

MANAGEMENT'S DISCUSSION AND ANALYSIS

of Financial Condition and Results of Operations

We are pleased to report to you our financial condition and results of operations. During our fiscal year 2002, Powell Industries achieved record revenues of \$306.4 million, a 13% increase from fiscal 2001, and net earnings grew 32% to \$17.9 million. The following discussion should be read in conjunction with the accompanying consolidated financial statements and related notes.

In the course of operations, we are subject to certain risk factors, including but not limited to competition and competitive pressures, sensitivity to general economic and industry conditions, international political and economic risks, availability and price of raw materials and execution of business strategy. Any forward-looking statements made by or on our behalf are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Readers are cautioned that such forward-looking statements involve risks and uncertainties in that the actual results may differ materially from those projected in the forward-looking statements.

Results of Operations

Revenue and Gross Profit

Revenues increased 13% to a record \$306.4 million in fiscal 2002 as compared to fiscal year 2001. Revenues in fiscal 2001 were \$271.2 million, an increase of 22% over fiscal 2000 revenues of \$223.0 million. Our electrical power products, which consists of the Switchgear and Bus Duct segments, recorded revenues in fiscal 2002 of \$283.6 million compared to \$244.8 million in fiscal 2001 and \$193.7 million in fiscal 2000. During fiscal 2002, one aspect of our revenue growth was due to new worldwide investments in oil & gas production facilities. Furthermore, demand for additional electrical power generation capacities in the United States strengthened over the expansion realized in fiscal 2001. Revenues in our Process Control Systems segment were \$22.8 million compared to \$26.4 million in fiscal 2001 and \$29.3 million in fiscal 2000. For additional information related to our business segments, see Note L of the Notes to Consolidated Financial Statements.

International revenues increased in fiscal 2002 following a decline in the previous two years. Revenues outside of the United States accounted for 9% of consolidated revenues in fiscal 2002 compared to 8% and 20% in fiscal 2001 and 2000, respectively.

Gross profit, as a percentage of revenues, improved to 22.1% in fiscal 2002, compared to 21.0% and 18.2% in fiscal years 2001 and 2000, respectively. Higher production volumes, improved operating efficiencies, along with the quality of our backlog have all contributed to the improvement in gross profit. We continue to implement lean manufacturing initiatives to reduce costs and respond to the competitive markets that we serve.

Operating Expenses

Selling, general and administrative expenses, including research and development expenditures, were \$39.0 million (12.7% of revenues) in fiscal 2002 compared to \$35.0 million (12.9% of revenues) and \$29.8

million (13.4% of revenues) in fiscal years 2001 and 2000, respectively. Increases in operating expenses are largely due to the growth in business volumes during the same periods.

We have continued to invest in research activities. Research and development expenditures were \$3.4 million in fiscal 2002 compared to \$3.1 million and \$2.9 million in fiscal years 2001 and 2000, respectively. Our research efforts are directed toward the discovery and development of new products and processes as well as improvements in existing products and processes.

Interest Income and Expense

Net interest expense decreased to \$210 thousand in fiscal 2002 from \$359 thousand in fiscal 2001 due to lower levels of debt. Interest expense is related to our revolving credit facility and long-term debt which is partially offset by interest income from short-term investments. Fiscal 2000 resulted in net interest income of \$44 thousand.

Provision for Income Taxes

Our provision for income taxes reflects an effective income tax rate on earnings before income taxes of 37.1% in fiscal 2002 compared to 36.8% in fiscal 2001. The increase in our effective tax rate is primarily a result of higher state taxes and is also partly attributable to increases in non-deductible expenses.

Net Earnings

Net earnings were \$17.9 million, or \$1.67 per diluted share, in fiscal year 2002 compared to \$13.5 million, or \$1.28 per diluted share, and \$7.1 million, or \$0.67 per diluted share, in fiscal years 2001 and 2000, respectively. Growth in business volume and increased gross profits resulted in earnings improvement in fiscal 2002 and fiscal 2001. In fiscal 2000 we incurred additional costs on a major project in our Process Control Systems segment which decreased earnings in the period.

Liquidity and Capital Resources

We have maintained a strong liquidity position. Working capital was \$86.5 million at October 31, 2002 compared to \$89.0 million at October 31, 2001. As of October 31, 2002, current assets exceeded current liabilities by nearly 2.7 times and our debt to capitalization ratio was less than 0.1 to 1.

Cash and cash equivalents were \$14.4 million at October 31, 2002, an increase of 120% over year end 2001. Long-term debt, including current maturities, totaled \$12.0 million at October 31, 2002 compared to \$22.7 million at October 31, 2001. In addition to our long-term debt, we have a \$25.0 million revolving credit agreement expiring February 2005. As of October 31, 2002, there were no borrowings under this line of credit. For further information regarding our debt, see Note F of the Notes to Consolidated Financial Statements.