NASDAQ:PSIX Q2 2026 Earnings Call Transcript

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Operator:

Good afternoon and welcome to Power Solutions International's second quarter 2026 earnings conference call. Currently, all participants are in a listen-only mode. The question and answer session will follow the formal presentation. As a reminder, this conference is being recorded. I would now like to hand the conference over to Ken Jenke, VP Corporate Counselor, PSI. Sir, please go ahead.

Ken Janke | Vice President and Corporate Controller:

Good afternoon and welcome to Power Solutions International's second quarter 2026 earnings conference call. I'm Ken Janke, Vice President and Corporate Controller, and joining me today is Ken Lee, our Interim Chief Executive Officer and Chief Financial Officer. Before we begin, I would like to remind everyone that today's prepared remarks and responses to questions may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on current expectations and assumptions, speak only as of today, and are subject to risks and uncertainties that could cause actual results to differ materially. Important factors include the timing and ultimate conversion of power systems orders into revenue, including data center related orders. quarterly variability in product mix, and the corresponding effect on gross profit and gross margin. The cost, pace, throughput, and operational outcomes of capacity ramp-up activities at our Wisconsin operations, our ability to execute operational improvement initiatives, the level and persistence of customer demand, including demand conditions in the oil and gas end market, Supply chain and component availability. Integration of recent acquisition, including MTL manufacturing and equipment. Macroeconomic regulatory and trade conditions, including U.S. tariffs and trade restrictions. Changes in management or other personnel and the outcome of pending or threatened litigation and other legal or regulatory matters. Additional information concerning factors that could cause actual results to differ materially is contained in the cautionary language in today's earnings release and in the factors and other cautionary disclosures in our most recent Form 10-K. Subsequent 10-Qs and other SEC filings. Those disclosures are incorporated by reference for purposes of today's call and are available in the investor relations section of our website and at sec.gov. We undertake no obligation to update any forward-looking statements except as required by law. We will also reference certain non-GAAP financial measures today's call. EBITDA margin represents EBITDA as a percentage of net sales. A definition of EBITDA and a reconciliation to net income appear in today's earnings release. which is available in the investor relations section of our website. With that, I will turn the call over to Ken.

Ken Lee | Interim Chief Executive Officer and Chief Financial Officer:

