

POWELL INDUSTRIES INC

Form 10-Q

September 11, 2006

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON D.C. 20549
FORM 10-Q**

(Mark one)

Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended July 31, 2006.

or

Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____ to _____ .

Commission File Number 001-12488

POWELL INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

DELAWARE

88-0106100

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

8550 Mosley Drive, Houston, Texas

77075-1180

(Address of principal executive offices)

(Zip Code)

(713) 944-6900

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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

Common Stock, par value \$.01 per share; 10,909,946 shares outstanding as of September 6, 2006.

POWELL INDUSTRIES, INC. AND SUBSIDIARIES
INDEX
For the Quarter Ended July 31, 2006

Part I Financial Information

<u>Item 1.</u>	<u>Condensed Consolidated Financial Statements</u>	
	<u>Condensed Consolidated Balance Sheets</u>	3
	<u>Condensed Consolidated Statements of Operations</u>	4
	<u>Condensed Consolidated Statements of Cash Flows</u>	5
	<u>Notes to Condensed Consolidated Financial Statements</u>	6
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	17
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	21
<u>Item 4.</u>	<u>Controls and Procedures</u>	21

Part II Other Information

<u>Item 1.</u>	<u>Legal Proceedings</u>	22
<u>Item 1A.</u>	<u>Risk Factors</u>	22
<u>Item 6.</u>	<u>Exhibits</u>	23
	<u>Signatures</u>	24

<u>Certification of CEO Pursuant to Section 302</u>	
<u>Certification of CFO Pursuant to Section 302</u>	
<u>Certification of CEO Pursuant to Section 906</u>	
<u>Certification of CFO Pursuant to Section 906</u>	

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements**

Powell Industries, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(In thousands, except share and per share data)

	July 31, 2006	October 31, 2005
	(Unaudited)	
Assets		
Current Assets:		
Cash and cash equivalents	\$ 27,833	\$ 24,844
Marketable securities		8,200
Accounts receivable, less allowance for doubtful accounts of \$825 and \$567, respectively	84,549	65,385
Costs and estimated earnings in excess of billings on uncompleted contracts	39,767	35,328
Inventories, net	30,295	21,616
Income taxes receivable	44	507
Deferred income taxes	643	1,836
Prepaid expenses and other current assets	2,776	4,461
Total Current Assets	185,907	162,177
Property, plant and equipment, net	56,591	55,678
Goodwill	203	203
Intangible assets, net	4,625	3,505
Other assets	6,144	5,096
Total Assets	\$ 253,470	\$ 226,659

Liabilities and Stockholders Equity

Current Liabilities:		
Current maturities of long-term debt and capital lease obligations	\$ 3,415	\$ 2,095
Income taxes payable	4,086	1,185
Accounts payable	31,214	22,104
Accrued salaries, bonuses and commissions	12,367	9,820
Billings in excess of costs and estimated earnings on uncompleted contracts	15,537	15,742
Accrued product warranty	3,384	1,836
Other accrued expenses	7,549	5,957
Total Current Liabilities	77,552	58,739
Long-term debt and capital lease obligations, net of current maturities	17,450	19,436
Deferred compensation	1,733	1,918
Other liabilities	1,526	1,871
Total Liabilities	98,261	81,964

Commitments and contingencies (Note G)

Minority interest	303	281
Stockholders' Equity:		
Preferred stock, par value \$.01; 5,000,000 shares authorized; none issued		
Common stock, par value \$.01; 30,000,000 shares authorized; 11,001,733 and 11,001,733 shares issued, respectively; 10,907,546 and 10,849,278 shares outstanding, respectively	110	110
Additional paid-in capital	12,510	10,252
Retained earnings	143,665	136,670
Treasury stock, 94,187 and 152,455 shares, respectively, at cost	(847)	(1,417)
Accumulated other comprehensive income (loss)	432	(11)
Deferred compensation	(964)	(1,190)
Total Stockholders' Equity	154,906	144,414
Total Liabilities and Stockholders' Equity	\$ 253,470	\$ 226,659

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

Table of Contents

Powell Industries, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations (unaudited)
(In thousands, except per share data)

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2006	2005	2006	2005
Revenues	\$ 104,021	\$ 66,915	\$ 286,265	\$ 173,518
Cost of goods sold	84,928	54,354	231,652	145,556
Gross profit	19,093	12,561	54,613	27,962
Selling, general and administrative expenses	15,705	9,887	42,540	28,761
Income (loss) before interest, income taxes and minority interest	3,388	2,674	12,073	(799)
Interest expense	476	130	1,137	346
Interest income	(197)	(289)	(736)	(883)
Income (loss) before income taxes and minority interest	3,109	2,833	11,672	(262)
Income tax provision (benefit)	1,345	695	4,655	(680)
Minority interest in net income	7	6	22	7
Net income	\$ 1,757	\$ 2,132	\$ 6,995	\$ 411
Net earnings per common share:				
Basic	\$ 0.16	\$ 0.20	\$ 0.64	\$ 0.04
Diluted	\$ 0.16	\$ 0.19	\$ 0.63	\$ 0.04
Weighted average shares:				
Basic	10,888	10,775	10,869	10,757
Diluted	11,140	10,939	11,090	10,886

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

Table of Contents

Powell Industries, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows (unaudited)
(In thousands)

	Nine Months Ended July	
	31,	
	2006	2005
Operating Activities:		
Net income	\$ 6,995	\$ 411
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	4,906	3,244
Amortization of unearned restricted stock	138	91
Stock-based compensation	1,841	
Bad debt expense	254	30
Loss (gain) on disposition of assets	79	(21)
Net realized gain on available-for-sale securities		(28)
Deferred income taxes	(991)	(1,048)
Other	22	149
Changes in operating assets and liabilities:		
Accounts receivable, net	(18,681)	(19,961)
Costs and estimated earnings in excess of billings on uncompleted contracts	(4,238)	(5,680)
Inventories	(8,490)	(3,359)
Prepaid expenses and other current assets	2,174	(2,762)
Other assets	573	68
Accounts payable and income taxes payable	11,690	(770)
Accrued liabilities	5,578	128
Billings in excess of costs and estimated earnings on uncompleted contracts	(302)	1,473
Deferred compensation	(60)	351
Other liabilities	85	(37)
Net cash provided by (used in) operating activities	1,573	(27,721)
Investing Activities:		
Proceeds from sale of fixed assets	29	46
Proceeds from maturities and sales of available-for-sale securities		3,817
Purchases of property, plant and equipment	(4,803)	(3,226)
Proceeds from sale of short-term auction rate securities	8,200	43,060
Purchases of short-term auction rate securities		(5,000)
Acquisition of S&I		(18,460)
Acquisition of UMS	(1,524)	
Net cash provided by investing activities	1,902	20,237
Financing Activities:		
Borrowings on U.S. revolving line of credit	3,791	5,905
Payments on U.S. revolving line of credit	(3,791)	(5,905)

Edgar Filing: POWELL INDUSTRIES INC - Form 10-Q

Borrowings on UK term loan		10,598
Payments on UK term loan	(1,107)	
Payments on UK revolving line of credit	(913)	
Proceeds from short-term financing	897	
Payments on short-term financing	(160)	
Payments on capital lease obligations	(73)	(119)
Debt issue costs		(461)
Tax benefit from exercise of stock options	134	234
Proceeds from exercise of stock options	640	1,350
Net cash (used in) provided by financing activities	(582)	11,602
Net increase in cash and cash equivalents	2,893	4,118
Effect of exchange rate changes on cash and cash equivalents	96	
Cash and cash equivalents at beginning of period	24,844	8,974
Cash and cash equivalents at end of period	\$ 27,833	\$ 13,092

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

Table of Contents

POWELL INDUSTRIES, INC. AND SUBSIDIARIES

Notes To Condensed Consolidated Financial Statements (Unaudited)

A. OVERVIEW AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Overview

We develop, design, manufacture and service equipment and systems for the management and control of electrical energy and other critical processes. Headquartered in Houston, Texas, we serve the transportation, environmental, industrial, and utility industries. Our business operations are consolidated into two business segments: Electrical Power Products and Process Control Systems. Financial information related to these business segments is included in Note I herein.

