PIONEER POWER SOLUTIONS, INC.
Form 10-Q
November 14, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended: September 30, 2011

OR

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

For the transition period from to
Commission file number: 333-155375

PIONEER POWER SOLUTIONS, INC.
(Exact name of registrant as specified in its charter)

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

One Parker Plaza
400 Kelby Street, 9th Floor
Fort Lee, New Jersey 07024
(Address of principal executive offices)
(Zip Code)
(212) 867-0700
(Registrant’s telephone number, including area code)

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

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

Yes x No ¨

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

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

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

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

Class	Outstanding at November 14, 2011
Common Stock, $0.001 par value	5,907,255

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

PIONEER POWER SOLUTIONS, INC.
Consolidated Balance Sheets
(In thousands, except per share data)

	September 30, 2011	December 31, 2010
ASSETS	(unaudited)	
Current Assets		
Cash and cash equivalents	$624	$516
Accounts receivable	8,967	5,263
Inventories	11,985	7,193
Income taxes receivable	166	1,191
Deferred income taxes	249	245
Prepaid expenses and other current assets	1,260	333
Current assets of discontinued operations	461	2,193
Total current assets	23,712	16,934
Property, plant and equipment	9,561	4,588
Noncurrent deferred income taxes	1,037	611
Intangible assets	5,995	4,436
Goodwill	6,800	5,534
Total assets	$47,105	$32,103
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Bank overdrafts	$1,050	$-
Accounts payable and accrued liabilities	10,605	7,328
Current maturities of long-term debt and capital lease obligations	8,269	6,063
Income taxes payable	77	161
Current liabilities of discontinued operations	772	824
Total current liabilities	20,773	14,376
Long-term debt and capital lease obligations, net of current maturities	8,351	17
Pension deficit	426	308
Noncurrent deferred income taxes	3,540	2,310
Total liabilities	33,090	17,011
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; 5,907,255 shares issued and outstanding	6	6
Additional paid-in capital	7,730	7,541
Accumulated other comprehensive income (loss)	(1,015)	(305)
Retained earnings	7,294	7,850
Total shareholders' equity	14,015	15,092
Total liabilities and shareholders' equity	$47,105	$32,103

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Revenues	$17,927	$13,807	$50,065	$34,408
Cost of goods sold	14,110	10,765	38,376	26,576
Gross profit	3,817	3,042	11,689	7,832
Operating expenses				
Selling, general and administrative	2,895	1,951	7,991	4,998
Foreign exchange (gain) loss	48	(38)	36	(95)
Total operating expenses	2,943	1,913	8,027	4,903
Operating income	874	1,129	3,664	2,929
Interest and bank charges	271	116	428	210
Other expense (income)	352	135	769	315
Earnings from continuing operations before income taxes	251	878	2,467	2,404
Provision for income taxes	48	220	584	775
Earnings from continuing operations	203	658	1,883	1,629
Earnings (loss) from discontinued operations, net of income taxes	(2,029)	(270)	(2,440)	522
Net earnings (loss)	$(1,826)	$388	$(557)	$2,151
Earnings from continuing operations per share:				
Basic	$0.03	$0.11	$0.32	$0.28
Diluted	$0.03	$0.11	$0.32	$0.28
Earnings per common share:				
Basic	$(0.31)	$0.07	$(0.09)	$0.37
Diluted	$(0.31)	$0.06	$(0.09)	$0.36
Weighted average common shares outstanding:				
Basic	5,907	5,907	5,907	5,861
Diluted	5,982	5,974	5,973	5,915

