Sevcon, Inc.
Second Quarter 2013 Investor Conference Call
Wednesday, May 8, 2013, 9:00 a.m. ET

Management's Prepared Remarks

David Reichman:

Good morning everyone, and thank you for joining us. If you have not received a copy of the earnings press release issued yesterday afternoon, you can find it in the Investor Relations section of the Sevcon website, Sevcon.com.

Please be reminded that remarks that management may make during this call may contain forward-looking statements about future financial results. Important factors that may cause the company's actual results to differ materially from the anticipated events, performance, or results expressed or implied by the company's forward-looking statements are described in the risk factors detailed in its periodic reports filed with the SEC, which can also be accessed through the Sevcon website. The company advises you to read them and cautions you not to place undue reliance upon any forward-looking statements that may be made this morning, which speak only as of the date of this call. Sevcon undertakes no obligation to update any forward-looking statements.

With us today are Sevcon's Chief Executive Officer Matt Boyle and Chief Financial Officer Paul Farquhar. At this point, I will turn the call over to Matt.

Matt Boyle:

Thank you, David. Welcome everyone. We appreciate your joining us this morning.

I'll begin our prepared remarks by looking at our Q2 operational results. Paul will follow with the financial review, and then as usual we'll open the call for your questions.

The pickup in order flow that we discussed on our Q1 call in January continued through the second quarter. Conditions in both the off-road and on-road segments of our business remain challenging. However, our lead times and visibility have stabilized somewhat, and we were encouraged to see some pockets of end-market strength in the quarter.

As I said in January, our highest near-term priority is to return the business to profitability. We implemented personnel and cost reduction measures in the second quarter designed to rapidly accomplish this goal, based on the assumption of continuing soft demand.

We expect these initiatives to result in approximately 2 million dollars of annual run rate savings. Although we incurred a related restructuring charge of 605,000 dollars in the second quarter, these cost reductions enabled us to significantly narrow our operating loss. Given these factors and what we're seeing in our present order intake, we are not planning any further restructuring.

The macroeconomic environment and underlying trends in our markets improved a little this quarter. Our total revenues were down 20% from the same period last year, reflecting lower product sales in both the off-road and in 4 wheel on-road sectors of our business. However they improved by 23% from those we experienced in Q1.

We’re continuing to feel the effects of the uncertain economic times in some of our traditional sectors. Worldwide demand for forklift trucks was especially hard-hit this quarter, and sales for airport ground support applications were flat with Q2 last year. But on a more positive note sales to Aerial Work Platform customers improved, year-over-year.

Demand in Europe for our traditional off-road industrial EV products remained weak in the second quarter compared to the same quarter last year as the recession in that region continued. This weakness was partially offset, however, by slightly improved European sales for 2-wheel on road applications.

Although still down from a year ago, overall demand in China and the Far East, and to a lesser extent North America, was modestly improved from the immediately preceding first quarter. This improvement was primarily driven by stronger sales of products for aerial work platform applications in Asia. Our second-quarter sales also reflected higher levels of building investment in the Far East in general.

Looking specifically at the on-road EV segment, shipments for four-wheel applications remained well-below prior year levels, and were significantly lower than we had anticipated. This was mainly due to slower ramp up in Renault Twizy production compared to last year’s demand.

Along with improved AWP demand in Asia, our major bright spot this quarter was our continued growth in controller shipments for two-wheel on-road applications such as electric scooters and motorcycles. As in Q1, this growth was driven by increased demand in Europe in Scooter applications and by our business with motorcycle manufacturers in the US.

Our European customers Brammo, Govecs and Peugeot increased production during the quarter, as did our major U.S customer, Zero Motorcycles. Looking ahead, we're encouraged by the progress that Helmut Ollhaeuser is making as our new business development director in Germany.

Helmut is building excellent prospects for us in a country where our prior representation was minimal. In addition to 4-wheel on road opportunities, our pipeline in Germany includes some potentially exciting new projects related to next-generation EV motorcycle technology.

Looking ahead longer term, we believe that Sevcon is well-positioned to leverage the underlying strength in global demand for environmentally friendly transportation. Given the present state of battery technology, we continue to believe that it will be some years before this demand is satisfied by the practical and affordable mass-market electric sedan. Consequently, we believe that our current focus traditional markets and on scooters, motorcycles and city cars will enable us to maximize our growth in the near term.

The foundation for this strategy consists of two dimensions. The first is to continue to expand our portfolio of relationships with OEM and Tier 1 automotive suppliers in Europe, Asia and North America. Our focus this quarter was Europe, where we signed agreements with partners in

Finland, Bulgaria and Turkey. Our objective is to enhance our dealer network across continental Europe, and we plan to sign additional partnership agreements in Russia and Poland later this year.

As we've stated previously, our policy is not to discuss specific customer relationships until the vehicles are commercially introduced and shipping in volume.

The second dimension to our growth strategy is technology. Our engineering team continues to work closely with our customers around the world on solutions for making electric vehicles safer, more convenient and cheaper to run than ever before. We were awarded three patents this quarter related to electric motor control solutions that enhance EV drivability and battery life. These patents substantially broaden the ring fence that protects the proprietary black magic that underpins our competitive advantage.

As I've mentioned previously, we're working to replace many of our legacy DC products for traditional industrial off-road applications with our new Gen4 AC controller technology. We're developing solutions for hybridizing existing internal combustion engine-driven, off-road vehicles in order to meet upcoming emissions standards.

