UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

# FORM 10-Q

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

For the quarterly period ended September 30, 2020

or

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

For the transition period from ________to________
Commission file number 001-35944

**POWER SOLUTIONS INTERNATIONAL, INC.**
(Exact Name of Registrant as Specified in its Charter)

| | |
|---|---|
| **Delaware** | **33-0963637** |
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification No.) |
| **201 Mittel Drive, Wood Dale, IL** | **60191** |
| (Address of Principal Executive Offices) | (Zip Code) |

**(630) 350-9400**
(Registrant’s Telephone Number, Including Area Code)

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

| Title of Each Class | Trading Symbol(s) | Name of Each Exchange on Which Registered |
|---|---|---|
| None | ___ | ___ |

**Securities Registered Pursuant to Section 12(g) of the Act:**
Common Stock, par value $0.001 per share

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 x NO ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). YES x NO ☐

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

| | | | |
|---|---|---|---|
| Large accelerated filer | ☐ | Accelerated filer | ☐ |
| Non-accelerated filer | x | Smaller reporting company | x |
| | | Emerging growth company | ☐ |

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

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

As of November 9, 2020, there were 22,891,345 outstanding shares of the Common Stock of the registrant.

**TABLE OF CONTENTS**


| | | Page |
|---|---|---|
| | PART I – FINANCIAL INFORMATION | |
| | Forward-Looking Statements | 3 |
| Item 1. | Financial Statements | 4 |
| | Consolidated Balance Sheets as of September 30, 2020 (Unaudited) and December 31, 2019 | 4 |
| | Consolidated Statements of Operations for the three and nine months ended September 30, 2020 and 2019 (Unaudited) | 5 |
| | Consolidated Statements of Stockholders' Equity for the three and nine months ended September 30, 2020 and 2019 (Unaudited) | 6 |
| | Consolidated Statements of Cash Flows for the nine months ended September 30, 2020 and 2019 (Unaudited) | 7 |
| | Notes to Consolidated Financial Statements (Unaudited) | 8 |
| Item 2. | Management's Discussion and Analysis of Financial Condition and Results of Operations | 27 |
| Item 3. | Quantitative and Qualitative Disclosures About Market Risk | 38 |
| Item 4. | Controls and Procedures | 39 |
| | PART II – OTHER INFORMATION | |
| Item 1. | Legal Proceedings | 42 |
| Item 1A. | Risk Factors | 42 |
| Item 2. | Unregistered Sales of Equity Securities and Use of Proceeds | 42 |
| Item 3. | Defaults Upon Senior Securities | 42 |
| Item 4. | Mine Safety Disclosures | 42 |
| Item 5. | Other Information | 42 |
| Item 6. | Exhibits | 43 |
| | Signatures | 43 |

## FORWARD-LOOKING STATEMENTS

*Certain statements contained in this Quarterly Report on Form 10-Q for the three and nine months ended September 30, 2020 (the "Quarterly Report") that are not historical facts are intended to constitute "forward-looking statements" entitled to the safe-harbor provisions of Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These statements may involve risks and uncertainties. These statements often include words such as "anticipate," "believe," "budgeted," "contemplate," "estimate," "expect," "forecast," "guidance," "may," "outlook," "plan," "projection," "should," "target," "will," "would" or similar expressions, but these words are not the exclusive means for identifying such statements. These forward-looking statements include statements regarding Power Solutions International, Inc.'s, a Delaware corporation ("Power Solutions," "PSI" or the "Company"), projected sales, potential profitability and liquidity, strategic initiatives, future business strategies, warranty mitigation efforts and market opportunities, improvements in its business, remediation of internal controls, improvement of product margins, and product market conditions and trends. These statements are not guarantees of performance or results, and they involve risks, uncertainties and assumptions. Although the Company believes that these forward-looking statements are based on reasonable assumptions, there are many factors that could affect the Company's results of operations and liquidity and could cause actual results, performance or achievements to differ materially from those expressed in, or implied by, the Company's forward-looking statements.*

*The Company cautions that the risks, uncertainties and other factors that could cause its actual results to differ materially from those expressed in, or implied by, the forward-looking statements include, without limitation, the factors discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2019, and from time to time in the Company's subsequent filings with the United States Securities and Exchange Commission (the "SEC"); management's ability to successfully implement the Audit Committee's remedial recommendations; the timing of completion of steps to address, and the inability to address and remedy, material weaknesses; the identification of additional material weaknesses or significant deficiencies; variances in non-recurring expenses; risks relating to the substantial costs and diversion of personnel's attention and resources deployed to address the internal control matters; the ability of the Company to accurately forecast sales, and the extent to which sales result in recorded revenue; changes in customer demand for the Company's products; volatility in oil and gas prices; the impact of U.S. tariffs on imports from China on the Company's supply chain; the Company's obligations to indemnify past and present directors and officers and certain current and former employees with respect to the investigations conducted by the SEC and the criminal division of the United States Attorney's Office for the Northern District of Illinois (the "USAO"), which will be funded by the Company with its existing cash resources due to the exhaustion of its historical primary directors' and officers' insurance coverage; any delays and challenges in recruiting key employees consistent with the Company's plans; risks related to complying with the terms and conditions of the settlements with the SEC and USAO; the Company's ability to continue as a going concern; the Company's ability to raise additional capital when needed and its liquidity; uncertainties around the Company's ability to meet funding conditions under its financing arrangements and access to capital thereunder; the impact the recent outbreak of a new strain of coronavirus ("COVID-19 outbreak") could have on the Company's business and financial results; any negative impacts from delisting of the Company's common stock par value $0.001 (the "Common Stock") from the NASDAQ Stock Market ("NASDAQ") and any delays and challenges in obtaining a re-listing on a stock exchange.*

*The Company's forward-looking statements are presented as of the date hereof. Except as required by law, the Company expressly disclaims any intention or obligation to revise or update any forward-looking statements, whether as a result of new information, future events or otherwise.*

## AVAILABLE INFORMATION

*The Company is subject to the reporting and information requirements of the Exchange Act, and as a result, it is obligated to file annual, quarterly and current reports, proxy statements and other information with the SEC. The Company makes these filings available free of charge on its website (http://www.psiengines.com) as soon as reasonably practicable after it electronically files them with, or furnishes them to, the SEC. Information on the Company's website does not constitute part of this Quarterly Report on Form 10-Q. In addition, the SEC maintains a website (http://www.sec.gov) that contains the annual, quarterly and current reports, proxy and information statements, and other information the Company electronically files with, or furnishes to, the SEC.*

## PART I – FINANCIAL INFORMATION

**Item 1. Financial Statements.**

### POWER SOLUTIONS INTERNATIONAL, INC.
### CONSOLIDATED BALANCE SHEETS
### (UNAUDITED)

| (in thousands, except par values) | As of September 30, 2020 | As of December 31, 2019 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 26,727 | $ 3 |
| Restricted cash | 3,299 | — |
| Accounts receivable, net of allowances of $3,058 and $3,561 as of September 30, 2020 and December 31, 2019, respectively | 52,379 | 104,515 |
| Income tax receivable | 3,716 | 1,055 |
| Inventories, net | 128,827 | 108,839 |
| Prepaid expenses and other current assets | 15,030 | 8,110 |
| Total current assets | 229,978 | 222,522 |
| Property, plant and equipment, net | 21,116 | 23,194 |
| Intangible assets, net | 11,082 | 13,372 |
| Goodwill | 29,835 | 29,835 |
| Other noncurrent assets | 22,042 | 24,749 |
| **TOTAL ASSETS** | $ 314,053 | $ 313,672 |
| | | |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 45,237 | $ 75,835 |
| Current maturities of long-term debt | 288 | 195 |
| Revolving line of credit | 130,000 | 39,527 |
| Other accrued liabilities | 83,049 | 66,030 |
| Total current liabilities | 258,574 | 181,587 |
| Deferred income taxes | 839 | 1,105 |
| Long-term debt, net of current maturities | 754 | 55,657 |
| Noncurrent contract liabilities | 10,009 | 17,998 |
| Other noncurrent liabilities | 34,841 | 28,828 |
| **TOTAL LIABILITIES** | $ 305,017 | $ 285,175 |
| | | |
| **STOCKHOLDERS' EQUITY** | | |
| Preferred stock – $0.001 par value. Shares authorized: 5,000. No shares issued and outstanding at all dates. | $ — | $ — |
| Common stock – $0.001 par value; 50,000 shares authorized; 23,117 and 23,117 shares issued; 22,886 and 22,857 shares outstanding at September 30, 2020 and December 31, 2019, respectively | 23 | 23 |
| Additional paid-in capital | 157,138 | 156,727 |
| Accumulated deficit | (146,832) | (126,912) |
| Treasury stock, at cost, 231 and 260 shares at September 30, 2020 and December 31, 2019, respectively | (1,293) | (1,341) |
| **TOTAL STOCKHOLDERS' EQUITY** | 9,036 | 28,497 |
| **TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY** | $ 314,053 | $ 313,672 |

*See Notes to Consolidated Financial Statements*

**POWER SOLUTIONS INTERNATIONAL, INC.**
**CONSOLIDATED STATEMENTS OF OPERATIONS**
**(UNAUDITED)**

| (in thousands, except per share amounts) | For the Three Months Ended September 30, 2020 | For the Three Months Ended September 30, 2019 | For the Nine Months Ended September 30, 2020 | For the Nine Months Ended September 30, 2019 |
|---|---|---|---|---|
| **Net sales** | $ 114,450 | $ 138,512 | $ 312,603 | $ 392,983 |
| Cost of sales | 96,281 | 111,640 | 272,943 | 322,793 |
| **Gross profit** | 18,169 | 26,872 | 39,660 | 70,190 |
| Operating expenses: | | | | |
| Research, development and engineering expenses | 6,555 | 6,366 | 19,121 | 18,695 |
| Selling, general and administrative expenses | 11,964 | 11,461 | 38,434 | 41,476 |
| Amortization of intangible assets | 763 | 910 | 2,290 | 2,729 |
| Total operating expenses | 19,282 | 18,737 | 59,845 | 62,900 |
| **Operating (loss) income** | (1,113) | 8,135 | (20,185) | 7,290 |
| Other expense: | | | | |
| Interest expense | 1,510 | 1,921 | 4,211 | 6,156 |
| Loss from change in value of warrants | — | — | — | 1,352 |
| Loss on extinguishment of debt | — | — | 497 | — |
| Other income, net | (947) | (25) | (1,202) | (526) |
| Total other expense | 563 | 1,896 | 3,506 | 6,982 |
| **(Loss) income before income taxes** | (1,676) | 6,239 | (23,691) | 308 |
| Income tax (benefit) expense | (210) | 483 | (3,771) | 136 |
| **Net (loss) income** | $ (1,466) | $ 5,756 | $ (19,920) | $ 172 |
| | | | | |
| **Weighted-average common shares outstanding:** | | | | |
| Basic | 22,881 | 22,849 | 22,866 | 21,064 |
| Diluted | 22,881 | 22,876 | 22,866 | 21,088 |
| **(Loss) earnings per common share:** | | | | |
| Basic | $ (0.06) | $ 0.25 | $ (0.87) | $ 0.01 |
| Diluted | $ (0.06) | $ 0.25 | $ (0.87) | $ 0.01 |

*See Notes to Consolidated Financial Statements*

**POWER SOLUTIONS INTERNATIONAL, INC.**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

**(UNAUDITED)**

| (in thousands) | For the Three Months Ended | | | | |
|---|---|---|---|---|---|
| | **Common Stock** | **Additional Paid-in Capital** | **Accumulated Deficit** | **Treasury Stock** | **Total Stockholders' Equity** |
| **Balance at June 30, 2020** | $ 23 | $ 157,052 | $ (145,366) | $ (1,354) | $ 10,355 |
| Net loss | — | — | (1,466) | — | (1,466) |
| Stock-based compensation expense | — | 94 | — | 71 | 165 |
| Common stock issued for stock-based awards, net | — | (8) | — | (10) | (18) |
| **Balance at September 30, 2020** | $ 23 | $ 157,138 | $ (146,832) | $ (1,293) | $ 9,036 |
| | | | | | |
| **Balance at June 30, 2019** | $ 23 | $ 158,530 | $ (140,744) | $ (3,418) | $ 14,391 |
| Net income | — | — | 5,756 | — | 5,756 |
| Stock-based compensation expense | — | 173 | — | — | 173 |
| Common stock issued for stock-based awards, net | — | (2,123) | — | 2,080 | (43) |
| **Balance at September 30, 2019** | $ 23 | $ 156,580 | $ (134,988) | $ (1,338) | $ 20,277 |

| (in thousands) | For the Nine Months Ended | | | | |
|---|---|---|---|---|---|
| | **Common Stock** | **Additional Paid-in Capital** | **Accumulated Deficit** | **Treasury Stock** | **Total Stockholders' Equity** |
| **Balance at December 31, 2019** | $ 23 | $ 156,727 | $ (126,912) | $ (1,341) | $ 28,497 |
| Net loss | — | — | (19,920) | — | (19,920) |
| Stock-based compensation expense | — | 411 | — | 71 | 482 |
| Common stock issued for stock-based awards, net | — | — | — | (23) | (23) |
| **Balance at September 30, 2020** | $ 23 | $ 157,138 | $ (146,832) | $ (1,293) | $ 9,036 |
| | | | | | |
| **Balance at December 31, 2018** | $ 19 | $ 119,724 | $ (135,160) | $ (3,161) | $ (18,578) |
| Net income | — | — | 172 | — | 172 |
| Stock-based compensation expense | — | 1,101 | — | — | 1,101 |
| Common stock issued for stock-based awards, net | — | (2,309) | — | 1,823 | (486) |
| Exercise of Weichai Warrant | 4 | 38,064 | — | — | 38,068 |
| **Balance at September 30, 2019** | $ 23 | $ 156,580 | $ (134,988) | $ (1,338) | $ 20,277 |

*See Notes to Consolidated Financial Statements*

**POWER SOLUTIONS INTERNATIONAL, INC.**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(UNAUDITED)**

| (in thousands) | For the Nine Months Ended September 30, 2020 | 2019 |
|---|---|---|
| **Cash (used in) provided by operating activities** | | |
| Net (loss) income | $ (19,920) | $ 172 |
| Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities: | | |
| Amortization of intangible assets | 2,290 | 2,729 |
| Depreciation | 3,922 | 3,875 |
| Change in value of warrants | — | 1,352 |
| Stock-based compensation expense | 482 | 1,101 |
| Amortization of financing fees | 1,102 | 545 |
| Deferred income taxes | (265) | (30) |
| Loss on extinguishment of debt | 497 | — |
| Other adjustments, net | (260) | 193 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net | 52,083 | 9,213 |
| Inventory, net | (20,842) | (9,613) |
| Prepaid expenses and other assets | (5,362) | 6,897 |
| Accounts payable | (30,482) | 379 |
| Accrued expenses | 16,572 | 6,262 |
| Other noncurrent liabilities | (2,100) | (3,953) |
| **Net cash (used in) provided by operating activities** | (2,283) | 19,122 |
| **Cash used in investing activities** | | |
| Capital expenditures | (1,991) | (2,048) |
| Proceeds from corporate-owned life insurance | 930 | — |
| Other investing activities, net | 7 | 13 |
| **Net cash used in investing activities** | (1,054) | (2,035) |
| **Cash provided by (used in) financing activities** | | |
| Repayments of long-term debt and lease liabilities | (55,200) | (136) |
| Proceeds from revolving line of credit | 180,298 | 394,631 |
| Repayments of revolving line of credit | (89,826) | (412,488) |
| Payments of deferred financing costs | (1,970) | (375) |
| Proceeds from Weichai Warrant exercise | — | 1,616 |
| Other financing activities, net | 58 | (388) |
| **Net cash provided by (used in) financing activities** | 33,360 | (17,140) |
| **Net increase (decrease) in cash, cash equivalents, and restricted cash** | 30,023 | (53) |
| Cash, cash equivalents, and restricted cash at beginning of the period | 3 | 54 |
| **Cash, cash equivalents, and restricted cash at end of the period** | $ 30,026 | $ 1 |

| (in thousands) | As of September 30, 2020 | 2019 |
|---|---|---|
| **Reconciliation of cash, cash equivalents, and restricted cash to the Consolidated Balance Sheets** | | |
| Cash and cash equivalents | $ 26,727 | $ 1 |
| Restricted cash | 3,299 | — |
| **Total cash, cash equivalents, and restricted cash** | $ 30,026 | $ 1 |

*See Notes to Consolidated Financial Statements*

## Note 1. Summary of Significant Accounting Policies and Other Information

### Nature of Business Operations

Power Solutions International, Inc. ("Power Solutions," "PSI" or "the Company"), a Delaware corporation, is a global producer and distributor of a broad range of high-performance, certified, low-emission power systems, including alternative-fueled power systems for original equipment manufacturers ("OEMs") of off-highway industrial equipment and certain on-road vehicles and large custom-engineered integrated electrical power generation systems.