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

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

	Nine Months Ended September 30,	
	2011	2010
Operating activities		
Net earnings (loss)	$(557)	$2,151
Depreciation	572	416
Amortization of intangibles	174	85
Deferred tax expense	(525)	(226)
Accrued pension	(7)	(95)
Stock-based compensation	190	100
Warrant issuance expense	-	92
Common stock issuance expense	-	140
Non-cash expense (income) from discontinued operations	1,811	(1,144)
Changes in current operating assets and liabilities		
Accounts receivable, net	(1,375)	(134)
Inventories	(2,340)	1,762
Prepaid expenses and other current assets	(856)	22
Income taxes	1,121	(1,771)
Accounts payable and accrued liabilities	1,762	581
Discontinued operations assets and liabilities, net	(128)	(16)
Net cash provided by (used in) operating activities	(158)	1,963
Investing activities		
Additions to property, plant and equipment	(714)	(1,406)
Acquisition of subsidiaries, net of cash acquired	(8,227)	(832)
Proceeds from sale of assets of discontinued operations	-	202
Net cash used in investing activities	(8,941)	(2,036)
Financing activities		
Increase (decrease) in bank overdrafts	588	845
Increase (decrease) in revolving credit facilities	1,508	(1,717)
Increase in long-term debt	9,729	-
Repayment of long-term debt and capital lease obligations	(3,373)	(297)
Repayment of advances from limited partners of a shareholder	-	(150)
Issuance of warrants	-	12
Transaction costs	-	(108)
Net cash provided by (used in) financing activities	8,452	(1,415)
Increase (decrease) in cash and cash equivalents	(647)	(1,488)
Effect of foreign exchange on cash and cash equivalents	755	(7)
Cash and cash equivalents		
Beginning of year	516	1,560
End of period	$624	$65

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

1.Basis of Presentation

Unless the context requires otherwise, references in this Form 10-Q to the "Company," "Pioneer," "we," "our" and "us" refer Pioneer Power Solutions, Inc. and its subsidiaries, including Pioneer Electrogroup Canada Inc., Pioneer Transformers Ltd., Bemag Transformer Inc., Pioneer Wind Energy Systems Inc., and Jefferson Electric, Inc.

These unaudited consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain prior year amounts have been reclassified to conform to current year presentation, including amounts related to discontinued operations.

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

These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto of the Company and its subsidiaries included in its Annual Report on Form 10-K for the year ended December 31, 2010, which was filed with the SEC on March 31, 2011.

Reverse Stock Split

The Company's board of directors authorized a one-for-five reverse stock split on June 1, 2011, which took effect on June 20, 2011. All share and related stock option and warrant information presented in these financial statements and accompanying footnotes has been retroactively adjusted to reflect the reduced number of shares resulting from this action.

Certain prior year amounts have been reclassified to conform to the current year presentation.

2. Adoption of New Accounting Standards and recently issued accounting pronouncements

New accounting standards

Fair Value Measurements and Disclosures

In January 2010, the Financial Accounting Standards Board ('FASB') issued Accounting Standards Update ("ASU") No. 2010-06, "Fair Value Measurements and Disclosures (Topic 820)" ("ASU 2010-06"). ASU 2010-06 requires reporting entities to make more robust disclosures about (1) the different classes of assets and liabilities measured at fair value, (2) the valuation techniques and inputs used, (3) the activity in Level 3 fair value measurements, including information on purchases, sales, issuances, and settlements on a gross basis, and (4) the transfers between Levels 1, 2, and 3. ASU 2010-06 is effective for fiscal years beginning on or after December 15, 2009, except for the disclosure regarding Level 3 activity, which is effective for fiscal years beginning after December 15, 2010. The adoption of

ASU 2010-06 for Levels 1, 2 and 3 did not have a material impact on the Company's consolidated financial statements.

Intangibles – Goodwill & Other

In December 2010, the FASB issued ASU No. 2010-28, "Intangibles - Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts" ("ASU 2010-28"). ASU 2010-28 affects all entities that have recognized goodwill and have one or more reporting units whose carrying amount for purposes of performing Step 1 of the goodwill impairment test is zero or negative. ASU 2010-28 modifies Step 1 so that for those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The qualitative factors are consistent with existing guidance, which requires that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. ASU 2010-28 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. The adoption of ASU 2010-28 did not have a material impact on the Company's consolidated financial statements.

Business Combinations

In December 2010, the FASB issued ASU No. 2010-29, "Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations ("ASU 2010-29"). The objective of ASU 2010-29 is to address diversity in practice about the interpretation of the pro forma revenue and earnings disclosure requirements for business combinations. ASU 2010-29 specifies that if a public entity presents comparative financial statements, it should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments also expand the required supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. ASU 2010-29 affects any public entity as defined by Topic 805 that enters into business combinations that are material on an individual or aggregate basis. ASU 2010-29 is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period on or after December 15, 2010. The adoption of ASU 2010-29 did not have a material impact on the Company's consolidated financial statements.

