Sevcon, Inc.
First-Quarter 2014 Investor Conference Call
Wednesday, February 5, 2014, 9:00 a.m. ET

Management's Prepared Remarks

David Calusdian:

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 with some comments on the first quarter. Paul will follow with the financial review, and then we'll open the call for your questions.

Sevcon is off to a good start in fiscal 2014, with our quarter one results substantially better than in the same quarter of fiscal 2013. We've continued to see consistent sequential top-line growth since what appears to be a low point in quarter one of fiscal 2013. Our sales this quarter were up 36%, compared with that year-ago quarter and, and the strongest since quarter two of fiscal 2012.

In terms of geography, sales were up mid double digits this quarter in all three regions. The growth we experienced in the US and the UK was largely in the off-road EV sector. In the US, demand from mining equipment customers was flat, year-over-year, but we benefited from substantially stronger product demand for fork lift truck applications.

Our US sales also reflected solid growth in our aftermarket business, which focuses mainly on providing low-volume, end-of-life product support for aerial work platform customers. We've established a new consolidated channel for this part of the business, enabling us to serve these customers more efficiently through a single third-party distributor.

In the UK, our quarter-one sales reflected the success of our ongoing efforts to expand Sevcon's business in the Far East. This was another quarter of increased demand in Japan and China, mainly for aerial work platform and fork lift truck applications. Quarter one sales to customers in Europe were also up in double digits, largely driven by demand from industrial customers and for our Size 8 controllers in on-road markets. Although the European economy still faces significant challenges, this was our second consecutive quarter of growth in that region, year-over-year.

On our call last quarter I talked about how the role we've played as the controller supplier to Renault has opened doors for us with a number of other European OEMs that are developing next generations of four-wheel EV city vehicles. It's encouraging to see business with these customers, not only in France but also in Eastern Europe, beginning to offset the effects of last year's decline in Renault Twizy production.

We're working to expand Sevcon's presence in Germany as well. The projects in Germany that I mentioned on our call last quarter, which range from 2-wheel on-road, to electro-hydraulics, to multi-controller systems for industrial applications, are all making good progress.

With sales up substantially year over year in both our traditional off-road markets as well as 4-wheel on-road, our only disappointment this quarter was in the 2-wheel EV market, which is focused primarily on scooters and motorcycles in the 125 to 550 cc equivalent range.

We bring to this market a unique combination of both cutting-edge technology and proven experience in high-volume production. As a result, we're continuing to make progress in our long-term effort to build relationships and grow our business with OEM and Tier 1 suppliers to the scooter and motorcycle markets in Europe, Asia and North America.

This market is still in its early stages and likely to be lumpy from quarter to quarter. Looking forward, we expect electric scooter and motorcycle applications to be a significant growth driver in the quarters ahead.

Our growth strategy for Sevcon goes beyond expanding our OEM and Tier 1 relationships in the automotive sector. We're also working to penetrate a broader range of transportation-related and industrial sectors where our motor control technology can open doors to new applications.

We’re continuing to expand our sales and engineering capabilities in line with this strategy. I mentioned last quarter that, in addition to traditional recruiting channels, we’ve implemented an engineering apprenticeship program in the UK. This program is continuing to be successful in attracting young top talent to Sevcon. We’re also continuing to pursue UK government grant opportunities as a means of supplementing our internally funded R&D programs.

It’s our policy not to discuss specific customer relationships until we’re in commercial production and shipping in volume. I will say, however, that our new business pipeline has never been stronger.

As we announced yesterday, we’ve entered into a joint-venture agreement with Risenbo Technology Co., Ltd, to market and sell our products for on-road electric and hybrid vehicle applications principally to Tier 1 automotive suppliers in China. We’ve received the required government approvals in China, and we expect the JV agreement to become effective in the first quarter of calendar 2014. Under its terms, Sevcon and Risenbo each will own a 50 percent stake in the joint venture, which will be led by a Sevcon-nominated chair.

Based in Hubei Province, Risenbo is a subsidiary of a Tier 1 automotive supplier in China, and an established and respected player in the Chinese automotive industry. As you know, China has long been one of the most important growth regions, primarily in our traditional off-road sectors, and more recently in the two-wheel on-road sector. China is potentially the world’s largest electric and hybrid vehicle market. Partnering with Risenbo will enable us to forge new customer relationships and capitalize on this potential far more rapidly and efficiently than we could do on our own.

Probably our biggest near-term opportunity is with growth of customers working on hybrid electric vehicle technologies. One of them a manufacturer of hybrid powertrain conversion systems in the US . We’re also making good progress on supplier relationships related to hybrid vehicles in Europe.

In the industrial sector, we’re continuing to explore using our Gen 4 and new HVLP products to capitalize on opportunities related to electrohydraulics – that is, the replacement of older and less efficient hydraulic systems with electrical. Similar to the electric steering technology which has virtually replaced conventional hydraulic steering in automobiles, migrating to electric drives in commercial and industrial applications has the potential to dramatically improve efficiency, save energy and reduce total cost of ownership.

In summary, the underlying demand patterns appear to be getting stronger in the majority of our markets worldwide. Our customers are expressing a greater sense of confidence in the future, and our lead times and order visibility are steadily improving. Our portfolio of customer relationships and product pipeline continue to expand, and we've seen four consecutive quarters of revenue growth.