Note B contains information related to our acquisitions of Switchgear & Instrumentation Limited in July 2005, herein referred to as S&I, and Utility Metering Specialists, Inc. in July 2006, herein referred to as UMS. The operating results of both acquisitions are included in our Electrical Power Products business segment.

Subsequent to the period covered by this report, we acquired certain assets from General Electric Company's Consumer and Industrial Division as described in Note K herein.

Basis of Presentation

The condensed consolidated financial statements include the accounts of Powell Industries, Inc. and its wholly-owned subsidiaries (we, us, our, Powell, or the Company). All significant intercompany accounts and transactions are eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared using accounting principles generally accepted in the United States of America (GAAP) for interim financial information in accordance with the rules of Regulation S-X of the Securities and Exchange Commission. Accordingly, these interim financial statements do not include all annual disclosures required by GAAP. These financial statements should be read in conjunction with the financial statements and related footnotes included in the Company's annual report on Form 10-K for the year ended October 31, 2005. In the opinion of management, these condensed consolidated financial statements include all adjustments, consisting of normal recurring adjustments that are necessary for a fair presentation of our financial position, results of operations and cash flows. The interim period results are not necessarily indicative of the results to be expected for the full fiscal year.

Use of Estimates

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

Table of Contents*Foreign Currency Translation*

The functional currency for our 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 in accordance with Statement of Financial Accounting Standards No. 52, *Foreign Currency Translation*. All assets and liabilities of foreign operations are translated into U.S. Dollars using period-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 (loss) in stockholders' equity.

Supplemental disclosures of cash flow information

	Nine Months Ended July 31,	
	2006	2005
Cash paid during the period for:		
Interest	\$ 934	\$ 326
Income taxes	2,645	562
Non-cash investing and financing activities:		
Change in fair value of marketable securities during the period, net of \$0 and \$9 income taxes, respectively	\$	\$ 26
Receivable for stock options exercised	24	
Issuance of common stock for deferred directors' fees	24	14
Restricted stock grants	129	
Unrealized gain on forward contracts		13
Unrealized foreign currency gain/(loss)	443	(67)
Accrued acquisition costs		485

Stock-Based Compensation

In the first quarter of fiscal 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123R). We adopted the new statement using the modified prospective method of adoption, which does not require restatement of prior periods. The revised standard eliminated the intrinsic value method of accounting for share-based employee compensation under APB Opinion No. 25, *Accounting for Stock-Based Compensation*, which we previously used (see pro-forma disclosure of prior period included herein). The revised standard generally requires the recognition of the cost of employee services for share-based compensation based on the grant date fair value of the equity or liability instruments issued and any unearned or deferred compensation (contra-equity accounts) related to awards prior to adoption be eliminated against the appropriate equity accounts. Also under the new standard, excess income tax benefits related to share-based compensation expense that must be recognized directly in equity are considered financing rather than operating cash flow activities. The effect of the adoption of the new standard on cash flows in the third quarter of 2006 was not material.

Under SFAS No. 123R, we continue to use the Black-Scholes option pricing model to estimate the fair value of our stock options. However, we will apply the expanded guidance under SFAS No. 123R for the development of our assumptions used as inputs for the Black-Scholes option pricing model for grants issued after November 1, 2005. Expected volatility is determined using historical volatilities based on historical stock prices for a period equal to the expected term. The expected volatility assumption is adjusted if future volatility is expected to vary from historical experience. The expected term of options represents the period of time that options granted are expected to be outstanding and falls between the option's vesting and contractual expiration dates. The risk-free interest rate is based on the yield at the date of grant of a zero-coupon U.S. Treasury bond whose maturity period equals the option's expected term.

Table of Contents

Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss), which is included as a component of stockholders' equity net of tax, includes unrealized gains or losses on available-for-sale marketable securities, derivative instruments and currency translation adjustments in foreign consolidated subsidiaries.

New Accounting Pronouncement

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the Company's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The provisions of FIN 48 are to be applied to all tax positions upon initial adoption of this standard. Only tax positions that meet the more likely than not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption of FIN 48. FIN 48 is effective for our fiscal year beginning October 1, 2007. The Company is currently evaluating the impact of adopting FIN 48.

Reclassifications

Certain reclassifications have been made in prior period financial statements to conform to current period presentation. These reclassifications had no effect on net income, financial position or cash flows.

B. ACQUISITION

Utility Metering Specialists, Inc. (UMS)

On July 14, 2006, we acquired certain assets and hired the service and administrative employees of an electrical services company in Louisiana for approximately \$1.5 million. The purchase price was paid from existing cash and short-term marketable securities. This acquisition allows us to extend sales and service to the Eastern Gulf Coast Region. As this acquisition is not material to the consolidated financial results or financial position of the Company, no additional disclosure is included in these Notes to Condensed Consolidated Financial Statements. Approximately \$1.5 million of the purchase price is included in intangible assets in the Condensed Consolidated Balance Sheets. The purchase price resulted primarily in additional intangible assets and as a result such amounts are subject to further adjustment as information becomes available.

Switchgear & Instrumentation Limited (S&I)

On July 4, 2005, we acquired selected assets and assumed certain operating liabilities and contracts of Switchgear & Instrumentation Limited. S&I's primary manufacturing facility is in the United Kingdom. This acquisition is part of our overall strategy to increase our international presence. S&I affords us the opportunity to serve our customers with products covering a wider range of electrical standards and opens new geographic markets previously closed due to a lack of product portfolio. The fit, culture and market position of Powell and S&I are favorably comparable with similar reputations in engineered-to-order solutions. S&I is a supplier of medium- and low-voltage switchgear, intelligent motor control systems, and power distribution solutions to a wide range of process industries, with a focus on oil and gas, petrochemical and other process-related industries. Total consideration paid for S&I was approximately \$18.0 million (excluding expenses of approximately \$1.2 million). Approximately \$10.3 million was funded from existing cash and investments and the balance was provided from

the UK Term Loan (as defined in Note F herein). The results of operations of S&I are included in our Condensed Consolidated Financial Statements from July 4, 2005. The Condensed Consolidated Balance Sheets include an allocation of the purchase price to the assets acquired and liabilities assumed based on estimates of fair value.