Recently Issued Accounting Pronouncements

In May 2011, the FASB issued ASU No. 2011-04, "Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs" ("ASU 2011-04"). ASU 2011-04 creates fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. For many of the requirements, the FASB does not intend to change the application of the requirements in Topic 820. Some of the amendments clarify the FASB's intent regarding the application of existing fair value measurement requirements. Other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. For public entities, ASU 2011-04 is effective during interim and annual periods beginning after December 15, 2011 and early application is not permitted. The Company is currently evaluating the impact of ASU 2011-04 on its consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, "Comprehensive Income (Topic 220): Presentation of Comprehensive Income" ("ASU 2011-05"). Under the amendments, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. ASU 2011-05 does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. ASU 2011-05 should be applied retrospectively. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. The Company is currently evaluating the impact of ASU 2011-05 on its consolidated financial statements.

In September 2011, the FASB issued No. 2011-08, "Intangibles—Goodwill and Other (Topic 350): Testing Goodwill for Impairment" ("ASU 2011-08"). The amendments in this Update will allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under these amendments, an entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The amendments include a number of events and circumstances for an entity to consider in conducting the qualitative assessment. For public entities, ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. The Company is currently evaluating the impact of ASU 2011-08 on its consolidated financial statements.

3. 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.

4. Acquisitions

Bemag Transformer Inc. Acquisition

On July 1, 2011, 7834080 Canada Inc., an indirect wholly-owned subsidiary of the Company, completed the acquisition of all of the capital shares of Bemag Transformer Inc. Pursuant to the share purchase agreement, as amended, all the capital shares of Bemag Transformer Inc. were purchased in a transaction valued at approximately $9.1 million, which amount includes approximately $2.8 million of Bemag Transformer Inc.'s former revolving and long-term debt which was repaid by the Company at closing.

The transaction was 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 acquisition, based on their estimated fair values as of the effective date of the acquisition. Goodwill arising from the acquisition has been determined as the excess of the purchase price over the net of the amounts assigned to acquired assets and liabilities assumed.

The preliminary allocation of the purchase price for the transaction was based on management's best current estimates of the fair value of tangible and intangible assets acquired and liabilities assumed. Management has up to one year from the date of the acquisition in which to complete its definitive assessment of the fair value of net assets acquired. The preliminary purchase price allocation may be adjusted after obtaining more information regarding, among other things, asset valuations, liabilities assumed, the tax attributes of certain liabilities, and revisions of preliminary estimates. When finalized, the impact of these adjustments may result in a change to the preliminary value attributed to goodwill. The preliminary allocation of the purchase price was as follows (in thousands):

Purchase Price	
Cash	$6,231
Debt repaid at closing	2,841
Total consideration	$9,071
Preliminary Purchase Price Allocation	
Cash and cash equivalents	$0
Accounts receivable	2,870
Inventory	2,901
Prepaid expenses	30
Deferred income taxes	3
Income taxes receivable	181
Property and equipment	3,695
Accounts payable and accrued liabilities	(2,683)
Deferred tax liabilities	(1,185)
Net tangible assets acquired	5,812
Intangible assets acquired	1,883
Goodwill	1,376
Total purchase price	$9,071

Identifiable intangible assets having finite lives arising from the acquisition are preliminarily valued at $0.8 million, consisting primarily of customer relationships and a non-compete agreement. These intangible assets will be amortized on a straight-line basis with a weighted average remaining useful life of 18.3 years. None of these definite-lived intangible assets acquired are deductible for tax purposes. Indefinite-lived intangible assets acquired consist of trademarks and certain technology-related industry accreditations, neither of which are deductible for tax purposes. The excess of the purchase price over the preliminary aggregate fair values, which was approximately $1.4 million, was recorded as goodwill. Goodwill has an indefinite life, is not subject to amortization and is not deductible for tax purposes. Goodwill arising from the acquisition will be tested for impairment at least annually (more frequently if indicators of impairment arise). In the event that management determines that the 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.

