreign exchange gain                                   | (83 )                      | (188 )   |
| Total operating expenses                                | 14,636                     | 12,993   |
| Operating income                                        | 7,134                      | 5,947    |
| Interest expense                                        | 754                        | 933      |
| Other expense                                           | 428                        | 92       |
| Earnings from continuing operations before income taxes | 5,952                      | 4,922    |
| Provision for income taxes                              | 682                        | 1,733    |
| Earnings from continuing operations                     | 5,270                      | 3,189    |
| Loss from discontinued operations, net of income taxes  | -                          | (199 )   |
| Net earnings                                            | \$5,270                    | \$2,990  |
| Earnings from continuing operations per share:          |                            |          |
| Basic                                                   | \$0.84                     | \$0.54   |
| Diluted                                                 | \$0.84                     | \$0.54   |
| Earnings per common share:                              |                            |          |
| Basic                                                   | \$0.84                     | \$0.51   |
| Diluted                                                 | \$0.84                     | \$0.51   |
| Weighted average common shares outstanding:             |                            |          |
| Basic                                                   | 6,263                      | 5,907    |
| Diluted                                                 | 6,298                      | 5,913    |

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

**PIONEER POWER SOLUTIONS, INC.**

**Consolidated Statements of Comprehensive Income**

**(In thousands)**

|                                                                  | Year Ended December 31, |          |
|------------------------------------------------------------------|-------------------------|----------|
|                                                                  | 2013                    | 2012     |
| Net earnings                                                     | \$ 5,270                | \$ 2,990 |
| Other comprehensive income, net of tax:                          |                         |          |
| Foreign currency translation adjustments                         | (866 )                  | 133      |
| Amortization of net prior service costs and net actuarial losses | 373                     | (246 )   |
| Other comprehensive loss                                         | (493 )                  | (113 )   |
| Comprehensive income                                             | \$ 4,777                | \$ 2,877 |

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



**PIONEER POWER SOLUTIONS, INC.****Consolidated Balance Sheets****(In thousands)**

|                                                                                                                      | December 31, |          |
|----------------------------------------------------------------------------------------------------------------------|--------------|----------|
|                                                                                                                      | 2013         | 2012     |
| <b>ASSETS</b>                                                                                                        |              |          |
| Current Assets                                                                                                       |              |          |
| Cash and cash equivalents                                                                                            | \$425        | \$467    |
| Accounts receivable                                                                                                  | 9,739        | 10,579   |
| Inventories                                                                                                          | 12,643       | 14,912   |
| Income taxes receivable                                                                                              | 65           | 69       |
| Deferred income taxes                                                                                                | 1,982        | 563      |
| Prepaid expenses and other current assets                                                                            | 1,291        | 885      |
| Current assets of discontinued operations                                                                            | -            | 47       |
| Total current assets                                                                                                 | 26,145       | 27,522   |
| Property, plant and equipment                                                                                        | 12,213       | 10,937   |
| Noncurrent deferred income taxes                                                                                     | 1,091        | 700      |
| Other assets                                                                                                         | 1,129        | 798      |
| Intangible assets                                                                                                    | 5,285        | 5,329    |
| Goodwill                                                                                                             | 7,998        | 6,892    |
| Total assets                                                                                                         | \$53,861     | \$52,178 |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                                                                          |              |          |
| Current Liabilities                                                                                                  |              |          |
| Revolving credit facilities                                                                                          | \$795        | \$-      |
| Accounts payable and accrued liabilities                                                                             | 8,370        | 12,044   |
| Current maturities of long-term debt and capital lease obligations                                                   | 2,108        | 7,335    |
| Income taxes payable                                                                                                 | 1,072        | 1,135    |
| Current liabilities of discontinued operations                                                                       | -            | 125      |
| Total current liabilities                                                                                            | 12,345       | 20,639   |
| Long-term debt and capital lease obligations, net of current maturities                                              | 7,205        | 9,795    |
| Pension deficit                                                                                                      | 213          | 837      |
| Noncurrent deferred income taxes                                                                                     | 3,306        | 2,992    |
| Total liabilities                                                                                                    | 23,069       | 34,263   |
| Commitments                                                                                                          |              |          |
| Shareholders' Equity                                                                                                 |              |          |
| Preferred stock, par value \$0.001; 5,000,000 shares authorized; none issued                                         | -            | -        |
| Common stock, par value \$0.001; 30,000,000 shares authorized; 7,172,255 and 5,907,255 shares issued and outstanding | 7            | 6        |
| Additional paid-in capital                                                                                           | 16,164       | 8,065    |
| Accumulated other comprehensive loss                                                                                 | (1,429 )     | (936 )   |
| Retained earnings                                                                                                    | 16,050       | 10,780   |
| Total shareholders' equity                                                                                           | 30,792       | 17,915   |

|                                            |          |          |
|--------------------------------------------|----------|----------|
| Total liabilities and shareholders' equity | \$53,861 | \$52,178 |
|--------------------------------------------|----------|----------|

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

**PIONEER POWER SOLUTIONS, INC.****Consolidated Statements of Cash Flows****(In thousands)**

|                                                                     | Year Ended December 31, |          |
|---------------------------------------------------------------------|-------------------------|----------|
|                                                                     | 2013                    | 2012     |
| Operating activities                                                |                         |          |
| Net earnings                                                        | \$ 5,270                | \$ 2,990 |
| Depreciation                                                        | 1,225                   | 1,251    |
| Amortization of intangibles                                         | 330                     | 285      |
| Deferred tax expense                                                | (1,474 )                | (153 )   |
| Accrued pension                                                     | (589 )                  | 9        |
| Stock-based compensation                                            | 228                     | 270      |
| Restructuring and asset impairment charges, discontinued operations | -                       | 49       |
| Foreign currency remeasurement loss                                 | 384                     | -        |
| Changes in current operating assets and liabilities                 |                         |          |
| Accounts receivable, net                                            | 460                     | (2,288 ) |
| Inventories                                                         | 1,912                   | (1,000 ) |
| Prepaid expenses and other assets                                   | (686 )                  | (658 )   |
| Income taxes                                                        | (33 )                   | 1,137    |
| Accounts payable and accrued liabilities                            | (4,002 )                | 585      |
| Discontinued operations assets and liabilities, net                 | -                       | (69 )    |
| Net cash provided by operating activities                           | 3,025                   | 2,408    |
| Investing activities                                                |                         |          |
| Additions to property, plant and equipment                          | (2,693 )                | (2,069 ) |
| Business acquisitions, net of cash acquired                         | (1,601 )                | -        |
| Note receivable                                                     | (30 )                   | (300 )   |
| Net cash used in investing activities                               | (4,324 )                | (2,369 ) |
| Financing activities                                                |                         |          |
| Decrease in bank overdrafts                                         | (1 )                    | -        |
| Decrease in revolving credit facilities                             | (4,312 )                | (1,092 ) |
| Increase in long-term debt                                          | 455                     | 2,496    |
| Repayment of long-term debt and capital lease obligations           | (2,598 )                | (2,447 ) |
| Net proceeds from issuance of common stock                          | 7,872                   | -        |
| Net cash provided by (used in) financing activities                 | 1,416                   | (1,043 ) |
| Increase (decrease) in cash and cash equivalents                    | 117                     | (1,004 ) |
| Effect of foreign exchange on cash and cash equivalents             | (159 )                  | 73       |
| Cash and cash equivalents                                           |                         |          |

|                                     |          |        |
|-------------------------------------|----------|--------|
| Beginning of year                   | 467      | 1,398  |
| End of year                         | \$ 425   | \$ 467 |
| Supplemental cash flow information: |          |        |
| Interest paid                       | \$ 763   | \$ 936 |
| Income taxes paid, net of refunds   | \$ 2,311 | \$ 952 |

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

**PIONEER POWER SOLUTIONS, INC.****Consolidated Statements of Shareholders' Equity****(Dollars in thousands)**

|                                                          | Common Stock |        | Additional<br>paid-in | Retained  | Accumulated<br>other<br>compre-<br>hensive | Total                   |
|----------------------------------------------------------|--------------|--------|-----------------------|-----------|--------------------------------------------|-------------------------|
|                                                          | Shares       | Amount | capital               | earnings  | (loss)                                     | shareholders'<br>equity |
| Balance - December 31, 2011                              | 5,907,255    | \$ 6   | \$ 7,795              | \$ 7,790  | \$ (823)                                   | ) \$ 14,768             |
| Net Earnings                                             | -            | -      | -                     | 2,990     | -                                          | 2,990                   |
| Stock-based compensation                                 | -            | -      | 270                   | -         | -                                          | 270                     |
| Foreign currency translation adjustment                  | -            | -      | -                     | -         | 133                                        | 133                     |
| Pension adjustment, net of taxes                         | -            | -      | -                     | -         | (246)                                      | ) (246)                 |
| Balance - December 31, 2012                              | 5,907,255    | 6      | 8,065                 | 10,780    | (936)                                      | ) 17,915                |
| Net Earnings                                             | -            | -      | -                     | 5,270     | -                                          | 5,270                   |
| Stock-based compensation                                 | -            | -      | 228                   | -         | -                                          | 228                     |
| Foreign currency translation adjustment                  | -            | -      | -                     | -         | (866)                                      | ) (866)                 |
| Pension adjustment, net of taxes                         | -            | -      | -                     | -         | 373                                        | 373                     |
| Issuance of common stock, net of transaction costs       | 1,265,000    | 1      | 7,739                 | -         | -                                          | 7,740                   |
| Underwriter's warrants, related to common stock offering | -            | -      | 133                   | -         | -                                          | 133                     |
| Balance - December 31, 2013                              | 7,172,255    | \$ 7   | \$ 16,164             | \$ 16,050 | \$ (1,429)                                 | ) \$ 30,792             |

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

## **1. Business and Organization**

Pioneer Power Solutions, Inc. (the “Company”), a Delaware corporation, is a manufacturer of specialty electrical equipment and provides a broad range of custom-engineered and general purpose electrical transformers for applications in the utility, industrial and commercial segments of the electrical transmission and distribution industry. The Company is headquartered in Fort Lee, New Jersey and operates from eight additional locations in the U.S., Canada and Mexico for manufacturing, centralized distribution, engineering, sales and administration.