The Company's customers include large, industry-leading and multinational organizations. The Company's products and services are sold predominantly to customers throughout North America as well as to customers located throughout the Pacific Rim and Europe. The Company's power systems are highly engineered, comprehensive systems which, through the Company's technologically sophisticated development and manufacturing processes, including its in-house design, prototyping, testing and engineering capabilities and its analysis and determination of the specific components to be integrated into a given power system (driven in large part by emission standards and cost considerations), allow the Company to provide its customers with power systems customized to meet specific OEM application requirements, other technical customers' specifications, and requirements imposed by environmental regulatory bodies.

The Company's power system configurations range from a basic engine integrated with appropriate fuel system components to completely packaged power systems that include any combination of cooling systems, electronic systems, air intake systems, fuel systems, housings, power takeoff systems, exhaust systems, hydraulic systems, enclosures, brackets, hoses, tubes and other assembled componentry. The Company also designs and manufactures large, custom-engineered integrated electrical power generation systems for both standby and prime power applications. The Company purchases engines from third-party suppliers and produces internally designed engines, all of which are then integrated into its power systems.

Of the other components that the Company integrates into its power systems, a substantial portion consist of internally designed components and components for which it coordinates significant design efforts with third-party suppliers, with the remainder consisting largely of parts that are sourced off-the-shelf from third-party suppliers. Some of the key components (including purchased engines) embody proprietary intellectual property of the Company's suppliers. As a result of its design and manufacturing capabilities, the Company is able to provide its customers with a power system that can be incorporated into a customer's specified application. In addition to the certified products described above, the Company sells diesel, gasoline and non-certified power systems and aftermarket components.

### Stock Ownership and Control

Weichai America Corp., a wholly-owned subsidiary of Weichai Power Co., Ltd. (HK2338, SZ000338) (herein collectively referred to as "Weichai"), currently owns a majority of the outstanding shares of the Company's Common Stock. As a result, Weichai is able to exercise control over Company matters including those requiring stockholders' approval, including the election of the directors, amendments to the Company's Charter and approval of significant corporate transactions. This control could have the effect of delaying or preventing a change of control of the Company and could deter or prevent actions that may be favored by other stockholders.

Weichai currently has three representatives on the Company's Board of Directors (the "Board"). Under the Investor Rights Agreement (the "Rights Agreement") between Weichai and the Company, since Weichai became the majority owner of the Company's outstanding shares of Common Stock, the Company became required to appoint to the Board an additional individual designated by Weichai, or such additional number of individuals so that Weichai designees constitute the majority of the directors serving on the Board. As of the date of this filing, Weichai has nominated an additional representative to stand for election to the Board at the Company's upcoming Annual Meeting of Stockholders on December 15, 2020. According to the Rights Agreement, during any period when the Company is a "controlled company" within the meaning of the NASDAQ Stock Market ("NASDAQ") Listing Rules, it will take such measures as to avail itself of the "controlled company" exemptions available under Rule 5615 of the NASDAQ Listing Rules of Rules 5605(b), (d) and (e).

### Going Concern Considerations

In April 2020, the Company closed on its new senior secured revolving credit facility pursuant to that certain credit agreement, dated as of March 27, 2020, between the Company and Standard Chartered Bank ("Standard Chartered"), as administrative agent (the "Credit Agreement"). The Credit Agreement, which allows the Company to borrow up to $130.0 million, matures on March 26, 2021 with an optional 60-day extension, subject to certain conditions and payment of a 0.25% extension fee. See Note 6. *Debt* for further information regarding the terms and conditions of the Credit Agreement.

The Credit Agreement includes financial covenants which were effective for the Company beginning with the six months ended June 30, 2020. The financial covenants include an interest coverage ratio and a minimum threshold for earnings before interest, taxes, depreciation and amortization ("EBITDA") as further defined in the Credit Agreement. For the six months ended June 30, 2020 and the nine months ended September 30, 2020, the Company did not meet the defined minimum EBITDA requirement. A breach of the financial covenants under the Credit Agreement constitutes an event of default and, if not cured or waived, could result in the obligations under the Credit Agreement being accelerated. Accordingly, the Company is currently in discussions with Standard Chartered to seek appropriate waivers and amendments to cure its financial covenant breach and amend its financial covenants.

Significant uncertainties exist about the Company's ability to refinance, extend, or repay its outstanding indebtedness, maintain sufficient liquidity to fund its business activities, obtain a waiver or satisfactory amendment in connection with the financial covenant breach, and maintain compliance with the covenants and other requirements under the Credit Agreement in the future. Based on the Company's current forecasts, without additional financing, the Company anticipates that it will not have sufficient cash and cash equivalents to repay the Credit Agreement by March 26, 2021. Management plans to seek an extension and/or replacement of the Credit Agreement or additional liquidity from its current or other lenders before March 26, 2021. There can be no assurance that the Company's management will be able to obtain waivers or satisfactory amendments to its financial covenants or successfully complete an extension of the Credit Agreement or obtain new financing on acceptable terms when required or if at all. The consolidated financial statements included in this Quarterly Report do not include any adjustments that might result from the outcome of the Company's efforts to address these issues.

Furthermore, if the Company cannot raise capital on acceptable terms, it may not, among other things, be able to do the following:

- continue to expand the Company's research and product investments and sales and marketing organization;
- continue to fund and expand operations both organically and through acquisitions; and
- respond to competitive pressures or unanticipated working capital requirements.

Additionally, as discussed further below, in January 2020, the World Health Organization ("WHO") announced a global health emergency because of a new strain of coronavirus (the "COVID-19 outbreak") and the risks to the international community as the virus spreads globally. In March 2020, the WHO classified the COVID-19 outbreak as a global pandemic (the "COVID-19 pandemic"), based on the rapid increase in exposure globally. The potential impact of future disruptions to the Company, continued economic uncertainty, and continued depressed crude oil prices and low rig count levels may have a material adverse impact on the results of operations, financial position, and liquidity of the Company.

The Company's management has concluded that, due to uncertainties surrounding the Company's future ability to refinance, extend, or repay its outstanding indebtedness, maintain sufficient liquidity to fund its business activities, obtain a cure or waiver of its financial covenant breach, and maintain compliance with the covenants and other requirements under the Credit Agreement in the future, substantial doubt exists as to its ability to continue as a going concern within one year after the date that these financial statements are issued. The Company's plans to alleviate the substantial doubt about its ability to continue as a going concern may not be successful, and it may be forced to limit its business activities or be unable to continue as a going concern, which would have a material adverse effect on its results of operations and financial condition.

The consolidated financial statements included herein have been prepared assuming that the Company will continue as a going concern and contemplating the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. The Company's ability to continue as a going concern is dependent on generating profitable operating results, having sufficient liquidity, obtaining a cure or waiver in connection with the financial covenant breach, maintaining compliance with the covenants and other requirements under the Credit Agreement in the future, and extending, refinancing or repaying the indebtedness outstanding under the Credit Agreement.

**Recent COVID-19 Outbreak and Oil and Gas Market Price Volatility**

As a result of the COVID-19 pandemic, the global economy has experienced substantial turmoil including impacts from the world financial markets which have experienced a period of significant volatility and overall declines. In addition, due to unprecedented decreases in demand, an oil price war, and economic uncertainty resulting from the COVID-19 pandemic, crude oil prices have declined considerably as compared to prices at the end of 2019. A significant portion of the Company's sales and profitability is derived from the sale of products that are used within the oil and gas industry. While the Company has yet to experience significant supply chain interruptions or material cancellations of orders, the Company has seen a decline in orders and lower volumes compared to the prior year. The potential impact of future disruptions, continued economic uncertainty, and continued depressed crude oil prices and low rig count levels may have a significant adverse impact on the timing of delivery of customer orders and the levels of future customer orders. Accordingly, these adverse impacts may significantly impact the Company's future results of operations, financial position, and liquidity.

The Company performs its annual goodwill impairment test as of October 1, or more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. The

Company considered the significant changes in the market due to the COVID-19 pandemic and the oil and gas market price volatility in performing its assessment of whether an interim impairment review was required for any reporting units and determined that a triggering event had occurred for both reporting units as of March 31, 2020. The Company considered both qualitative and quantitative factors in its assessment including the significant amount of headroom resulting from the prior fiscal year's impairment test and potential changes in key assumptions, including discount rates, expected profitability and long-term growth rates, used in the last fiscal year's impairment analysis that may have been impacted by the recent market conditions and economic events. Based on this interim assessment, the Company concluded that goodwill was not impaired as of March 31, 2020. It is reasonably possible that potential adverse impacts of the factors noted above could result in the recognition of material impairments of goodwill and other long-lived assets or other related charges in future periods as the extent and duration of the impact of the COVID-19 pandemic and resulting effect on the Company's operations continues to evolve and remains uncertain.

The Company has initiated certain contingency actions as a result of the significant negative impacts of these factors. During the nine months ended September 30, 2020, the Company has taken actions to continue to improve its manufacturing operations which includes making reductions in its production facility workforce to align with current volume trends. In addition, the Company implemented various temporary cost reduction measures, including reduced pay for salaried employees, suspension of the 401(k) match program, and deferred spending on certain R&D programs, among others. The measures with regard to pay for employees and the Company's 401(k) plan match will run through December 31, 2020. The Company plans to reinstate full pay for employees and 401(k) matching effective January 1, 2021. The Company continues to review operating expenses as part of the contingency planning process.

**Basis of Presentation and Consolidation**

The Company is filing this Form 10-Q for the three and nine months ended September 30, 2020, which contains unaudited consolidated financial statements as of and for the three and nine months ended September 30, 2020 and 2019.

The consolidated financial statements include the accounts of Power Solutions International, Inc. and its wholly-owned subsidiaries and majority-owned subsidiaries in which the Company exercises control. The foregoing financial information was prepared in accordance with generally accepted accounting principles in the United States ("U.S. GAAP") and rules and regulations of the U.S. Securities and Exchange Commission ("SEC") for interim financial reporting. All intercompany balances and transactions have been eliminated in consolidation.

Certain information and note disclosures normally included in the Company's annual financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. The accompanying consolidated financial statements should be read in conjunction with, and have been prepared in accordance with accounting policies reflected in, the consolidated financial statements and related notes, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2019 ("the 2019 Annual Report"). The Company's significant accounting policies are described in the aforementioned 2019 Annual Report. Included below are certain updates to those policies. The accompanying interim financial information is unaudited; however, the Company believes the financial information reflects all adjustments (consisting of items of a normal recurring nature) necessary for a fair presentation of financial position, results of operations and cash flows in conformity with U.S. GAAP. Operating results for interim periods are not necessarily indicative of annual operating results.

The Company operates as one business and geographic operating segment. Operating segments are defined as components of a business that can earn revenue and incur expenses for which discrete financial information is available that is evaluated on a regular basis by the chief operating decision maker ("CODM"). The Company's CODM is its principal executive officer, who decides how to allocate resources and assess performance. A single management team reports to the CODM, who manages the entire business. The Company's CODM reviews consolidated statements of operations to make decisions, allocate resources and assess performance, and the CODM does not evaluate the profit or loss from any separate geography or product line.

***Immaterial Revision to Prior Period Financial Statements***

During the third quarter of 2020, the Company determined that, in certain prior periods, treasury stock had not been relieved at the appropriate share prices when restricted shares were issued under the Company's incentive compensation plan (refer to Item 8. Note 13. *Stock-Based Compensation* in the 2019 Annual Report for further discussion of the Company's incentive compensation plan). The Company assessed the materiality of the issue considering both qualitative and quantitative factors and determined the adjustments were immaterial. The Company has decided to correct the prior year presentation to provide comparability to the 2020 financial statements. The adjustments had no impact on total assets, total liabilities or total stockholders' equity, the Consolidated Statements of Operations, or the Consolidated Statements of Cash Flows.

**Consolidated Balance Sheet**

The effects of the adjustments on the line items within the Company's Consolidated Balance Sheet at December 31, 2019 are as follows:

| (in thousands) | December 31, 2019 (As Previously Reported) | Adjustment | December 31, 2019 (As Revised) |
|---|---|---|---|
| Additional paid-in capital | $ 165,527 | $ (8,800) | $ 156,727 |
| Treasury stock | $ (10,141) | $ 8,800 | $ (1,341) |

**Consolidated Statements of Stockholders' Equity (unaudited)**

The effects of the adjustments on the line items within the Company's Consolidated Statement of Stockholders' Equity for the year ended December 31, 2019 are as follows:

| (in thousands) | Additional Paid-in Capital | | | Treasury Stock | | |
|---|---|---|---|---|---|---|
| | As previously reported | Adjustment | As revised | As previously reported | Adjustment | As revised |
| **Year ended December 31, 2019** | | | | | | |
| Balance at December 31, 2018 | $ 126,412 | $ (6,688) | $ 119,724 | $ (9,849) | $ 6,688 | $ (3,161) |
| Stock-based compensation expense * | 1,540 | (2,112) | (572) | (292) | 2,112 | 1,820 |
| Balance at December 31, 2019 | $ 165,527 | $ (8,800) | $ 156,727 | $ (10,141) | $ 8,800 | $ (1,341) |

* There was no impact to total stock-based compensation expense as a result of the adjustment.

The effects of the adjustments on the line items within the Company's Consolidated Statement of Stockholders' Equity (unaudited) for the three month periods ended June 30, 2020, March 31, 2020, and September 30, 2019, the six month period ended June 30, 2020, and the nine month period ended September 30, 2019, respectively, are as follows:

| (in thousands) | Additional Paid-in Capital | | | Treasury Stock | | |
|---|---|---|---|---|---|---|
| | As previously reported | Adjustment | As revised | As previously reported | Adjustment | As revised |
| **Three months ended June 30, 2020 (unaudited)** | | | | | | |
| Balance at March 31, 2020 | $ 165,691 | $ (8,800) | $ 156,891 | $ (10,149) | $ 8,800 | $ (1,349) |
| Balance at June 30, 2020 | $ 165,852 | $ (8,800) | $ 157,052 | $ (10,154) | $ 8,800 | $ (1,354) |
| **Three months ended March 31, 2020 (unaudited)** | | | | | | |
| Balance at December 31, 2019 | $ 165,527 | $ (8,800) | $ 156,727 | $ (10,141) | $ 8,800 | $ (1,341) |
| Balance at March 31, 2020 | $ 165,691 | $ (8,800) | $ 156,891 | $ (10,149) | $ 8,800 | $ (1,349) |
| **Three months ended September 30, 2019 (unaudited)** | | | | | | |
| Balance at June 30, 2019 | $ 165,437 | $ (6,907) | $ 158,530 | $ (10,325) | $ 6,907 | $ (3,418) |
| Stock-based compensation expense * | (14) | (1,893) | (1,907) | 187 | 1,893 | 2,080 |
| Balance at September 30, 2019 | $ 165,380 | $ (8,800) | $ 156,580 | $ (10,138) | $ 8,800 | $ (1,338) |
| **Six months ended June 30, 2020 (unaudited)** | | | | | | |
| Balance at December 31, 2019 | $ 165,527 | $ (8,800) | $ 156,727 | $ (10,141) | $ 8,800 | $ (1,341) |
| Balance at June 30, 2020 | $ 165,852 | $ (8,800) | $ 157,052 | $ (10,154) | $ 8,800 | $ (1,354) |
| **Nine months ended September 30, 2019 (unaudited)** | | | | | | |
| Balance at December 31, 2018 | $ 126,412 | $ (6,688) | $ 119,724 | $ (9,849) | $ 6,688 | $ (3,161) |
| Stock-based compensation expense * | 1,390 | (2,112) | (722) | (289) | 2,112 | 1,823 |
| Balance at September 30, 2019 | $ 165,380 | $ (8,800) | $ 156,580 | $ (10,138) | $ 8,800 | $ (1,338) |

* There was no impact to total stock-based compensation expense as a result of the adjustment.

**Reclassifications**

Certain amounts presented in the prior-period Consolidated Statements of Stockholders' Equity have been reclassified between *Stock-based compensation expense* and *Common stock issued for stock-based awards, net* to conform to the current period financial statement presentation. These reclassifications had no effect on previously reported total stockholders' equity, the Consolidated Balance Sheet, Consolidated Statements of Operations or Consolidated statements of Cash Flow.