Thank you, Ken, and good afternoon, everyone. Thank you for joining us. Before we review the second quarter results, I would like to briefly address the leadership transition we announced on July 27th. Richard Hu will become PSI's Chief Executive Officer on August 17th. Richard brings more than 25 years of global industrial leadership experience, including six years as BorgWarner, most recently as Vice President and General Manager of the Americs region for its Turbo and Thermal Technology Business Unit. where he led a multi-billion dollar operation and a global team of approximately 3,900 employees across the United States, Mexico, and Brazil. We look forward to welcoming him and working with him as PSI continues to execute its strategy. I will continue to serve as Interim Chief Executive Officer until Richard begins and will continue as Chief Financial Officer following the transition. Now let me turn to our second quarter results. 2Q Financials. Before I walk through the detailed financials, I want to briefly run the quarter. On a sequential basis, the second quarter showed a meaningful improvement in several key metrics. Sales of $152.5 million increased 18.6% from the first quarter. And the gross margin improved approximately 420 base points to 27.1% from 22.9%. The gross margin improvements reflect in part the early benefits of ongoing operational improvement efforts in Wisconsin and was partially offset by unfavorable pandemic. Strong operating cash flow also enabled us to reduce total debt by approximately $38.8 million during the quarter. Compared to the second quarter of 2025, net sales reflects the timing of certain power systems' shipments and the softened demand in our oil and gas business. Gold's margin reflects a low mix of oil and gas products, together with elevated production costs associated with capacity ramp-up activities at our Wisconsin operations. Year-over-year comparisons in net income were also significantly affected by a non-recurring $29.2 million per dilute share tax benefits in the prior year period right to the release of a valuation allowance. Demand for our data center power solutions remains strong. Based on our current production schedule, we expect the second half of 2026 years to exceed the first half of 2026 sales as larger power systems orders move into production. Although shipment timing and quarterly results may vary, the remainder of our remarks will cover results by earned markets, gross margin drivers, operating expense, cash flow and balances, and updates on MTL and our Oslo. Net sales for the second quarter of 2026 were $152.5 million, a decrease of $39.4 million, or 21%, compared to the second quarter of 2025. Sequentially, sales increased 18.6% from the first quarter of 2026, exceeding our prior expectation that the second quarter revenue would be generally consistent with the first quarter. The year-over-year decrease was primarily driven by loader sales of $34.6 million in the power systems and the markets, $3.0 million in the industrial and the markets, and $1.7 million in the transportation and the markets. Within our power systems and the markets, the year-over-year decline primarily reflects the uneven order patterns and the shipment timing for data center rates the product. Together, we continue the softness in our oil and gas business. We continue to see strong demand for our data center power solutions. And based on our current production schedule, we expect the second half 2026 years to exceed the first half 2026 years as larger power systems orders move into production and are recognized as revenue. At the same time, the timing and ultimate volume of revenue recognized from that demand remains subject to customer scheduling, manufacturing slow parts, supply chain factors, and other variables. And we are not predicting any specific level of data center revenue in any future period. Growth profits for the second quarter of 2026 was $41.4 million. compared to $54.1 million in the second quarter of 2025. Gold's margin was 27.1% in the quarter compared to 28.2% in the prior year period. On a sequential basis, gold's margin improved approximately 420 base points from 22.9% in the first quarter to 27.1% in the second quarter. The improvements reflect in part the early benefits of our ongoing operational improvement efforts in Wisconsin, and was partially offset by unfavorable hard mix in the quarter. We're encouraged by that progress. For the first half of 2026, growth margin was 25.2%. I want to be just about on growth margin. Our capacity ramp up activities in Wisconsin are continuing. and we expect rates to elevate the production costs to persist. The trajectory of any future sequential improvements will depend on pattern mix, slow parts, and other operational factors. We are not providing a specific goals margin outlook for 2026 at this time. Over the longer term, our goal is to focus on business opportunities. that can support growth margin at or around 25% level. Research and development expense were $5.1 million in the second quarter, compared to $4.6 million in the prior year period. The increase was primarily driven by higher IND program expenses to support new programs in 2026 and the recovery of IND costs from certain customers in 2025. selling general and admin expense were $2.1 million in the second quarter, a decrease of $4.6 million, or 27%, compared to the second quarter of 2025. The decrease was primarily attributable to loader composition expense raised to the revaluation of