On March 6, 2013, the Company’s wholly-owned subsidiary Pioneer Critical Power Inc. acquired substantially all the assets and assumed certain liabilities of Power Systems Solutions, Inc., a Minneapolis-based provider of paralleling switchgear and engine generator controls used in on-site backup power and distributed generation applications.

On August 19, 2013, the Company’s wholly-owned subsidiary Pioneer Custom Electrical Products Corp., acquired all the machinery and equipment, certain inventory assets and all the intellectual property assets of Pico Electrical Equipment, Inc. and Pico Metal Products, Inc., a Los Angeles-based manufacturer of electrical switchboards, panelboards and custom electrical enclosures.

On September 24, 2013, the Company completed an underwritten public offering of 1,265,000 shares of its common stock at a gross sales price of \$7.00 per share, resulting in net proceeds to the Company of approximately \$7.9 million, after deducting underwriting discounts and commissions and other offering expenses. In connection with the public offering, the Company’s common stock began trading on the Nasdaq Capital Market under the symbol PPSI.

On January 1, 2014, the Company completed an internal legal reorganization whereby all of its direct and indirect wholly-owned Canadian subsidiaries were combined into a single corporation, Pioneer Electrogroupp Canada Inc. As a result of the transaction that occurred on such date, the three former subsidiaries of Pioneer Electrogroupp Canada Inc., consisting of Pioneer Transformers Ltd., Bemag Transformer Inc. and Pioneer Wind Energy Systems Inc., were vertically amalgamated into Pioneer Electrogroupp Canada Inc. which continues as the surviving corporation.

## **2. Summary of Significant Accounting Policies**

### **Principles of Consolidation**

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated on consolidation.

### **Reclassifications**

Certain reclassifications have been made in prior years' financial statements to conform to the presentation used in the current year. These reclassifications have not resulted in any changes to the previously reported net income for any year.

### **Use of Estimates**

The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The financial statements include estimates based on currently available information and management's judgment as to the outcome of future conditions and circumstances. Significant estimates in these financial statements include allowance for doubtful accounts, inventory provision, useful lives and impairment of long-lived assets, warranty accruals, income tax determination, stock-based compensation, cost of pension benefits and estimates related to purchase price allocation.

Changes in the status of certain facts or circumstances could result in material changes to the estimates used in the preparation of the financial statements and actual results could differ from the estimates and assumptions.

## Revenue Recognition

Revenue is recognized when (1) persuasive evidence of an arrangement exists, (2) delivery occurs, (3) the sales price is fixed or determinable, (4) collectability is reasonably assured and (5) customer acceptance criteria, if any, has been successfully demonstrated. Revenue is recognized on the sale of goods, when the significant risks and rewards of ownership have been transferred to the buyer upon delivery, provided that the Company maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold. There are no further obligations on the part of the Company subsequent to revenue recognition, except when customers have the right of return or when the Company warrants the product. The Company records a provision for future returns, based on historical experience at the time of shipment of products to customers. The Company warrants some of its products against defects in design, materials and workmanship for periods ranging from one to three years depending on the model. The Company records a provision for estimated future warranty costs based on the historical relationship of warranty claims to sales at the time of shipment of products to customers. The Company periodically reviews the adequacy of its product warranties and adjusts, if necessary, the warranty percentage and accrued warranty reserve for actual experience.

The following table provides detail of change in the Company's product warranty provision, which is a component of accrued liabilities on the consolidated balance sheets for the years ended December 31, 2013 and 2012 (in thousands):

|                                            | December 31, |       |
|--------------------------------------------|--------------|-------|
|                                            | 2013         | 2012  |
| Balance at beginning of year               | \$211        | \$312 |
| Increase due to warranty expense           | 174          | 108   |
| Deductions for warranty charges            | (219)        | (215) |
| Change due to foreign currency translation | (11 )        | 6     |
| Balance at end of year                     | \$155        | \$211 |

## Financial Instruments

The Company estimates the fair value of its financial instruments based on current interest rates, market value and pricing of financial instruments with comparable terms. Unless otherwise indicated, the carrying value of these financial instruments approximates their fair market value.



## **Cash and Cash Equivalents**

Cash and cash equivalents comprise cash on hand, demand deposits and investments with an original maturity at the date of purchase of three months or less.

## **Accounts Receivable**

The Company accounts for trade receivables at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Management determines the allowance for doubtful accounts by regularly evaluating individual customer receivables and considering a customer's financial condition, credit history and current economic conditions. The Company writes off trade receivables when they are deemed uncollectible. The Company records recoveries of trade receivables previously written off when it receives them. Management considers the Company's allowance for doubtful accounts, which was \$480,000 and \$29,000 as of December 31, 2013 and 2012, respectively, sufficient to cover any exposure to loss in its accounts receivable.

## **Long-Lived Assets**

Depreciation and amortization for property, plant and equipment, and finite life intangible assets, is computed and included in cost of goods sold and in selling and administrative expense, as appropriate. Long-lived assets, consisting primarily of property, plant and equipment, are stated at cost less accumulated depreciation. Depreciation is recorded using the declining balance method for buildings, furniture and fixtures at the Company's Canadian operations. Non-Canadian property, plant and equipment are depreciated using the straight line method, based on the estimated useful lives of the assets (buildings – 25 years, machinery and equipment - 5 to 15 years, computer hardware and software - 3 to 5 years). Depreciation commences once the assets are ready for their intended use.

Finite life intangible assets consist of non-compete agreements, which have defined terms, and three categories of customer relationships for which estimated useful lives were determined based on actual historical customer attrition rates. These finite life intangible assets are amortized by the Company over periods ranging from three to twenty years.

Long-lived and finite life intangible assets are reviewed for impairment whenever events or circumstances have occurred that indicate the remaining useful life of the asset may warrant revision or that the remaining balance of the asset may not be recoverable. In addition, finite life intangible assets are tested at least once annually through quantitative analysis. Upon indications of impairment, or in the normal course of annual testing, assets and liabilities are grouped at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. The measurement of possible impairment is generally estimated by the ability to recover the balance of an asset group from its expected future operating cash flows on an undiscounted basis. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds the fair value thereof. Determining asset groups and underlying cash flows requires the use of significant judgment.

## **Goodwill and Indefinite Life Intangible Assets**

Goodwill is tested for impairment at the reporting unit level, which is equivalent to the Company's subsidiary-level financial statements, and based on the net assets for each subsidiary, including goodwill and intangible assets. Goodwill is assigned to each operating subsidiary, as this represents the lowest level that constitutes a business for which discrete financial information is available, and is the level at which management regularly reviews operating results.

Goodwill and indefinite life intangible assets are evaluated for impairment annually, or immediately if events or other conditions indicate there may be a possible permanent loss of value, using either a quantitative or a qualitative

analysis. The Company performs a quantitative analysis using a discounted cash flow model and other valuation techniques, but may elect to perform a qualitative analysis. A quantitative analysis is used to determine an estimated fair value representing the amount at which a reporting unit could be bought or sold in a current transaction between willing parties on an arms-length basis. The estimated fair value of each reporting unit is derived using a discounted cash flow method based on market and reporting unit-specific assumptions, including estimated future revenues and expenses, weighted average cost of capital, capital expenditures, the useful life over which cash flows will occur and other assumptions which are considered reasonable and inherent in discounted cash flow analysis. A qualitative analysis is performed by assessing certain trends and factors, including projected market outlook and growth rates, forecasted and actual sales and operating profit margins, discount rates, industry data and other relevant qualitative factors. These trends and factors are compared to, and based on, the assumptions used in the most recent quantitative assessment.

Goodwill impairment testing for 2013 and 2012 was performed by using quantitative analysis, as described above, for each of the Company's reporting units having a carrying amount of goodwill. As a result of the quantitative analysis performed, the Company determined that no impairments were warranted for 2013 and 2012.

Indefinite life intangible assets primarily consist of trademarks. The fair value of these assets are determined using a royalty relief methodology similar to that employed when the associated assets were acquired, but using updated estimates of future sales, cash flows and profitability. For 2013 and 2012, the fair value of indefinite life intangible assets exceeded their respective carrying values.