Impact of Acquisition to Consolidated Interim Statements of Earnings

The operating results of Bemag Transformer Inc. since the date of the acquisition (July 1, 2011) were included in the Company's unaudited consolidated interim statements of earnings as follows (in thousands, except per share data):

	Three Months Ended September 30, 2011		
	Pioneer Power Solutions, Inc.	Bemag Transformer Inc.	As Reported
Revenues	$15,062	$2,865	$17,927
Earnings from continuing operations	569	(366)	203
Earnings from continuing operations per share:			
Basic	-	-	$0.03
Diluted	-	-	0.03

Weighted average number of common shares outstanding:			
Basic	-	-	5,907
Diluted	-	-	5,982

Pro Forma Financial Information

The following unaudited combined pro forma statements of income for the nine month periods ended September 30, 2011 and 2010 have been prepared as if the acquisition had occurred as of the beginning of each period presented. The unaudited combined pro forma statements of income are based on accounting for the acquisition under the purchase method of accounting. The unaudited pro forma information may not be indicative of the results that actually would have occurred if the acquisition had been in effect from and on the dates indicated or which may be obtained in the future (in thousands, except per share data):

	Nine Months Ended September 30,	
	2011	2010
Revenues		
As reported	$50,065	$34,408
Pro forma	58,231	44,928
Earnings from continuing operations		
As reported	$1,883	$1,629
Pro forma	1,861	1,443
Basic earnings per common share from continuing operations		
As reported	$0.32	$0.28
Pro forma	0.31	0.25
Diluted earnings per common share from continuing operations		
As reported	$0.32	$0.28
Pro forma	0.31	0.24

Vermont Transformer Equipment Acquisition

On July 1, 2011, 7834080 Canada Inc., an indirect wholly-owned subsidiary of the Company, entered into an equipment purchase agreement with the former shareholders of Vermont Transformers, Inc., pursuant to which, on such date, all of the equipment used by Vermont Transformers, Inc. in the operation of its business was acquired in exchange for $1.6 million. For accounting purposes the transaction was treated as a purchase of assets and the amount of consideration paid, plus transaction expenses, was attributed to the assets acquired consisting solely of machinery and equipment.

5. Discontinued Operations

During September 2011, the Company committed to a plan to divest or wind down its Pioneer Wind Energy Systems Inc. subsidiary which was established by the Company in 2010 to market its utility scale wind turbine designs, after-sales services and equipment financing to community wind and industrial customers. This decision is part of the Company’s strategy to focus on businesses that create the most shareholder value. Weak domestic wind energy market conditions combined with the inability of the Company to establish an arrangement, on commercially acceptable terms, with a qualified third party to provide outsourced parts procurement and assembly services, caused the Company to reduce and extend further out into the future its projected sales and operating profit of the business. The decision to divest or wind down the business resulted in a non-cash asset impairment charge of $1.2 million to adjust the carrying value of the subsidiary’s assets to fair value. This impairment charge was recognized in the third quarter of 2011 on certain inventory, property, plant and equipment and other assets. In addition, the Company recognized a $0.6 million charge related to its expected future severance, rent and insurance payment obligations.

The results of operations for Pioneer Wind Energy Systems Inc. are reported as discontinued operations for all periods presented and are summarized as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net sales	$-	$-	$-	$-
Gain (loss) from operations of discontinued business (1)	(2,029)	(270)	(2,440)	522
Income tax expense	-	-	-	-
Loss from discontinued operations, net of tax	$(2,029)	$(270)	$(2,440)	$522

(1) Includes non-cash asset impairment charges of $1.6 million and $0.2 million of anticipated expenses related to discontinuing the business during the three and nine month periods ended September 30, 2011. The nine month period ended September 30, 2010 included a $1.1 million non-cash gain on bargain purchase.

6. Inventories

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

	September 30, 2011	December 31, 2010
Raw materials	$4,776	$3,072
Work in process	2,775	2,029
Finished goods	4,434	2,092
Total inventories	$11,985	$7,193

Included in raw materials at September 30, 2011 and December 31, 2010 are goods in transit of approximately $0.4 million and $0.3 million, respectively.

The preceding amounts are net of inventory reserves of approximately $0.8 million and $0.4 million at September 30, 2011 and December 31, 2010, respectively.

7. Goodwill and Other Intangible Assets

Changes in goodwill and intangible asset balances for the nine months ended September 30, 2011, consisted of the following (in thousands):

	Goodwill	Intangible Assets
Balance December 31, 2010	$5,534	$4,436
Additions due to acquisitions	1,266	1,733
Amortization	-	(174)
Balance September 30, 2011	$6,800	$5,995

The components of intangible assets are summarized below (in thousands):

	Intangible Assets	Accumulated Amortization	Intangible Assets, Net

Customer relationships	$2,716	$ (282)	$2,434
Non-compete agreement	165	(37)	$128
Trademarks	2,315	-	2,315
Technology-related industry accreditations	1,118	-	1,118
Total intangible assets	$6,314	$ (319)	$5,995