previously awarded stock appreciation rights, as well as loader costs associated with employee incentive programs, partially offset by incremental selling and administrative expense associated with MTL manufacturing and equipment. Total operating expense was $17.4 million in the quarter. Operating income was $23.9 million, compared to $32.5 million in the second quarter of 2025. Interest expense was $1.6 million in the second quarter, compared to $1.7 million in the prior year period, reflecting lower overall effective interest rates. Income tax expense was $5.6 million in the second quarter of 2026, compared to an income tax benefit of $20.1 million in the prior year period. As noted at the outset, The prior year second costs included a $29.2 million over $1.27 per diluted share, non-recurring tax benefits raised to the release of a valuation allowance on default tax assets. That one-time benefit is the primary driver of the significant year-over-year difference in net income, and investors should keep that context in mind when reading the year-over-year comparison. Net income was $16.9 million, or $0.73 per diluted share, in the second quarter of 2026, compared to net income of $31.2 million, or $2.22 per diluted share. In the second quarter of 2025, on a sequential basis, net income increased $9.6 million and diluted earnings per share more than doubled from the first quarter. EBITDA for the second quarter was $25.7 million compared to $34.1 million in the prior year period. EBITDA margin was 16.9% compared to 17.8% in the prior year period. On a sequential basis, EBITDA nearly doubled from $13.2 million in the first quarter, while EBITDA margin improved 670 basis points from 10.2% to 16.9%. The sequential increase reflects the higher sales and the gross profit in the second quarter, together with lower operating expense. Turning to cash flow, we generated $56.6 million of operating cash flow in the second quarter, compared to $20.2 million in the prior year period. For the first half of 2026, operating cash flow was $75.7 million, compared to $25.5 million in the first half of 2025, with favorable working capital movements and operational improvements contributing to the year-over-year increase. Capital expenditures were $0.8 million in the second quarter and $2.7 million for the first half of the year. Strong cash flow enabled us to reduce total debt by approximately $38.8 million during the quarter. We ended the second quarter with $70.1 million in cash and cash equivalents and the total debt of approximately $72.6 million, including $65 million draw and our revolving credits facility. Total debt was approximately $103.4 million as of March 31, 2026. As of December 31, 2025, cash and cash equivalents were $41.3 million, and total debt was approximately $96.6 million. Our balance sheet is solid, and we believe our current liquidity position is sufficient to meet our anticipated cash needs. MTA updates. On January 9, 2026, we acquired MTR Manufacturing and Equipment, Inc. MTR's operations contribute positively to our consolidated net income in the second quarter. The acquisition expanded PSI's vertical integration by adding in-house manufacturing capabilities for components used in power generation products, including fuel tanks and incursional assemblies. We believe these capabilities will enhance supply chain control and manufacturing flexibility and support future goals. Given ongoing variability in order timing and market conditions, we are not providing formal four-year guidance at this time. Based on our current production schedule and information available as of today, we expect the second half of 2026 sales to exceed the first half of 2026 sales and to be approximately in line with sales in the second half of 2025, as larger power systems orders move into production and are recognized as revenue. The timing and ultimate volume of these shipments remains subject to customer scheduling, manufacturing slow powers, supply chain factors, and other variables. And there can be no assurance that those orders will translate who are uniformly strong second half. Continued softness in oil and gas and the markets is expected to weigh on quarterly revenue trends. Capacity ramp-up activities at our Wisconsin operations and their raised cost effects on growth margin are expected to continue. Key takeaways. Let me close our prepared remarks with three key takeaways from the second quarter. First, we delivered a meaningful sequential improvement in revenue and the goals margin. We sales up 18.6% from the first quarter, and the goals margin improved approximately 420 base points. The goals margin improvements reflect in part the early benefits of ongoing operational improvement efforts in Wisconsin. Although capacity ramp up activities and rate of cost continue. Our financial position is stronger. Operating cash flow of $56.6 million in the quarter enabled us to reduce total debt by approximately $30.8 million. We ended the quarter with roughly balanced cash and debt and increased financial flexibility to support our goals. Third, demand for our data center power solutions remains strong. Based on our current production schedule, We expect the second half of 2026 sales to exceed the first half of 2026 sales as larger power system orders move into production. Although shipment timing and quarter results may vary, we remain focused on operational execution and converting that demand into revenue. With that operator, we are ready to open the line for questions.