## **Foreign Currency Translation**

The functional currency for the Companies foreign subsidiaries is the local currency in which the entity is located. The financial statements of all subsidiaries with a functional currency other than the U.S. dollar have been translated into U.S. dollars. All assets and liabilities of foreign operations are translated into U.S. dollars using year-end exchange rates, and all revenues and expenses are translated at average rates during the respective period. The U.S. dollar results that arise from such translation, as well as exchange gains and losses on intercompany balances of a long-term investment nature, are included in the cumulative currency translation adjustments in accumulated other comprehensive income in stockholders' equity.

## **Income Taxes**

The Company accounts for income taxes under the asset and liability method, based on the income tax laws and rates in the countries in which operations are conducted and income is earned. This approach requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax basis of assets and liabilities. Developing the provision for income taxes requires significant judgment and expertise in federal, international and state income tax laws, regulations and strategies, including the determination of deferred tax assets and liabilities and, if necessary, any valuation allowances that may be required for deferred tax assets. The Company records a valuation allowance to reduce its deferred tax assets to the amount that is more likely than not to be realized. The Company believes that the deferred tax asset recorded as of December 31, 2013, is realizable through future reversals of existing taxable temporary differences and future taxable income. If the Company was to subsequently determine that it would be able to realize deferred tax assets in the future in excess of its net recorded amount, an adjustment to deferred tax assets would increase earnings for the period in which such determination was made. The Company will continue to assess the adequacy of the valuation allowance on a quarterly basis. The Company's judgments and tax strategies are subject to audit by various taxing authorities.

The objective of accounting for income taxes is to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences or events that have been recognized in the Company's financial statements or tax returns. The Company recognizes the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position (see "Unrecognized Tax Benefits" below).

Interest and penalties are grouped with interest expense on the consolidated statement of earnings.

## **Unrecognized Tax Benefits**

The Company accounts for unrecognized tax benefits in accordance with Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) “Income Taxes” (“ASC 740”). ASC 740 prescribes a recognition threshold that a tax position is required to meet before being recognized in the financial statements and provides guidance on de-recognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition issues. ASC 740 contains a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained upon ultimate settlement with a taxing authority, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement.

Additionally, ASC 740 requires the Company to accrue interest and related penalties, if applicable, on all tax positions for which reserves have been established consistent with jurisdictional tax laws.

## **Share-Based Payments**

The Company accounts for share based payments in accordance with the provisions of FASB ASC 718 "Compensation - Stock Compensation" and accordingly recognizes in its financial statements share based payments at their fair value. In addition, it recognizes in the financial statements an expense based on the grant date fair value of stock options granted to employees and directors. The expense is recognized on a straight line basis over the expected option life while taking into account the vesting period and the offsetting credit is recorded in additional paid-in capital. Upon exercise of options, the consideration paid together with the amount previously recorded as additional paid-in capital is recognized as capital stock. The Company estimates its forfeiture rate in order to determine its compensation expense arising from stock based awards. The Company uses the Black-Scholes Merton option pricing model to determine the fair value of the options. Non-employee members of the Board of Directors are deemed to be employees for the purposes of recognizing share-based compensation expense.

## **Employee Benefit Plan**

The Company sponsors a defined benefit plan as described in Note 14. The cost of pension benefits earned by employees is actuarially determined using the accumulated benefit method and a discount rate, used to measure interest cost on the accrued employee future benefit obligation, based on market interest rates on high-quality debt instruments with maturities that match the timing and benefits expected to be paid by the plan. Plan assets are valued using current market values and the expected return on plan assets is based on the fair value of the plan assets.

The costs that relate to employee current service are charged to income annually.

The transitional obligation created upon adoption of the FASB ASC 715 "Compensation - Retirement Benefits" is amortized over the average remaining service period of employees. For a given year, unrecognized actuarial gains or losses are recognized into income if the unamortized balance at the beginning of the year is more than 10% of the greater of the plan asset or liability balance. Any unrecognized actuarial gain or loss in excess of this threshold is recognized in income over the remaining service period of the employees.

The Company reflects the funded status of its defined pension plans as a net asset or net liability in its balance sheet, with an offsetting amount in accumulated other comprehensive income, and recognizes changes in that funded status in the year in which the changes occur through comprehensive income.

## **Inventories**

Inventories are stated at the lower of cost or market using first-in, first-out (FIFO) or weighted-average methods and include the cost of materials, labor and manufacturing overhead. The Company uses estimates in determining the level of reserves required to state inventory at the lower of cost or market. The Company estimates are based on market activity levels, production requirements, the physical condition of products and technological innovation. Changes in any of these factors may result in adjustments to the carrying value of inventory.

### **Earnings Per Share**

Basic earnings per share is computed by dividing the earnings for the period by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing the earnings for the period by the weighted average number of common and common equivalent shares outstanding during the period. Potentially dilutive securities composed of incremental common shares issuable upon the exercise of stock options or warrants was included in diluted earnings per share since the exercise price of some of the Company's stock options and/or warrants were in the money (see Note 18 "Basic and Diluted Earnings Per Share").

### **Fair Value Measurements**

FASB ASC 820 "Fair Value Measurement and Disclosure" applies to all assets and liabilities that are being measured and reported on a fair value basis. ASC 820 establishes a framework for measuring fair value in U.S GAAP, and expands disclosure about fair value measurements. ASC 820 enables the reader of the financial statements to assess the inputs used to develop those measurements by establishing a hierarchy for ranking the quality and reliability of the information used to determine fair values. ASC 820 requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

- Level 1: Quoted market prices in active markets for identical assets or liabilities.  
Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.  
Level 3: Unobservable inputs that are not corroborated by market data.

In determining the appropriate levels, the Company performs a detailed analysis of the assets and liabilities that are subject to ASC 820. At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs are classified as Level 3.

The fair value represents management's best estimates based on a range of methodologies and assumptions. The carrying value of receivables and payables arising in the ordinary course of business approximate fair value because of the relatively short period of time between their origination and expected realization. These items have been classified as Level 1.

### 3. Recent Accounting Pronouncements

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

*Testing Indefinite-Lived Intangible Assets for Impairment* – In July 2012, the FASB issued ASU No. 2012-02, Intangibles—Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment. This standard, which amends the guidance on testing indefinite-lived intangible assets, other than goodwill, for impairment, provides companies with the option to first perform a qualitative assessment before performing the two-step quantitative impairment test. If the company determines, on the basis of qualitative factors, that the fair value of the indefinite-lived intangible asset is more likely than not to exceed its carrying amount, then the company would not need to perform the two-step quantitative impairment test. This standard does not revise the requirement to test indefinite-lived intangible assets annually for impairment. This standard became effective for the Company on a prospective basis commencing January 1, 2013. The adoption of this standard had no effect on the Company's financial position or results of operations.

*Presentation of Unrecognized Tax Benefit* – In July 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit when a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. This standard requires an entity to present unrecognized tax benefits as a reduction to deferred tax assets when a net operating loss carryforward, similar tax loss or a tax credit carryforward exists, with limited exceptions. This standard is effective for fiscal years beginning on or after December 15, 2013, and for interim periods within those fiscal years. The Company is currently assessing the potential impact of ASU No. 2013-11 on our financial statements.





#### 4. Acquisitions

On March 6, 2013, Pioneer Critical Power Inc., a wholly-owned subsidiary of the Company, acquired substantially all the assets and assumed certain trade liabilities comprising the business of Power Systems Solutions, Inc. The total purchase price was \$655,000, consisting of \$605,000 in cash paid at closing to acquire the net assets and repay associated debt, and a deferred, non-interest bearing payment of \$50,000 due to the seller on December 31, 2013. The transaction was accounted for under the purchase method of accounting.

On August 19, 2013, through its wholly-owned subsidiary Pioneer Custom Electrical Products Corp., or Pioneer CEP, the Company hired all the employees and acquired all the machinery and equipment, certain inventory assets and all of the intellectual property of Pico Electrical Equipment, Inc. and Pico Metal Products, Inc, or "Pico". The total purchase price was approximately \$945,000, consisting of \$165,000 in cash paid at closing, a \$455,000 non-interest bearing promissory note issued to the sellers, a \$150,000 consulting contract obligation and \$175,000 of deferred payments for certain inventories and transfer taxes. The transaction was accounted for under the purchase method of accounting.

The transactions were accounted for under the purchase method of accounting. Under the purchase method of accounting, the total estimated purchase price is allocated to the tangible and intangible assets acquired and liabilities assumed in connection with the acquisitions, based on their estimated fair values as of the effective date of the acquisitions. Goodwill arising from the acquisitions has been determined as the excess of the purchase price over the net of the amounts assigned to acquired assets and liabilities assumed.

The Company made an initial allocation of the purchase price at the date of each acquisition, based upon its understanding of the fair value of the acquired assets and assumed liabilities. The Company obtained this information during due diligence and through other sources including asset appraisals.

The entire purchase price allocation for Power Systems Solutions, Inc. has been finalized. Identifiable intangible assets having finite lives arising from the acquisition were valued at \$0.4 million, consisting a non-compete agreement that will be amortized on a straight-line basis over six years for accounting purposes, and over 15 years for tax purposes. The excess of the purchase price over the aggregate fair values, which was approximately \$0.7 million, was recorded as goodwill.