**Concentrations**

The following table presents customers individually accounting for more than 10% of the Company's net sales:

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2020 | 2019 | 2020 | 2019 |
| Customer A | 17 % | 15 % | 10 % | 12 % |
| Customer B | 11 % | 11 % | 14 % | 15 % |
| Customer C | 11 % | ** | 11 % | ** |
| Customer D | ** | 11 % | ** | ** |
| Customer E | ** | 11 % | ** | ** |

The following table presents customers individually accounting for more than 10% of the Company's accounts receivable:

| | As of September 30, 2020 | As of December 31, 2019 |
|---|---|---|
| Customer A | ** | 49 % |
| Customer B | 16 % | ** |
| Customer C | 18 % | ** |

The following table presents suppliers individually accounting for more than 10% of the Company's purchases:

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2020 | 2019 | 2020 | 2019 |
| Supplier A | 38 % | 29 % | 25 % | 20 % |
| Supplier B | ** | 12 % | ** | 12 % |

** Less than 10% of the total

***Use of Estimates***

The preparation of consolidated financial statements in conformity with U.S. GAAP requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Significant estimates and assumptions include the valuation of allowances for uncollectible receivables, inventory reserves, warranty reserves, stock-based compensation, evaluation of goodwill, other intangibles, plant and equipment for impairment, and determination of useful lives of long-lived assets. Actual results could materially differ from those estimates.

***Research and Development***

Research and development ("R&D") expenses are expensed when incurred. R&D expenses consist primarily of wages, materials, testing and consulting related to the development of new engines, parts and applications. These costs were $6.2 million and $5.9 million for the three months ended September 30, 2020 and 2019, respectively. These costs were $18.2 million and $17.4 million for the nine months ended September 30, 2020 and 2019, respectively.

***Restricted Cash***

In April 2020, the Company entered into the Credit Agreement with Standard Chartered and extinguished the prior credit agreement with Wells Fargo Bank, N.A. ("Wells Fargo") as discussed further in Note 6. *Debt*. While the revolving credit facility with Wells Fargo was extinguished, Wells Fargo continues to perform other services for the Company including issuing letters of credit. Wells Fargo required the Company to have cash collateral to support the letters of credit and other services provided. As discussed in Note 9. *Commitments and Contingencies*, the Company had outstanding letters of credit of $2.8 million and restricted cash of $3.3 million at September 30, 2020.

***Inventories***

The Company's inventories consist primarily of engines and parts. Engines are valued at the lower of cost plus estimated freight-in or net realizable value. Parts are valued at the lower of cost or net realizable value. Net realizable value approximates replacement cost. Cost is principally determined using the first-in, first-out method and includes material, labor and manufacturing overhead. It is the Company's policy to review inventories on a continuing basis for obsolete, excess and slow-moving items and to record valuation adjustments for such items in order to eliminate non-recoverable costs from inventory. Valuation adjustments are recorded in an inventory reserve account and reduce the cost basis of the inventory in the period in which the reduced valuation is determined. Inventory reserves are established based on quantities on hand, usage and sales history, customer orders, projected demand and utilization within a current or future power system. Specific analysis of individual items or groups of items is performed based on these same criteria, as well as on changes in market conditions or any other identified conditions.

Inventories consisted of the following:

(in thousands)

| Inventories | As of September 30, 2020 | As of December 31, 2019 |
|---|---|---|
| Raw materials | $ 104,286 | $ 90,677 |
| Work in process | 5,014 | 2,007 |
| Finished goods | 22,751 | 19,119 |
| **Total inventories** | 132,051 | 111,803 |
| Inventory allowance | (3,224) | (2,964) |
| **Inventories, net** | $ 128,827 | $ 108,839 |

Activity in the Company's inventory allowance was as follows:

| (in thousands) | For the Nine Months Ended September 30, | |
|---|---|---|
| **Inventory Allowance** | **2020** | **2019** |
| **Balance at beginning of period** | $ 2,964 | $ 5,730 |
| Charged to expense | 1,272 | 560 |
| Write-offs | (1,012) | (2,027) |
| **Balance at end of period** | $ 3,224 | $ 4,263 |

***Other Accrued Liabilities***

Other accrued liabilities consisted of the following:

(in thousands)

| Other Accrued Liabilities | As of September 30, 2020 | As of December 31, 2019 |
|---|---|---|
| Accrued product warranty | $ 16,210 | $ 17,142 |
| Litigation reserves * | 2,535 | 5,020 |
| Contract liabilities | 52,502 | 26,898 |
| Accrued compensation and benefits | 1,978 | 6,599 |
| Operating lease liabilities | 3,802 | 3,789 |
| Accrued interest expense | 917 | 1,087 |
| Other | 5,105 | 5,495 |
| **Total** | $ 83,049 | $ 66,030 |

***** As of September 30, 2020 litigation reserves primarily consisted of reserves related to the settlement of the SEC and USAO investigations that were resolved in September 2020 and other matters. As of December 31, 2019, litigation reserves primarily consisted of reserves related to the settlement of the SEC and USAO investigations and the Federal Derivative Litigation. The Company concluded that insurance recovery was probable related to $0.2 million and $1.9 million of the litigation reserves as of September 30, 2020 and December 31, 2019, respectively, and recognized full recovery of the reserved amounts in *Prepaid expenses and other current assets*. See Note 9. *Commitments and Contingencies* for additional information.

***Warranty Costs***

The Company offers a standard limited warranty on the workmanship of its products that in most cases covers defects for a defined period. Warranties for certified emission products are mandated by the U.S. Environmental Protection Agency (the "EPA") and/or the California Air Resources Board (the "CARB") and are longer than the Company's standard warranty on certain emission related products. The Company's products also carry limited warranties from suppliers. The Company's warranties generally apply to engines fully manufactured by the Company and to the modifications the Company makes to supplier base products. Costs related to supplier warranty claims are generally borne by the supplier and passed through to the end customer.

Warranty estimates are based on historical experience and represent the projected cost associated with the product. A liability and related expense are recognized at the time products are sold. The Company adjusts estimates when it is determined that actual costs may differ from initial or previous estimates.

Accrued product warranty activities are presented below:

| (in thousands) | For the Nine Months Ended September 30, | |
|---|---|---|
| **Accrued Product Warranty** | **2020** | **2019** |
| **Balance at beginning of period** | $ 25,501 | $ 23,102 |
| Current year provision * | 13,949 | 7,706 |
| Changes in estimates for preexisting warranties ** | 8,756 | 2,730 |
| Payments made during the period | (15,357) | (7,244) |
| **Balance at end of period** | 32,849 | 26,294 |
| Less: Current portion | 16,210 | 14,677 |
| **Noncurrent accrued product warranty** | $ 16,639 | $ 11,617 |

* Warranty costs, net of supplier recoveries, were $18.2 million and $7.4 million for the nine months ended September 30, 2020 and 2019, respectively. Supplier recoveries were $4.6 million and $3.0 million for the nine months ended September 30, 2020 and 2019, respectively.

** Change in estimates for preexisting warranties reflect changes in the Company's estimate of warranty costs for products sold in prior periods. Such adjustments typically occur when claims experience deviates from historical and expected trends. The Company's warranty liability is generally affected by failure rates, repair costs and the timing of failures. Future events and circumstances related to these factors could materially change the estimates and require adjustments to the warranty liability. In addition, new product launches require a greater use of judgment in developing estimates until historical experience becomes available. The Company recorded a benefit for changes in estimates of preexisting warranties of $1.2 million, or $0.05 per diluted share, for the three months ended September 30, 2020, and charges of $8.8 million, or $0.38 per diluted share, for the nine months ended September 30, 2020. The Company recorded charges for changes in estimates of preexisting warranties of $2.7 million, or $0.13 per diluted share, for the nine months ended September 30, 2019.

**Recently Issued Accounting Pronouncements – Adopted**

In August 2018, the FASB issued ASU 2018-15, *Intangibles – Goodwill and Other – Internal Use Software: Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*. This guidance requires the use of existing accounting guidance applicable to software developed for internal use to be applied to cloud computing service contracts' implementation costs. The costs capitalized would be amortized over the life of the agreement, including renewal option periods likely to be used. The Company adopted the standard effective January 1, 2020 on a prospective basis. There was no impact on the Company's financial statements including the related notes as a result of adopting the guidance.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement: Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*, which both reduces and expands selected disclosure requirements. The principal changes expected to impact the Company's disclosure are requirements to disclose the range and weighted average of each of the significant unobservable items and the way the weighted average of a range is calculated for items in the "table of significant unobservable inputs." The guidance also requires disclosure of changes in unrealized gains and losses in other comprehensive income and removes requirements regarding, among other items, disclosure of the valuation process for Level 3 measurements. The Company adopted the guidance on January 1, 2020. There was no impact on the Company's financial statements including the related notes as a result of adopting the guidance.

In January 2017, the FASB issued ASU 2017-04, *Intangibles – Goodwill and Other: Simplifying the Test for Goodwill Impairment*, which eliminated the requirement to calculate the implied fair value of goodwill to measure a goodwill impairment charge. Instead, entities will record an impairment charge based on the excess of a reporting unit's carrying amount over its fair value. The Company adopted the guidance on January 1, 2020 on a prospective basis. There was no impact on the Company's financial statements including the related notes as a result of adopting the guidance.

**Recently Issued Accounting Pronouncements – Not Yet Adopted**

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments*, which applies primarily to the Company's accounts receivable impairment loss allowances. The guidance provides a revised model whereby the current expected credit losses are used to compute impairment of financial instruments. The new model requires evaluation of historical experience and various current and expected factors, which may affect the estimated amount of losses and requires determination of whether the affected financial instruments should be grouped in units of account. The guidance, as originally issued, was effective for fiscal years beginning after December 15, 2019. In November 2019, the FASB issued ASU 2019-10, *Financial Instruments – Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842) Effective Dates*, which deferred the effective dates of these standards for certain entities. Based on the guidance, the effective date of ASU 2016-13 is deferred for the Company until fiscal year 2023. The Company currently plans to adopt the guidance on January 1, 2023 when it becomes effective. The Company is continuing to assess the impact of the standard on its financial statements.

## Note 2. Revenue

### Disaggregation of Revenue

The following table summarizes net sales by end market:

| (in thousands) | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| **End Market** | **2020** | **2019** | **2020** | **2019** |
| Energy | $ 33,813 | $ 64,331 | $ 113,546 | $ 162,224 |
| Industrial | 29,843 | 37,020 | 97,437 | 142,267 |
| Transportation | 50,794 | 37,161 | 101,620 | 88,492 |
| **Total** | $ 114,450 | $ 138,512 | $ 312,603 | $ 392,983 |

The following table summarizes net sales by geographic area:

| (in thousands) | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| **Geographic Area** | **2020** | **2019** | **2020** | **2019** |
| North America | $ 104,840 | $ 125,971 | $ 281,339 | $ 343,593 |
| Pacific Rim | 5,466 | 6,744 | 18,215 | 30,173 |
| Europe | 2,395 | 4,329 | 7,630 | 12,712 |
| Other | 1,749 | 1,468 | 5,419 | 6,505 |
| **Total** | $ 114,450 | $ 138,512 | $ 312,603 | $ 392,983 |

### Contract Balances

Most of the Company’s contracts are for a period of less than one year; however, certain long-term manufacturing and extended warranty contracts extend beyond one year. The timing of revenue recognition may differ from the time of invoicing to customers and these timing differences result in contract assets or contract liabilities on the Company’s Consolidated Balance Sheets. Contract assets include amounts related to the contractual right to consideration for completed performance when the right to consideration is conditional. The Company records contract liabilities when cash payments are received or due in advance of performance. Contract assets and contract liabilities are recognized at the contract level.

| (in thousands) | As of September 30, 2020 | As of December 31, 2019 |
|---|---|---|
| Short-term contract assets (included in *Prepaid expenses and other current assets*) | $ 8,601 | $ 694 |
| Short-term contract liabilities (included in *Other accrued liabilities*) | (52,502) | (26,898) |
| Long-term contract liabilities (included in *Noncurrent contract liabilities*) | (10,009) | (17,998) |
| **Net contract liabilities** | $ (53,910) | $ (44,202) |

During the nine months ended September 30, 2020 and 2019, the Company recognized $18.4 million and $4.1 million, respectively, of revenue upon satisfaction of performance obligations related to amounts that were included in the net contract liabilities balance as of December 31, 2019 and 2018, respectively. The increase in the contract asset during the nine months ended September 30, 2020 is related to performance completed and revenue recognized under certain contracts for which the Company’s right to consideration is conditional at the end of the period. The increase in the contract liabilities during the nine months ended September 30, 2020 is primarily related to prepayments for certain engines by a customer under a long-term supply agreement.

### Remaining Performance Obligations

For performance obligations that extend beyond one year, the Company had $62.1 million of remaining performance obligations as of September 30, 2020 which primarily relates to prepayments for certain engines by a customer under a long-term supply agreement. The Company expects to recognize revenue related to these remaining performance obligations of approximately $14.8 million in the remainder of 2020, $44.5 million in 2021, $0.7 million in 2022, $0.9 million in 2023, $0.8 million in 2024 and $0.4 million in 2025 and beyond.

## Note 3. Weichai Transactions

### Weichai Warrant

In September 2018, Weichai's stock purchase warrant (the "Weichai Warrant") was amended under the terms of a second amended and restated warrant ("Amended and Restated Warrant") to defer its exercise date to a 90-day period commencing April 1, 2019, to adjust the exercise price to a price per share of the Company's Common Stock equal to the lesser of (i) 50% of the Volume-Weighted Average Price ("VWAP") during the 20 consecutive trading day period preceding October 1, 2018 and (ii) 50% of the VWAP during the 20 consecutive trading day period preceding the date of exercise, subject to an adjustment that could reduce the exercise price by up to $15.0 million. In the event that the adjustment exceeded the exercise price, the excess would be due to the warrant holder.

The Weichai Warrant was a freestanding derivative financial instrument that was not indexed solely to the Company's Common Stock due to the Weichai Warrant exercise terms. On April 23, 2019, Weichai exercised the Weichai Warrant resulting in the Company issuing 4,049,759 shares of the Company's Common Stock and Weichai becoming the owner of 51.5% of the outstanding shares of the Company's Common Stock, as of such date. The exercise proceeds for the warrants of $1.6 million were based on 50% of the VWAP during the 20 consecutive trading day period preceding April 23, 2019 and the $15.0 million reduction in the exercise price described above. Changes in value of the Weichai Warrant, including the impact of the exercise, resulted in a loss of $1.4 million reported in *Loss from change in value of warrants* in the Company's Consolidated Statement of Operations for the nine months ended September 30, 2019.

### Weichai Collaboration Arrangement and Related Party Transactions

The Company and Weichai executed a strategic collaboration agreement (the "Collaboration Agreement") in March 2017, in order to achieve their respective strategic objectives and enhance the strategic cooperation alliance to share experiences, expertise and resources. Among other things, the Collaboration Agreement established a joint steering committee, permitted Weichai to second a limited number of certain technical, marketing, sales, procurement and finance personnel to work at the Company and established several collaborations, related to stationary natural-gas applications and Weichai diesel engines. The Collaboration Agreement provided for the steering committee to create various sub-committees with operating roles and otherwise governs the treatment of intellectual property of parties prior to the collaboration and the intellectual property developed during the collaboration. The Collaboration Agreement had a term of three years that was set to expire in March 2020. On March 26, 2020, the Collaboration Agreement was extended for an additional term of three years.

The Company evaluates whether an arrangement is a collaborative arrangement at its inception based on the facts and circumstances specific to the arrangement. The Company also reevaluates whether an arrangement qualifies or continues to qualify as a collaborative arrangement whenever there is a change in either the roles of the participants or the participants' exposure to significant risks and rewards dependent on the ultimate commercial success of the endeavor. For those collaborative arrangements where it is determined that the Company is the principal participant, costs incurred, and revenue generated from third parties are recorded on a gross basis in the financial statements. For the three and nine months ended September 30, 2020 and 2019, the Company's sales to Weichai were immaterial in all periods. Purchases of inventory from Weichai were $4.1 million and $16.3 million for the three and nine months ended September 30, 2020, respectively. Purchases of inventory from Weichai were $0.6 million and $1.5 million for the three and nine months ended September 30, 2019, respectively. As of September 30, 2020 and December 31, 2019, the Company had immaterial receivables from Weichai and outstanding payables to Weichai of $6.6 million and $5.9 million, respectively.