Table of Contents

The purchase price allocation was as follows (in thousands):

Accounts receivable	\$ 4,730
Costs and estimated earnings in excess of billings	4,492
Inventories	3,745
Prepaid expenses and other current assets	379
Property, plant and equipment	9,542
Intangible assets	3,846
Accounts payable	(5,793)
Billings in excess of costs and estimated earnings	(1,440)
Other accrued expenses	(334)
 Total purchase price	 \$ 19,167

The amounts assigned to property, plant and equipment were based on independent appraisals of the property and plant, as well as the more significant pieces of machinery and equipment.

The amounts allocated to intangible assets related to the S&I acquisition were as follows (in thousands):

	Amount	Estimated Life
Unpatented technology	\$ 2,175	7 years
Tradenames	1,025	10 years
Backlog	646	6 months
 Total	 \$ 3,846	

The unaudited pro forma data presented below reflects the results of Powell Industries, Inc. and the acquisition of S&I assuming the acquisition was completed on November 1, 2004 (in thousands, except per share data):

	Three Months Ended July 31, 2005	Nine Months Ended July 31, 2005
Revenues	\$ 73,791	\$ 213,880
Net income	\$ 1,458	\$ 246
Net earnings per common share:		
Basic	\$ 0.14	\$ 0.02
Diluted	\$ 0.13	\$ 0.02

The unaudited pro forma information includes the operating results of S&I prior to the acquisition date adjusted to include the pro forma impact of the following:

- 1) Impact of additional interest expense related to the portion of the purchase price financed with the UK Term Loan and lower interest income as a result of the sale of available-for-sale securities used to fund the remainder of the purchase price;
- 2) Elimination of the operating results of certain businesses of S&I which were not acquired;
- 3) Elimination of lease expense and recording of additional depreciation expense related to assets which were previously leased from S&I's previous parent;
- 4) Impact of amortization expense related to intangible assets;

5) Adjustment to the income tax provision to reflect the statutory rate in the United Kingdom. The unaudited pro forma results above do not purport to be indicative of the results that would have been obtained if the acquisition occurred as of the beginning of the period presented or that may be obtained in the future. Prior to the acquisition by Powell, S&I's operating results were reported under accounting principles generally accepted in the United Kingdom (UK GAAP). Revenues and costs related to long-term contracts accounted for under UK GAAP were not recognized on a percentage-of-completion basis of accounting. UK GAAP allows companies to recognize revenue on long-term contracts when the contract is complete (completed contract method). The unaudited pro forma results above were prepared based on the Company's best estimate of

Table of Contents

percentage-of-completion for long-term contracts under SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*.

C. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share data):

	Three Months Ended July		Nine Months Ended July	
	2006	31, 2005	2006	31, 2005
<i>Numerator:</i>				
Net income	\$ 1,757	\$ 2,132	\$ 6,995	\$ 411
<i>Denominator:</i>				
Denominator for basic earnings per share-weighted average shares	10,888	10,775	10,869	10,757
Dilutive effect of stock options	252	164	221	129
Denominator for diluted earnings per share-adjusted weighted average shares with assumed conversions	11,140	10,939	11,090	10,886
<i>Net earnings per share:</i>				
Basic	\$ 0.16	\$ 0.20	\$ 0.64	\$ 0.04
Diluted	\$ 0.16	\$ 0.19	\$ 0.63	\$ 0.04

Excluded from the computation of diluted earnings per share were options to purchase approximately 24,000 shares of common stock for the three and nine months ended July 31, 2006, and options to purchase approximately 24,000 and 297,000 shares of common stock for the three and nine months ended July 31, 2005, respectively. These options were excluded from the computation because the effect of the options was not dilutive as their exercise prices were greater than the average market price of our common stock.

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

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

	Three Months Ended July		Nine Months Ended July	
	2006	31, 2005	2006	31, 2005
Balance at beginning of period	\$ 756	\$ 678	\$ 567	\$ 617
Adjustments to the allowance	67	(35)	248	30
Deductions for uncollectible accounts written off, net of recoveries	1		6	(4)

Edgar Filing: POWELL INDUSTRIES INC - Form 10-Q

Increase due to foreign currency translation	1		4	
Balance at end of period	\$ 825	\$ 643	\$ 825	\$ 643

10

Table of Contents*Warranty Accrual*

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

	Three Months Ended July		Nine Months Ended July	
	31, 2006	2005	31, 2006	2005
Balance at beginning of period	\$ 3,337	\$ 1,373	\$ 1,836	\$ 1,545
Adjustments to the accrual	848	441	3,159	1,078
Deductions for warranty charges	(816)	(207)	(1,652)	(1,016)
Increase due to foreign currency translation	15		41	
Balance at end of period	\$ 3,384	\$ 1,607	\$ 3,384	\$ 1,607

For the three and nine months ended July 31, 2006, our warranty accrual includes approximately \$0.8 million for estimated costs related to the resolution of a specific product performance issue that was identified in the second quarter of 2006.

Inventories

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

	July 31, 2006	October 31, 2005
Raw materials, parts and subassemblies	\$ 17,342	\$ 12,794
Work-in-progress	12,953	8,822
Total Inventories	\$ 30,295	\$ 21,616

Costs and Estimated Earnings on Uncompleted Contracts

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

	July 31, 2006	October 31, 2005
Costs incurred on uncompleted contracts	\$ 274,914	\$ 293,741
Estimated earnings	59,709	55,360
	334,623	349,101
Less: Billings to date	310,393	329,515
	\$ 24,230	\$ 19,586

Included in the accompanying balance sheets under the following captions:

Costs and estimated earnings in excess of billings on uncompleted contracts	\$ 39,767	\$ 35,328
Billings in excess of costs and estimated earnings on uncompleted contracts	(15,537)	(15,742)
	\$ 24,230	\$ 19,586

E. COMPREHENSIVE INCOME

Edgar Filing: POWELL INDUSTRIES INC - Form 10-Q

Comprehensive income for the three and nine months ended July 31, 2006 and 2005 is as follows (in thousands):

	Three Months Ended July		Nine Months Ended July	
	31,		31,	
	2006	2005	2006	2005
Net income	\$ 1,757	\$ 2,132	\$ 6,995	\$ 411
Other comprehensive income, net of tax				
Unrealized gain (loss) on marketable securities		2		(26)
Unrealized gain (loss) on foreign currency translation	(51)	(48)	443	(67)
Unrealized gain on fair value hedge		13		13
Comprehensive income	\$ 1,706	\$ 2,099	\$ 7,438	\$ 331

Table of Contents**F. LONG-TERM DEBT***US and UK Revolvers*

On June 29, 2005, we entered into a new senior credit agreement (*Credit Agreement*) with a major domestic bank and certain other financial institutions which replaced our existing revolving line of credit. The *Credit Agreement* also replaced an existing letter of credit facility used to guarantee payment of our existing loan agreement that was funded with proceeds from tax-exempt industrial development revenue bonds. This expanded credit facility was put in place to partially fund the acquisition of and provide working capital support for S&I.

The *Credit Agreement* provides for a 1) \$22.0 million revolving credit facility (*US Revolver*), 2) £4.0 million (pound sterling) (approximately \$7.0 million) revolving credit facility (*UK Revolver*) and 3) £6.0 million (approximately \$10.7 million) single advance term loan (*UK Term Loan*). The *Credit Agreement* contains customary affirmative and negative covenants and restricts our ability to pay dividends. In addition, there are various restrictive covenants pertaining to maintenance of net worth and certain financial ratios. Obligations are secured by the stock of our subsidiaries. The interest rate for amounts outstanding under the *Credit Agreement* is a floating rate based upon LIBOR plus a margin which can range from 1.25% to 2.25%, as determined by the Company's consolidated leverage ratio as defined in the *Credit Agreement*.