The purchase price allocation for Pico is preliminary. The excess of the purchase price over the aggregate fair values, which was approximately \$0.5 million, has been recorded as goodwill. As the Company finalizes the fair value of assets acquired and liabilities assumed with respect to Pico, additional purchase price adjustments may be recorded during the measurement period in 2014. Fair value estimates are based on a complex series of judgments about future

events and uncertainties and rely heavily on estimates and assumptions. The judgments used to determine the estimated fair value assigned to each class of assets acquired and liabilities assumed, as well as asset lives, can impact the Company's results of operations. The finalization of the purchase accounting assessment for Pico may result in changes in the valuation of assets acquired and liabilities assumed and may have a material impact on the Company's results of operations.

This goodwill recorded in connection with the acquisitions has an indefinite life, is not subject to amortization and is deductible for tax purposes. Goodwill arising from acquisitions is tested for impairment at least annually (more frequently if indicators of impairment arise). In the event that management determines that goodwill has become impaired, the Company will incur an accounting charge for the amount of the impairment during the fiscal quarter in which the determination is made.

The Company incurred acquisition transaction costs of approximately \$0.3 million for the year ended December 31, 2013. These costs were expensed in 2013.

## 5. Inventories

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

|                                             | December 31, |          |
|---------------------------------------------|--------------|----------|
|                                             | 2013         | 2012     |
| Raw materials                               | \$5,210      | \$5,130  |
| Work in process                             | 2,635        | 4,360    |
| Finished goods                              | 5,125        | 5,779    |
| Provision for excess and obsolete inventory | (327 )       | (357 )   |
| Total inventories                           | \$12,643     | \$14,912 |

Included in raw materials and finished goods are goods in transit of approximately \$0.1 million (2012 - \$0.3 million).

## 6. Property, Plant and Equipment

Property, plant and equipment are summarized below (in thousands):

|                                          | December 31, |          |
|------------------------------------------|--------------|----------|
|                                          | 2013         | 2012     |
| Land                                     | \$106        | \$113    |
| Buildings                                | 2,874        | 3,091    |
| Machinery and equipment                  | 11,465       | 11,738   |
| Furniture and fixtures                   | 250          | 209      |
| Computer hardware and software           | 1,010        | 929      |
| Leasehold improvements                   | 147          | 57       |
| Construction in progress                 | 2,829        | 397      |
|                                          | 18,681       | 16,534   |
| Less: Accumulated depreciation           | (6,468 )     | (5,597 ) |
| Total property, plant and equipment, net | \$12,213     | \$10,937 |

## 7. Goodwill and Other Intangible Assets

Changes in goodwill and intangible asset balances for the years ended December 31, 2013 and 2012 consisted of the following (in thousands):

|                               | Goodwill | Intangible<br>assets |
|-------------------------------|----------|----------------------|
| Balance December 31, 2011     | \$ 6,862 | \$ 5,585             |
| Additions due to acquisitions | -        | -                    |
| Amortization                  | -        | (285 )               |
| Foreign currency translation  | 30       | 29                   |
| Balance December 31, 2012     | 6,892    | 5,329                |
| Additions due to acquisitions | 1,194    | 370                  |
| Amortization                  | -        | (330 )               |
| Foreign currency translation  | (88 )    | (84 )                |
| Balance December 31, 2013     | \$ 7,998 | \$ 5,285             |

The components of intangible assets at December 31, 2013 are summarized below (in thousands):

|                                            | Intangible<br>assets | Accumulated<br>amortization | Foreign<br>currency<br>translation | Net<br>book<br>value |
|--------------------------------------------|----------------------|-----------------------------|------------------------------------|----------------------|
| Customer relationships                     | \$ 2,962             | \$ (873 )                   | \$ (77 )                           | \$2,012              |
| Non-compete agreements                     | 465                  | (138 )                      | (1 )                               | 326                  |
| Trademarks                                 | 2,049                | -                           | (25 )                              | 2,024                |
| Technology-related industry accreditations | 950                  | -                           | (27 )                              | 923                  |
| Total intangible assets                    | \$ 6,426             | \$ (1,011 )                 | \$ (130 )                          | \$5,285              |

Future scheduled annual amortization expense for finite life intangible assets is as follows (in thousands):

| Years Ending December 31, | Total   |
|---------------------------|---------|
| 2014                      | \$327   |
| 2015                      | 325     |
| 2016                      | 324     |
| 2017                      | 324     |
| 2018                      | 247     |
| Thereafter                | 790     |
|                           | \$2,337 |

## 8. Debt

### *Canadian Credit Facilities*

The Company's Canadian operations have maintained credit facilities with Bank of Montreal since October 2009. In June 2011, Pioneer Electrogroupp Canada Inc., together with its operating businesses, Pioneer Transformers Ltd. and Bemag Transformer Inc., entered into a letter loan agreement with Bank of Montreal (the "Canadian Facilities") that replaced and superseded all prior financing arrangements with the bank.

The Canadian Facilities provide for up to \$23.0 million Canadian dollars ("CAD") (approximately \$21.6 million expressed in U.S. dollars) consisting of a \$10.0 million demand revolving credit facility ("Facility A") to finance ongoing operations, a \$2.0 million term credit facility ("Facility B") that financed a plant expansion, a \$10.0 million term credit facility ("Facility C") to finance acquisitions, capital expenditures or to provide funding to the Company's U.S. operations, a \$50,000 Corporate MasterCard credit facility ("Facility D") and a \$1.0 million foreign exchange

settlement risk facility ("Facility E").

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

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

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

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

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

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

As of December 31, 2013, the Company had approximately \$9.0 million in U.S. dollar equivalents outstanding under the Canadian Facilities and was in compliance with its financial covenant requirements. The Company's borrowings consisted of approximately \$0.8 million outstanding under Facility A, \$1.1 million outstanding under Facility B and \$7.1 million outstanding under Facility C.



*United States Credit Facilities*

The Company's Jefferson Electric, Inc. subsidiary had a loan agreement with a Johnson Bank that included a revolving credit facility and a term credit facility. In November 2011, the loan agreement was revised to provide for an increase in the borrowing base limit of the revolving credit facility to \$6.0 million and a decrease in the interest rate to the U.S. prime rate plus 2.0%. In connection with the amendment, the interest rate under the term credit facility was reduced to 6.0% annually.

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

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

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

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

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

As of December 31, 2013, the Company had no borrowings outstanding under the U.S. Facilities and the Company was in compliance with its financial covenant requirements.

*Nexus Promissory Note*

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

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

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

#### *Pico Promissory Note*

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

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

|                                                    | December 31, |         |
|----------------------------------------------------|--------------|---------|
|                                                    | 2013         | 2012    |
| Revolving credit facilities                        | \$-          | \$5,141 |
| Term credit facilities                             | 8,239        | 10,615  |
| Nexus promissory note                              | 824          | 1,371   |
| Pico promissory note                               | 250          | -       |
| Capital lease obligations                          | -            | 3       |
| Total debt and capital lease obligations           | 9,313        | 17,130  |
| Less current portion                               | (2,108)      | (7,335) |
| Total long-term debt and capital lease obligations | \$7,205      | \$9,795 |

The annual maturities of long-term debt at December 31, 2013, were as follows (in thousands):

| Years Ending December 31, | Long-term<br>debt<br>maturities |
|---------------------------|---------------------------------|
| 2014                      | \$ 2,108                        |
| 2015                      | 2,090                           |

|                                 |          |
|---------------------------------|----------|
| 2016                            | 5,102    |
| 2017                            | 13       |
| Thereafter                      | -        |
| Total long-term debt maturities | \$ 9,313 |

## 9. Other Assets

In December 2011 and January 2012, the Company's Pioneer Transformers Ltd. subsidiary funded two promissory notes, each in the amount of \$0.3 million, due from a developer of a renewable energy project in the U.S. The promissory notes accrue interest at a rate of 4.5% per annum with a final payment of all unpaid principal and interest becoming fully due and payable upon the earlier to occur of (i) the four year anniversary of the issuance date of the promissory notes, or (ii) an event of default. As defined in the promissory notes, an event of default includes, but is not limited to, the following: any bankruptcy, reorganization or similar proceeding involving the borrower, a sale or transfer of substantially all the assets of the borrower, a default by the borrower relating to any indebtedness due to third parties, the incurrence of additional indebtedness by the borrower without the Company's written consent and failure of the borrower to perform its obligations pursuant to its other agreements with the Company, including its purchase order for pad mount transformers.

Also included in Other Assets are deferred financing costs of \$0.3 million and prepaid sales taxes of \$0.2 million at December 31, 2013 and deferred financing costs of \$0.2 million 2012.

## 10. Commitments

The Company leases certain offices, facilities and equipment under operating leases expiring at various dates through 2018. At December 31, 2013, the minimum annual lease commitments under the leases having terms in excess of one year were as follows (in thousands):

| Years Ending December 31, | Operating leases |
|---------------------------|------------------|
| 2014                      | \$ 906           |
| 2015                      | 845              |
| 2016                      | 418              |
| 2017                      | 317              |
| 2018                      | 172              |
| Thereafter                | -                |
| Total lease commitments   | \$ 2,658         |

Rent and lease expense was approximately \$0.8 million for 2013 and 2012, respectively.