## Note 4. Property, Plant and Equipment

Property, plant and equipment by type were as follows:

| (in thousands) | As of September 30, 2020 | As of December 31, 2019 |
|---|---|---|
| **Property, Plant and Equipment** | | |
| Leasehold improvements | $ 6,820 | $ 6,745 |
| Machinery and equipment | 42,857 | 41,243 |
| Construction in progress | 1,543 | 1,679 |
| **Total property, plant and equipment, at cost** | 51,220 | 49,667 |
| Accumulated depreciation | (30,104) | (26,473) |
| **Property, plant and equipment, net** | $ 21,116 | $ 23,194 |

## Note 5. Goodwill and Other Intangibles

### Goodwill

The carrying amount of goodwill at both September 30, 2020 and December 31, 2019 was $29.8 million. Accumulated impairment losses at both September 30, 2020 and December 31, 2019 were $11.6 million.

See *Note 1. Summary of Significant Accounting Policies and Other Information* for additional discussion of the Company's impairment considerations related to the impacts of the COVID-19 pandemic and the oil and gas market price volatility.

### Other Intangible Assets

Components of intangible assets are as follows:

| (in thousands) | As of September 30, 2020 | | |
|---|---|---|---|
| | Gross Carrying Value | Accumulated Amortization | Net Book Value |
| Customer relationships | $ 34,940 | $ (24,397) | $ 10,543 |
| Developed technology | 700 | (639) | 61 |
| Trade names and trademarks | 1,700 | (1,222) | 478 |
| **Total** | $ 37,340 | $ (26,258) | $ 11,082 |

| (in thousands) | As of December 31, 2019 | | |
|---|---|---|---|
| | Gross Carrying Value | Accumulated Amortization | Net Book Value |
| Customer relationships | $ 34,940 | $ (22,236) | $ 12,704 |
| Developed technology | 700 | (605) | 95 |
| Trade names and trademarks | 1,700 | (1,127) | 573 |
| **Total** | $ 37,340 | $ (23,968) | $ 13,372 |

## Note 6. Debt

The Company's outstanding debt consisted of the following:

| (in thousands) | As of September 30, 2020 | As of December 31, 2019 |
|---|---|---|
| **Short-term financing:** | | |
| Revolving credit facility | $ 130,000 | $ 39,527 |
| | | |
| **Long-term debt:** | | |
| Unsecured senior notes | $ — | $ 55,000 |
| Finance leases and other debt | 1,042 | 1,087 |
| Unamortized debt issuance costs | — | (235) |
| **Total long-term debt and finance leases** | 1,042 | 55,852 |
| Less: Current maturities of long-term debt and finance leases | 288 | 195 |
| **Long-term debt** | $ 754 | $ 55,657 |

* Unamortized financing costs and deferred fees on the revolving credit facility are not presented in the above table as they are classified in *Prepaid expenses and other current assets* on the Consolidated Balance Sheet. Unamortized debt issuance costs related to the revolving credit facility were $1.0 million as of September 30, 2020.

### *Credit Agreement*

On April 2, 2020, the Company closed on its new senior secured revolving credit facility pursuant to that certain credit agreement, dated as of March 27, 2020, by and between the Company and Standard Chartered as administrative agent. The Credit Agreement allows the Company to borrow up to $130.0 million and matures on March 26, 2021 with an optional 60-day extension, subject to certain conditions and payment of a 0.25% extension fee. Borrowings under the Credit Agreement bear interest at either the base rate as defined in the Credit Agreement or the London Interbank Offered Rate ("LIBOR") plus 2.00% per annum, and the Company is required to pay a 0.25% commitment fee on the average daily unused portion of the revolving credit facility under the Credit Agreement. The Credit Agreement is secured by substantially all of the Company's assets and includes certain financial covenants as well as a change of control provision. On April 2, 2020, the Company borrowed $95.0

million under the Credit Agreement and utilized the funds (i) to repay the outstanding balance of $16.8 million on the revolving credit agreement between the Company and Wells Fargo Bank, N.A. (the “Wells Fargo Credit Agreement”), (ii) to fully redeem and discharge $55.0 million in aggregate outstanding principal amount of its unsecured notes due June 2020 (the “Unsecured Senior Notes”) and pay related interest, and (iii) for general corporate purposes. The Wells Fargo Credit Agreement was terminated in connection with repayment of the outstanding balance. The Company recognized a loss on the extinguishment of the Wells Fargo Credit Agreement and the Unsecured Senior Notes of $0.5 million related to premiums to early retire the Unsecured Senior Notes and unamortized debt issuance costs. The Company deferred debt issuance costs related to the closing of the Credit Agreement of $2.0 million. On April 29, 2020, the Company borrowed an additional $35.0 million under the Credit Agreement, which was the remaining portion of availability, providing the Company with greater financial flexibility.

As discussed above, the Credit Agreement includes financial covenants which were effective for the Company beginning with the six months ended June 30, 2020. The financial covenants include an interest coverage ratio and a minimum EBITDA threshold as further defined in the Credit Agreement. For the six months ended June 30, 2020 and the nine months ended September 30, 2020, the Company did not meet the defined minimum EBITDA requirement. A breach of the financial covenants under the Credit Agreement constitutes an event of default and, if not cured or waived, could result in the obligations under the Credit Agreement being accelerated. The Company is currently in discussion with Standard Chartered in connection with the financial covenant breach. See Note 1. *Summary of Significant Accounting Policies and Other Information* for further discussion of the Company’s going concern considerations.

## Note 7. Leases

### Leases

The Company has obligations under lease arrangements primarily for facilities, equipment and vehicles. These leases have original lease periods expiring between December 2020 and August 2034. For the three and nine months ended September 30, 2020, the Company recorded lease expense of $1.4 million and $4.9 million within *Cost of sales*, $0.4 million and $0.5 million within *Research, development, and engineering expenses*, $0.1 million and $0.2 million within *Selling, general and administrative expenses* and less than $0.1 million within *Interest expense* in the Consolidated Statements of Operations, respectively. For the three and nine months ended September 30, 2019, the Company recorded lease expense of $1.6 million and $5.2 million within *Cost of sales*, $0.3 million and $0.5 million within *Research, development and engineering expenses*, $0.1 million and $0.2 million within *Selling, general and administrative expenses* and less than $0.1 million within *Interest expense* in the Consolidated Statements of Operations, respectively.

The following table summarizes the components of lease expense:

| (in thousands) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2020 | 2019 | 2020 | 2019 |
| Operating lease cost | $ 1,394 | $ 1,386 | $ 4,141 | $ 4,193 |
| Finance lease cost | | | | |
| Amortization of right-of-use (“ROU”) asset | 52 | 50 | 156 | 119 |
| Interest expense | 12 | 14 | 37 | 35 |
| Short-term lease cost | 105 | 177 | 322 | 453 |
| Variable lease cost | 363 | 390 | 1,160 | 1,156 |
| **Total lease cost** | $ 1,926 | $ 2,017 | $ 5,816 | $ 5,956 |

The following table presents supplemental cash flow information related to leases:

| (in thousands) | For the Nine Months Ended September 30, | |
|---|---|---|
| | 2020 | 2019 |
| Cash paid for amounts included in the measurement of lease liabilities | | |
| Operating cash flows paid for operating leases | $ 4,105 | $ 3,816 |
| Operating cash flows paid for interest portion of finance leases | 37 | 36 |
| Financing cash flows paid for principal portion of finance leases | 145 | 106 |
| Right-of-use assets obtained in exchange for lease obligations | | |
| Operating leases | 299 | 280 |
| Finance leases | 11 | 517 |

As of September 30, 2020 and December 31, 2019, the weighted-average remaining lease term was 6.3 years and 6.7 years for operating leases and 4.0 years and 4.5 years for finance leases, respectively. The weighted-average discount rate was 7.2% for operating leases as of both September 30, 2020 and December 31, 2019 and 6.7% and 6.8% for finance leases as of September 30, 2020 and December 31, 2019, respectively.

The following table presents supplemental balance sheet information related to leases:

| (in thousands) | September 30, 2020 | December 31, 2019 |
|---|---|---|
| **Operating lease ROU assets, net** [1] | $ 18,083 | $ 20,677 |
| Operating lease liabilities, current [2] | 3,802 | 3,789 |
| Operating lease liabilities, non-current [3] | 15,114 | 17,679 |
| **Total operating lease liabilities** | $ 18,916 | $ 21,468 |
| **Finance lease ROU assets, net** [1] | $ 617 | $ 777 |
| Finance lease liabilities, current [2] | 197 | 195 |
| Finance lease liabilities, non-current [3] | 464 | 617 |
| **Total finance lease liabilities** | $ 661 | $ 812 |

1. Included in *Other noncurrent assets* for operating leases and *Property, plant and equipment, net* for finance leases on the Consolidated Balance Sheets.
2. Included in *Other accrued liabilities* for operating leases and *Current maturities of long-term debt* for finance leases on the Consolidated Balance Sheets.
3. Included in *Other noncurrent liabilities* for operating leases and *Long-term debt, net of current maturities* for finance leases on the Consolidated Balance Sheets.

The following table presents maturity analysis of lease liabilities as of September 30, 2020:

| (in thousands) | Operating Leases | Finance Leases |
|---|---|---|
| Three months ending December 31, 2020 | $ 1,300 | $ 61 |
| Year ending December 31, 2021 | 4,948 | 245 |
| Year ending December 31, 2022 | 4,788 | 177 |
| Year ending December 31, 2023 | 3,283 | 103 |
| Year ending December 31, 2024 | 1,813 | 84 |
| Thereafter | 7,399 | 83 |
| **Total undiscounted lease payments** | 23,531 | 753 |
| Less: imputed interest | 4,615 | 92 |
| **Total lease liabilities** | $ 18,916 | $ 661 |

## Note 8. Fair Value of Financial Instruments

For assets and liabilities measured at fair value on a recurring and nonrecurring basis, a three-level hierarchy of measurements based upon observable and unobservable inputs is used to arrive at fair value. Observable inputs are developed based on market data obtained from independent sources, while unobservable inputs reflect the Company's assumptions about valuation based on the best information available in the circumstances. Depending on the inputs, the Company classifies each fair-value measurement as follows:

- Level 1 – based on quoted prices in active markets for identical assets or liabilities;
- Level 2 – based on other significant observable inputs for the assets or liabilities through corroborations with market data at the measurement date; and
- Level 3 – based on significant unobservable inputs that reflect management's best estimate of what market participants would use to price the assets or liabilities at the measurement date.

### Financial Instruments Measured at Carrying Value

***Debt***

The Company measured its revolving credit facilities and the Unsecured Senior Notes at original carrying value including accrued interest, net of unamortized deferred financing costs and fees. The fair value of the revolving credit facility approximated carrying value, as it consisted of short-term variable rate loans.

The fair value measurement of the Unsecured Senior Notes was defined as Level 3 at December 31, 2019 in the three-level fair value hierarchy, as the inputs to their valuation were not all market observable.

| (in thousands) | As of September 30, 2020 | | | |
|---|---|---|---|---|
| | | Fair Value | | |
| | Carrying Value | Level 1 | Level 2 | Level 3 |
| Revolving credit facility | $ 130,000 | $ — | $ 130,000 | $ — |

| (in thousands) | As of December 31, 2019 | | | |
|---|---|---|---|---|
| | | Fair Value | | |
| | Carrying Value | Level 1 | Level 2 | Level 3 |
| Revolving credit facility | $ 39,527 | $ — | $ 39,527 | $ — |
| Unsecured Senior Notes | 54,765 | — | — | 54,600 |

### Financial Instruments Measured at Fair Value

***Warrants***

The following table summarizes changes in the estimated fair value of the Company’s warrant liability:

| (in thousands) | For the Nine Months Ended September 30, 2019 |
|---|---|
| **Balance at beginning of period** | $ 35,100 |
| Change in value of warrants * | 1,352 |
| Settlement of warrants | (36,452) |
| **Balance at end of period** | $ — |

* The change in value of the warrant liability is presented as *Loss from change in value of warrants* in the Company’s Consolidated Statements of Operations.

## Note 9. Commitments and Contingencies

### Legal Contingencies

The legal matters discussed below and others could result in losses, including damages, fines, civil penalties and criminal charges, which could be substantial. The Company records accruals for these contingencies to the extent the Company concludes that a loss is both probable and reasonably estimable. Regarding the matters disclosed below, unless otherwise disclosed, the Company has determined that liabilities associated with these legal matters are reasonably possible; however, unless otherwise stated, the possible loss or range of possible loss cannot be reasonably estimated. Given the nature of the litigation and investigations and the complexities involved, the Company is unable to reasonably estimate a possible loss for all such matters until the Company knows, among other factors, the following:

- what claims, if any, will survive dispositive motion practice;
- the extent of the claims, particularly when damages are not specified or are indeterminate;
- how the discovery process will affect the litigation;
- the settlement posture of the other parties to the litigation; and
- any other factors that may have a material effect on the litigation or investigation.

However, the Company could incur judgments, enter into settlements or revise its expectations regarding the outcome of certain matters, and such developments could have a material adverse effect on the Company’s results of operations in the period in which the amounts are accrued and/or liquidity in the period in which the amounts are paid.

***Securities and Exchange Commission and United States Attorney's Office for the Northern District of Illinois Investigations***

In August 2016, the Chicago Regional Office of the SEC commenced an investigation focused on, among other things, the Company's financial reporting, misapplication of U.S. GAAP, revenue recognition practices and related conduct, which resulted in the accounting errors giving rise to the financial restatements reported in prior SEC filings. In 2016, the United States Attorney's Office for the Northern District of Illinois (the "USAO") began conducting a parallel investigation regarding these matters. In September 2020, the Company entered into agreements with the SEC and USAO to resolve the investigations into the Company's past revenue recognition practices. As part of this resolution, the Company made a payment of $1.7 million as a civil penalty to the SEC in October 2020. Furthermore, under the settled administrative order with the SEC, the Company is committed to remediate the deficiencies in its internal control over financial reporting that constituted material weaknesses identified in its 2017 Form 10-K filed in May 2019 by April 30, 2021 unless an extension is provided by the SEC. The Company also entered into a Non-Prosecution Agreement (the "NPA") with the USAO, which contains no further monetary penalty and provides that the USAO will not charge the Company with a crime, provided that the Company complies with the provisions of the NPA, including making enhancements to its corporate compliance program. The Company also will continue to fully cooperate with the SEC and USAO pursuant to these agreements. With these agreements, the investigations into the Company by the SEC and USAO have concluded. The Company had accrued the $1.7 million penalty in *Other accrued liabilities* in the first quarter of 2019.

***Federal Derivative Litigation***

In February 2017, Travis Dorvit filed a putative stockholder derivative action in the U.S. District Court for the Northern District of Illinois, captioned *Dorvit v. Winemaster, et al.*, No. 1:17-cv-01097 (N.D. Ill.) (the "*Dorvit* Action"), against certain of the Company's current and former officers and directors. The complaint asserted claims for breach of fiduciary duty and unjust enrichment arising from the same matters at issue in the consolidated case captioned Guinta v. Power Solutions International, Inc., No. 1:16-cv-09599 (N.D.Ill.), which had alleged violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), arising from public filings, press releases and conference calls between February 2014 and February 2017, and which was settled in May 2019 (hereinafter, the "*Giunta* Action"). In April 2018, Michael Martin filed a second putative stockholder derivative action, captioned *Martin v. Winemaster, et al.*, No. 18-CV-2386 (N.D. Ill.) (the "*Martin* Action"), in the same court against certain of the Company's current and former officers and directors. In July 2018, the court consolidated the *Martin* Action and the *Dorvit* Action.

In July 2018, the plaintiffs in the consolidated *Dorvit* and *Martin* Actions filed an amended consolidated complaint (the "Second Amended Complaint") against certain of the Company's current and former officers and directors, who are indemnified by the Company as to their legal fees and defense costs. The Second Amended Complaint asserts claims for breach of fiduciary duty, unjust enrichment, corporate waste and failure to hold an annual stockholders' meeting, and it seeks an unspecified amount of damages, an order compelling the Company to hold an annual stockholders' meeting and an award of costs, including reasonable attorneys' fees and expenses. In April 2019, the parties reached an agreement in principle to settle the litigation for approximately $1.9 million ("Settlement Amount"), half of which will be used to pay certain defense costs on behalf of the Company, and the remaining half of which the plaintiffs sought as an award of their attorneys' fees and expenses in connection with the benefit conferred by the settlement. The settlement was approved by the court in August 2019 over two objections, including from the plaintiffs in the *McClenney* Action (defined below). Plaintiffs in the *McClenney* Action appealed the court's order approving the settlement. In February 2020, the U.S. Court of Appeals for the Seventh Circuit affirmed the district court's approval of the settlement. The deadline for the plaintiffs in the *McClenney* Action to seek further review in the U.S. Supreme Court elapsed in July 2020 and the settlement is a final judgement. The Company's insurers made a payment of half of the Settlement Amount in September 2019 toward the fulfillment of the plaintiff's award of attorneys' fees and expenses, and the insurer allocated the remaining half of the Settlement Amount toward the payment of certain defense costs consistent with the terms of the settlement. The Company had accrued for the settlement in *Other accrued liabilities* and for the full insurance recovery of the Settlement Amount in *Prepaid expenses and other current assets* as of December 31, 2019.