The *US Revolver* and the *UK Revolver* provide for the issuance of letters of credit which would reduce the amounts which may be borrowed under the respective revolvers. The amount available under this agreement is reduced by \$11.9 million for our outstanding letters of credit at July 31, 2006. There was £1.9 million, or approximately \$3.5 million, outstanding under the *UK Revolver* as of July 31, 2006, with interest rates ranging from 5.60% to 5.635%. No amounts were borrowed on the *US Revolver* as of July 31, 2006. The *US Revolver* and the *UK Revolver* expire on June 30, 2008.

UK Term Loan

The *UK Term Loan* is a single advance term loan of £6.0 million, or approximately \$10.7 million, used for financing the acquisition of S&I. Approximately £5.0 million, or approximately \$8.9 million, of this facility was used to finance the portion of the purchase price of S&I that was denominated in pounds sterling. The remaining £1.0 million, or approximately \$1.8 million, was utilized as the initial working capital for S&I. Quarterly installments of £300,000, or approximately \$532,000, began March 31, 2006, with the final payment due on March 31, 2010. As of July 31, 2006, £5.4 million, or approximately \$10.1 million of the *UK Term Loan* was outstanding and the per annum interest rate was 5.75%.

Expenses associated with the issuance of the *Credit Agreement* are classified as deferred loan costs and totaled \$501,000 and are being amortized as a non-cash charge to interest expense over the term of the agreement (three years).

Tax Exempt Industrial Development Revenue Bonds

We borrowed \$8.0 million in October 2001 through a loan agreement funded with proceeds from tax-exempt industrial development revenue bonds (*Bonds*). These *Bonds* were issued by the Illinois Development Finance Authority and were used for the completion of our Northlake, Illinois facility. While the *Bonds* mature in 2021, the reimbursement agreement requires annual redemptions of \$400,000. A sinking fund is used for the redemption of the *Bonds*. The *Bonds* bear interest at a floating rate determined weekly by the *Bonds* remarketing agent, which was the underwriter for the *Bonds* and is an affiliate of the bank. At July 31, 2006, approximately \$6.4 million was outstanding on the *bonds* and the interest rate is based on similar types of short-term municipal securities and was

3.73% per annum on July 31, 2006.

We are currently engaged in an audit with the Internal Revenue Service (IRS) related to our tax exempt industrial development revenue bonds. We have furnished the IRS with various requested materials in connection with the audit. The IRS is reviewing these materials and has not yet informed us as to their conclusions. Based on discussions with the IRS, management does not believe the outcome will have a material impact on its consolidated financial position or results of operations.

Table of Contents

Capital Leases

Some machinery and equipment used in our manufacturing facilities was financed through capital lease agreements. These capital lease agreements are collateralized by the leased property. The capital lease obligations are at a fixed interest rate of 3%.

G. COMMITMENTS AND CONTINGENCIES

Letters of Credit and Bonds

Certain customers require us to post a bank letter of credit guarantee or performance bonds issued by a surety. These guarantees and performance bonds assure our customers that we will perform under terms of our contract. In the event of default, the customer may demand payment from the bank under a letter of credit or performance by the surety under a performance bond. To date, there have been no significant expenses related to either for the periods reported. We were contingently liable for secured and unsecured letters of credit of \$12.5 million as of July 31, 2006. We also had performance bonds totaling approximately \$125.3 million outstanding at July 31, 2006.

In November 2005, we entered into a new facility agreement (Facility Agreement) with a large international bank. The Facility Agreement provides for 1) £15.0 million in bonds (approximately \$26.0 million), 2) £1.5 million of forward exchange contracts and currency options (approximately \$2.6 million), and 3) the issuance of bonds and the entering into of forward exchange contracts and currency options. At July 31, 2006, we had outstanding bonds of £0.6 million, or approximately \$1.1 million.

Contingencies

The Company previously entered into a construction joint venture agreement to supply, install, and commission a Supervisory Control and Data Acquisition System (SCADA) to monitor and control the distribution and delivery of fresh water to the City and County of San Francisco Public Utility Commission (Commission). The project was substantially completed and has been performing to the satisfaction of the Commission. However, various factors outside of the control of the Company and its joint venture partner caused numerous changes and additions to the work that in turn delayed the completion of the project. The Commission has withheld liquidated damages and earned contract payments from the joint venture. The Company has made claims against the Commission for various matters including compensation for extra work and delay to the project.

The Company is currently pursuing the recovery of amounts owed under the contract, as well as legal and other costs incurred to prosecute its claim. Unless this matter is otherwise resolved, this claim is scheduled to go to trial in 2006. As of July 31, 2006, the Company had approximately \$1.6 million recorded in the consolidated balance sheet for contractually owed amounts in accounts receivable and costs and estimated earnings in excess of billings on uncompleted contracts related to its portion of this contract. Consistent with Company policy, only revenue to the extent of costs of directed change orders have been recorded by the Company. No amounts have been recorded by the Company related to the Company's claims and counterclaims alleging breach of the agreement. Although a failure to recover the amounts recorded could have a material adverse effect on the Company's results of operations, the Company believes that, under the circumstances and on the basis of information now available, an unfavorable outcome is unlikely.

The Company was a party to a construction joint venture (the Joint Venture), which provided process control systems to the Central Artery/Tunnel Project (the Project) in Boston, Massachusetts under a contract with the Massachusetts Turnpike Authority (the MTA). The Joint Venture submitted claims against the MTA seeking

additional reimbursement for work done by the Joint Venture on the project. These claims were settled and resulted in a net increase in the contract amount of approximately \$2.0 million, of which \$1.5 million was reflected as additional revenues by the Company for the three and nine months ended July 31, 2005.

See Note F for discussion related to our tax exempt industrial development revenue bonds.

H. STOCK-BASED COMPENSATION

Refer to the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 2005 for a full description of the Company's stock-based compensation plans.

Table of Contents*Modification to Stock Option Vesting*

In July 2006, the Compensation Committee of the Board of Directors modified the vesting requirements for stock options upon retirement. The Committee voted to automatically vest granted options upon retirement at age 60 with 10 years of service or at age 62 regardless of service. Stock options are vested at retirement and will remain exercisable for the remaining life of the option. All other terms of stock options remain the same.

In accordance with SFAS No. 123R, we recognized approximately \$0.9 million in non-cash compensation expense in the third quarter of 2006 related to the modification. This non-cash expense was recorded in selling, general and administrative expenses in July 2006. After the modification adjustment, there is \$1.8 million of unrecognized non-cash compensation expense related to non-vested stock options at July 31, 2006. Of the \$1.8 million unrecognized compensation expense, \$0.5 million will be expensed over a revised weighted-average period of approximately 1.7 years. The remaining \$1.3 million is expected to be recognized over a weighted-average period of approximately 2.1 years. In addition, at July 31, 2006, there was approximately \$0.1 million of total unrecognized compensation expense related to restricted stock which is expected to be recognized over a period of less than one year.