## 11. Shareholders' Equity

The Company had common stock, \$0.001 par value per share, outstanding of 7,172,255 and 5,907,255 shares as of December 31, 2013 and December 31, 2012, respectively. In September 2013, the Company completed a public offering and issued 1,265,000 shares of its common stock at a gross sales price of \$7.00 per share, resulting in \$7.9 million in net proceeds after deducting the underwriting discount and costs directly attributable to the offering.

In connection with the public offering, the Company issued warrants to the underwriters to purchase 50,600 shares of common stock, exercisable at the public offering price, or \$7.00 per share. The warrants were accounted for at their fair value amounting to \$0.1 million, as determined by the Black-Scholes Merton valuation model, based on the following assumptions:

|                         | Year Ended December 31, |   |   |
|-------------------------|-------------------------|---|---|
|                         | 2013                    |   |   |
| Expected Volatility     | 40.9                    | % | - |
| Expected life in years  | 5.0                     |   | - |
| Risk-free interest rate | 1.5                     | % | - |
| Dividend yield          | 0.0                     | % | - |

As of December 31, 2013, the Company had warrants outstanding to purchase 690,600 shares of common stock with a weighted average exercise price of \$13.49 per share. The warrants expire on dates beginning on April 19, 2014 and ending on September 18, 2018. No warrants were exercised during the years ended December 31, 2013 and 2012.

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

## **12. Stock-Based Compensation**

On December 2, 2009, the Company adopted the 2009 Equity Incentive Plan (the “2009 Plan”) for the purpose of issuing incentive stock options intended to qualify under Section 422 of the Internal Revenue Code of 1986, as amended, non-qualified stock options, restricted stock, stock appreciation rights, performance unit awards and stock bonus awards to employees, directors, consultants and other service providers. A total of 320,000 shares of common stock are reserved for issuance under the 2009 Plan. Options may be granted under the 2009 Plan on terms and at prices as determined by the board of directors or by the plan administrators appointed by the board of directors.

On May 11, 2011, the board of directors of the Company adopted the Pioneer Power Solutions, Inc. 2011 Long-Term Incentive Plan (the “2011 Plan”) which was subsequently approved by stockholders of the Company on May 31, 2011. The 2011 Plan replaces and supersedes the 2009 Plan. The Company’s outside directors and employees, including the Company’s principal executive officer, principal financial officer and other named executive officers, and certain contractors are all eligible to participate in the 2011 Plan. The 2011 Plan allows for the granting of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units, performance awards, dividend equivalent rights, and other awards, which may be granted singly, in combination, or in tandem, and upon such terms as are determined by the Board or a committee of the Board that is designated to administer the Plan. Subject to certain adjustments, the maximum number of shares of the Company’s common stock that may be delivered pursuant to awards under the 2011 Plan is 700,000 shares. As of December 31, 2013, 261,400 stock options had been granted, consisting of 160,200 incentive stock options and 101,200 non-qualified stock options.

Expense for stock-based compensation recorded for the years ended December 31, 2013 and 2012 was approximately \$0.2 million and \$0.3 million, respectively. All of the stock-based compensation expense is included in selling, general and administrative expenses in the accompanying consolidated statements of earnings. As of December 31, 2013, the Company had total stock-based compensation expense remaining to be recognized of approximately \$0.1 million.



The fair value of the stock options granted was measured using the Black-Scholes valuation model with the following assumptions:

|                         | Year Ended December 31, |              |
|-------------------------|-------------------------|--------------|
|                         | 2013                    | 2012         |
| Expected Volatility     | 41 - 43%                | 39 - 43%     |
| Expected life in years  | 5.0 - 6.0               | 3.5 - 6.0    |
| Risk-free interest rate | 0.92 - 2.49%            | 0.70 - 1.34% |
| Dividend yield          | 0%                      | 0%           |

A summary of stock option activity for the years ended December 31, 2013 and 2012, and changes during the years then ended is presented below:

|                                     | Stock options | Weighted average exercise price | Weighted average remaining contractual term | Aggregate intrinsic value |
|-------------------------------------|---------------|---------------------------------|---------------------------------------------|---------------------------|
| Balance December 31, 2011           | 118,400       | \$ 15.07                        | 7.0                                         | \$ -                      |
| Granted                             | 50,000        | 4.22                            | 7.9                                         | 309,500                   |
| Exercised                           | -             | -                               | -                                           | -                         |
| Forfeited                           | -             | -                               | -                                           | -                         |
| Balance December 31, 2012           | 168,400       | \$ 11.85                        | 6.6                                         | \$ 309,500                |
| Granted                             | 93,000        | 6.10                            | 9.3                                         | 390,600                   |
| Exercised                           | -             | -                               | -                                           | -                         |
| Forfeited                           | -             | -                               | -                                           | -                         |
| Outstanding as of December 31, 2013 | 261,400       | \$ 9.81                         | 6.9                                         | \$ 700,100                |
| Exercisable as of December 31, 2013 | 202,400       | \$ 11.10                        | 6.4                                         | \$ 402,795                |

Intrinsic value is the difference between the market value of the stock at December 31, 2013 and the exercise price which is aggregated for all options outstanding and exercisable. A summary of the weighted-average grant-date fair value of options, total intrinsic value of options exercised, and cash receipts from options exercised is shown below (in thousands, except per share amounts):

|                                                            | Year Ended December 31, |         |         |
|------------------------------------------------------------|-------------------------|---------|---------|
|                                                            | 2013                    | 2012    | 2011    |
| Weighted-average fair value of options granted (per share) | \$ 2.48                 | \$ 1.54 | \$ 5.20 |
| Intrinsic value gain of options exercised                  | -                       | -       | -       |
| Cash receipts from exercise of options                     | -                       | -       | -       |

### 13. Income Taxes

The components of the income tax provision were as follows (in thousands):

|                            | Year Ended   |         |
|----------------------------|--------------|---------|
|                            | December 31, |         |
|                            | 2013         | 2012    |
| Current                    |              |         |
| Federal                    | \$-          | \$-     |
| State                      | 37           | 15      |
| Foreign                    | 2,315        | 2,131   |
| Deferred                   | (1,670)      | (413 )  |
| Total income tax provision | \$682        | \$1,733 |

The components of earnings before income taxes are summarized below (in thousands):

|                                                       | Year Ended December 31, |           |
|-------------------------------------------------------|-------------------------|-----------|
|                                                       | 2013                    | 2012      |
| U.S. operations                                       | \$ (2,208 )             | \$ (343 ) |
| Foreign                                               | 8,160                   | 5,265     |
| Income from continuing operations before income taxes | \$ 5,952                | \$ 4,922  |

A reconciliation from the statutory U.S. income tax rate and the Company's effective income tax rate, as computed on earnings before income taxes, is as follows:

|                                      | Year Ended December 31, |   |      |   |
|--------------------------------------|-------------------------|---|------|---|
|                                      | 2013                    |   | 2012 |   |
| Federal Income tax at statutory rate | 35                      | % | 35   | % |
| State and local income tax, net      | (1                      | ) | -    |   |
| Foreign rate differential            | (9                      | ) | (8   | ) |
| Uncertain tax positions              | -                       |   | 1    |   |
| Other                                | (6                      | ) | 7    |   |
| Recognition of prior years' NOLs     | (8                      | ) | -    |   |
| Effective income tax expense rate    | 11                      | % | 35   | % |

The Company's provision for income taxes reflects an effective tax rate on earnings before income taxes of 11% in 2013 (35% in 2012). The decrease in the Company's effective tax rate during 2013 primarily reflects a \$1.0 million income tax benefit recognized during the fourth quarter resulting from a corporate legal reorganization by which all of the Company's directly and indirectly wholly-owned Canadian subsidiaries were amalgamated into a single corporation, Pioneer Electrogroupp Canada Inc. These subsidiaries included the Company's discontinued wind energy equipment business, Pioneer Wind Energy Systems Inc., whose accumulated tax losses since the date its business was first acquired will now be available for future use by the continuing businesses of Pioneer Electrogroupp Canada Inc.

The net deferred income tax asset (liability) was comprised of the following (in thousands):

|                                              | December 31, |           |
|----------------------------------------------|--------------|-----------|
|                                              | 2013         | 2012      |
| Current deferred income taxes                |              |           |
| Gross assets                                 | \$1,982      | \$563     |
| Gross liabilities                            | -            | -         |
| Net current deferred income tax asset        | 1,982        | 563       |
| Noncurrent deferred income taxes             |              |           |
| Gross assets                                 | 1,091        | 700       |
| Gross liabilities                            | (3,306)      | (2,992)   |
| Net noncurrent deferred income tax liability | (2,215)      | (2,292)   |
| Net deferred income tax liability            | \$(233 )     | \$(1,729) |

The tax effect of temporary differences between GAAP accounting and federal income tax accounting creating deferred income tax assets and liabilities were as follows (in thousands):

|                                          | December 31, |           |
|------------------------------------------|--------------|-----------|
|                                          | 2013         | 2012      |
| Deferred tax assets                      |              |           |
| Canada net operating loss carry forwards | \$1,688      | \$244     |
| Pension plan                             | 80           | 253       |
| Foreign tax credits                      | 1,064        | 497       |
| Property and equipment                   | 245          | -         |
| Other                                    | 477          | 269       |
|                                          | 3,554        | 1,263     |
| Less valuation allowance                 | (481 )       | -         |
| Net deferred tax assets                  | 3,073        | 1,263     |
| Deferred tax liabilities                 |              |           |
| Other                                    | (3,306)      | (2,992)   |
| Deferred liability, net                  | \$(233 )     | \$(1,729) |

The Company believes that its deferred tax assets in other tax jurisdictions are more likely than not realizable through future reversals of existing taxable temporary differences and its estimate of future taxable income.