While rebuilding our momentum on the top line, we're making progress on the bottom line as well. Our business continues to benefit from having a low-cost, flexible manufacturing model. As a result, we believe that Sevcon is positioned to deliver significant margin leverage on incremental sales as conditions in our markets improve.

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 that reported a small operating income in the first quarter of fiscal 2014.

Reviewing Sevcon's financial performance for the quarter and starting with the Income Statement, revenues were $9 million, compared with $6.6 million in the same period in fiscal 2013.

As Matt said, in our controls business segment, sales in our traditional aerial work platform and fork lift truck markets were up this quarter, compared with Q1 last year, as were sales for four-wheel on-road applications. However, these increases were partially offset by lower sales in the two-wheel on-road sector.

In terms of geography and excluding foreign currency effects, revenues increased 31% from the first quarter last year in North America. This growth was driven by product demand in both the aerial work platform and fork lift truck markets, while demand in the mining sector was essentially flat, year-over-year.

Sales in the Far East showed 65% year-over-year growth due to stronger demand for aerial work platform applications in China and Japan.

Sales in Europe increased 38% from quarter one last year, also reflecting stronger aerial work platform business, as well as higher product demand for 4-wheel on-road EV applications.

Matt mentioned our low-cost manufacturing model, and I'd like to expand on that. We've traditionally relied on third parties for the majority of our production. Outsourcing to trusted manufacturing partners allows us to add capacity while minimizing the addition of fixed costs. As a consequence, our operating expenses consist primarily of product development, engineering, sales-related expenses and general and administrative expenses, including compensation and direct R&D costs.

During the second quarter of fiscal 2013 we implemented a number of personnel and cost reduction measures, with the goal of returning the business to profitability given the highly challenging industry conditions at the time. Our results for the first quarter of fiscal 2014 indicate that we are continuing to deliver the $2 million in annual run rate savings that we anticipate from these initiatives – in terms of both gross profit and operating costs.

Gross profit for the first quarter of 2014 improved nearly 9 percentage points to 42.3% of sales, from 33.7% in quarter one last year. As Matt said, our restructuring initiatives have reduced our cost of sales and an improved sales mix in the controls business also contributed to the gross margin improvement this quarter.

Total operating expense for Q1 was $300,000, or 9%, lower than the first quarter of fiscal 2013. This decrease year-on-year partly reflects the cost savings implemented in the second quarter of 2013, just mentioned. But also, in addition, the Company recorded grant income of $115,000 in the first quarter of 2014 compared to $6,000 in the first quarter in the prior year; this grant income was recorded as a reduction of research and development expense in each year. I'll also note, however, that operating expense a year ago reflected a final round of consulting and legal expenses related to the replacement of our defined benefit UK pension plan with a defined contribution arrangement, effective on the first of October 2012.

Sequentially, operating expenses were up about $200,000 from quarter four of fiscal 2013, driven mainly by higher sales and marketing spend.

Our reported operating expenses include engineering and R&D expense which are reported net of grants received. R&D expense, net of grants, was 10.3% of sales in the first quarter of fiscal 2014, compared with 16.3% in our revenue-challenged Q1 last year.

Sevcon reported operating income for the first quarter of $710,000, compared with an operating loss of $1.2 million in the same period last year. We reported an income tax provision of $121,000 this quarter, compared with an income tax benefit of $108,000 in Q1 last year.

Sevcon reported GAAP net income of $488,000, or 14 cents per diluted share, for the first quarter of 2014, compared with a GAAP net loss of $1.3 million, or a loss of 39 cents per share, in the first quarter of fiscal 2013.

Turning now to cash flow and working capital items, receivables increased by $1.7 million from the first quarter last year and inventories and prepaid expenses decreased by $500,000 and $600,000, respectively. Accounts payable, accrued expenses and accrued taxes increased by a combined $1.4 million year-over-year. The number of days' receivables was 63 at both December 28, 2013 and at December 29 a year earlier.

As announced in yesterday's press release, last month one of our customers in France was placed into administration. The receivable from the customer is $555,000 including taxes. Although we are pursuing full payment of the debt, it's not clear at this time if it can or will be repaid, and its collection is subject to a legal process. The full amount of this receivable is recorded on the balance sheet at December 28, 2013.

Turning to the balance sheet, Sevcon ended the first quarter with cash and cash equivalents of $2.2 million, compared with $1.3 million a year earlier. Finally, we closed the first quarter of fiscal 2014 with $1.8 million in short- and long-term debt. This compares with $1.8 million also, a year earlier.

As a reminder, we currently have a $3.5 million secured revolving credit facility with RBS Citizens Bank. $1.7 million of this facility was drawn down at the end of Q4, which represented the majority of the $1.8 million in short and long-term debt just mentioned which was the same amount at the end of Q1 of 2014 This revolving credit facility was extended as of September 30, 2013 and will expire on June 14, 2017 when the principal will be re-payable in full. We also have a $1.5 million bank overdraft facility with RBS Nat West Bank available to our UK subsidiary companies; this facility was unused at the end of the first quarter of fiscal 2014 and a year earlier.

Summing up, and in line with Matt's comments, with improved sentiment in our customer base, our lower cost structure and conservative balance sheet, we are confident that Sevcon is well-positioned for growth and improved profitability in fiscal 2014. We look forward to reporting our progress in the quarters ahead.

Operator, you can open the call for questions now.

Matt Boyle:

Thank you very much, and thanks everyone for listening this morning. We look forward to speaking with you next quarter. This concludes our call.

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