Pro Forma Earnings Per Share

The following table presents the pro forma effect on net income and earnings per share as if we had applied the fair value recognition to stock-based compensation prior to the adoption of SFAS No. 123R during the three and nine month period ended July 31, 2005 (in thousands except per share amounts):

	Three Months Ended July 31, 2005	Nine Months Ended July 31, 2005
Net income as reported	\$ 2,132	\$ 411
Less: Stock option compensation expense, net of taxes	(185)	(504)
 Net income (loss) pro forma	 \$ 1,947	 \$ (93)
 Basic earnings (loss) per share:		
As reported	\$ 0.20	\$ 0.04
Pro forma	\$ 0.18	\$ (0.01)
 Diluted earnings (loss) per share:		
As reported	\$ 0.19	\$ 0.04
Pro forma	\$ 0.18	\$ (0.01)

Table of Contents*Stock Options*

Stock option activity for the nine months ended July 31, 2006 is as follows:

	Stock Options	Weighted- Average Exercise Price	Remaining Weighted-Average Contractual Term (years)	Aggregate Intrinsic Value (in thousands)
Outstanding at October 31, 2005	908,690	\$ 16.37		
Granted				
Exercised	44,800	14.82		
Forfeited				
Outstanding at July 31, 2006	863,890	16.45	4.07	\$ 4,567
Exercisable at July 31, 2006	643,610	16.11	3.49	\$ 3,605

I. BUSINESS SEGMENTS

We manage our business through operating subsidiaries, which are comprised of two reportable business segments: Electrical Power Products and Process Control Systems. Electrical Power Products includes equipment and systems for the distribution and control of electrical energy. Process Control Systems consists principally of instrumentation, computer controls, communications, and data management systems to control and manage critical processes.

On July 14, 2006, we acquired certain assets and hired the service and administrative employees of an electrical services company in Louisiana (UMS). The operating results of UMS are included in our Electrical Power Products business segment as of that date.

On July 4, 2005, we acquired selected assets and assumed certain operating liabilities and contracts of Switchgear & Instrumentation Limited in the United Kingdom (S&I). The operating results and tangible assets of S&I are included in our Electrical Power Products business segment as of that date.

The tables below reflect certain information relating to our operations by segment. All revenues represent sales from unaffiliated customers. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. Corporate expenses and certain assets are allocated to the operating segments primarily based on revenues. The corporate assets are mainly cash, cash equivalents, and marketable securities.

Detailed information regarding our business segments is shown below (in thousands):

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2006	2005	2006	2005
Revenues:				
Electrical Power Products	\$ 96,896	\$ 58,214	\$ 265,413	\$ 146,362
Process Control Systems	7,125	8,701	20,852	27,156

Edgar Filing: POWELL INDUSTRIES INC - Form 10-Q

Total	\$ 104,021	\$ 66,915	\$ 286,265	\$ 173,518
Gross profit:				
Electrical Power Products	\$ 17,431	\$ 9,221	\$ 49,277	\$ 20,403
Process Control Systems	1,662	3,340	5,336	7,559
Total	\$ 19,093	\$ 12,561	\$ 54,613	\$ 27,962
Income (loss) before income taxes and minority interest:				
Electrical Power Products	\$ 2,942	\$ 994	\$ 10,779	\$ (3,140)
Process Control Systems	167	1,839	893	2,878
Total	\$ 3,109	\$ 2,833	\$ 11,672	\$ (262)

	July 31, 2006	October 31, 2005
Identifiable tangible assets:		
Electrical Power Products	\$ 208,509	\$ 172,544
Process Control Systems	10,406	10,762
Corporate	28,648	39,013
Total	\$ 247,563	\$ 222,319

Table of Contents

In addition, the Electrical Power Products business segment had \$203,000 and \$203,000 of goodwill and \$4,625,000 and \$3,505,000 of intangible assets as of July 31, 2006 and October 31, 2005, respectively. Additionally, Corporate had \$1,079,000 and \$632,000 of deferred loan costs and other assets as of July 31, 2006 and October 31, 2005, respectively, which are not included in identifiable tangible assets above.

J. CONSOLIDATION OF OPERATIONS

To reduce overhead costs and improve efficiency, we initiated a consolidation plan in fiscal 2004 to reduce the number of operating locations within our Electrical Power Products segment. The majority of the costs related to this consolidation related to severance and employee benefit expenses for involuntary terminations in 2004. During the first nine months of fiscal 2005, \$66,000 of additional shutdown costs and write downs of fixed assets were expensed and included in the Condensed Consolidated Statements of Operations.

K. SUBSEQUENT EVENT

On August 7, 2006, we purchased certain assets related to the American National Standards Institute (ANSI) medium voltage switchgear and circuit breaker business of General Electric Company s (GE) Consumer & Industrial unit located at its West Burlington, Iowa facility for \$32 million, not including expenses. An initial payment of \$8.5 million was paid at closing from existing cash and short-term marketable securities with the remainder payable in four installments every 10 months over the next 40 months of \$5.5 million, \$6.25 million, \$6.25 million and \$5.5 million, respectively. The deferred installments result in a discounted purchase price of approximately \$28.8 million. We are also required to purchase the remaining inventory for additional consideration and have the option to purchase additional equipment after completion of the transition and product relocation to Houston, Texas.

In connection with the acquisition, we entered into a 15 year supply agreement with GE pursuant to which GE will purchase from the Company (subject to limited conditions for exceptions) all of its requirements for ANSI medium voltage switchgear and circuit breakers and other related equipment and components. We have also agreed to purchase certain of our required product components and subassemblies from GE. In addition, GE has agreed to provide services related to transitioning the product line from West Burlington, Iowa to the Company s Houston, Texas facility.

In connection with the acquisition, we entered into a lease agreement for a facility in Houston, Texas, which increased our manufacturing space by approximately 140,000 square feet. The lease will cost approximately \$34,000 per month.

Additionally, we amended our existing Credit Agreement with Bank of America, N.A. to increase the US Revolver by \$20.0 million to \$42.0 million. This increase in our credit facility was made to assist with future payments related to the GE acquisition and to finance the increase in working capital associated with the start-up, relocation and operation of the product line. This amended line of credit expires on December 31, 2010. Certain financial covenants were changed in conjunction with this amendment to our credit facility.

Table of Contents**Item 2. Management's Discussion And Analysis Of Financial Condition And Results Of Operations**

The following discussion of our financial condition and results of operations should be read in conjunction with the accompanying condensed consolidated financial statements and related notes included elsewhere in this Form 10-Q and our Annual Report on Form 10-K as filed with the Securities and Exchange Commission for the year ended October 31, 2005. In the course of operations, we are subject to certain risk factors, including but not limited to competition and competitive pressures, sensitivity to general economic and industry conditions, international political and economic risks, availability and price of raw materials and execution of business strategy. Any forward-looking statements made by or on our behalf are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Readers are cautioned that such forward-looking statements involve risks and uncertainties in that actual results may differ materially from those projected in the forward-looking statements.