A reconciliation of the beginning and ending amount of gross unrecognized tax benefits, exclusive of interest and penalties, is as follows (in thousands):

|                                                             | UTP   |
|-------------------------------------------------------------|-------|
| Balance as of December 31, 2011                             | \$265 |
| Increases related to tax positions taken during the period  | 52    |
| Decreases related to expectations of statute of limitations | -     |
| Balance as of December 31, 2012                             | 317   |
| Increases related to tax positions taken during the period  | 13    |
| Decreases related to expectations of statute of limitations | (13 ) |
| Balance as of December 31, 2013                             | \$317 |

The Company's policy is to recognize interest and penalties related to income tax matters as interest expense.

Management believes that an adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company's tax audits are resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs. Although timing of the resolution and/or closure of audits is highly uncertain, the Company does not believe it is reasonably possible that its unrecognized tax benefits would materially change in the next twelve months.

**14. Pension Plan**

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

**Cost of Benefits**

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

|                                                     | Year Ended December 31, |        |
|-----------------------------------------------------|-------------------------|--------|
|                                                     | 2013                    | 2012   |
| Current service cost, net of employee contributions | \$ 54                   | \$ 32  |
| Interest cost on accrued benefit obligation         | 128                     | 140    |
| Expected return on plan assets                      | (166 )                  | (156 ) |
| Amortization of transitional obligation             | 13                      | 14     |
| Amortization of past service costs                  | 9                       | 9      |
| Amortization of net actuarial gain                  | 60                      | 46     |
| Total cost of benefit                               | \$ 98                   | \$ 85  |

**Benefit Obligation**

The Company's obligation for the pension plan is valued annually as of the beginning of each fiscal year. The projected benefit obligation represents the present value of benefits ultimately payable to plan participants for both past and future services expected to be provided by the plan participants.

The Company's obligations pursuant to the pension plan are as follows (in thousands):

|                                                     | December 31, |         |
|-----------------------------------------------------|--------------|---------|
|                                                     | 2013         | 2012    |
| Projected benefit obligation, at beginning of year  | \$3,383      | \$2,911 |
| Current service cost, net of employee contributions | 52           | 32      |
| Employee contributions                              | 40           | 39      |

|                                              |         |         |
|----------------------------------------------|---------|---------|
| Interest cost                                | 124     | 140     |
| Actuarial loss                               | -       | (49 )   |
| Impact of change in discount rate            | (322 )  | 395     |
| Impact in change of assumptions              | -       | 36      |
| Benefits paid                                | (173 )  | (188 )  |
| Foreign exchange adjustment                  | (177 )  | 67      |
| Projected benefit obligation, at end of year | \$2,927 | \$3,383 |



A summary of expected benefit payments related to the pension plan is as follows (in thousands):

Year ending December 31, Pension Plan

|             |        |
|-------------|--------|
| 2014        | \$ 218 |
| 2015        | 243    |
| 2016        | 247    |
| 2017        | 254    |
| 2018        | 257    |
| 2019 - 2023 | 1,285  |

Other changes in plan assets and benefit obligations recognized in other comprehensive income are as follows (in thousands):

|                                                              | December<br>31, |       |
|--------------------------------------------------------------|-----------------|-------|
|                                                              | 2013            | 2012  |
| Net (Gain) / loss                                            | \$(432)         | \$407 |
| Amortization of prior service cost                           | (9 )            | (9 )  |
| Amortization of gain                                         | (59 )           | (47 ) |
| Amortization of transitional asset                           | (13 )           | (13 ) |
|                                                              | (513)           | 338   |
| Taxes                                                        | (140)           | (92 ) |
| Total recognized in other comprehensive income, net of taxes | \$(373)         | \$246 |

The estimated net loss amortized from accumulated other comprehensive income into net periodic benefit cost over the next year amounts to approximately \$59,000. The estimated prior service cost amortized from accumulated other comprehensive income into net periodic benefit cost over the next year amounts to approximately \$9,000. The estimated transitional asset amortized from accumulated other comprehensive income into net periodic benefit cost over the next year amounts to approximately \$13,000.

The accumulated other comprehensive loss consists of the following amounts that have not yet been recognized as components of net benefit cost (in thousands):

|                                      | December 31, |         |
|--------------------------------------|--------------|---------|
|                                      | 2013         | 2012    |
| Unrecognized prior service cost      | \$112        | \$120   |
| Unrecognized net actuarial loss      | 71           | 84      |
| Unrecognized transitional obligation | 1,050        | 1,542   |
| Deferred income taxes                | (367 )       | (507 )  |
|                                      | \$866        | \$1,239 |

### Plan Assets

Assets held by the pension plan are invested in accordance with the provisions of the Company's approved investment policy. The pension plan's strategic asset allocation was structured to reduce volatility through diversification and enhance return to approximate the amounts and timing of the expected benefit payments. The asset allocation for the pension plan at the end of 2013 and 2012 and the target allocation for 2014, by asset category, is as follows:

|                         | Allocation at |       | 2014 Target |   |
|-------------------------|---------------|-------|-------------|---|
|                         | December      |       | Allocation  |   |
|                         | 2013          | 2012  |             |   |
| Equity securities       | 0 %           | 57 %  | 0           | % |
| Fixed income securities | 90            | 30    | 90          |   |
| Real estate             | 10            | 9     | 10          |   |
| Other                   | 0             | 4     | 0           |   |
| Total                   | 100 %         | 100 % | 100         | % |

The fair market values, by asset category are as follows (in thousands):

|                         | Fair Value Measurements at<br>December 31, |          |
|-------------------------|--------------------------------------------|----------|
|                         | 2013                                       | 2012     |
| Equity securities       | \$ -                                       | \$ 1,451 |
| Fixed income securities | 2,442                                      | 764      |
| Real estate             | 271                                        | 229      |
| Other                   | -                                          | 102      |
| Total                   | \$ 2,713                                   | \$ 2,546 |

The Company has classified the assets as level 1. Changes in the assets held by the pension plan in the years 2013 and 2012 are as follows (in thousands):

|                                                 | December 31, |         |
|-------------------------------------------------|--------------|---------|
|                                                 | 2013         | 2012    |
| Fair value of plan assets, at beginning of year | \$2,546      | \$2,342 |
| Actual return on plan assets                    | 271          | 131     |
| Employer contributions                          | 173          | 169     |
| Employee contributions                          | 40           | 39      |
| Benefits paid                                   | (173 )       | (188 )  |
| Foreign exchange adjustment                     | (144 )       | 53      |
| Fair value of plan assets, at end of year       | \$2,713      | \$2,546 |

### Contributions

The Company's policy is to fund the pension plan at or above the minimum required by law. The Company made \$0.2 million of contributions to its defined benefit pension plan in each of the 2013 and 2012 years. The Company expects to make contributions of less than \$0.2 million to the defined benefit pension plan in 2014. Changes in the discount rate and actual investment returns which continue to remain lower than the long-term expected return on plan assets could result in the Company making additional contributions.

### Funded Status

The funded status of the pension plan is as follows (in thousands):

|                                | December 31, |         |
|--------------------------------|--------------|---------|
|                                | 2013         | 2012    |
| Projected benefit obligation   | \$2,926      | \$3,383 |
| Fair value of plan assets      | 2,713        | 2,546   |
| Accrued obligation (long term) | \$213        | \$837   |

### Assumptions

Assumptions used in accounting for the pension plan are as follows:

|                                                                                  | December 31, |        |
|----------------------------------------------------------------------------------|--------------|--------|
|                                                                                  | 2013         | 2012   |
| Weighted average discount rate used to determine the accrued benefit obligations | 4.60 %       | 3.80 % |
| Discount rate used to determine the net pension expense                          | 3.80 %       | 4.80 % |
| Expected long-term rate on plan assets                                           | 6.50 %       | 6.50 % |

To determine the expected long-term rate of return on pension plan assets, the Company considers the current and expected asset allocations, as well as historical and expected returns on various categories of plan assets. The Company applies the expected rate of return to a market related value of the assets which reduces the underlying variability in assets to which the Company applies that expected return. The Company amortizes gains and losses as well as the effects of changes in actuarial assumptions and plan provisions over a period no longer than the average future service of employees.

Primary actuarial assumptions are determined as follows:

The expected long-term rate of return on plan assets is based on the Company's estimate of long-term returns for equities and fixed income securities weighted by the allocation of assets in the plans. The rate is impacted by changes in general market conditions, but because it represents a long-term rate, it is not significantly impacted by short-term market swings. Changes in the allocation of plan assets would also impact this rate.

