Sevcon, Inc.
Third-Quarter 2013 Investor Conference Call
Wednesday, August 7, 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 with our Q3 operational results. Paul will follow with the financial review, and then as usual we'll open the call for your questions.

Sevcon's results this quarter were in line with our expectations, overall. There was more stability in the demand environment than we've experienced in the past few quarters. Stability is not the same as growth, however, and we continued to face significant challenges in both the off-road and on-road segments of our business.

As I said last quarter, our lead times and visibility have improved since the start of the fiscal year. Q3 order intake shone further light on market sector demand. Overall customer demand was lower in Europe and to a lesser extent the US offset by higher requirements from Asia.

In our traditional markets, we continued to see lower demand from our global mining customers. However, conditions in the aerial work platform and global fork lift truck segments improved in Q3 compared to last year.

In Asia, sales to fork lift truck and aerial work platform customers were higher than in Q3 last year, mainly driven by demand in Japan and China. Europe was a similar picture with demand from both of these traditional markets higher than in the same period last year. In the US, whilst Fork Lift Truck demand was higher, this was offset by lower demand from our mining customers than in the prior year.

In the on road sectors we saw a lower demand in the four-wheel on road segment, a continuation of the situation experienced since the start of the fiscal year. As we mentioned in our call last quarter, this was mainly due to the slower ramp up in Renault Twizy production compared with last year's demand. Twizy has been the major revenue driver in the four-wheel segment of our on-road business and, as such, it's raised our profile as supplier in the four-wheel space. Renault has proven with the Twizy that a quadricycle is a viable alternative to the car for intra-city mobility. Our presence as the control supplier to Renault has opened doors for us with a number of other OEMs that are developing a next generation of four-wheel EV city vehicles.

Although Renault has been an important customer for us in the four-wheel segment of our on road business, our strategy for the on-road market is focused not only on city cars, but also on two-wheel applications, mainly electric scooters and motorcycles in the 125 to 550 cc equivalent range. We're continuing to see good success in the two-wheel market globally. Q3 was another quarter of solid growth in shipments of controllers to scooter and motorcycle manufacturers in Europe and North America.

Our new business development director in Germany, Helmut Ollhaeuser, is building an encouraging pipeline of future business in that country. This pipeline is largely focused on four-wheel on road opportunities. However, as we mentioned last quarter, our pipeline in Germany includes some potentially exciting new projects related to next-generation EV motorcycle technology.

The two-wheel on road sector is probably our most competitive market. What's driving our performance versus the competition is our proven ability to deliver higher quality and higher performance, as well as our experience over the years in higher volume production.

Based on these advantages, we are continuing to expand our 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.

In addition to proven experience, another of our key competitive advantages is our technology. Leveraging this technology in close cooperation with our customers, we are continuing to develop new solutions for making electric vehicles safer, more convenient and cheaper to run.

As we announced yesterday, we have been awarded a UK government grant of approximately 450,000 dollars to develop next-generation controls for high-voltage, low-power applications. These funds will defray a significant portion of the research and development expenses associated with this project, which we expect to continue over the next 18 months.

As I've mentioned previously, we're working to replace many of our legacy DC products for traditional industrial off-road applications with DC versions of our Gen4 AC controller technology. Last month we announced that we've launched the first of what we are planning as a full Gen4 DC line that encompasses products in a variety of sizes similar to the sizes we cover with our Gen4 AC controllers. We expect our Gen4 DC products to be highly price- and performance-competitive and well-suited to a large number of applications, especially in the fork-lift truck and aerial work platform markets.

In summary, we believe that Sevcon is well-positioned for the challenges ahead. Fundamentally, we're in the right place at the right time with our technology and products, and with our expanding portfolio of OEM relationships. Although our near-term visibility is still cloudier than we would like, we believe markets are more stable than they were at the beginning of the year.

Turning now to operational plans, we made consistent progress toward returning Sevcon to sustained profitability in the third quarter. The restructuring initiatives that we discussed last quarter are on track toward delivering the two million dollars of annualized operating expense reduction that we anticipated.

We're confident that, with our lower cost structure and conservative balance sheet, a more consistent recovery in end-market demand will enhance the operating leverage in our business. We remain committed to growth and improved profitability, and look forward to reporting continued progress toward these goals.

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 reported a small operating income in the third quarter of fiscal 2013.

Reviewing Sevcon's financial performance for the quarter and starting with the Income Statement, revenues were 8.7 million dollars, compared with 8.9 million dollars in the same period in fiscal 2012.