***State Derivative Litigation***

In May 2017, Lewis McClenney filed a putative stockholder derivative action in the Chancery Division of the Circuit Court of Cook County, Illinois, captioned *McClenney v. Winemaster, et al.*, No. 2017-CH-06481 (the "*McClenney* Action"), against certain of the Company's current and former officers and directors. The *McClenney* Action asserted claims for breach of fiduciary duty, unjust enrichment, abuse of control, gross mismanagement and corporate waste arising from the same matters at issue in the *Giunta* Action. On the same day that the *McClenney* Action was filed, Sara Rebscher also filed a putative stockholder derivative action in the same court, captioned *Rebscher v. Winemaster, et al.*, No. 2017-CH-06517 (the "*Rebscher* Action"). The *Rebscher* Action asserts claims for breach of fiduciary duty and unjust enrichment against certain of the Company's current and former officers and directors, arising from the same matters at issue in the *Giunta* Action. Additionally, the complaint in the *Rebscher* Action asserts a claim for professional negligence and accounting malpractice against the Company's former auditor, RSM U.S. LLP ("RSM"). In July 2017, the court consolidated the *McClenney* Action and the *Rebscher* Action. Subsequently, the court appointed Rebscher as lead plaintiff and designated the *Rebscher* Action as the operative complaint. In November 2018, the court granted the Company's motion to dismiss the consolidated case with prejudice on the grounds that it is duplicative of the *Dorvit* and *Martin* Actions. Plaintiffs moved for reconsideration of the court's decision, which the court denied in January 2019. In February 2019, plaintiffs filed a notice of appeal from the court's order dismissing the case. In December 2019, the Illinois Appellate Court affirmed the dismissal of the *McClenney* Action. Plaintiffs did not seek rehearing in the Illinois Appellate Court and did not petition for leave to appeal to the Illinois Supreme Court.

***Jerome Treadwell v. the Company***

In October 2018, a putative class-action complaint was filed against the Company and NOVAtime Technology, Inc. ("NOVAtime") in the Circuit Court of Cook County, Illinois. In December 2018, NOVAtime removed the case to the U.S. District Court for the Northern District of Illinois, Eastern Division under the Class Action Fairness Act. Plaintiff has since voluntarily dismissed NOVAtime from the lawsuit without prejudice and filed an amended complaint in April 2019. The operative, amended complaint asserts violations of the Illinois Biometric Information Privacy Act ("BIPA") in connection with employees' use of the time clock to clock in and clock out using a finger scan and seeks statutory damages, attorneys' fees, and injunctive and equitable relief. An aggrieved party under BIPA may recover (i) $1,000 per violation if the Company is found to have negligently violated BIPA or (ii) $5,000 per violation if the Company is found to have intentionally or recklessly violated BIPA plus reasonable attorneys' fees. In May 2019, the Company filed its motion to dismiss the plaintiff's amended complaint. In December 2019, the court denied the Company's motion to dismiss. In January 2020, the Company moved for reconsideration of the court's order denying the motion to dismiss, or in the alternative, to stay the case pending the Illinois Appellate Court's ruling in *McDonald v. Symphony Healthcare* on a legal question that would be potentially dispositive in this matter. In February 2020, the court denied the Company's motion for reconsideration, but required the parties to submit additional briefing on the Company's motion to stay. In April 2020, the court granted the Company's motion to stay and stayed the case pending the Illinois Appellate Court's ruling in *McDonald v. Symphony Healthcare*. In October 2020, after the *McDonald* ruling, the court granted the parties' joint request to continue the stay of the case for 60 days. The court also ordered the parties to schedule a settlement conference with the Magistrate Judge, and scheduling is in progress. At this time, the Company is unable to predict the outcome of this matter or meaningfully quantify how the final resolution of this matter may impact its results of operations, financial condition or cash flows.

***Elton Evans v. the Company***

In September 2020, a claim was filed against the Company in the Circuit Court of DuPage County, Illinois. The claim asserts an individual violation of the Illinois BIPA similar to the claims made in the *Jerome Treadwell v. the Company* matter discussed above. The Company's responsive pleading is currently due on November 16, 2020. At this time, the Company is unable to predict the outcome of this matter or meaningfully quantify how the final resolution of this matter may impact its results of operations, financial condition or cash flows.

***Don Wilkins v. the Company***

In April 2017, Don Wilkins, former VP of Advanced Product Development for the Company, filed a two-count complaint alleging breach of contract by the Company and violation of the Illinois Wage Payment and Collections Act ("IWPCA") by the Company and its former CEO, Gary Winemaster (the "Wilkins Complaint"). The Wilkins Complaint claims the Company did not have cause to terminate Mr. Wilkins' Employment and Confidentiality Agreement (the "Wilkins Agreement"), executed January 6, 2012, and that the Company and Mr. Winemaster violated the IWPCA by failing to pay him accrued but unpaid vacation and earned commissions. The Wilkins Complaint seeks damages including a $2.0 million bonus entitlement in the Wilkins Agreement, guaranteed annual salary to increase at 1.5 times the Consumer Price Index per year from the termination date to the end-date of the Wilkins Agreement, December 31, 2020, and 20,000 shares of restricted stock granted to him in 2013 with a vesting schedule through 2020. In June 2017, the Company and Mr. Winemaster answered the complaint and asserted numerous defenses. The Company also asserted counterclaims against Mr. Wilkins including violation of the Illinois Trade Secrets Act, breach of the Wilkins Agreement, breach of fiduciary duty, and spoliation. In January 2019, Wilkins voluntarily dismissed with prejudice his claims for unpaid commissions and vacation against the Company and Mr. Winemaster, subject to the parties' confidential settlement agreement of those claims. In February 2020, the Company filed a motion for protective order to stay the litigation, which the court denied in April 2020. In May 2020, the parties reached an agreement to settle all remaining claims for a $1.1 million payment ("Wilkins Settlement Amount") to Mr. Wilkins. The Company paid $0.9 million of the Wilkins Settlement Amount which was reserved as of the first quarter of 2019. The Company's insurance provider contributed the remainder of the Wilkins Settlement Amount. In June 2020, the court dismissed the Wilkins Complaint with prejudice and with each party to bear their own costs and attorneys' fees.

***Mast Powertrain v. the Company***

In February 2020, the Company received a demand for arbitration from Mast Powertrain, LLC ("Mast") pursuant to a development agreement entered into in November 2011 (the "Development Agreement"). Mast claimed that it is owed more than $9.0 million in past royalties and other damages for products sold by the Company pursuant to the Development

Agreement. The Company has disputed Mast's damages, denied that any royalties are owed to Mast, denied any liability, and counterclaimed for overpayment on invoices paid to Mast. Mast has subsequently clarified its claim for past royalties owed to be approximately $4.5 million. Arbitration is anticipated to occur in the Spring of 2021. At this time, the Company is unable to predict the outcome of this matter or meaningfully quantify how the final resolution of this matter may impact its results of operations, financial condition or cash flows.

**Indemnification Agreements**

Under the Company's bylaws and certain indemnification agreements, the Company has obligations to indemnify current and former officers and directors and certain current and former employees. As a result of cumulative legal fees and settlements previously paid, the Company fully exhausted its primary directors' and officers' insurance coverage of $30 million during the first quarter of 2020. Additional expenses currently expected to be incurred and that will occur in the future and/or liabilities that may be imposed in connection with actions against certain of the Company's past and present directors and officers and certain current and former employees who are entitled to indemnification will be funded by the Company with its existing cash resources. The Company accrues for such costs as incurred within *Selling, general and administrative expenses* in the Company's Consolidated Statements of Operations. At this time, the Company is not able to estimate the impact of these obligations due to the actions ongoing; however, the impact may be material to the Company's results of operations, financial condition, and cash flows.

At the end of June 2020, the Company entered into a new directors' and officers' liability insurance policy. The insurance policy includes standard exclusions including for any ongoing or pending litigation such as the previously disclosed investigations by the SEC and USAO.

**Other Commitments**

At September 30, 2020, the Company had six outstanding letters of credit totaling $2.8 million. The letters of credit primarily serve as collateral for the Company for certain facility leases and insurance policies. As discussed in Note 1. *Summary of Significant Accounting Policies and Other Information*, the Company had restricted cash of $3.3 million at September 30, 2020 related to these letters of credit.

The Company has arrangements with certain suppliers that require it to purchase minimum volumes or be subject to monetary penalties. As of September 30, 2020, if the Company were to stop purchasing from each of these suppliers, the aggregate amount of the penalty would be approximately $4.0 million. Most of these arrangements enable the Company to secure supplies of critical components. The Company does not currently anticipate any material penalties under these contracts; however, given the significant declines in oil prices in early 2020 and the impacts of the COVID-19 pandemic, the Company continues to monitor and evaluate the impact of potential future purchase volume reductions.

**Note 10. Income Taxes**

On a quarterly basis, the Company computes an estimated annual effective tax rate considering ordinary income and related income tax expense. Ordinary income refers to income (loss) before income tax expense excluding significant, unusual or infrequently occurring items. The tax effect of an unusual or infrequently occurring item is recorded in the interim period in which it occurs.

The Company has assessed the need to maintain a valuation allowance for deferred tax assets based on an assessment of whether it is more likely than not that deferred tax benefits will be realized through the generation of future taxable income. Appropriate consideration is given to all available evidence, both positive and negative, in assessing the need for a valuation allowance. In assessing the realizability of the Company's deferred tax assets, the Company considered whether it is more likely than not that some or all of the deferred tax assets will be realized through the generation of future taxable income. In making this determination, the Company assessed all of the evidence available at the time, including recent earnings, forecasted income projections and historical performance. The Company determined that the negative evidence outweighed the objectively verifiable positive evidence and continues to maintain a full valuation allowance against deferred tax assets.

In March 2020, President Trump signed into law the *Coronavirus Aid, Relief, and Economic Security Act* (the "CARES Act"). Among the changes to the U.S. federal income tax rules, the CARES Act modified net operating loss carryback rules that were eliminated by the 2017 *Tax Cuts and Jobs Act*, restored 100% bonus depreciation for qualified improvement property, increased the limit on the deduction for net interest expense and accelerated the time frame for refunds of alternative minimum tax ("AMT") credits. The Company's ability to elect bonus depreciation for the 2018 and 2019 tax years, carryback net operating losses to earlier years, and immediately refund AMT credits due to the enactment of the CARES Act resulted in a tax benefit of $2.2 million for the nine months ended September 30, 2020. There is no material impact to the Company's deferred tax assets due to the full valuation allowance.

The effective tax rate for the three and nine months ended September 30, 2020 was 12.5% and 15.9%, respectively, compared to an effective tax rate for the three and nine months ended September 30, 2019 of 7.7% and 44.2%. The effective tax rates for all periods were significantly different than the applicable U.S. statutory tax rate. For the three months ended September 30, 2020, the difference between the effective and statutory tax rates was primarily due to an adjustment to the impact of the CARES Act. For the nine months ended September 30, 2020, the difference between the effective and statutory tax rates was primarily due to the impact of the CARES Act, a change in the deferred tax liability related to an indefinite-lived intangible asset and the Company's full valuation allowance. For the three and nine months ended September 30, 2019, the difference between the effective and statutory tax rates is primarily due to the Company's full valuation allowance, the impact of the losses related to the Weichai Warrant (except the three months ended September 30, 2019, which was not impacted due to the April 2019 exercise of the Weichai Warrant) and an increase in the deferred tax liability related to indefinite-lived assets which cannot serve as a source of income for the realization of deferred tax assets and states that base tax on gross margin.

## Note 11. Stockholders' Equity

### *Common and Treasury Stock*

The changes in shares of Common and Treasury Stock are as follows:

| (in thousands) | Common Shares Issued | Treasury Stock Shares | Common Shares Outstanding |
|---|---|---|---|
| **Balance as of January 1, 2020** | 23,117 | 260 | 22,857 |
| Net shares issued for Stock awards | — | (29) | 29 |
| **Balance as of September 30, 2020** | 23,117 | 231 | 22,886 |

## Note 12. (Loss) Earnings Per Share

The Company computes basic (loss) earnings per share by dividing net (loss) income distributable to common shares by the weighted-average common shares outstanding during the period. Diluted (loss) earnings per share is calculated to give effect to all potentially dilutive common shares that were outstanding during the period. Weighted-average diluted common shares outstanding primarily reflect the additional shares that would be issued upon the assumed exercise of stock options and the assumed vesting of unvested share awards. The treasury stock method has been used to compute diluted (loss) earnings per share for the three and nine months ended September 30, 2020 and 2019.

The Company issued warrants that represent the right to purchase shares of Common Stock, Stock Appreciation Rights ("SARs") and Restricted Stock Awards ("RSAs"), all of which have been evaluated for their potentially dilutive effect under the treasury stock method. See Note 3. *Weichai Transactions* herein for additional information on the Weichai Warrant and Note 12. *Stock-Based Compensation* in the Company's 2019 Annual Report for additional information on the SARs and the RSAs.

The computations of basic and diluted (loss) earnings per share are as follows:

| (in thousands, except per share basis) | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2020** | **2019** | **2020** | **2019** |
| **Numerator:** | | | | |
| Net (loss) income | $ (1,466) | $ 5,756 | $ (19,920) | $ 172 |
| **Denominator:** | | | | |
| **Shares used in computing net (loss) income per share:** | | | | |
| Weighted-average common shares outstanding – basic | 22,881 | 22,849 | 22,866 | 21,064 |
| Effect of dilutive securities | — | 27 | — | 24 |
| **Weighted-average common shares outstanding – diluted** | 22,881 | 22,876 | 22,866 | 21,088 |
| **(Loss) earnings per common share:** | | | | |
| **(Loss) earnings per share of common stock – basic** | $ (0.06) | $ 0.25 | $ (0.87) | $ 0.01 |
| **(Loss) earnings per share of common stock – diluted** | $ (0.06) | $ 0.25 | $ (0.87) | $ 0.01 |

The aggregate number of shares excluded from the diluted (loss) earnings per share calculations, because they would have been anti-dilutive, were 0.2 million shares for both the three and nine months ended September 30, 2020, respectively, and 0.2 million and 1.8 million shares during the three and nine months ended September 30, 2019, respectively. For the three and nine months ended September 30, 2020 and 2019, SARs and RSAs were not included in the diluted (loss) earnings per share calculations as they would have been anti-dilutive (1) due to the losses reported in the Consolidated Statements of Operations or (2) the Company's average stock price was less than the exercise price of the SARs or the grant price of the RSAs.

## Note 13. Related Party Transactions

### Weichai Transactions

See Note 3. *Weichai Transactions* for information regarding transactions with Weichai.

### Transactions with Joint Ventures

***Doosan-PSI, LLC***

In 2015, the Company and Doosan Infracore Co., Ltd. ("Doosan"), a subsidiary of Doosan Group, entered into an agreement to form Doosan-PSI, LLC. The Company invested $1.0 million to acquire 50% of the venture, which was formed to operate in the field of developing, designing, testing, manufacturing, assembling, branding, marketing, selling, distributing and providing support for industrial gas engines and all components and materials required for assembly of the gas engines to the global power generation market outside of North America and South Korea. In the fourth quarter of 2019, Doosan and the Company agreed to wind down and dissolve the joint venture. This is expected to be completed by the end of 2020.

***Joint Venture Operating Results***

The Company's Consolidated Statements of Operations included income from this investment of less than $0.1 million and $0.3 million for the three and nine months ended September 30, 2020, respectively. Income from this investment was $0.1 million and $0.5 million for the three and nine months ended September 30, 2019, respectively. The joint venture operating results are presented in *Other income, net* in the Company's Consolidated Statements of Operations.

