Sevcon, Inc.
First-Quarter Fiscal 2016 Investor Conference Call
Wednesday, February 3, 2016

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.

Given the announcement of our acquisition of Bassi on Monday, I'll be spending the bulk of the call this morning discussing this important milestone for Sevcon. In short, we believe it will accelerate our strategic growth and create significant long-term value for our stockholders.

Before getting into more detail about Bassi, I'll provide some comments on the quarter and Paul will follow with his financial review per usual. I'll come back on to talk about Bassi at that point.

Looking at the first quarter overall, continued weakness on the industrial side of the business as a result of macro-economic conditions offset nice growth in the on-road and other EV categories. Sales were down for the quarter by 5%. Excluding FX, they would have been down by 1.4%.

Let's look closer at our sales performance, beginning with geography. As a reminder, it's our policy not to discuss specific customer relationships until we're in commercial production and shipping in volume.

Sales in the United States were down 8%. Continued weakness in Mining and other traditional markets was substantially offset by a significant increase in on-road sales in the US. Marine sales were also strong.

Sales in Asia were up 25%. Like the US, on-road continues to do very well in China. Industrial off-road was down in line with other geographies except Japan where Aerial Work Platform demand doubled compared to the same period last year.

Sales in Europe declined approximately 19% year-over-year, primarily due to industrial markets which were all lower year over year. In Europe the on road sector was also lower. In Q1 fiscal 2015, a large value shipment to a European customer for production start did not repeat. This was partially offset by the recognition of engineering services to European customers.

Looking at our quarter one results by end-use sector, sales remained weak in our industrial off-road markets, continuing to reflect the underlying macroeconomic trends. Mining, airport ground support and fork lift truck sales were down double-digits from quarter one last year. Aerial work platforms were up double digits driven by Japan, but were offset by lower shipments to European and US customers.

Turning now to the on-road business, we continued to see strong growth in the 2-wheel sector. In fact, we recorded the third consecutive quarter of double digit growth – up 47%. Sales in the 2-wheel market were once again driven mainly by product shipments to electric motorcycle OEMs in Europe and the United States.

In the four-wheel sector, sales were down 5% as a result of the major European order that we shipped in Q1 a year ago which did not repeat. We expect to see a return to growth in four-wheel sales in the remainder of the year. Most importantly, our reputation is growing in the four-wheel market and we look forward to increasing the number of contracts with automotive OEMs.

We also continue to make progress with our Chinese joint venture, and we're on track to begin production shipments by the end of calendar '16. We're initially targeting four-wheel on-road electric and hybrid vehicle applications in what is becoming the world's largest market for two- and four-wheel electric vehicles.

In addition to the on-road and off-road sectors, we continue to see accelerated growth in our Other EV market, where quarter one sales were up 17% from the prior year. We're making great progress with our emerging marine business, in addition to other applications such as recreational and utility vehicles.

Before I turn the call over to Paul, I'll sum up by saying that, while the off-road markets continue to be challenging, we're gaining excellent traction in growing our reputation and our stable of clients in on-road markets. We're encouraged by this progress and look forward to reporting future successes to you as we capitalize on many opportunities related to the global demand for electrification. We believe that this progress will be accelerated with the acquisition of Bassi, and I'll be back to discuss that exciting development after Paul reviews our quarter one financial results. Paul?

Paul Farquhar:

Thank you Matt and good morning everyone.

Reviewing Sevcon's financial performance for the quarter and starting with the Income Statement, total revenues decreased 8.2% to $9.1 million, from $9.9 million in the same period in fiscal 2015. As Matt mentioned, this decline primarily reflects the continued weakness on the industrials side of the business.

Foreign currency fluctuations decreased reported sales by $312,000, or 3.1%, for the quarter, mainly due to a stronger U.S. dollar compared with the Euro and the British pound than in the first quarter of fiscal 2015. Excluding the impact of currency fluctuations, revenues decreased 5%.

In terms of geography, our overall Q1 sales decline was largely driven by the United States and Europe, where revenues decreased by approximately 8% and 29%, respectively, from the same period last year. This was primarily due to the continued weakness in mining and our traditional markets. Sales were up approximately 25% in Asia due to strength in the on-road sector.

As Matt mentioned, we are making good progress with our Chinese JV, which continues to ship product prototypes designed specifically for the unique requirements of the Chinese market.

Turning now to operating expenses, we are continuing to benefit from our low-cost manufacturing model. 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.

Our operating expense includes engineering and R&D costs, which are reported net of grants received. Engineering and R&D expense, net of grants, was 10% of sales in the first quarter of fiscal 2016, compared with 8% in Q1 last year. This continuing level of expenditure reflects our on-going commitment to product development and improvement.