The assumed discount rate is used to discount future benefit obligations back to today's dollars. The discount rate is reflective of yield rates on U.S. long-term investment grade corporate bonds on and around the December 31 valuation date. This rate is sensitive to changes in interest rates. A decrease in the discount rate would increase the Company's obligation and expense.

## 15. Major Customers

Sales to two customers accounted for approximately 19% and 12% of the Company's sales in 2013 and 2012.

## 16. Geographical Information

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

|               | Year Ended December 31, |           |
|---------------|-------------------------|-----------|
|               | 2013                    | 2012      |
| Canada        | \$ 52,613               | \$ 53,238 |
| United States | 33,527                  | 30,296    |

|        |           |           |
|--------|-----------|-----------|
| Others | 2,022     | 426       |
| Total  | \$ 88,162 | \$ 83,960 |

The distribution of the Company's property, plant and equipment by geographic location is approximately as follows (in thousands):

|               | December 31, |          |
|---------------|--------------|----------|
|               | 2013         | 2012     |
| Canada        | \$8,557      | \$7,202  |
| United States | 859          | 174      |
| Mexico        | 2,797        | 3,561    |
| Total         | \$12,213     | \$10,937 |

**17. Basic and Diluted Earnings Per Common Share**

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

|                                                                 | Year Ended December 31, |          |
|-----------------------------------------------------------------|-------------------------|----------|
|                                                                 | 2013                    | 2012     |
| Numerator:                                                      |                         |          |
| Earnings from continuing operations                             | \$ 5,270                | \$ 3,189 |
| Denominator:                                                    |                         |          |
| Weighted average basic shares outstanding                       | 6,263                   | 5,907    |
| Effect of dilutive securities - equity based compensation plans | 32                      | 6        |
| Net dilutive effect of warrants outstanding                     | 3                       | -        |
| Denominator for diluted earnings per common share               | 6,298                   | 5,913    |
| Earnings from continuing operations per common share:           |                         |          |
| Basic                                                           | \$ 0.84                 | \$ 0.54  |
| Diluted                                                         | \$ 0.84                 | \$ 0.54  |
| Anti-dilutive securities (excluded from per share calculation): |                         |          |
| Equity based compensation plans                                 | 118                     | 118      |
| Warrants                                                        | 640                     | 640      |

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.**

Not applicable.

**ITEM 9A. CONTROLS AND PROCEDURES.**

**Management's Conclusions Regarding Effectiveness of Disclosure Controls and Procedures**

We conducted an evaluation of the effectiveness of our “disclosure controls and procedures” (“Disclosure Controls”), as defined by Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), as of December 31, 2013, the end of the period covered by this Annual Report on Form 10-K. The Disclosure Controls evaluation was done in conjunction with an independent consulting firm and under the supervision and with the participation of management, including our chief executive officer and chief financial officer. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based upon this evaluation, our chief executive officer and chief financial officer have concluded that our Disclosure Controls were effective as of December 31, 2013 at the reasonable assurance level.

**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) under the Exchange Act. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness of internal control over financial reporting 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 over time.



Management, including our chief executive officer and our chief financial officer, assessed the effectiveness of our internal control over financial reporting as of December 31, 2013. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control—Integrated Framework*. Based on its assessment and those criteria, management has concluded that we maintained effective internal control over financial reporting as of December 31, 2013.

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our registered public accounting firm.

### **Changes in Internal Control over Financial Reporting**

There were no changes in our internal control over financial reporting during the quarter ended December 31, 2013 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### **ITEM 9B. OTHER INFORMATION.**

Not applicable.

**PART III**

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information required by this item will be included in our Proxy Statement for the 2014 Annual Meeting of Stockholders to be filed with the SEC within 120 days of the fiscal year ended December 31, 2013 (2014 Proxy Statement) and is incorporated herein by reference.

We have adopted a Code of Business Conduct and Ethics that applies to all our directors and employees, including the principal executive officer, principal financial officer, principal accounting officer and controller. The full text of our Code of Business Conduct and Ethics is published on the Investors section of our website at [www.pioneerpowersolutions.com](http://www.pioneerpowersolutions.com). We intend to disclose any future amendments to certain provisions of the Code of Business Conduct and Ethics, or waivers of such provisions granted to executive officers and directors, on this website within four business days following the date of any such amendment or waiver.

**ITEM 11. EXECUTIVE COMPENSATION**

The information required by this item will be included in the 2014 Proxy Statement and is incorporated herein by reference.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by this item will be included in the 2014 Proxy Statement and is incorporated herein by reference.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information required by this item will be included in the 2014 Proxy Statement and is incorporated herein by reference.

**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

The information required by this item will be included in the 2014 Proxy Statement and is incorporated herein by reference.

**PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.**

a. We have filed the following documents as part of this Annual Report on Form 10-K:

1. **Consolidated Financial Statements**

The following financial statements are included in Item 8 herein:

Report of Independent Registered Public Accounting Firm

Consolidated Statements of Earnings for the Years Ended December 31, 2013 and 2012

Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2013 and 2012

Consolidated Balance Sheets as of December 31, 2013

Consolidated Statements of Cash Flows for the Years Ended December 31, 2013 and 2012

Consolidated Statements of Shareholders' Equity for the Years Ended December 31, 2013 and 2012

Notes to Consolidated Financial Statements

2. **Financial Statement Schedules**

None

3.

**Exhibits**

See the Index to Exhibits immediately following the signature page of this Annual Report on Form 10-K.

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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.

**PIONEER POWER SOLUTIONS, INC.**

Date: March 14, 2014 By: /s/ Nathan J. Mazurek  
 Name: Nathan J. Mazurek  
 Title: Chief Executive 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 and on the dates indicated.

| <b>Signature</b>                           | <b>Title</b>                                                                                                                    | <b>Date</b>    |
|--------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------|----------------|
| /s/ Nathan J. Mazurek<br>Nathan J. Mazurek | President, Chief Executive Officer and<br>Chairman of the Board of Directors<br>(Principal Executive Officer)                   | March 14, 2014 |
| /s/ Andrew Minkow<br>Andrew Minkow         | Chief Financial Officer, Secretary, Treasurer and Director (Principal<br>Financial<br>Officer and Principal Accounting Officer) | March 14, 2014 |
| /s/ Thomas Klink<br>Thomas Klink           | Director, President of Jefferson Electric, Inc.                                                                                 | March 14, 2014 |
| /s/ Yossi Cohn<br>Yossi Cohn               | Director                                                                                                                        | March 14, 2014 |
| /s/ David J. Landes<br>David J. Landes     | Director                                                                                                                        | March 14, 2014 |
| /s/ Ian Ross<br>Ian Ross                   | Director                                                                                                                        | March 14, 2014 |
| /s/ David Tesler<br>David Tesler           | Director                                                                                                                        | March 14, 2014 |
| /s/ Jonathan Tulkoff<br>Jonathan Tulkoff   | Director                                                                                                                        | March 14, 2014 |



**INDEX TO EXHIBITS**

| <b>Exhibit<br/>No.</b> | <b>Description</b>                                                                                                                                                                                                                                                                                                                                       |
|------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1                    | Composite Certificate of Incorporation (Incorporated by reference to Exhibit 3.1 to Amendment No. 4 to the Registration Statement on Form S-1 of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on June 21, 2011).                                                                                                      |
| 3.2                    | Bylaws (Incorporated by reference to Exhibit 3.2 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on December 2, 2009).                                                                                                                                                              |
| 4.1                    | Form of Securities Purchase Agreement (Incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on December 7, 2009).                                                                                                                              |
| 4.2                    | Form of \$10.00 Warrant (Incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on December 7, 2009).                                                                                                                                            |
| 4.3                    | Form of \$16.25 Warrant (Incorporated by reference to Exhibit 10.3 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on December 7, 2009).                                                                                                                                            |
| 4.4                    | Warrant to Purchase Common Stock, dated April 30, 2010, issued to Thomas Klink (Incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on May 4, 2010).                                                                                           |
| 4.5                    | Warrant to Purchase Common Stock, dated April 26, 2010 (Incorporated by reference to Exhibit 4.6 to Post-Effective Amendment No. 1 to Registration Statement on Form S-1 of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on June 1, 2010).                                                                            |
| 4.6                    | Form of Warrant to Purchase Common Stock, dated May 11, 2010, issued to investor relations firm and its designees (Incorporated by reference to Exhibit 4.7 to the Registration Statement on Form S-1 of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on April 20, 2011).                                             |
| 4.7                    | Form of Warrant to Purchase Common Stock, dated September 24, 2013, issued to Roth Capital Partners, LLC and to Monarch Capital Group, LLC (Incorporated by reference to Exhibit 4.8 to Amendment No. 1 to Registration Statement on Form S-1 of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on September 10, 2013). |
| 4.8                    | Form of common stock certificate (Incorporated by reference to Exhibit 4.7 to Registration Statement on Form S-1 of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on August 1, 2013).                                                                                                                                  |
| 10.1+                  | Form of Director and Officer Indemnification Agreement (Incorporated by reference to Exhibit 10.1 to the Annual Report on Form 10-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission for the year ended December 31, 2010).                                                                                            |



- 10.2+ Pioneer Power Solutions, Inc. 2009 Equity Incentive Plan (Incorporated by reference to Exhibit 10.8 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on December 7, 2009).
- 10.3+ Form of 2009 Incentive Stock Option Agreement (Incorporated by reference to Exhibit 10.9 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on December 7, 2009).
- 10.4+ Form of 2009 Non-Qualified Stock Option Agreement (Incorporated by reference to Exhibit 10.10 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on December 7, 2009).
- 10.5+ Pioneer Power Solutions, Inc. 2011 Long-Term Incentive Plan (Incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on May 31, 2011).