Operator:

Thank you. As a reminder to ask a question if you Please press star 11 on your telephone and wait for your name to be announced. To withdraw your question, please press star 11 again. We ask that you please limit yourself to one question and one follow-up. One moment while we compile our Q&A roster. Our first question comes from the line of Eric Stein with Craig Hallam Capital Group. Your line is open. Please go ahead.

Ken Lee | Interim Chief Executive Officer and Chief Financial Officer:

Hi, Ken.

Eric Stein | Analyst, Craig-Hallam Capital Group:

Hi, Alex. How are you? Hey, doing well, thanks. So maybe we could just talk a little bit more in depth about Q2. I mean, clearly it came in ahead of your internal projections. You know, so maybe some clarity because you've still got softness in oil and gas, you know, how far you are through the ramp and the enclosure business. And I would guess that goes hand in hand with the gross margin improvement, which, you know, this is a level that, you know, we haven't seen in several quarters and is a level that you achieved back when oil and gas was strong and it's your highest margin business. So I'm just trying to get my arms around how you know, that improvement came about in Q2, both revenues and margins.

Ken Lee | Interim Chief Executive Officer and Chief Financial Officer:

Yeah. Alex, thanks for the question. So if you compare the Q2 sales by 152 million versus Q1, 128 million, the total increased about 24 million. And I would say most of the increase is from the power systems. And definitely the Wisconsin operation, you know, increased the production and the sales. And If you look back at the past performance, you know, we start to have some challenging headwind on Wisconsin operations second half last year. And our gross margin, you know, 3Q last year was like 23.9%. Then 4Q last year, 21.9%. And the 1Q, we made this improvement 22.9%. So since then, we implement various operation, you know, improvement initiatives in Wisconsin. And we see improvements in productivity, efficiency, you know, slow parts and also material availability, which enable us to increase the production and also sales for enclosure. And also, you know, when we produce more, it has positive impacts on the fixed cost absorption. So definitely, you know, Wisconsin post-margin also improving. So all of these together, you know, help us to deliver quite improvements in the second quarter. But going forward, we continue to see, I would say, softness in the oil and gas. You know, we're not seeing any sign, you know, for significant improvement. But we do have some larger custom orders for the AI data center products. And the team is working on transforming the order into production and sales. So we expect the second half sales will exceed the first half. And our internal expectation is the second half will be inconsistent with the second half last year. But our sales team is working closely with our customer to generate more sales initiative. And the operation team is working with supply chain to make sure on time delivery and the material availability. So we are doing our best. increase or improve sales in the second half, and we try to exceed our expectation.

Eric Stein | Analyst, Craig-Hallam Capital Group:

Okay. And then maybe, I guess, for my follow-up, just more on the competitive front in that data center and closure business, and frankly, this is a question that I've been getting increasingly from investors, shareholders, and not, and that is, so I know that You've got Generac, and they're using the Bowdoin engine, and clearly that's a Weichi engine. But you've got PSI, also used as a Weichi engine. So I'm just kind of curious if you can speak to the differences between what is being used by you and your competitors in terms of size, price, and performance. And I am also curious what that means for your future product roadmap.

Ken Lee | Interim Chief Executive Officer and Chief Financial Officer:

Mm-hmm. Mm-hmm. Yeah, we serve different customers, right? We tie engines, the bottom end, they sell the engine gen sets to GenX, and we sell to a different customer. And I, you know, I, frankly, I'm not so clear, you know, which type of engine gen sets they sell to GenX. But I think there's some difference. And we deal with different customers, you know, we work with our customers very closely. And you might know, you know, there's some trend change on the AI data center power system. Historically, the data center used the utility grid to impress the diesel genset as standby. And right now, the trend is more towards using gas gensets for prime. They use the diesel for standby and the battery for instantaneous response. So we focus on our product development and the customer needs.

Eric Stein | Analyst, Craig-Hallam Capital Group:

Okay, so these are different engines or different sizes. Maybe if there's a way to just kind of get my arms around that a little bit.

Ken Lee | Interim Chief Executive Officer and Chief Financial Officer:

Yeah, I think with the diesel gensets, maybe it's similar. But we are also working on potentially gas gensets. And we have different customers. They sell to Genelac. We sell to our different customers. So I don't think we're in the competition. And based on our meeting with our customer, we see a strong demand for our products for this year and also for next year.

Eric Stein | Analyst, Craig-Hallam Capital Group:

OK. I guess I'll just take the rest of this offline. Thank you. Thank you, Alex.

Operator:

Thank you. One moment for our next question. Our next question comes from the line of Alan Lau with Jefferies. Your line is open. Please go ahead.

Alan Lau | Analyst, Jefferies:

Thanks, operator. Thanks for taking my question and congratulations of the great result in the second quarter. I would like to follow up on the previous question. I wonder if there's any guidance into 2027 especially given that we are in the second half of 2026 and there seems to be progress in gas engine as well. So I wonder if there's any color into 2027. Yeah, thank you.