As Matt said, we experienced mixed conditions in our end markets in our controls business segment. We saw increased sales in our traditional markets of aerial work platforms and fork lift trucks and also to two-wheel on-road applications. However, these increases were offset by lower sales in the four-wheel on-road sector compared with the third quarter last year. Sales were up year-over-year in the Far East, but down in Europe and the U.S.

Excluding foreign currency effects, revenues declined 6% in North America, largely reflecting lower demand from our mining customers.

Sales in Europe were down 16%, reflecting lower shipments to Renault as well as the ongoing recession in certain parts of Europe.

In the Far East, sales were up 57% from Q3 last year, driven by stronger product demand for fork-lift truck and aerial work platform applications in China and Japan.

Gross profit for the third quarter of 2013 was 37.3% of sales, compared with 33.3% in Q3 last year. The increase in the gross profit percentage being due to improved sales mix in the controls business.

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.

We talked in some detail on our last call about the personnel and cost reduction measures we implemented in the second quarter with the goal of returning the business to profitability based on the assumption of continuing soft demand. As Matt discussed, our results for Q3 indicate that we are well on our way toward delivering the 2 million dollars in annual run rate savings that we anticipate from these initiatives.

Operating expenses for the third quarter of fiscal 2013 were essentially flat with both the sequential second quarter and the third quarter of fiscal 2012. Operating expenses include engineering and R&D expenses which, as a percentage of total sales, were 11.2% in the third quarter of fiscal 2013, compared with 10.7% in Q3 last year. This reflects our continued investment in R&D to support our development efforts.

Sevcon reported operating income for the third quarter of 293,000 dollars. Foreign currency fluctuations reduced operating income by 256,000 dollars compared to the same period last year, due mainly to the weakness of the US dollar compared to the euro. Excluding the impact of currency, operating income was 514,000 dollars higher than the 35,000 dollars reported in the same period last year. This compares with an operating loss of 463,000 dollars for the sequential second quarter, which included a 605,000 dollar restructuring charge.

We recorded an income tax charge for the quarter of 47,000 dollars compared with an income tax benefit of 99,000 dollars in Q3 last year. For the nine months ended June 2013 we recorded an income tax benefit of 699,000 dollars or 38.5% of the loss before income tax compared to an income tax charge of 148,000 dollars or 14% of income before tax in the same period last year. The differing effective tax rate percentages 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.

As we mentioned last quarter, 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 350,000 dollars of additional tax liability. The associated legislation was passed by Parliament in the UK in July, so this write-down will impact our effective tax rate for the fourth quarter of fiscal 2013.

Sevcon reported GAAP net income of 124,000 dollars, or 4 cents per diluted share, for the third quarter of 2013, compared with GAAP net income of 156,000 dollars, or 5 cents per diluted share, in the third quarter of fiscal 2012.

Turning now to cash flow and working capital items for the third quarter of fiscal 2013. Excluding currency translation, receivables increased by 632,000 dollars which reduced cash during the period. Inventories and prepaid expenses decreased by 186,000 dollars and 68,000 dollars, respectively, and accounts payable, accrued expenses and accrued taxes increased by a combined 711,000 dollars, all of which increased cash in the period. The number of days' receivables at June 29, 2013 and June 30, 2012 remained consistent at 63 days.

Turning to the balance sheet, Sevcon ended the third quarter with cash and cash equivalents of 1.3 million dollars, compared with 1 million dollars at the end of Q2.

Finally, we closed the third 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 of which $1.7m was drawn down at the end of Q3 and which represented the majority of the $1.8m short and long-term debt just mentioned. This revolving credit facility will expire on June 14, 2014 and the principal will be payable in full; accordingly, the outstanding amount under this credit facility is shown as a current liability in the Q3 consolidated balance sheet. We also have a 1.4 million dollar bank overdraft facility with RBS Nat West Bank available to our UK subsidiary companies of which 342,000 dollars was drawn down as at the end of Q3.

Now, turning to our income statement results for the first nine months of fiscal 2013. Sevcon's sales for the nine-month period were 23.3 million dollars, compared with 27.5 million dollars in the same period last year.

Gross profit for the nine-month period was 36.3% of sales, compared with 34.8% of sales a year earlier. Sevcon's operating loss was 1,355,000 dollars, after charging 605,000 dollars in one-time restructuring costs in the second quarter, compared with operating income of 982,000 dollars for the nine-month period last year. Our net loss for the nine months of this year was 1,116,000 dollars, or 33 cents per diluted share, compared with net income of 910,000 dollars, or 27 cents per diluted share, in the same period last year.

In summary, we’re pleased with our progress on the bottom line this quarter, and we’re looking forward to reporting further progress in the quarters ahead.

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

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