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

*The following discussion and analysis includes forward-looking statements about the Company's business and consolidated results of operations for the three and nine months ended September 30, 2020 and 2019, including discussions about management's expectations for the Company's business. These statements represent projections, beliefs and expectations based on current circumstances and conditions and in light of recent events and trends, and these statements should not be construed either as assurances of performance or as promises of a given course of action. Instead, various known and unknown factors are likely to cause the Company's actual performance and management's actions to vary, and the results of these variances may be both material and adverse. See "Forward-Looking Statements." The following discussion should also be read in conjunction with the Company's unaudited consolidated financial statements and the related Notes included in this Quarterly Report.*

**Executive Overview**

The Company designs, engineers, manufactures, markets and sells a broad range of advanced, emission-certified engines and power systems that run on a wide variety of fuels, including natural gas, propane, gasoline, diesel and biofuels, within the energy, industrial and transportation end markets with primary manufacturing, assembly, engineering, research and development ("R&D"), sales and distribution facilities located in suburban Chicago, Illinois, and Darien, Wisconsin. The Company provides highly engineered, comprehensive solutions designed to meet specific customer application requirements and technical specifications, including those imposed by environmental regulatory bodies, such as the U.S. Environmental Protection Agency ("EPA"), the California Air Resources Board ("CARB") and the People's Republic of China's Ministry of Ecology and Environment ("MEE," formerly the Ministry of Environmental Protection).

The COVID-19 pandemic has resulted in the implementation of significant governmental measures to control the spread of the virus, including quarantines, travel restrictions, business shutdowns and restrictions on the movement of people in the United States and abroad, and the related recent historic decline in oil demand. The Company has experienced a significant overall reduction in demand for its products which is, in large part, attributable to the impact of the COVID-19 pandemic. This reduction in demand has adversely impacted the Company's financial results for the three and nine months ended September 30, 2020.

The Company's products are primarily used by global original equipment manufacturers ("OEMs") and end-user customers across a wide range of applications and equipment that includes standby and prime power generation, demand response, microgrid, combined heat and power, arbor care, material handling (including forklifts), agricultural and turf, construction, pumps and irrigation, compressors, utility vehicles, light- and medium-duty vocational trucks, school and transit buses, and utility power. The Company manages the business as a single reporting segment.

For the three months ended September 30, 2020, the Company's net sales decreased $24.1 million, or 17%, from the three months ended September 30, 2019 to $114.5 million, the result of decreased sales across the energy and industrial end markets of $30.5 million and $7.2 million, respectively, partly offset by a $13.6 million increase in the transportation end market. Gross margin for the three months ended September 30, 2020 was 15.9%, a decrease versus 19.4% in the comparable 2019 period. Gross profit declined by $8.7 million for the three months ended September 30, 2020, while operating expenses increased by $0.5 million, as compared to the comparable period in 2019. Other income, net increased by $0.9 million during the three months ended September 30, 2020 compared to the three months ended September 30, 2019 primarily due to the receipt of life insurance benefits. Collectively, these factors contributed to a $7.2 million increase in the net loss, which totaled $1.5 million in the 2020 period compared to net income of $5.8 million in the same period in 2019. Diluted loss per share was $0.06 in the 2020 period compared to diluted earnings per share of $0.25 in the comparable 2019 period. Adjusted net income, which excludes certain items described below that the Company believes are not indicative of its ongoing operating performance, was $0.7 million in the 2020 period, a decrease of $7.5 million, compared to Adjusted net income of $8.1 million in 2019. Adjusted earnings per share was $0.03 in 2020 compared to Adjusted earnings per share of $0.35 in 2019. Adjusted earnings before interest expense, income taxes, depreciation and amortization ("EBITDA") was $4.3 million in 2020 compared to Adjusted EBITDA of $12.7 million in 2019. Adjusted net loss (income), Adjusted loss (income) per share and Adjusted EBITDA are non-GAAP financial measures. For a reconciliation of each of these measures to the nearest applicable GAAP financial measure, as well as additional information about these non-GAAP measures, see the section entitled Non-GAAP Financial Measures in this Item 2.

For the nine months ended September 30, 2020, the Company's net sales decreased $80.4 million, or 20%, compared to the nine months ended September 30, 2019, as a result of sales declines across the energy and industrial end markets of $48.7 million and $44.8 million, respectively, partly offset by a $13.1 million increase in the transportation end market. Gross margin was 12.7% and 17.9% during the nine months ended September 30, 2020 and 2019, respectively. Gross profit decreased during the nine months ended September 30, 2020 by $30.5 million compared to the nine months ended September 30, 2019, while operating expenses decreased by $3.1 million as compared to the comparable period in 2019. Interest expense decreased by $1.9 million for the nine months ended September 30, 2020 versus the comparable period in 2019. The Company recognized a loss of $1.4 million for the nine months ended September 30, 2019 as a result of the change in the value of the Weichai Warrant including the impact of the exercise in the second quarter of 2019. See Note 3. *Weichai Transactions*, included in Part 1, Item 1. *Financial Statements*, for additional information. Also, the Company recorded an income tax benefit of $3.8 million for the nine months ended September 30, 2020 versus an expense of $0.1 million for the same period last year. Collectively, these factors contributed to a $20.1 million increase in the net loss, which totaled $19.9 million in the 2020 period compared to net income of $0.2 million in the same period of 2019. Diluted loss per share was $0.87 in the 2020 period compared to diluted earnings per share of $0.01 in the comparable 2019 period. Adjusted net loss, which excludes certain items described below that the Company believes are not indicative of its ongoing operating performance, was $12.2 million in the 2020 period compared to Adjusted net income of $16.5 million in 2019. Adjusted loss per share was $0.53 in 2020 compared to Adjusted earnings per share of $0.78 in 2019. Adjusted EBITDA was a loss of $1.6 million in 2020 compared to Adjusted EBITDA of $29.4 million in 2019. Adjusted net loss (income), Adjusted loss (earnings) per share and Adjusted EBITDA are non-GAAP financial measures. For a reconciliation of each of these measures to the nearest applicable GAAP financial measure, as well as additional information about these non-GAAP measures, see the section entitled Non-GAAP Financial Measures in this Item 2.

Net sales by geographic area and by end market for the three and nine months ended September 30, 2020 and 2019 are presented below:

| | For the Three Months Ended September 30, | | | | For the Nine Months Ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2020 | | 2019 | | 2020 | | 2019 | |
| **Geographic Area** | | % of Total | | % of Total | | % of Total | | % of Total |
| North America | $ 104,840 | 92 % | $ 125,971 | 91 % | $ 281,339 | 90 % | $ 343,593 | 87 % |
| Pacific Rim | 5,466 | 5 % | 6,744 | 5 % | 18,215 | 6 % | 30,173 | 8 % |
| Europe | 2,395 | 2 % | 4,329 | 3 % | 7,630 | 2 % | 12,712 | 3 % |
| Others | 1,749 | 1 % | 1,468 | 1 % | 5,419 | 2 % | 6,505 | 2 % |
| **Total** | **$ 114,450** | **100 %** | **$ 138,512** | **100 %** | **$ 312,603** | **100 %** | **$ 392,983** | **100 %** |

| | For the Three Months Ended September 30, | | | | For the Nine Months Ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2020 | | 2019 | | 2020 | | 2019 | |
| **End Market** | | % of Total | | % of Total | | | | |
| Energy | $ 33,813 | 30 % | $ 64,331 | 46 % | $ 113,546 | 36 % | $ 162,224 | 41 % |
| Industrial | 29,843 | 26 % | 37,020 | 27 % | 97,437 | 31 % | 142,267 | 36 % |
| Transportation | 50,794 | 44 % | 37,161 | 27 % | 101,620 | 33 % | 88,492 | 23 % |
| **Totals** | **$ 114,450** | **100 %** | **$ 138,512** | **100 %** | **$ 312,603** | **100 %** | **$ 392,983** | **100 %** |

## Results of Operations

***Results of operations for the three and nine months ended September 30, 2020 compared with the three and nine months ended September 30, 2019***:

| (in thousands, except per share amounts) | For the Three Months Ended September 30, 2020 | For the Three Months Ended September 30, 2019 | Change | % Change | For the Nine Months Ended September 30, 2020 | For the Nine Months Ended September 30, 2019 | Change | % Change |
|---|---|---|---|---|---|---|---|---|
| **Net sales** | $ 114,450 | $ 138,512 | $ (24,062) | (17)% | $ 312,603 | $ 392,983 | $ (80,380) | (20)% |
| Cost of sales | 96,281 | 111,640 | (15,359) | (14)% | 272,943 | 322,793 | (49,850) | (15)% |
| **Gross profit** | 18,169 | 26,872 | (8,703) | (32)% | 39,660 | 70,190 | (30,530) | (43)% |
| *Gross margin %* | *15.9 %* | *19.4 %* | *(3.5)%* | | *12.7 %* | *17.9 %* | *(5.2)%* | |
| Operating expenses: | | | | | | | | |
| Research, development and engineering expenses | 6,555 | 6,366 | 189 | 3 % | 19,121 | 18,695 | 426 | 2 % |
| *Research, development and engineering expenses as a % of sales* | *5.7 %* | *4.6 %* | *1.1 %* | | *6.1 %* | *4.8 %* | *1.3 %* | |
| Selling, general and administrative expenses | 11,964 | 11,461 | 503 | 4 % | 38,434 | 41,476 | (3,042) | (7)% |
| *Selling, general and administrative expenses as a % of sales* | *10.5 %* | *8.3 %* | *2.2 %* | | *12.3 %* | *10.6 %* | *1.7 %* | |
| Amortization of intangible assets | 763 | 910 | (147) | (16)% | 2,290 | 2,729 | (439) | (16)% |
| Total operating expenses | 19,282 | 18,737 | 545 | 3 % | 59,845 | 62,900 | (3,055) | (5)% |
| **Operating (loss) income** | (1,113) | 8,135 | (9,248) | (114)% | (20,185) | 7,290 | (27,475) | *NM |
| Other expense: | | | | | | | | |
| Interest expense | 1,510 | 1,921 | (411) | (21)% | 4,211 | 6,156 | (1,945) | (32)% |
| Loss from change in value of warrants | — | — | — | — % | — | 1,352 | (1,352) | (100)% |
| Loss on extinguishment of debt | — | — | — | — % | 497 | — | 497 | — % |
| Other income, net | (947) | (25) | (922) | NM | (1,202) | (526) | (676) | 129 % |
| Total other expense | 563 | 1,896 | (1,333) | (70)% | 3,506 | 6,982 | (3,476) | (50)% |
| (Loss) income before income taxes | (1,676) | 6,239 | (7,915) | (127)% | (23,691) | 308 | (23,999) | *NM |
| Income tax (benefit) expense | (210) | 483 | (693) | (143)% | (3,771) | 136 | (3,907) | *NM |
| **Net (loss) income** | $ (1,466) | $ 5,756 | $ (7,222) | (125)% | $ (19,920) | $ 172 | $ (20,092) | *NM |
| **(Loss) earnings per common share:** | | | | | | | | |
| Basic | $ (0.06) | $ 0.25 | $ (0.31) | (124)% | $ (0.87) | $ 0.01 | $ (0.88) | *NM |
| Diluted | $ (0.06) | $ 0.25 | $ (0.31) | (124)% | $ (0.87) | $ 0.01 | $ (0.88) | *NM |
| **Non-GAAP Financial Measures:** | | | | | | | | |
| **Adjusted net income (loss) *** | $ 652 | $ 8,147 | $ (7,495) | (92)% | $ (12,197) | $ 16,502 | $ (28,699) | (174)% |
| **Adjusted earnings (loss) per share – diluted *** | $ 0.03 | $ 0.35 | $ (0.32) | (91)% | $ (0.53) | $ 0.78 | $ (1.31) | (168)% |
| **EBITDA *** | $ 1,911 | $ 10,340 | $ (8,429) | (82)% | $ (13,268) | $ 13,068 | $ (26,336) | *NM |
| **Adjusted EBITDA *** | $ 4,316 | $ 12,731 | $ (8,415) | (66)% | $ (1,640) | $ 29,398 | $ (31,038) | (106)% |

*NM Not meaningful
* Non-GAAP measurement, see reconciliation below

***Net Sales***

Net sales decreased $24.1 million, or 17%, during the three months ended September 30, 2020 compared to the three months ended September 30, 2019, as a result of sales declines of $30.5 million and $7.2 million in the energy and industrial end markets, respectively, partly offset by a $13.6 million increase in the transportation end market. Lower energy end market sales were driven by decreased demand for the Company's power generation products, especially those used within the oil and gas industry. The decreased sales within the industrial end market reflects lower demand for products used across a wide range of applications, with the largest decrease attributable to those products used in the material handling/forklift markets. The increase in transportation end market sales was primarily due to increased medium duty truck market business in addition to higher sales in the terminal tractor market and a nominal increase in the school bus market.

Net sales decreased $80.4 million, or 20%, during the nine months ended September 30, 2020 compared to the nine months ended September 30, 2019, as a result of sales declines of $48.7 million and $44.8 million in the energy and industrial end markets, respectively, partly offset by an increase of $13.1 million in the transportation end market. Lower energy end market sales were driven by decreased demand for the Company's power generation products, particularly those used within the oil and gas industry, partly offset by increased demand for demand response products. The decreased sales within the industrial end market reflects lower demand for products used across various applications, with the largest decreases attributable to lower demand for products used in the material handling/forklift and arbor care markets. The increase in transportation end market sales was primarily due to increased demand for products used in the medium duty truck market, as well as stronger demand for products used within the terminal tractor and school bus markets.

***Gross Profit***

Gross profit decreased during the three months ended September 30, 2020 by $8.7 million, or 32%, compared to the three months ended September 30, 2019. Gross margin was 15.9% and 19.4% during the three months ended September 30, 2020 and 2019, respectively. The decline in gross margin is primarily due to unfavorable product mix and the impact of lower sales, partly mitigated by cost savings driven by reductions in the production facility workforce and other actions. For the three months ended September 30, 2020, warranty costs were $2.7 million (net of supplier recoveries of $2.8 million), including a $1.2 million benefit for adjustments to preexisting warranties, a decrease of $0.3 million compared to warranty costs of $3.0 million (net of supplier recoveries of $0.1 million) for the three months ended September 30, 2019. The warranty costs for the three months ended September 30, 2020 included $1.0 million of net charges related to specific engine supplier quality issues, for which the Company is actively seeking additional cost reimbursement.

Gross profit decreased during the nine months ended September 30, 2020 by $30.5 million, or 43%, compared to the nine months ended September 30, 2019. Gross margin was 12.7% and 17.9% during the nine months ended September 30, 2020 and 2019, respectively. The decline in gross margin is primarily due to significantly higher warranty expense related to charges from adjustments to preexisting warranties largely within the transportation end market, reduced operating leverage as a result of lower sales and unfavorable product mix, partly mitigated by cost savings driven by reductions in the production facility workforce and other actions. For the nine months ended September 30, 2020, warranty costs were $18.2 million (net of supplier recoveries of $4.6 million), including $8.8 million of charges for adjustments to preexisting warranties, an increase of $10.8 million compared to warranty costs of $7.4 million (net of supplier recoveries of $3.0 million) for the nine months ended September 30, 2019. The warranty costs for the nine months ended September 30, 2020 included $1.6 million of net charges related to specific engine supplier quality issues, for which the Company is actively seeking additional cost reimbursement.

***Research, Development and Engineering Expenses***

Research, development and engineering expenses during the three months ended September 30, 2020 were $6.6 million, an increase of $0.2 million, or 3%, from the three months ended September 30, 2019 levels. The increase was primarily related to the timing of projects, partly offset by the impact of cost savings actions.

Research, development and engineering expenses during the nine months ended September 30, 2020 were $19.1 million, an increase of $0.4 million, or 2%, from the nine months ended September 30, 2019 levels. The increase was primarily related to the timing of projects, partly offset by the impact of cost savings actions.

***Selling, General and Administrative Expenses***

Selling, general and administrative expenses increased during the three months ended September 30, 2020 by $0.5 million, or 4%, compared to the three months ended September 30, 2019. The increase was primarily due to higher legal costs related to the recently settled government investigations and the Company's indemnification obligations of former officers and employees as a result of the exhaustion of its directors and officers insurance during the early part of 2020 (see additional discussion in Note 9. *Commitments and Contingencies* in Part I, Item 1. *Financial Statements*), among other items, partly offset by lower incentive compensation expense, lower financial reporting expenses, and the impact of cost savings actions.

Selling, general and administrative expenses decreased during the nine months ended September 30, 2020 by $3.0 million, or 7%, compared to the nine months ended September 30, 2019. The decrease was primarily due to lower financial reporting costs as a result of the completion of the restatement of the Company's financial statements in May 2019, lower incentive compensation expense, lower severance costs and lower key employee retention program costs. Partly offsetting the decline were higher legal costs related to the recently settled government investigations and the Company's indemnification obligations of former officers and employees as a result of the exhaustion of its directors' and officers' insurance during the early part of 2020 (see additional discussion in Note 9. *Commitments and Contingencies* in Part I, Item 1. *Financial Statements*), among other items.