8. Credit Facilities

Canadian Credit Facilities

In June 2011, Pioneer Electrogroup Canada Inc., a wholly owned subsidiary of Pioneer Power Solutions, Inc. and the parent company of Pioneer Transformers Ltd., Pioneer Wind Energy Systems Inc., 7834080 Canada Inc. and Bemag Transformer Inc. (the "Borrowers"), entered into a letter loan agreement with the Company's Canadian bank (the "Canadian Facilities") that replaced and superseded all the Company's prior financing arrangements with the bank. Bemag Transformer Inc. became a party to the Canadian Facilities on July 1, 2011, upon the acquisition of all of its capital shares by 7834080 Canada Inc. (see Note 4 "Acquisitions").

The Canadian Facilities provide for up to $23.0 million CAD (approximately $21.9 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 for one of the Company's operating subsidiaries, a $10.0 million CAD term credit facility ("Facility C") to finance acquisitions, capital expenditures or to provide funding to Pioneer Power Solutions, Inc., a $50,000 CAD Corporate MasterCard credit facility ("Facility D") and a $1.0 million CAD foreign exchange settlement risk facility ("Facility E").

The Canadian Facilities are secured by a first-ranking lien in the amount of approximately $25 million CAD on all of the present and future movable and immovable property of the borrowers and their subsidiaries.

The Canadian Facilities require the Borrowers 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 Borrowers to, among other things, (i) provide any funding to any person, including affiliates, in an aggregate amount exceeding $5.0 million CAD or (ii) to make distributions in an aggregate amount exceeding 50% of Pioneer Electrogroup 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 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.

As of September 30, 2011, the Company had approximately $9.5 million in U.S. dollar equivalents outstanding under the Canadian Facilities and the Borrowers were in compliance with their financial covenant requirements.

United States Credit Facilities

Jefferson Electric, Inc. has a bank loan agreement with a U.S. bank that includes a revolving credit facility with a borrowing base limit of $5.0 million and a term credit facility ("the U.S. Facilities"). Monthly payments of accrued interest must be made under the revolving credit facility and monthly payments of principal and accrued interest must be made under the term credit facility, with a final payment of all outstanding amounts due on October 31, 2011. Borrowings under the bank loan agreement are collateralized by substantially all the assets of Jefferson Electric, Inc. which had a net carrying value of approximately $10.6 million as of September 30, 2011 and are guaranteed by its Mexican subsidiary. In addition, an officer of Jefferson Electric, Inc. is a guarantor under the bank loan agreement and has provided additional collateral to the bank in the form of common stock and a warrant to purchase shares of common stock of the Company held by him.

The bank loan agreement requires Jefferson Electric, Inc. to comply with certain financial covenants, including a requirement to exceed minimum quarterly targets for tangible net worth and maintain a minimum debt service coverage ratio. The bank loan agreement also restricts Jefferson Electric, Inc.'s ability to pay dividends or make distributions, advances or other transfers of assets. The interest rate under the revolving credit facility is equal to the greater of the bank's reference rate (currently 3.25% per annum) or 6.5% per annum. The interest rate under the term credit facility is 7.27% annually.

As of September 30, 2011, Jefferson Electric, Inc. had approximately $4.7 million outstanding under the revolving credit facility, approximately $2.3 million outstanding under the term credit facility and was in compliance with its financial covenant requirements.

In November 2011, Jefferson Electric, Inc. revised its financing arrangement with its U.S. bank and extended the maturity date of its loan agreement to October 31, 2012. The amended loan agreement provides for an increase in the borrowing base limit of its revolving credit facility to $6.0 million and a decrease in the interest rate to the bank's reference rate (currently 3.25% per annum) plus 2.0% per annum. In connection with the amendment, the Company prepaid $250,000 under the term credit facility and agreed to prepay an additional $750,000 by January 31, 2012. The interest rate under the term credit facility was reduced to 6.0% annually, with monthly payments of principal and accrued interest calculated based on an amortization of the then-remaining principal balance outstanding over a hypothetical 5-year term, with a final payment of all outstanding amounts due on October 31, 2012.

