Sevcon, Inc.
First Quarter 2013 Investor Conference Call
Wednesday, January 30, 2013, 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 by looking at our Q1 operational results. Paul will follow with the financial review, and then as usual we'll open the call for your questions.

As the results we released yesterday attest, this was a very challenging quarter in both the off-road and on-road segments of our business. Sevcon has long been focused on consistently making money, so reporting a quarterly loss is anathema to us.

We experienced exceptionally weak order flow this past October and November, we were pleased however, to see a pickup in December that appears to have continued into this calendar year. Nonetheless, our highest near-term priority is to return the business to profitability.

We're now implementing measures designed to rapidly accomplish this goal, based on the assumption of continuing soft demand.

Looking at the dynamics of the business in the first quarter, we continued to feel the effects of a challenging macroeconomic environment, particularly in Europe. Product demand for traditional off-road industrial EV applications remained soft, reflecting ongoing weakness in the global construction, distribution and mining sectors. Reversing the strength we saw in the September quarter, our controller sales in the fork lift truck segment, for instance, were essentially flat on a year-over-year basis.

In the on-road EV market, product sales to customers decreased overall from the first quarter of FY12. As in the September quarter, shipments for four-wheel applications were down on a year-over-year basis, reflecting seasonal effects, technology adoption issues and consequential weak end-market demand.

However, we again saw growth in controller shipments for two-wheel on-road applications such as electric scooters and motorcycles. This growth was driven by increased demand in Europe in Scooter applications and in the US by our business with motorcycle manufacturers.

In Europe, Brammo increased production of its Empulse motorcycle during the quarter. Sales in the first quarter also reflected higher shipments to GOVECS, which is now manufacturing a line of new electric scooters.

In the US we also continued to see growing sales to our new customer, Zero Motorcycles. Zero uses our Gen4 Size 4 and Size 6 controllers fitted with special software catering for a mixture of on- and off-road motorcycle applications.

If you step back and look at our business as a whole, along with lower shipment volumes we're seeing shorter order lead times reflecting, we believe, a higher level of uncertainty in end user markets. This has reduced our visibility for future periods. As I mentioned however, the gradual rebound we've seen in our order flow for the past two months is broadly across all market segments and geographies. However, lead times and visibility are still relatively short, this leads us to approach the quarters ahead with a sense of cautious optimism.

In addition, our order book includes substantially increased business with Renault as it ramps up production of its Twizy city car commencing in March. We believe that the Twizy was one of the world's best-selling four-wheel on-road electric vehicles in 2012, and Renault is looking to further expand its share of this segment in 2013.

Looking a little bit farther ahead, we're encouraged by the progress that Helmut Ollhaeuser has made as our new business development director based in Stuttgart. Although it's still early days for Helmut and for us in Germany, we've already begun building a meaningful order pipeline in a country where we had no previous appreciable levels of business.

Looking ahead longer term, we believe that Sevcon is well-positioned to leverage the underlying strength in global demand for green transportation. The holy grail is a practical and affordable mass-market electric sedan, but given today's state of the art in battery technology, we're some years away from that.

In the meantime, we believe that in focusing on scooters and motorcycles and city cars like Twizy, we're targeting a sweet spot for near-term growth in the on-road EV market.

As we execute on this strategy, our recent investments in sales and customer support have enabled us to forge a growing portfolio of relationships with OEM and Tier 1 automotive suppliers in Europe, Asia and North America. As we've stated previously, our policy is not to discuss specific customer relationships until the vehicles are commercially introduced and shipping in volume. However, I can say that, working closely with our customers, our recently expanded engineering team is advancing our technology in ways that promise to make electric vehicles safer, more convenient and more cost-efficient in markets around the world.

As a result, Sevcon's product pipeline is the strongest it's ever been. For example, we're working to replace many of our legacy DC products for traditional industrial off-road applications. These next generation controllers are developed using Gen4 technology that will enable our customers to use our Gen4 AC controller to control DC motors.

We're continuing to make progress on the projects I mentioned last quarter. These relate to hybridizing existing internal combustion engine-driven off-road vehicles to meet upcoming emissions standards. In addition we are working with OEMs and Tier 1 suppliers with fully integrated EV drivetrain systems. These systems have potential applications ranging from four-wheel electric city cars like the Twizy, to hybrid, plug-in hybrid and pure electric passenger cars and commercial vehicles.