***Interest Expense***

Interest expense decreased $0.4 million to $1.5 million for the three months ended September 30, 2020 as compared to the three months ended September 30, 2019, largely due to lower overall interest rates on the Company's debt during the third quarter of 2020, as compared to the prior year.

Interest expense decreased $1.9 million to $4.2 million for the nine months ended September 30, 2020 as compared to the nine months ended September 30, 2019, largely due to lower overall interest rates on the Company's debt during the nine months ended September 30, 2020, as compared to the prior year.

Lower interest rates in 2020 were primarily due to refinancing the debt in April 2020. See Note 6. *Debt*, included in Part I, Item 1. *Financial Statements*, for additional information.

***Loss from Change in Value of Warrants***

There was no impact from a change in value of warrants for the nine months ended September 30, 2020 due to the Weichai Warrant being exercised in April 2019. The Company recognized a loss of $1.4 million for the nine months ended September 30, 2019 as a result of the change in the value of the Weichai Warrant including the impact of the exercise.

See Note 3. *Weichai Transactions* and Note 8. *Fair Value of Financial Instruments*, included in Part I, Item 1. *Financial Statements*, for additional information.

***Loss on Extinguishment of Debt***

There was no impact related to the loss on the extinguishment of debt for the three months ended September 30, 2020 and 2019. The Company recognized a loss on the extinguishment of debt for the nine months ended September 30, 2020 of $0.5 million. There was no loss on the extinguishment of debt for the nine ended September 30, 2019.

See Note 6. *Debt*, included in Part I, Item 1. *Financial Statements*, for additional information.

***Other Income, Net***

Other income, net increased by $0.9 million to $0.9 million during the three months ended September 30, 2020 compared to the three months ended September 30, 2019 primarily due to the receipt of life insurance proceeds upon the death of a former employee.

Other income, net increased by $0.7 million to $1.2 million during the nine months ended September 30, 2020 compared to the nine months ended September 30, 2019 primarily due to the receipt of life insurance proceeds upon the death of a former employee, partially offset by lower equity earnings from the Company's joint venture.

Refer to Note 13. *Related Party Transactions*, in Part I, Item 1. *Financial Statements*, for further discussion of the Company's joint venture.

***Income Tax Expense***

The Company recorded an income tax benefit of $0.2 million for the three months ended September 30, 2020, as compared to income tax expense of $0.5 million for the three months ended September 30, 2019. The Company's pretax loss was $1.7 million for the three months ended September 30, 2020, compared to pretax income of $6.2 million for the three months ended September 30, 2019. Income tax benefit for the three months ended September 30, 2020 primarily related to an adjustment in the impact of the CARES Act. The Company continues to record a full valuation allowance against deferred tax assets which offsets the tax benefit associated with the pre-tax loss for the three months ended September 30, 2020.

The Company recorded an income tax benefit of $3.8 million for the nine months ended September 30, 2020, as compared to income tax expense of $0.1 million for the nine months ended September 30, 2019. The Company's pretax loss was $23.7 million for the nine months ended September 30, 2020, compared to pretax income of $0.3 million for the nine months ended September 30, 2019. The increase in the tax benefit for the nine months ended September 30, 2020 is primarily attributable to the impact of the CARES Act enacted in the first quarter of 2020, which allowed the Company to elect bonus depreciation for the 2018 and 2019 tax years, carryback net operating losses to earlier years, and immediately refund AMT credits as well as a change in the deferred tax liability related to an indefinite-lived intangible asset. The Company continues to record a full valuation allowance against deferred tax assets which offsets the tax benefits associated with the pre-tax loss for the nine months ended September 30, 2020.

See Note 10. *Income Taxes*, included in Part I, Item 1. *Financial Statements*, for additional information related to the Company's income tax provision.

**Non-GAAP Financial Measures**

In addition to the results provided in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") above, this report also includes non-GAAP (adjusted) financial measures. Non-GAAP financial measures provide insight into selected financial information and should be evaluated in the context in which they are presented. These non-GAAP financial measures have limitations as analytical tools and should not be considered in isolation from, or as a substitute for, financial information presented in compliance with U.S. GAAP, and non-GAAP financial measures as reported by the Company may not be comparable to similarly titled amounts reported by other companies. The non-GAAP financial measures should be considered in conjunction with the consolidated financial statements, including the related notes, and *Management's Discussion and Analysis of Financial Condition and Results of Operations* included in this report. Management does not use these non-GAAP financial measures for any purpose other than the reasons stated below.

| Non-GAAP Financial Measure | Comparable GAAP Financial Measure |
|---|---|
| Adjusted net income (loss) | Net (loss) income |
| Adjusted earnings (loss) per share | (Loss) earnings per common share – diluted |
| EBITDA | Net (loss) income |
| Adjusted EBITDA | Net (loss) income |

The Company believes that Adjusted net income (loss), Adjusted earnings (loss) per share, EBITDA, and Adjusted EBITDA provide relevant and useful information, which is widely used by analysts, investors and competitors in its industry as well as by the Company's management in assessing the performance of the Company. Adjusted net income (loss) is defined as net loss as adjusted for certain items that the Company believes are not indicative of its ongoing operating performance. Adjusted earnings (loss) per share is a measure of the Company's diluted (loss) earnings per common share adjusted for the impact of special items. EBITDA provides the Company with an understanding of earnings before the impact of investing and financing charges and income taxes. Adjusted EBITDA further excludes the effects of other non-cash charges and certain other items that do not reflect the ordinary earnings of the Company's operations.

Adjusted net income (loss), Adjusted earnings (loss) per share, EBITDA, and Adjusted EBITDA are used by management for various purposes, including as a measure of performance of the Company's operations and as a basis for strategic planning and forecasting. Adjusted net income (loss), Adjusted earnings (loss) per share, and Adjusted EBITDA may be useful to an investor because these measures are widely used to evaluate companies' operating performance without regard to items excluded from the calculation of such measures, which can vary substantially from company to company depending on the accounting methods, the book value of assets, the capital structure and the method by which the assets were acquired, among other factors. They are not, however, intended as alternative measures of operating results or cash flow from operations as determined in accordance with U.S. GAAP.

During 2020, the Company changed the presentation of certain non-GAAP financial measures to separate incremental financial reporting and government investigation expenses into: (1) incremental financial reporting, (2) internal control remediation, and (3) government investigations and other legal matters. In addition, the Company changed the presentation of non-GAAP adjustments for the comparative periods of 2019 in order to align to the current period presentation. There was no impact to Adjusted net income, Adjusted earnings per share, EBITDA or Adjusted EBITDA for the three and nine months ended September 30, 2019 as a result of this change in presentation. The Company believes the updated presentation may provide more useful information to investors regarding the Company's non-GAAP adjustments and better aligns with management's use of the information.

The following table presents a reconciliation from Net (loss) income to Adjusted net income (loss) for the three and nine months ended September 30, 2020 and 2019:

| (in thousands) | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2020 | 2019 | 2020 | 2019 |
| Net (loss) income | $ (1,466) | $ 5,756 | $ (19,920) | $ 172 |
| Change in value of warrants [1] | — | — | — | 1,352 |
| Stock-based compensation [2] | 165 | 173 | 482 | 841 |
| Loss on debt extinguishment [3] | — | — | 497 | — |
| Key employee retention program [4] | — | 10 | — | 492 |
| Severance [5] | 332 | 267 | 332 | 1,865 |
| Incremental financial reporting [6] | 4 | 1,299 | 1,783 | 6,792 |
| Internal control remediation [7] | 137 | 216 | 1,029 | 1,467 |
| Government investigations and other legal matters [8] | 2,697 | 426 | 8,435 | 3,521 |
| Life insurance proceeds [9] | (930) | — | (930) | — |
| Discrete income tax items [10] | (287) | — | (3,905) | — |
| **Adjusted net income (loss)** | $ 652 | $ 8,147 | $ (12,197) | $ 16,502 |

The following table presents a reconciliation from (Loss) earnings per common share – diluted to Adjusted earnings (loss) per share for the three and nine months ended September 30, 2020 and 2019:

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2020 | 2019 | 2020 | 2019 |
| (Loss) earnings per common share – diluted | $ (0.06) | $ 0.25 | $ (0.87) | $ 0.01 |
| Changes in value of warrants [1] | — | — | — | 0.06 |
| Stock-based compensation [2] | 0.01 | 0.01 | 0.02 | 0.04 |
| Loss on debt extinguishment [3] | — | — | 0.02 | — |
| Key employee retention program [4] | — | — | — | 0.02 |
| Severance [5] | 0.01 | 0.01 | 0.01 | 0.09 |
| Incremental financial reporting [6] | — | 0.05 | 0.08 | 0.33 |
| Internal control remediation [7] | 0.01 | 0.01 | 0.05 | 0.07 |
| Government investigations and other legal matters [8] | 0.11 | 0.02 | 0.37 | 0.16 |
| Life insurance proceeds [9] | (0.04) | — | (0.04) | — |
| Discrete income tax items [10] | (0.01) | — | (0.17) | — |
| **Adjusted earnings (loss) per share – diluted** | $ 0.03 | $ 0.35 | $ (0.53) | $ 0.78 |
| | | | | |
| **Diluted shares (in thousands)** | 22,881 | 22,876 | 22,866 | 21,088 |

The following table presents a reconciliation from Net (loss) income to EBITDA and Adjusted EBITDA for the three and nine months ended September 30, 2020 and 2019:

| (in thousands) | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2020 | 2019 | 2020 | 2019 |
| Net (loss) income | $ (1,466) | $ 5,756 | $ (19,920) | $ 172 |
| Interest expense | 1,510 | 1,921 | 4,211 | 6,156 |
| Income tax (benefit) expense | (210) | 483 | (3,771) | 136 |
| Depreciation | 1,314 | 1,270 | 3,922 | 3,875 |
| Amortization of intangible assets | 763 | 910 | 2,290 | 2,729 |
| **EBITDA** | 1,911 | 10,340 | (13,268) | 13,068 |
| Change in value of warrants [1] | — | — | — | 1,352 |
| Stock-based compensation [2] | 165 | 173 | 482 | 841 |
| Loss on debt extinguishment [3] | — | — | 497 | — |
| Key employee retention program [4] | — | 10 | — | 492 |
| Severance [5] | 332 | 267 | 332 | 1,865 |
| Incremental financial reporting [6] | 4 | 1,299 | 1,783 | 6,792 |
| Internal control remediation [7] | 137 | 216 | 1,029 | 1,467 |
| Government investigations and other legal matters [8] | 2,697 | 426 | 8,435 | 3,521 |
| Life insurance proceeds [9] | (930) | — | (930) | — |
| **Adjusted EBITDA** | $ 4,316 | $ 12,731 | $ (1,640) | $ 29,398 |

1. Amount consists of the change in the value of the Weichai Warrant, including the impact of the exercise in April 2019.
2. Amounts reflect non-cash stock-based compensation expense (amounts exclude $0.3 million for the nine months ended September 30, 2019 associated with employee retention programs (see note 4 below)).
3. Amount represents the loss on the extinguishment of the Wells Fargo Credit Agreement and the Unsecured Senior Notes in April 2020 as further discussed in Note 6. *Debt* of Part I, Item 1. *Financial Statements*.
4. Amounts represent incremental compensation costs (including $0.3 million for the nine months ended September 30, 2019 of stock-based compensation) incurred to provide retention benefits to certain employees.
5. Amounts represent severance and other post-employment costs for certain former employees of the Company.
6. Amounts represent professional services fees related to the Company's efforts to restate prior period financial statements and prepare, audit and file delinquent financial statements with the SEC, as well as tax compliance matters impacted by the restatement of prior period financial statements. The amounts exclude $0.5 million and $1.5 million of recurring audit fees for the three and nine months ended September 30, 2020, respectively, and $0.1 million and $1.1 million for the three and nine months ended September 30, 2019, respectively.
7. Amounts represent professional services fees related to the Company's efforts to remediate internal control material weaknesses including certain costs to upgrade IT systems.
8. Amounts represent professional services fees and reserves primarily related to the recently settled SEC and USAO investigations of the Company and indemnification of certain former officers and employees. The Company is obligated to pay legal costs of certain former officers and employees in accordance with Company bylaws and certain indemnification agreements. As further discussed in Note 9. *Commitments and Contingencies* of Part I, Item 1. *Financial Statements*, the Company fully exhausted its historical primary directors' and officers' insurance coverage in connection with these matters during the first quarter of 2020. The amounts include $1.7 million and $5.5 million for the three and nine months ended September 30, 2020, respectively, related to indemnification of certain former officers and employees.
9. Amount represents a life insurance payment to the Company related to the death of a former employee.
10. Amount consists of the impact of the CARES Act and a change in the deferred tax liability related to an indefinite-lived intangible asset.

**Cash Flows**

Cash was impacted as follows:

| (in thousands) | For the Nine Months Ended September 30, 2020 | 2019 | Change | % Change |
|---|---|---|---|---|
| Net cash (used in) provided by operating activities | $ (2,283) | $ 19,122 | $ (21,405) | (112)% |
| Net cash used in investing activities | (1,054) | (2,035) | 981 | 48 % |
| Net cash provided by (used in) financing activities | 33,360 | (17,140) | 50,500 | *NM |
| **Net increase (decrease) in cash, cash equivalents, and restricted cash** | $ 30,023 | $ (53) | $ 30,076 | *NM |
| **Capital expenditures** | $ (1,991) | $ (2,048) | $ 57 | 3 % |

*NM Not meaningful

***Cash Flows for the Nine Months Ended September 30, 2020***

*Cash Flow from Operating Activities*

Net cash used in operating activities was $2.3 million in the nine months ended September 30, 2020 compared to net cash provided by operating activities of $19.1 million in the nine months ended September 30, 2019, resulting in an increase of $21.4 million in cash used in operating activities year-over-year. The increase in cash used in operating activities was primarily related to an increase in the net loss of $20.1 million and a $2.0 million decrease in the impact of non-cash adjustments to the net loss, primarily related to changes in the value of the Weichai Warrant during the nine months ended September 30, 2019, partially offset by an increase in cash generated from working capital accounts of $0.7 million, primarily due to increased collections of accounts receivable, partially offset by increased inventory and a net decrease in accounts payable and accrued expenses.

*Cash Flow from Investing Activities*

Net cash used in investing activities was $1.1 million for the nine months ended September 30, 2020 compared to $2.0 million for the nine months ended September 30, 2019, respectively. For the nine months ended September 30, 2020 and 2019, cash used in investing activities primarily related to capital expenditures associated with normal maintenance of the Company's facilities, partially offset by proceeds from a life insurance policy in 2020.

*Cash Flow from Financing Activities*

The Company generated $33.4 million in cash from financing activities in the nine months ended September 30, 2020 compared to $17.1 million in cash used by financing activities in the nine months ended September 30, 2019. The cash generated by financing activities for the nine months ended September 30, 2020 was primarily attributable to borrowing $130.0 million under the Credit Agreement in April 2020, partially offset by using a portion of the funds (i) to repay the outstanding balance of $16.8 million under the Wells Fargo Credit Agreement and (ii) to fully redeem and discharge $55.0 million in aggregate outstanding principal amount of the Unsecured Senior Notes and pay related interest. See additional discussion below and in Note 6. *Debt*, included in Part I, Item 1. *Financial Statements.* For the nine months ended September 30, 2019, cash used by financing activities primarily related to net repayments of the revolving credit facility.

**Liquidity and Capital Resources**

On April 2, 2020, the Company closed on its new senior secured revolving credit facility pursuant to that certain credit agreement dated March 27, 2020, between the Company and Standard Chartered Bank ("Standard Chartered"), as administrative agent (the "Credit Agreement"). The Credit Agreement, which allows the Company to borrow up to $130.0 million, matures on March 26, 2021 with an optional 60-day extension, subject to certain conditions and payment of a 0.25% extension fee. The Credit Agreement bears interest at either the alternate base rate or LIBOR plus 2.00%, and the Company is required to pay a 0.25% commitment fee on the average daily unused portion of the revolving credit facility under the Credit Agreement. The Credit Agreement is secured by substantially all of the Company's assets and includes certain financial covenants as well as a change of control provision. On April 2, 2020, the Company borrowed $95.0 million under the Credit Agreement and utilized the funds (i) to repay the outstanding balance of $16.8 million under the credit agreement between the Company and Wells Fargo Bank, N.A. ("Wells Fargo"), as administrative agent (the "Wells Fargo Credit Agreement"), (ii) to fully redeem and discharge $55.0 million in aggregate principal amount of the unsecured 5.50% senior notes due June 2020 (the "Unsecured Senior Notes") and pay related interest and (iii) for general corporate purposes. The Wells Fargo Credit Agreement was terminated in connection with the repayment of the outstanding balance. On April 29, 2020, the Company borrowed an additional $35.0 million under the Credit Agreement, which is the remaining portion of availability, providing the Company with greater financial flexibility. As of September 30, 2020, the Company's total debt obligations under the Credit Agreement were $130.0 million in the aggregate, and its cash and cash equivalents were $26.7 million. See Item 1. Note 6. *Debt*, included in Part I, Item 1. *Financial Statements*, for additional information. These amounts reflect a net positive cash impact from customer prepayments of $20.1 million.