Overview

We develop, design, manufacture, and service equipment and systems for the management and control of electrical energy and other critical processes. Headquartered in Houston, Texas, we serve the transportation, environmental, industrial, and utility industries. Our business operations are consolidated into two business segments: Electrical Power Products and Process Control Systems. On July 4, 2005, we acquired selected assets and assumed certain operating liabilities and contracts of Switchgear and Instrumentation Limited in the United Kingdom. The acquired business is referred to herein as S&I. The operating results of S&I are included in our Electrical Power Products business segment as of July 4, 2005. Financial information related to these business segments is included in Note I of the Notes to Condensed Consolidated Financial Statements.

Results of Operations*Revenue and Gross Profit*

Consolidated revenues increased \$37.1 million to \$104.0 million in the third quarter of fiscal 2006 compared to third quarter 2005 revenues of \$66.9 million. Revenues increased primarily due to general market recovery, concerted sales efforts in 2005 aimed at strengthening our backlog and the acquisition in early July 2005 of S&I. The acquisition of S&I added revenues of \$13.8 million and \$3.0 million, all outside the United States (International), in the third quarter of fiscal 2006 and 2005, respectively. For the three months ended July 31, 2006, domestic revenues increased by 53.4% to \$71.7 million. Total International revenues were \$32.3 million in the third quarter of 2006 compared to \$20.1 million in the same quarter of the prior year. International revenues increased primarily due to the acquisition of S&I. Gross profit for the third quarter of 2006 increased by approximately \$6.5 million as a result of improved backlog volume and pricing, coupled with the acquisition of S&I.

For the nine months ended July 31, 2006, consolidated revenues increased \$112.8 million to \$286.3 million compared to the nine months ended July 31, 2005 of \$173.5 million. The acquisition of S&I added revenues of \$40.7 million and \$3.0 million, all International, in the first nine months of fiscal 2006 and 2005, respectively. Domestic revenues for the first nine months of fiscal 2006 were \$200.5 million compared to \$138.0 million for the first nine months of fiscal 2005. Total International revenues were \$85.7 million for the first nine months of fiscal 2006 compared to \$35.6 million for the same period of last year. For the nine months ended July 31, 2006, International revenue accounted for 30% of consolidated revenues compared to 20% for the same period a year ago; the increase was primarily due to the acquisition of S&I. Gross profit for the first nine months of fiscal 2006 increased by approximately \$26.7 million as a result of improved backlog volume and pricing, coupled with the acquisition of S&I. The increase in gross profit was partially offset by \$0.8 million for estimated costs related to the resolution of a specific product performance issue.

Electrical Power Products

Our Electrical Power Products segment recorded revenues of \$96.9 million in the third quarter of 2006, which includes revenues of \$13.8 million from the acquisition of S&I, compared to \$58.2 million for the same period of the previous year. During the third quarter of fiscal 2006, revenues in all our major markets strengthened compared to the same period of the prior year. In the third quarter of fiscal 2006, revenues from public and private utilities were approximately \$28.1 million, an increase of \$0.2 million compared to the third quarter of fiscal 2005. Revenues from industrial customers totaled \$54.9 million in the third quarter of fiscal 2006 compared to \$28.7 million in the same period of the prior year. Municipal and transit projects generated revenues of \$14.0 million in the third quarter of

fiscal 2006 compared to \$1.6 million in the same period a year ago.

For the nine months ended July 31, 2006, this segment recorded revenues of \$265.4 million, which includes revenues of \$40.7 million from the acquisition of S&I, compared to \$146.4 million for the first nine months of fiscal 2005.

Utility revenues totaled \$84.5 million, an increase of approximately 19.4% over prior year. Industrial revenues were \$151.8 million compared to \$68.2 million a year ago and revenues from municipal and transit projects totaled \$29.0 million compared to \$7.4 million for the same period of last year.

The gross profit from the Electrical Power Products segment increased, as a percentage of revenues, to 18.0% in the third quarter of fiscal 2006, compared to 15.8% in the third quarter of fiscal 2005. This increase in gross profit resulted from improved pricing, operating efficiencies resulting from increased volume, as well as service and replacement projects resulting from the hurricanes of 2005 along the Gulf Coast Region. Material costs increased approximately \$1.6 million in the third quarter of fiscal 2006 compared to the same period a year ago, primarily due to higher unit prices for copper.

Table of Contents

For the nine months ended July 31, 2006, gross profit as a percentage of revenues increased to 18.6% from 13.9% in the first nine months of fiscal 2005. This increase in gross profit resulted from improved pricing, operating efficiencies resulting from increased volume, as well as increased services and replacement projects resulting from the hurricanes of 2005 along the Gulf Coast Region. Direct material costs increased approximately 1.7%, or \$2.4 million, during the first nine months of 2006 compared to the same period a year ago primarily due to higher unit prices for copper. In addition, incremental production costs of approximately \$0.6 million were incurred during the first nine months of fiscal 2005 due to start-up difficulties and inefficiencies with our recently relocated distribution switch product line.

Process Control Systems

Revenues in our Process Control Systems segment decreased to \$7.1 million in the third quarter of fiscal 2006 from \$8.7 million for the same period of the prior year. For the nine months ended July 31, 2006, segment revenues decreased to \$20.9 million compared to \$27.2 million in the same period last year. These decreases in revenue are attributable to a decrease in the proportion of subcontracted installation activities. As discussed in Note G of the Notes to Condensed Consolidated Financial Statements, Process Control Systems recorded additional revenue and profit of \$1.5 million from the settlement of a claim related to the Central Artery/Tunnel Project in the third quarter of 2005. Segment gross profit decreased to \$1.7 million compared to \$3.3 million in the third quarter of 2005 primarily related to the settlement of the claim related to the Central Artery/Tunnel Project mentioned above. Gross profit was negatively impacted by approximately \$0.5 million and \$0.9 million in the third quarter of 2006 and 2005, respectively, primarily due to legal costs incurred related to the recovery of amounts owed on a previously completed contract. For the nine months ended July 31, 2006, segment gross profit decreased to \$5.3 million compared to \$7.6 million in the same period last year primarily related to the settlement of the claim related to the Central Artery/Tunnel Project. In addition, gross profit was negatively impacted by approximately \$1.1 million and \$1.2 million for the nine months ended July 31, 2006 and 2005, respectively, due to legal costs incurred related to the recovery of amounts owed on a previously completed contract.

For additional information related to our business segments, see Note I of the Notes to Condensed Consolidated Financial Statements.

Consolidated Selling, General, and Administrative Expenses

Consolidated selling, general, and administrative expenses increased to 15.1% of revenues in the third quarter of 2006 compared to 14.8% of revenues in the same period of last year. Selling, general, and administrative expenses were \$15.7 million, an increase of \$5.8 million over the same period last year, of which the operating activities of S&I accounted for \$1.7 million of the increase. In the first quarter of fiscal 2006, we adopted SFAS No. 123 (Revised 2004), *Share-Based Payment* (SFAS No. 123R), which required us to expense the estimated non-cash compensation related to stock options. In July 2006, we accelerated vesting on stock options of employees of retirement age. This accelerated vesting resulted in the recognition of an additional \$0.9 million of non-cash compensation expense in accordance with SFAS No. 123R. The non-cash compensation expense and the vesting modification related to stock options increased selling, general, and administrative expenses by approximately \$1.1 million in the third quarter of fiscal 2006. In addition, we recorded additional sales tax expense of \$0.3 million due to an unfavorable outcome from a state audit. The remainder of this increase of \$2.7 million is primarily attributable to increased salaries, incentive wages and bonuses which are consistent with the increase in earnings. Consolidated selling, general and administrative expenses decreased to 14.9% of revenues in the first nine months of fiscal 2006 compared to 16.6% of revenues in the same period of last year. Selling, general and administrative expenses were \$42.5 million, an increase of \$13.8 million over the same period last year, of which the operating activities of S&I accounted for \$6.2 million of the increase. For the nine months ended July 31, 2006, research and development expenditures were \$3.4 million compared to \$1.8 million in the first nine months of fiscal 2005. The adoption of SFAS No. 123R and the vesting modification increased selling, general, and administrative expenses by approximately \$1.8 million in the first nine months of fiscal 2006. Salaries and incentive wages increased by approximately \$2.6 million in the first nine months of fiscal 2006 compared to the first nine months of fiscal 2005. In addition, we recorded additional sales tax expense of \$0.3 million due to an unfavorable outcome from a state audit. The remaining increase of \$1.3 million is primarily attributable to increased legal and accounting fees and sales and

use taxes.