Borrowings under the bank loan agreement continue to be collateralized by substantially all the assets of Jefferson Electric, Inc. and an officer of the subsidiary remains a guarantor. In addition, the Company entered into a guaranty agreement with respect to Jefferson Electric, Inc.'s obligations under the loan agreement and the bank agreed to release additional collateral consisting of common stock and a warrant held by the officer of Jefferson Electric, Inc. The bank loan agreement, as amended, requires Jefferson Electric, Inc. to comply with certain financial covenants, including a requirement to exceed minimum quarterly targets for tangible net worth and maintain a minimum debt service coverage ratio. The bank loan agreement, as amended, also restricts Jefferson Electric, Inc.'s ability to pay dividends or make distributions, advances or other transfers of assets.

9. Long-Term Debt

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

	September 30, 2011	December 31, 2010
Revolving credit facilities	$4,726	$3,217
Term credit facilities	11,874	2,832
Capital lease obligations	20	31
Total debt and capital lease obligations	16,620	6,080
Less current portion	(8,269)	(6,063)
Total long-term debt and capital lease obligations	$8,351	$17

10. Common Stock

On April 30, 2010, the Company issued 97,255 common shares in conjunction with the acquisition of Jefferson Electric, Inc.

During the quarter ended June 30, 2010, the Company also issued 10,000 common shares as payment for investor relations services. The issuance of the shares and related expense was accounted for at the fair value of the shares on the issue date which amounted to $140,000.

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 shares of preferred stock 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.

11. Additional Paid-in Capital

Stock Options

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. As of September 30, 2011, 118,400 stock options had been granted, consisting of 65,200 incentive stock options and 53,200 non-qualified stock options.

On March 24, 2011, the Company granted an aggregate of 5,200 incentive stock options to four employees to purchase common shares. Options to purchase 3,200 common shares are exercisable for common shares at an exercise price of $12.00 per share, expire on March 24, 2021 and vest over three years with one-third vesting on the first anniversary of the date of grant and one-third vesting on each of the second and third anniversaries of the date of grant. Options to purchase 2,000 common shares are exercisable for common shares at an exercise price of $13.20 per share, expire on March 24, 2016 and vest over three years with one third vesting on the first anniversary of the date of grant and one third vesting on each of the second and third anniversaries of the date of grant.

On March 24, 2011, the Company granted an aggregate of 3,200 non-qualified stock options to eight directors to purchase common shares. The stock options are exercisable for common shares at an exercise price of $12.00 per share, expire on March 24, 2021 and vest on the first anniversary of the date of grant.

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.

Expense for stock-based compensation recorded during the nine months ended September 30, 2011 and 2010 was approximately $190,000 and $100,000, respectively. As of September 30, 2011, the Company had total stock-based compensation expense remaining to be recognized of approximately $400,000.

A summary of stock option activity under all plans as of September 30, 2011, and changes during the nine months ended September 30, 2011, are presented below:

	Stock Options	Weighted-Average Exercise Price (Per Share)	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance December 31, 2010	110,000	$15.28		
Granted	8,400	$12.29		
Exercised	-	-		
Forfeited	-	-		
Outstanding on September 30, 2011	118,400	$15.07	7.30	$-
Exercisable on September 30, 2011	38,000	-	7.27	$-

Warrants

As of September 30, 2011, the Company had warrants outstanding to purchase 640,000 shares of common stock with an average exercise price of approximately $14.00 per share. The warrants expire on dates beginning on December 2, 2014 and ending on April 30, 2015. No warrants were exercised during the nine months ended September 30, 2011.

The following table summarizes the continuity of the Company's warrants:

	Number of Shares	Weighted average exercise price
Balance December 31, 2010	640,000	$14.00
Granted	-	-
Exercised	-	
Balance September 30, 2011	640,000	$14.00

12. Comprehensive Income

The components of the Company’s comprehensive income was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net Earnings	$(1,826)	$388	$(557)	$2,151
Foreign currency translation adjustments	(803)	$218	(560)	$158
Pension adjustment net of taxes	(124)	75	(150)	15
Total	$(2,753)	$681	$(1,267)	$2,324

13. Pension Plan

The Company sponsors a defined benefit pension plan in which a majority of its Canadian 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 and updated at its discretion.

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

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Current service cost, net of employee contributions	$4	$11	$21	$31
Interest cost on accrued benefit obligation	37	36	111	107
Expected return on plan assets	(39)	(33)	(117)	(102)
Amortization of transitional obligation	3	3	10	9
Amortization of past service costs	2	1	7	