In summary, we're optimistic about Sevcon's potential but fully aware of the challenges we face. Although the near-term demand environment is less than favorable, we begin the third quarter with a stronger backlog, improved order flow and a lower cost structure. We remain committed to returning the business to growth and profitability, and look forward to reporting continued progress toward this goal in the quarters ahead.

I'll now turn the call over to Paul for a review of our financial results. Paul?

Paul Farquhar:

Thank you Matt and good morning everyone.

As a reminder, the Controls segment that Matt discussed is Sevcon's core business. We also operate a legacy capacitor business which incurred a small operating loss in the quarter.

Reviewing Sevcon's financial performance for the second quarter of fiscal 2013 and starting with the Income Statement, revenues were 8 million dollars, compared with 10.1 million dollars in the same period in fiscal 2012.

As in the first quarter and as Matt said, this reflected lower sales in both the off-road and on-road markets. In our controls business segment, sales were down from the second quarter last year in all three of our main geographic markets.

Excluding foreign currency effects, revenues declined 22% in North America, driven mainly by lower demand in our traditional off-road markets.

Sales in Europe were down 26%, reflecting lower shipments to Renault as well as the ongoing European recession.

Sales were down 20% in the Far East, where lower demand for construction and mining vehicles in China more than offset stronger product demand for aerial work platform applications in Asia.

Foreign currency exchange rates were similar to those a year ago, with FX decreasing reported sales by 1% year-over-year.

Gross profit for the second quarter of 2013 was 37.5% of sales, compared with 35.9% in Q2 last year.

Turning to operating expenses, we continue to benefit from a low-cost manufacturing model. Outsourcing our production to third parties allows us to add capacity while minimizing the addition of fixed costs. Our operating expenses consist primarily of product development, engineering, sales-related expenses and general and administrative expenses, including compensation and direct R&D costs.

Our priority this quarter was to improve our profitability. As Matt discussed, we expect to realize approximately 2 million dollars in annual run rate savings as a result of the headcount and overhead costs taken out of the business in the second quarter.

As a result of these cost reduction initiatives, operating expenses for the second quarter decreased by 560,000 dollars, or 16%, compared with the first quarter of fiscal 2013. Our Q2 operating expenses were essentially flat with the same period in fiscal 2012, reflecting our strong focus on product development and, with it, the addition of engineering staff this past year.

Due to these higher fixed costs as well as the year-over-year decline in revenue, engineering and R&D expenses as a percentage of total sales were 14% in the second quarter of fiscal 2013, compared with 9% in Q2 last year.

Including the 605,000 dollar restructuring charge that Matt discussed, Sevcon reported an operating loss for the second quarter of fiscal 2013 of 463,000 dollars. This compares with operating income of 695,000 dollars in the same period last year.

We recorded an income tax benefit of 638,000 dollars compared with an income tax provision of 158,000 dollars in Q2 last year. The higher effective tax rate in the second quarter of 2013 reflects the significant variance in income tax rates in the jurisdictions in which we do business and the relative profit or loss made in each business in each year. In addition, there is a continuing impact of the year-on-year reduction in the corporate Income Tax rate in the UK and also the availability in the UK of favorable R&D tax credits, which further reduces our effective UK Income Tax rate.

Looking forward, however, these continued tax rate reductions in the UK will require us to write down certain of the deferred tax assets on our balance sheet, amounting to approximately 200,000 dollars of additional tax liability. The timing of this will depend on when the associated legislation is passed by Parliament in the UK. However, we expect to see this impact on our effective tax rate sometime in the second half of our 2013 fiscal year.

Sevcon reported GAAP net income of 62,000 dollars, or 2 cents per diluted share, for the second quarter of 2013, compared with GAAP net income of 470,000 dollars, or 14 cents per diluted share, in the second quarter of fiscal 2012.

Turning now to cash flow and working capital items for the second quarter of fiscal 2013. Excluding currency translation, receivables increased by 840,000 dollars and inventories decreased by 117,000 dollars from the sequential first quarter. Payables and accrued expenses increased by 589,000 dollars and 409,000 dollars, respectively. The number of days' receivables at both March 30, 2013 and March 31, 2012 was consistent at 63 days.

Turning to the balance sheet, Sevcon ended the second quarter with cash and cash equivalents of 1 million dollars, compared with 1.3 million dollars at the end of Q1.

Finally, we closed the second quarter of fiscal 2013 with 1.8 million dollars in short- and long-term debt. This compares with 1.8 million dollars also, a year earlier.

As a reminder, we currently have a 3.5 million dollar secured revolving credit facility with RBS Citizens Bank. We also have a 1.4 million dollar bank overdraft facility with RBS Nat West Bank available to our UK subsidiary companies. These UK facilities were unused at the end of Q2.

Now, turning to our income statement results for the first six months of fiscal 2013. Sevcon's sales for the six-month period were 14.6 million dollars, compared with 18.6 million dollars in the same period last year.

Gross profit for the six-month period was 35.8% of sales, compared with 35.5% of sales a year earlier. Sevcon's operating loss was 1,648,000 dollars, after charging 605,000 dollars in one-time restructuring costs in the second quarter, compared with operating income of 947,000 dollars for the six-month period last year. Our net loss for the first half of this year was 1,240,000 dollars, or 37 cents per share, compared with net income of 754,000 dollars, or 22 cents per diluted share, in the same period last year.

In summary, we made good progress this quarter toward returning Sevcon to profitability. We remain optimistic about the prospects for our business both near-term and longer term.

With that, we'll be happy to take your questions. Operator, you can proceed with the Q&A now.

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