Ken Lee | Interim Chief Executive Officer and Chief Financial Officer:

Thank you, Alan, for the question. So, Alan, you know, we are not providing formal guidance for the sales outlook for 2026 or 2027. But as you know, our part is serving the mission-critical AI data center, and the capacity for the power system for the data center is constrained. So there's a high demand for the system, power system, which is reliable, emission certified, and also scalable power system. So what I can see is we have high demand of our products for 2026, and our sales team is working closely with our customer to secure more orders for 2027. And the demand for our product remains very strong. And after we get more visibility for the 2027 sales information, we will share with our investors, maybe in 4Q.

Alan Lau | Analyst, Jefferies:

Thank you. So my follow-up question would be, so the margins of the second quarter has significantly improved. So we'd like to know, how would you comment on the drag from oil and gas? Because in your previous remarks, it seems that the growth in data center-related products are partially offset by oil and gas. I wonder if you would call this bottoming, or how would you describe the trends in oil and gas? Thank you.

Ken Lee | Interim Chief Executive Officer and Chief Financial Officer:

Yeah, the oil and gas market still remains soft. In our current forecast, we assume that the softness will continue, at least for this year, right? And the oil and gas products usually carry a relatively high gross margin, you know, for our products. And, you know, definitely we go our sales for the data center business and offset the sales job for oil and gas. So for this quarter, we still see, you know, quarter by quarter sales goals. And I will say, you know, we still We are not providing a very detailed quantity outlook, but we still think the second half sales definitely will exceed the first half sales. And our internal expectation is the second half will be consistent with the second half we had last year.

Alan Lau | Analyst, Jefferies:

Thank you. We'll take this offline. Thank you. Thank you.

Operator:

Thank you, and one moment for our next question. Our next question will come from the line of Dilyara Selabeva with Freedom Finance Global. Your line is open. Please go ahead.

Dilyara Selabeva | Analyst, Freedom Finance Global:

Hello, everyone. I just would like to know some updates on Wisconsin. Do you currently have enough capacity in Wisconsin to support the expected data center wrap, or would additional capacity expansion be needed if demand continues to grow into 2027?

Ken Lee | Interim Chief Executive Officer and Chief Financial Officer:

Okay, thank you. So for Wisconsin, definitely I say we're making measurable improvements, right? So that's the reason we see the sales goals and also goals margin improvements. And the team put up lots of resources, adding people, and also implement some process improvement initiatives. And we add a capacity. In Wisconsin, previously, we have about 150,000 square feet. Right now, it's about 800,000 square feet. And what I can see now is, at the current capacity, we can support the current demand. And for next year, as needed, definitely we can spend the capital to increase more capacity to serve our customers. And what I see is over the past several months, the team did a great job, improved lots of different areas, the labor efficiency, the cost structure, and also the material availability. And going forward, I will continue to expect the team to deliver more process improvements in Wisconsin.

Dilyara Selabeva | Analyst, Freedom Finance Global:

Okay, thanks. So just to follow up on that, so given the sequential improvement in gross margins, how should investors think about the normalized gross margin potential of the business once your Wisconsin operations stabilize?

Ken Lee | Interim Chief Executive Officer and Chief Financial Officer:

Yeah, we saw pretty significant gross margin improvements in Tokyo. And as you know, there are many things that could impact the quarterly gross margin. It could be impacted by mix. pricing and variable efficiency, fixed cost absorption, all this kind of thing. And if you see our year to date, the gold's margin is 25.2%. And we will continue to make a process in two months in Wisconsin. And also hopefully we can have favorable mix for the remainder of the year. I will not give you a specific number for the outlook. But I will say, you know, in the longer term, our business goal is to have a gross margin at a 25% range.

Dilyara Selabeva | Analyst, Freedom Finance Global:

Okay, great. Thanks. I'll turn it back.

Operator:

Thank you. And I would now like to hand the conference back over to Kenneth Lee for closing remarks.

Ken Lee | Interim Chief Executive Officer and Chief Financial Officer:

Okay, I just want to thank for everyone who joined the call today, and I appreciate your continued interest in TSI. And we look forward to giving you another update for the next quarter's meeting. Thank you.

Operator:

This concludes today's conference call. Thank you for participating. And you may now disconnect. Everyone, have a great day.