- 10.6+ Employment Agreement, dated December 2, 2009, by and between Pioneer Power Solutions, Inc. and Nathan J. Mazurek (Incorporated by reference to Exhibit 10.7 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on December 7, 2009).
- 10.7+ Employment Agreement, dated March 30, 2012, by and between Pioneer Power Solutions, Inc. and Nathan J. Mazurek (Incorporated by reference to Exhibit 10.42 to the Annual Report on Form 10-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on March 30, 2012).
- 10.8+ Employment and Non-Competition Agreement, dated August 12, 2010, by and between Pioneer Power Solutions, Inc. and Andrew Minkow (Incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on August 18, 2010).
- 10.9+ Employment Agreement, dated March 30, 2012, by and between Pioneer Power Solutions, Inc. and Andrew Minkow (Incorporated by reference to Exhibit 10.43 to the Annual Report on Form 10-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on March 30, 2012).
- 10.10 Collective Labor Agreement, dated November 26, 2010, by and between Pioneer Transformers Ltd. and United Steelworkers, Local Section 9414 (Incorporated by reference to Exhibit 10.8 to the Annual Report on Form 10-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission for the year ended December 31, 2010).
- 10.11\* Agreement dated January 1, 2010, by and between Pioneer Transformers Ltd. and Hydro-Quebec Utility Company (Incorporated by reference to Exhibit 10.34 to Amendment No. 1 to the Registration Statement on Form S-1 of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on March 10, 2010).
- 10.12\* Agreement dated January 8, 2010, by and between Pioneer Transformers Ltd. and Hydro-Quebec Utility Company (Incorporated by reference to Exhibit 10.35 to Amendment No. 1 to the Registration Statement on Form S-1 of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on March 10, 2010).
- 10.13 Contract Extension Agreements, Contract No. 4600017108 and 4600017040, dated March 6, 2012, by and between Pioneer Transformers Ltd. and Hydro-Quebec Utility Company (Incorporated by reference to Exhibit 10.41 to the Annual Report on Form 10-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on March 30, 2012).
- 10.14 Contract Extension Agreements, Contract No. 4600017108 and 4600017040, dated February 13, 2013, by and between Pioneer Transformers Ltd. and Hydro-Quebec Utility Company (Incorporated by reference to Exhibit 10.19 to the Annual Report on Form 10-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on April 1, 2013).
- 10.15\*\* Contract Extension Agreements, Contract No. 4600017108 and 4600017040, dated December 4, 2013, by and between Pioneer Transformers Ltd. and Hydro-Quebec Utility Company.
- 10.16+ Employment Agreement, dated April 30, 2010, by and between Jefferson Electric, Inc. and Thomas Klink (Incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K of Pioneer Power Solutions,

Inc. filed with the Securities and Exchange Commission on May 4, 2010).

10.17 Term Loan Agreement, dated July 25, 2012, by and between Nexus Magneticos S. de R.L. de C.V. and GE CF Mexico, S.A. de C.V. (Incorporated by reference to Exhibit 10.2 to Amendment No. 1 to the Quarterly Report on Form 10-Q/A of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on November 16, 2012).

10.18 Irrevocable Transfer of Title and Guaranty Trust Agreement, dated July 25, 2012, by and among, Nexus Magneticos S. de R.L. de C.V. and GE CF Mexico, S.A. de C.V., Jefferson Electric, Inc., GE CF Mexico, S.A. de C.V. and Banco Invex, S.A. (Incorporated by reference to Exhibit 10.3 to Amendment No. 1 to the Quarterly Report on Form 10-Q/A of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on November 16, 2012).

- 10.19 Corporate Guaranty, dated July 25, 2011, by and between Pioneer Power Solutions, Inc. and GE CF Mexico, S.A. de C.V. (Incorporated by reference to Exhibit 10.4 to Amendment No. 1 to the Quarterly Report on Form 10-Q/A of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on November 16, 2012).
- 10.20 Collective Bargaining Agreement Nexus Magneticos S. de R.L. de C.V., dated January 1, 2011 (Incorporated by reference to Exhibit 10.35 to the Annual Report on Form 10-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission for the year ended December 31, 2010).
- 10.21 Industrial Lease between Comercializadora Reynosa Para La Industria Maquiladora S.A. DE C.V. and Nexus Magneticos e Mexico S. de R.L. de C.V (Incorporated by reference to Exhibit 10.41 to the Annual Report on Form 10-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on April 1, 2013).
- 10.22 Share Purchase Agreement, dated May 13, 2011, by and among Fiducie Familiale Mazoyer, Bon-Ange Inc., Gilles Mazoyer and 7834080 Canada Inc. (Incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on May 19, 2011).
- 10.23 Amendment Agreement, dated June 30, 2011, by and among Fiducie Familiale Mazoyer, Bon-Ange Inc., Gilles Mazoyer and 7834080 Canada Inc. (Incorporated by reference to Exhibit 10.3 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on July 5, 2011).
- 10.24 Equipment Purchase Agreement, dated July 1, 2011, by and among Vermont Transformer, Inc., GCEFF Inc., Gilles Mazoyer and 7834080 Canada Inc. (Incorporated by reference to Exhibit 10.4 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on July 5, 2011).
- 10.25 Collective Labor Agreement, dated June 3, 2010, by and between Bemag Transformer Inc. and Syndicat Québécois des Employées et Employés de Service, Section Locale 298 (FTQ) (Incorporated by reference to Exhibit 10.45 to the Annual Report on Form 10-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on March 30, 2012).
- 10.26+ First Amendment to Employment Agreement, dated April 30, 2013, by and between Jefferson Electric, Inc. and Thomas Klink (Incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on April 30, 2013).
- 10.27 Credit Agreement, dated as of June 28, 2013, by and among Pioneer Power Solutions, Inc., as borrower, Pioneer Critical Power Inc. and Jefferson Electric, Inc., as guarantors, and Bank of Montreal, Chicago Branch, as lender (Incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on July 3, 2013).
- 10.28 Security Agreement, dated as of June 28, 2013, by and among Pioneer Power Solutions, Inc., Pioneer Critical Power Inc. and Jefferson Electric, Inc. and Bank of Montreal, Chicago Branch (Incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on July 3, 2013).

10.29 Amended and Restated Letter Loan Agreement, dated as of June 28, 2013, by and among Pioneer Electrogroup Canada Inc., Pioneer Transformers Ltd. and Bemag Transformer Inc., as borrowers, and Bank of Montreal, as lender (Incorporated by reference to Exhibit 10.3 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on July 3, 2013).

10.30\*\* First Amendment to Amended and Restated Letter Loan Agreement, dated as of March 10, 2014, by and among Pioneer Electrogroup Canada Inc., Pioneer Transformers Ltd. and Bemag Transformer Inc., as borrowers, and Bank of Montreal, as lender.

- 10.31 Guaranty Agreement, dated as of June 28, 2013, by Pioneer Power Solutions, Inc. in favor of Bank of Montreal (Incorporated by reference to Exhibit 10.4 to the Current Report on Form 8-K of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on July 3, 2013).
- 10.32 First Amendment to Credit Agreement, dated as of August 7, 2013, by and among Pioneer Power Solutions, Inc., Jefferson Electric, Inc., Pioneer Critical Power Inc. and Bank of Montreal (Incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on August 14, 2013).
- 10.33 Second Amendment to Credit Agreement, by and among Pioneer Power Solutions, Inc. and Bank of Montreal, Chicago Branch (Incorporated by reference to Exhibit 10.1 on Form 10-Q of Pioneer Power Solutions, Inc. filed with the Securities and Exchange Commission on November 12, 2013).
- 10.34\*\* Third Amendment to Credit Agreement, by and among Pioneer Power Solutions, Inc. and Bank of Montreal, Chicago Branch.
- 10.35\*\* Fourth Amendment to Credit Agreement, by and among Pioneer Power Solutions, Inc. and Bank of Montreal, Chicago Branch.
- 21.1\*\* List of subsidiaries.
- 31.1\*\* Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2\*\* Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1\*\* Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2\*\* Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101\*\*\* The following materials from the Company's Annual Report on Form 10-K for the year ended December 31, 2013, formatted in XBRL (eXtensible Business Reporting Language), (i) Consolidated Statements of Earnings, (ii) Consolidated Balance Sheets, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Cash Flows and (v) Notes to the Consolidated Financial Statements.

\* Confidential treatment has been granted with respect to certain portions of this exhibit.

\*\* Filed herewith.

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

+ Management contract or compensatory plan or arrangement.