As discussed further in Item 1. Note 6. *Debt*, included in Part I, Item 1. *Financial Statements*, the Credit Agreement includes financial covenants which were effective for the Company beginning with the six months ended June 30, 2020. The financial covenants include an interest coverage ratio and a minimum EBITDA threshold as further defined in the Credit Agreement. For the six months ended June 30, 2020 and the nine months ended September 30, 2020, the Company did not meet the defined minimum EBITDA requirement. A breach of the financial covenants under the Credit Agreement constitutes an event of default and, if not cured or waived, could result in the obligations under the Credit Agreement being accelerated. Accordingly, the Company is currently in discussions with Standard Chartered to seek appropriate waivers and amendments to cure its financial covenant breach and amend its financial covenants.

Significant uncertainties exist about the Company's ability to refinance, extend, or repay its outstanding indebtedness, maintain sufficient liquidity to fund its business activities, obtain a waiver or amendment in connection with the financial covenant breach, and maintain compliance with the covenants and other requirements under the Credit Agreement in the future. Based on the Company's current forecasts, without additional financing, the Company anticipates that it will not have sufficient cash and cash equivalents to repay the Credit Agreement by the March 26, 2021 maturity date. Management currently plans to seek an extension and/or replacement of the Credit Agreement or additional liquidity from its current or other lenders before March 26, 2021. There can be no assurance that the Company will be able to obtain waivers or satisfactory amendments to its financial covenants or successfully complete an extension of the Credit Agreement or obtain new financing on acceptable terms when required or if at all.

Additionally, due to the onset of the COVID-19 pandemic in early 2020, the global economy experienced substantial turmoil including impacts from the world financial markets which have experienced a period of significant volatility and overall declines. In addition, due to unprecedented decreases in demand, an oil price war, and economic uncertainty resulting from the COVID-19 pandemic, crude oil prices have declined considerably since the end of 2019. A significant portion of the Company's sales and profitability is derived from the sale of products that are used within the oil and gas industry. While the Company has yet to experience significant supply chain interruptions or material cancellations of orders, the potential impact of future disruptions, continued economic uncertainty, and continued depressed crude oil prices and low rig count levels may have a significant adverse impact that may result in the recognition of material impairments or other related charges. Moreover, the full impact of the COVID-19 pandemic on the Company's operations and liquidity continues to evolve.

Due to uncertainties surrounding the Company's future ability to refinance, extend, or repay its outstanding indebtedness, maintain sufficient liquidity to fund its business activities, obtain a cure or waiver in connection with the financial covenant breach, and maintain compliance with the covenants and other requirements under the Credit Agreement in the future, substantial doubt exists as to its ability to continue as a going concern within one year after the date that these financial statements are issued. If the Company does not have sufficient liquidity to fund its business activities, it may be forced to limit its business activities or be unable to continue as a going concern, which would have a material adverse effect on its results of operations and financial condition.

**Off-Balance Sheet Arrangements**

At September 30, 2020, the Company had six outstanding letters of credit totaling $2.8 million. See Item 1. Note 9. *Commitments and Contingencies* for additional information related to the Company's off-balance sheet arrangements and the outstanding letters of credit of $2.8 million and restricted cash of $3.3 million at September 30, 2020.

**Critical Accounting Policies and Estimates**

The Company's consolidated financial statements are prepared in accordance with U.S GAAP. Preparation of these financial statements requires the Company to make estimates, assumptions and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. The Company's most critical accounting policies and estimates are those most important to the portrayal of its financial condition and results of operations and which require the Company to make its most difficult and subjective judgments, often as a result of the need to make estimates regarding matters that are inherently uncertain. The Company has identified the following as its most critical accounting policies and judgments. Although management believes that its estimates and assumptions are reasonable, they are based on information available when they are made and, therefore, may differ from estimates made under different assumptions or conditions.

The Company's significant accounting policies are consistent with those discussed in Note 1. *Summary of Significant Accounting Policies and Other Information*, to the consolidated financial statements and the MD&A section of the Company's 2019 Annual Report on Form 10-K (the "2019 Annual Report"). During the nine months ended September 30, 2020, there were no significant changes in the application of critical accounting policies.

The Company has identified the following accounting policies as its most critical because they require the Company to make difficult, subjective, and complex judgments:

- Revenue Recognition
- Allowance for Doubtful Accounts
- Inventories
- Goodwill and Other Intangibles
- Impairment of Long-Lived Assets
- Warranty
- Deferred Tax Asset Valuation Allowance
- Uncertain Tax Positions

**Impact of New Accounting Standards**

For information about recently issued accounting pronouncements, see Note 1. *Summary of Significant Accounting Policies and Other Information*, included in Part 1, Item 1.

## Item 3. Quantitative and Qualitative Disclosures About Market Risk.

The Company is a smaller reporting company as defined by Rule 12b-2 of the Exchange Act and is not required to provide the information under this item.

## Item 4. Controls and Procedures.

***Evaluation of Disclosure Controls and Procedures***

The term "disclosure controls and procedures" is defined in Rule 13a-15(e) of the Exchange Act as "controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act are recorded, processed, summarized and reported, within the time periods specified in the SEC rules and forms." The Company's disclosure controls and procedures are designed to ensure that material information relating to the Company and its consolidated subsidiaries is accumulated and communicated to its management, including its Chief Executive Officer and its Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures.

The Company's management, with the participation of its Chief Executive Officer and Interim Chief Financial Officer, conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures as of September 30, 2020 (the end of the period covered by this Quarterly Report on Form 10-Q). Based upon that evaluation, the Company's Chief Executive Officer and Interim Chief Financial Officer have concluded that the Company's disclosure controls and procedures were not effective as of September 30, 2020, because of the previously reported material weaknesses in internal control over financial reporting, as described below.

***Ongoing Remediation of Material Weaknesses in Internal Control over Financial Reporting***

As previously disclosed under "Item 9A - Controls and Procedures" in the 2019 Annual Report, the Company's management concluded that its internal control over financial reporting was not effective based on the material weaknesses identified. Management is committed to the continued implementation of remediation efforts to address the material weaknesses. The remediation efforts summarized below, which have been or will be implemented, are intended both to address the identified material weaknesses and to enhance the Company's overall internal control environment.

***Control Environment, Risk Assessment, Information and Communication, and Monitoring***

**Control Environment:**

Since 2017, the Company has either replaced or appointed new Board and Audit Committee members, a Chief Executive Officer, a Chief Financial Officer, a Chief Commercial Officer, a Chief Information Officer, and a Vice President, Internal Audit. These changes, along with the actions of these individuals and other senior management, have collectively improved the tone of integrity, transparency and support of the Company's updated Code of Business Conduct and Ethics.

The Company has updated its Code of Business Conduct and Ethics and has initiated an ongoing training program to help ensure employees understand and comply with the Code. The Company continues to enhance the program to provide extensive communications and training to employees across the entire organization regarding the importance of integrity and accountability.

The Company has established a process to identify and address internal control weaknesses through the internal control function.

**IT Skillset and Competency:**

The information technology ("IT") function has been reorganized under the leadership of a new Chief Information Officer who reports to the Chief Executive Officer. The Company continues to assess the level of technical skills in the IT function to support the design and implementation of IT general controls ("ITGCs").

**Policies and Procedures:**

- The Company has issued a revised delegation of authority policy that appoints tiered approvers based upon risk and materiality of the transaction and trained employees on the revised policy.
- The Company has identified a central repository to maintain all the Company's policies, is providing training to users and is developing a framework to establish responsibility and accountability for executing and monitoring policies and procedures.
- The Company has drafted and is in the process of finalizing critical accounting, IT and record retention policies.
- The Company continues to create a culture of continuous improvement and design a framework for management to proactively and openly self-identify, document, reassess, report, and remediate policies, procedures, and control issues.

**Segregation of Duties:**

- The Company is establishing standards governing the segregation of incompatible duties across the organization.

- The Company is designing various accounting processes and application and system controls to adequately segregate job responsibilities and system access throughout the organization and to implement applicable mitigating internal controls.
- The Company completed a technical upgrade to its Enterprise Resource Planning System ("ERP System") and is redesigning system access roles across the Company to improve the segregation of incompatible duties.

***Control Activities***

As part of the overall remediation plan, the Company is designing and implementing review and approval controls over data utilized in various accounting processes. These controls will address the accuracy, timely recording and completeness of data used in the determination of significant accounting estimates, reserves, and valuations as well as impacted presentation and disclosures in accordance with U.S. GAAP.

**Revenue Accounting:**

- The Company is designing and implementing policies and procedures to ensure that critical inputs affecting the accuracy and timeliness of revenue recognition and related reserves and sales allowances are communicated to the accounting department on a timely basis.
- The Company has established and has begun implementing improved review and approval controls across the Company to ensure that revenue, including that of nonroutine revenue transactions and related reserves and sales allowances, is recognized consistently in accordance with U.S. GAAP.
- The Company has developed sales transaction review procedures to review certain key transaction attributes.

**Capitalization:**

The Company is designing and implementing policies, procedures, and controls over capitalization, including, but not limited to, the capitalization of costs incurred on capital asset projects and accounting treatment for research and development activities.

**Complex and Nonroutine Transactions:**

The Company is designing and implementing policies, procedures and controls over the evaluation, review and approval of complex and nonroutine transactions, including, but not limited to, identification of reporting units and triggering events that could impact the assessment of potential impairments of property, plant and equipment, intangibles and goodwill, accounting for debt transactions, purchase accounting for business combinations and lease classification.

**Reserves and Accruals:**

The Company is designing and implementing policies, procedures and controls over the review and approval of key reserves and accruals, including, but not limited to, warranty and excess and obsolete inventory reserves.

**Period End Close/Accounting Documentation:**

- The Company is designing and implementing policies, procedures and controls over the period-end close process and related documentation including, but not limited to, accounting for treasury stock, period-end checklists, review and approval of journal entries, taxes, inventory in-transit, account roll forwards and reconciliations, general ledger account maintenance and financial statement analysis/thresholds.
- The Company has implemented a formal Section 302 disclosure and certification program that requires management to complete representation letters and disclosure sub-certification questionnaires in connection with SEC filings.

**Information Technology:**

- The Company has reconstructed its ITGC framework to focus on controls that mitigate key financial reporting risks.
- The Company has designed and is implementing controls over access, change management and IT operations to ensure that access rights are restricted to appropriate individuals, and that data integrity is maintained via effective change controls over system updates and over the flow of data between systems.
- The Company is planning a re-implementation of its ERP System to further improve and automate ITGCs as well as other business process controls.

**Data Maintenance:**

- The Company is designing and implementing procedures and controls to appropriately identify and assess changes made to data repositories that could significantly impact data integrity and the internal control framework, including, but not limited to, (i) creating centralized, complete and accurate data repositories, (ii) maintaining customer and vendor master files, employee data files, perpetual inventory records, inventory cycle counts, stock compensation agreements and debt arrangements and (iii) communicating an enterprise data management policy and record retention policy.
- The Company is developing procedures to review and validate underlying data supporting the internal controls.

When fully implemented and operational, the Company believes the measures described above will remediate the control deficiencies that have led to the material weaknesses it has identified and will strengthen its internal control over financial reporting. The Company is committed to continuing to improve its internal control processes and it will continue to review its financial reporting controls and procedures. As the Company continues to evaluate and work to improve its internal control over financial reporting, it may determine that a need exists to take additional measures to address control deficiencies or modify certain remediation measures described above.

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

Other than the ongoing remediation efforts described above, there have been no changes in the Company's internal control over financial reporting during the quarter ended September 30, 2020 that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

## PART II – OTHER INFORMATION

### Item 1. Legal Proceedings.

See Note 9. *Commitments and Contingencies*, included in Part I, Item 1. *Financial Statements*, for a discussion of legal proceedings, which are incorporated herein by reference.

### Item 1A. Risk Factors.

The Company is a smaller reporting company as defined by Rule 12b-2 of the Exchange Act and is not required to provide the information under this item.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

### Item 3. Defaults upon Senior Securities.

See Note 6. *Debt*, included in Part I, Item 1. *Financial Statements*, for a discussion of the Company's default under the Credit Agreement, which is incorporated herein by reference.

### Item 4. Mine Safety Disclosures.

Not applicable.

### Item 5. Other Information.

Not applicable.

**Item 6. Exhibits.**

## EXHIBIT INDEX

The following documents listed below that have been previously filed with the SEC (1934 Act File No. 001-35944) are incorporated herein by reference:

| | | | Incorporated by Reference Herein | | | |
|---|---|---|---|---|---|---|
| **Exhibit No.** | | **Exhibit Description** | **Form** | **Exhibit** | **Filing Date** | **File No.** |
| 10.1 | | Consulting Agreement and Release, dated as of July 20, 2020 between the Company and Charles F. Avery, Jr. | 8-K | 10.1 | 07/24/2020 | 001-35944 |
| 31.1 | * | Certification of Chief Executive Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. | | | | |
| 31.2 | * | Certification of Chief Financial Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. | | | | |
| 32.1 | ** | Certification of Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002. | | | | |
| 32.2 | ** | Certification of Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002. | | | | |
| 101.INS | * | XBRL Instance Document. | | | | |
| 101.SCH | | XBRL Taxonomy Extension Schema Document. | | | | |
| 101.CAL | | XBRL Taxonomy Extension Calculation Linkbase Document. | | | | |
| 101.LAB | | XBRL Taxonomy Extension Labels Linkbase Document. | | | | |
| 101.PRE | | XBRL Taxonomy Extension Presentation Linkbase Document. | | | | |
| 101.DEF | * | XBRL Taxonomy Definition Linkbase Document. | | | | |

* Filed with this Report.

** This exhibit shall not be deemed "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that Section. Such exhibit shall not be deemed incorporated into any filing under the Securities Act of 1933, as amended, or the Exchange Act.

## SIGNATURES

Pursuant to the requirements of the Exchange Act, the registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 16th day of November 2020.

**POWER SOLUTIONS INTERNATIONAL, INC.**

By: /s/ Donald P. Klein

Name: **Donald P. Klein**

Title: Interim Chief Financial Officer (Principal Financial Officer)

**Exhibit 31.1**

**CERTIFICATION PURSUANT TO 17 CFR 240.13a-14 PROMULGATED UNDER SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, John P. Miller, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Power Solutions International, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

| | | |
|---|---|---|
| Date: November 16, 2020 | By: | /s/ John P. Miller |
| | Name: | **John P. Miller** |
| | Title: | Chief Executive Officer and President |

**Exhibit 31.2**

**CERTIFICATION PURSUANT TO 17 CFR 240.13a-14 PROMULGATED UNDER SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Donald P. Klein, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Power Solutions International, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

| | | |
|---|---|---|
| Date: November 16, 2020 | By: | /s/ Donald P. Klein |
| | Name: | **Donald P. Klein** |
| | Title: | Interim Chief Financial Officer |

**Exhibit 32.1**

**CERTIFICATION OF THE PRINCIPAL EXECUTIVE OFFICER PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Power Solutions International, Inc. (the “Company”) on Form 10-Q for the three and nine months ended September 30, 2020, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, John P. Miller, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

| | | |
|---|---|---|
| Date: November 16, 2020 | By: | /s/ John P. Miller |
| | Name: | **John P. Miller** |
| | Title: | Chief Executive Officer and President |

This certification accompanies each Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906 has been provided by the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

**Exhibit 32.2**

**CERTIFICATION OF THE PRINCIPAL FINANCIAL OFFICER PURSUANT TO
18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Power Solutions International, Inc. (the "Company") on Form 10-Q for the three and nine months ended September 30, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Donald P. Klein, Interim Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

| | | |
|---|---|---|
| Date: November 16, 2020 | By: | /s/ Donald P. Klein |
| | Name: | **Donald P. Klein** |
| | Title: | Interim Chief Financial Officer |

This certification accompanies each Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906 has been provided by the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.