However, this is not to ignore the macroeconomic and market challenges that we are clearly facing. This has been a very tough business environment for the past two quarters, and it is likely to remain so for the foreseeable future.

Our strategy is to remain focused on the areas within our control – ensuring that we have the internal resources that we need to fully capitalize on our future opportunities, while at the same time managing to a conservative revenue plan, maximizing our margins and rebuilding our cash position.

As I said earlier, from an operational perspective we are committed to returning the business to profitability. We have a number of initiatives underway designed to achieve this goal as quickly as possible. We look forward to reporting on our progress with these initiatives when we announce our second-quarter results.

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 made a small operating contribution in the quarter.

Reviewing Sevcon's financial performance for the first quarter of fiscal 2013 and starting with the Income Statement, revenues were 6.6 million dollars, compared with 8.5 million dollars in the same period in fiscal 2012.

As Matt said, this reflected lower sales in our traditional off-road markets, as well as lower demand for our Gen4 controllers in the on-road market.

In our controls business segment, sales were down from the first quarter last year in two of our three main geographic markets. Excluding foreign currency effects, revenues were down 44% from the first quarter last year in Europe, reflecting the ongoing macroeconomic weakness in that region.

Sales were down in North America by 18%, but up 17% in the Far East market. The growth in the Far East was principally in Japan where we are seeing recovery after the tsunami in 2011. In North America, as in the fourth quarter of 2012, the declines were centered in our traditional off-road markets, and were only slightly offset by growth in sales for two-wheel on-road applications.

Gross profit for the first quarter of 2013 was 33.7% of sales, compared with 35% in Q1 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. The majority of our recent reinvestment in the business has been focused in these areas.

Operating expenses for the first quarter increased by 695,000 dollars, or 25%, compared with the same period last year. In addition to additional engineering and sales staff hired in 2012, this increase reflects 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.

Engineering and R&D expenses as a percentage of total sales were 16.3% in the first quarter of fiscal 2013, compared with 9.6% in Q1 last year. This reflects our strong focus on product development and, with it, the addition of engineering staff, as well as the year-over-year decline in revenue.

Sevcon reported an operating loss for the first quarter of fiscal 2013 of 1.2 million dollars. This compares with operating income of 252,000 dollars in the same period last year. This is our first operating loss since the onset of the recession in the first quarter of calendar year 2009.

We recorded an income tax benefit of 108,000 dollars compared with an income tax provision of 89,000 dollars in Q1 last year. The low tax rate in the first quarter of 2013 largely reflects the impact of the continued 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.

Sevcon reported a net loss of 1.3 million dollars, or 39 cents per share, for the first quarter of 2013, compared with net income of 284,000 dollars, or 8 cents per diluted share, in the first quarter of fiscal 2012.

Turning now to cash flow and working capital items for the first quarter of fiscal 2013. Excluding currency translation, receivables and inventories decreased by 1.4 million and 1.3 million dollars, respectively, from the first quarter last year. Payables decreased by 982,000 dollars, and accrued expenses increased by 38,000 dollars, respectively. The number of days' receivables on December 29, 2012 was flat year-over-year at 63 days.

Turning to the balance sheet, Sevcon ended the first quarter with cash and cash equivalents of 1.3 million dollars, compared with 306,000 dollars a year earlier.

In terms of our liabilities, our liability for pension benefits in the US and the UK increased from 7.8 million dollars at the end of Q1 of fiscal 2012 to 10.3 million dollars at the end of Q1 2013. This increase, which largely reflects the Company's UK pension plan, was due to the lower discount rates which are used to measure the plan's present and future pension obligations. The reduction in the discount rate was itself largely due to the affect of quantitative easing in the U.S. and U.K. by central banks which has driven down yields on government bonds. However, as mentioned earlier, during the fourth quarter of fiscal 2012 we took action to minimize future increases in our pension liability by closing our UK defined benefit plan to future accrual.

Finally, we closed the first quarter of fiscal 2013 with 1.8 million dollars in short- and long-term debt. This compares with 1.84 million dollars 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 1.5 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 Q1.

In summary, this clearly was a difficult quarter for Sevcon. As Matt said, we're taking a number of actions to return the business to profitability, and 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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