Interest Income and Expense

Interest expense was approximately \$0.5 million in the third quarter of fiscal 2006, an increase of approximately \$0.3 million compared to the same period in fiscal 2005. For the nine months ended July 31, 2006, interest expense was \$1.1 million

Table of Contents

compared to \$0.3 million in the same period of last year. The increase in interest expense is primarily due to additional debt incurred to partially finance the acquisition of S&I and interest payments to state taxing authorities. Interest income was \$0.2 million in the third quarter of 2006 compared to \$0.3 million in the third quarter of 2005. For the nine months ended July 31, 2006, interest income was \$0.7 million compared to \$0.9 million in the same period of last year.

Provision for Income Taxes

Our provision (benefit) for income taxes reflects an effective tax rate on earnings before income taxes of 43.3% in the third quarter of fiscal 2006 compared to 24.5% in the third quarter of fiscal 2005 and an effective rate of 39.9% in the first nine months of fiscal 2006 compared to a tax benefit of (259.5%) in the first nine months of fiscal 2005. Our effective tax rate will generally be lower due to income generated in the United Kingdom which has a lower statutory rate than the United States; however, the lower statutory rate will be offset by certain expenses that are not deductible for tax purposes in the United Kingdom, such as amortization of intangible assets.

The tax rate for the third quarter and the nine month period ended July 31, 2005 resulted from a change in estimate on our Extraterritorial Income Exclusion Benefit on the prior year federal tax return and the reversal of state income tax accruals from previous years due to the expiration of the statutory limitations. The overall effective tax rate improved as a result of the favorable tax impact of approximately \$0.8 million of pretax deductions resulting from the reconciliation of the income tax provision to the prior year income tax return.

In addition, adjustments to estimated tax accruals are analyzed and adjusted quarterly as events occur to warrant such change. Adjustments to tax accruals are a component of the effective tax rate.

Net Income

In the third quarter of 2006, we generated net income of \$1.8 million, or \$0.16 per diluted share, compared to \$2.1 million, or \$0.19 per diluted share, in the third quarter of fiscal 2005. For the nine months ended July 31, 2006, we recorded net income of \$7.0 million, or \$0.63 per diluted share, compared to \$0.4 million, or \$0.04 per diluted share for the first nine months of 2005. Higher revenues and improved gross profits in our Electrical Power Products business segment, partially offset by increased selling, general and administrative expenses associated with higher levels of business activity including the effect of the S&I acquisition, have improved net income in 2006 compared to the same periods a year ago. These increases were partially offset by the reduction in net income in 2006 by non-cash compensation expense related to stock options and additional sales tax expense recorded due to an unfavorable outcome from a state audit. Additionally, net income in 2005 was increased by the favorable settlement of the Central/Artery Tunnel Project.

Backlog

The order backlog on July 31, 2006 was \$287.4 million, compared to \$259.0 million at fiscal year end 2005 and \$250.8 million at the end of the third quarter one year ago. New orders placed during the third quarter of 2006 totaled \$122.2 million compared to \$135.4 million in the same period one year ago.

Liquidity and Capital Resources

Working capital was \$108.4 million at July 31, 2006, compared to \$103.4 million at October 31, 2005. As of July 31, 2006, current assets exceeded current liabilities by 2.4 times and our debt to capitalization ratio was 11.9%.

As of July 31, 2006, we had cash, cash equivalents, and marketable securities of \$27.8 million compared to \$33.0 million as of October 31, 2005. Long-term debt and capital lease obligations, net of current maturities, totaled \$17.5 million at July 31, 2006, compared to \$19.4 million at October 31, 2005. In addition to our long-term debt, we have a \$22.0 million revolving credit agreement in the United States and £4.0 million (approximately \$7.0 million) revolving credit agreement in the United Kingdom expiring June 2008. As of July 31, 2006, there was £1.9 million, or approximately \$3.5 million, outstanding under the UK Revolver (as defined in Note F to Condensed Consolidated Financial Statements). No amounts were borrowed on the US Revolver as of July 31, 2006. We were in compliance with all debt covenants as of July 31, 2006.

Table of Contents

As of July 31, 2006, we had \$10.1 million available on the US Revolver and £2.1 million, or approximately \$3.8 million, available on the UK Revolver.

Operating Activities

For the nine months ended July 31, 2006 cash provided by operating activities was \$1.6 million compared to cash used in operating activities of \$27.7 million in the same period of 2005. A year ago, the reduction in cash was principally used to fund growth in accounts receivable, inventories and costs related to projects which could not be billed under the contract terms.

Investing Activities

Cash used for the purchase of property, plant, and equipment during the nine months ended July 31, 2006, was \$4.8 million compared to \$3.2 million for the same period of the prior year. The majority of our 2006 capital expenditures were used to implement our new Enterprise Resource Planning System (ERP System), which is expected to be completed by the end of calendar year 2006 in the United States and early in calendar year 2007 at S&I. Cash of \$1.5 million was also used for the acquisition of UMS. A year ago, the majority of our capital expenditures were used to improve our capabilities to manufacture switchgear and electrical power control rooms. The Company also used \$18.5 million for the acquisition of S&I in July 2005.

Proceeds from the sale of short-term auction rate securities for the nine months ended July 31, 2006 and 2005 were \$8.2 million and \$43.1 million, respectively.

Financing Activities

Cash used in financing activities was \$0.6 million for the nine months ended July 31, 2006 compared to cash provided by financing activities of \$11.6 million in the same period a year ago. The primary use of cash for the nine months ended July 31, 2006 was to repay approximately \$2.0 million of UK debt, offset in part by, proceeds from stock options and proceeds from a short-term financing agreement associated with the implementation of our new ERP System.

Outlook

We expect our principal markets to remain steady throughout the balance of 2006 and into 2007. Customer inquiries, or requests for proposals have remained strong during the second half of fiscal 2005 and into 2006. One of the positive trends we have experienced is strong new order activity. New orders in the third quarter of 2006 totaled \$122.2 million compared to \$135.4 million in the same period one year ago. Our new orders in the third quarter of 2005 included our previously announced \$51.0 million contract with the Washington Metropolitan Area Transit Authority. We are cautiously optimistic that we will continue to experience a strong level of bookings throughout fiscal 2006 and into early 2007.

In our Electrical Power Products segment, new orders in the third quarter of 2006 totaled \$120.5 million compared to \$128.4 million in the same period one year ago. Our new orders in the third quarter of 2005 included our previously announced \$51.0 million contract with the Washington Metropolitan Area Transit Authority. We believe that improved market pricing and increased volume along with our continued focus on cost containment should result in increased gross margins over historical trends. Raw material costs such as copper continue to negatively impact our gross margins; however, we believe raw material prices have become less volatile and their impact on our costs should be reduced in the future. Although our Process Control Systems segment continues to experience soft market conditions, we anticipate increased funding for municipal projects will be available as general economic conditions strengthen. We believe we are well positioned to take advantage of improved economic conditions.

We anticipate that we may need to continue to reinvest a portion of our cash in operating working capital for the remainder of fiscal 2006 and into 2007 due to increased business activity and the recent acquisition from GE. We believe that working capital, borrowing capabilities, and cash generated from operations will be sufficient to finance the anticipated operational activities, capital improvements, debt repayments, and possible future acquisitions for the foreseeable future.

Table of Contents**Item 3. *Quantitative And Qualitative Disclosures About Market Risk***

We are exposed to certain market risks arising from transactions we have entered into in the normal course of business. These risks primarily relate to fluctuations in interest rates, foreign exchange rates and commodity prices. Amounts invested in our foreign operations are translated into U.S. Dollars at the exchange rate in effect at the end of the period reported. The resulting translation adjustments are recorded as accumulated other comprehensive income, a component of stockholders' equity, in our condensed consolidated balance sheets. We believe the exposure to the effects that fluctuating foreign currencies have on our condensed consolidated results of operations is limited because the foreign operations primarily invoice customers and collect obligations in their respective currencies or U.S. Dollars. The Company's net exposure on its investment in S&I is offset by the UK Term Loan which is payable in pound sterling. Additionally, expenses associated with these transactions are generally contracted and paid for in the same local currencies.

We are subject to market risk resulting from changes in interest rates related to our outstanding debt. Regarding our various debt instruments outstanding at July 31, 2006 and October 31, 2005, a 100 basis point increase in interest rates would result in a total annual increase in interest expense of approximately \$200,000. While we do not currently have any derivative contracts to hedge our exposure to interest rate risk, we have in the past and may in the future enter into such contracts. Overall, we believe that changes in interest rates will not have a material near-term impact on our future earnings or cash flows. During each of the past three years, we have not experienced a significant effect on our business due to changes in interest rates.

We are subject to market risk from fluctuating market prices of certain raw materials. While such materials are typically available from numerous suppliers, commodity raw materials are subject to price fluctuations. We attempt to pass along such commodity price increases to our customers on a contract-by-contract basis to avoid profit margin erosion. While we may do so in the future, we have not entered into any derivative contracts to hedge our exposure to commodity risk in fiscal years 2006 or 2005. We continue to experience significant price pressures with some of our key raw materials. Competitive market pressures limited our ability to pass these cost increases to our customers, thus eroding our earnings in 2005. While improved market prices have allowed us to offset these cost increases, the long-term nature of our contracts expose us to cost increases which may negatively impact our profit on a particular contract. Fluctuations in commodity prices could have a material effect on our future earnings and cash flows.

Item 4. *Controls And Procedures*

Management, with the participation of our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based on such evaluation, our CEO and CFO have each concluded that as of the end of such period, our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate, to allow timely decisions regarding required disclosures.

We also maintain a system of internal accounting controls that are designed to provide reasonable assurance that our books and records accurately reflect our transactions and that our policies and procedures are followed. During the third quarter of 2006, management replaced its production and general ledger software at one of its divisions with Oracle. This conversion to Oracle involved various changes to internal processes and control procedures over financial reporting; however, the basic internal controls over financial reporting have not materially changed as a result of the Oracle implementation. There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II OTHER INFORMATION

Item 1. *Legal Proceedings*

The Company previously entered into a construction joint venture agreement to supply, install, and commission a Supervisory Control and Data Acquisition System (SCADA) to monitor and control the distribution and delivery of fresh water to the City and County of San Francisco Public Utility Commission (Commission). The project was substantially completed and has been performing to the satisfaction of the Commission. However, various factors outside of the control of the Company and its joint venture partner caused numerous changes and additions to the work that in turn delayed the completion of the project. The Commission has withheld liquidated damages and earned contract payments from the joint venture. The Company has made claims against the Commission for various matters including compensation for extra work and delay to the project.

The Company is currently pursuing the recovery of amounts owed under the contract, as well as legal and other costs incurred to prosecute its claim. Unless this matter is otherwise resolved, it is expected to go to trial in 2006 in Alameda County Superior Court, State of California. As of July 31, 2006, the Company had approximately \$1.6 million recorded in the consolidated balance sheet for contractually owed amounts in accounts receivable and costs and estimated earnings in excess of billings on uncompleted contracts related to its portion of this contract. Consistent with Company policy, only costs of directed change orders have been recorded by the Company. No amounts have been recorded by the Company related to the Company's claims and counterclaims alleging breach of the agreement. Although a failure to recover the amounts recorded could have a material adverse effect on the Company's results of operations, the Company believes that, under the circumstances and on the basis of information now available, an unfavorable outcome is unlikely.

The Company was a party to a construction joint venture (the Joint Venture), which provided process control systems to the Central Artery/Tunnel Project (the Project) in Boston, Massachusetts under a contract with the Massachusetts Turnpike Authority (the MTA). The Joint Venture submitted claims against the MTA seeking additional reimbursement for work done by the Joint Venture on the project. These claims were settled and resulted in a net increase in the contract amount of approximately \$2.0 million, of which \$1.5 million was reflected as additional revenues by the Company for the three and nine months ended July 31, 2005.

Item 1A. *Risk Factors*

There are no material changes from the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 2005.

Table of Contents

Item 6. Exhibits

- 3.1 - Certificate of Incorporation of Powell Industries, Inc. filed with the Secretary of State of the State of Delaware on February 11, 2004 (filed as Exhibit 3.1 to our Form 8-A/A filed November 1, 2004, and incorporated herein by reference).
 - 3.2 - Bylaws of Powell Industries, Inc. (filed as Exhibit 3.2 to our Form 8-A/A filed November 1, 2004, and incorporated herein by reference).
 - *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.
- * Filed herewith.

Table of Contents

SIGNATURES

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

POWELL INDUSTRIES, INC.

Registrant

September 11, 2006

/s/ THOMAS W. POWELL

Date

Thomas W. Powell
President and Chief Executive Officer
(Principal Executive Officer)

September 11, 2006

/s/ DON R. MADISON

Date

Don R. Madison
Vice President and Chief Financial Officer
(Principal Financial Officer)

24

Table of Contents

EXHIBIT INDEX

Number	Exhibit Title
3.1	- Certificate of Incorporation of Powell Industries, Inc. filed with the Secretary of State of the State of Delaware on February 11, 2004 (filed as Exhibit 3.1 to our Form 8-A/A filed November 1, 2004, and incorporated herein by reference).
3.2	- Bylaws of Powell Industries, Inc. (filed as Exhibit 3.2 to our Form 8-A/A filed November 1, 2004, and incorporated herein by reference).
*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.
* Filed herewith.	