On a reported dollar basis, total operating expense for Q1 increased by $709, 000 from the first quarter of fiscal 2015. This included $316,000 of costs incurred in the quarter relating to the acquisition of Bassi Srl which closed on January 29th. The balance of the increase reflects investment in sales and engineering resources including the hiring of additional staff. This investment in additional resource was in response to the increased project activity, particularly in on-road markets. Foreign currency fluctuations decreased reported operating expense by $123,000, or 4%, due to the stronger U.S. dollar compared with the Euro and the British pound than in the first quarter of fiscal 2015. Sevcon reported operating income for the first quarter of fiscal 2016 of $180,000, compared with operating income of $282,000 in the same period last year. Excluding the $316,000 of acquisition costs, reported operating income for the quarter would have been $496,000, an increase of $214,000 or 76% compared to Q1 2015. We reported an income tax charge of $11,000 this quarter, or 11.6% of pre-tax income, compared with a charge of $40,000, or 13% of pre-tax income, in Q1 last year.

After dividends paid and accrued of $111,000 to holders of Series A convertible preference shares, Sevcon reported net income attributable to common stockholders of $11,000, or zero cents per share, for the first quarter of 2016. This compares with $171,000, or 5 cents per share, in Q1 of fiscal 2015.

Let’s turn now to cash flow and working capital items. Excluding the impact of foreign currency, receivables, inventory, and prepaid expenses and other current assets increased by a combined $558,000, which decreased cash during the period. Accounts payable, accrued expenses and accrued taxes decreased by a combined $1,287,000 in the first quarter, which also decreased cash during the period. The Company invested $323,000 in tooling, test and R&D equipment during the quarter as we continue to invest in capitalizing on electrification opportunities.

The number of days' receivables was 12 days higher at 73 days at January, 2, 2016 than at the end of Q1 last year.

Sevcon ended the first quarter with cash and cash equivalents of $6.6 million, including the remaining rights issue funds. This compares with $8 million in cash, including the rights issue funds, at year-end 2015. The $1.4 million reduction in cash year to date was net of a new loan of $500,000 drawn down under the Citizens Bank secured revolving credit facility. Of the net $1.9 million reduction in cash and cash equivalents, we paid $217,000 of preferred stock dividends and invested $323,000 in capital items with the remaining $1.4 million reduction in cash in the quarter representing the net effect of the working capital changes discussed earlier. In January 2016 we paid off the Citizens Bank $1 million loan and terminated the Loan and Security Agreement with that bank.

We also have a $1.4 million bank overdraft facility with RBS Nat West Bank available to our U.K. subsidiary companies. We had drawn $172,000 of this facility at the end of Q1 and it was unused at the end of the first fiscal quarter last year. This overdraft facility was renewed for a further period of 12 months in July 2015 although, in common with most overdraft facilities in Europe, they can be withdrawn on demand by the bank.

Before I turn the call over to Matt for a discussion of Bassi, I'd like to summarize the terms of the Bassi deal. The acquisition was funded with 10 million Euros in cash (or about just under 11 million dollars), 500,000 shares of Sevcon common stock, and a dividend distribution of 3.38 million Euros over a three-year period. We obtained funding for the transaction under a five-year term loan facility provided by the New York City branch of the Italian bank Monte dei Paschi di Siena. The details of the loan facility were disclosed with the Company's Form 8-K filed on Monday of this week.

In terms of Bassi's financials, the company generated approximately $16 million in sales in 2015, and was profitable. The business will be disclosed as a separate segment for financial reporting purposes going forward.

With that, I'll turn the call back to Matt.

Matt Boyle:

Thank you, Paul.

The strategic implications of our acquisition of Bassi are very compelling.

First and foremost, adding Bassi's state-of-the-art battery charging technology and power management capabilities to Sevcon's advanced control technologies will significantly strengthen our ability to deliver the more integrated solutions that our markets and our customers are demanding.

Bassi's products start with a low-cost line of low frequency chargers for simple lead-acid battery applications. From there, the portfolio ranges to high frequency chargers using power modules for battery technologies such as Lithium-ion, to a newly introduced fast-charger system with sophisticated charge algorithms and communications to battery monitoring modules. Bassi is also developing a line of high-frequency chargers with wide input and output voltage ranges which are highly efficient and compact, with exciting potential for induction charging applications.

We'll be able to integrate battery charger and power management technology with Sevcon's new GEN5 family of motor controllers to offer a unified suite of electronics for on-road vehicles. These integrated control solutions will include standby, or overnight, charging capabilities, as well as fast charging and potentially electric vehicle induction charging.

By offering customers a broader product portfolio that eliminates motor controller/battery charger interoperability concerns, we believe our company can secure a greater share of the on-road and industrial electrification markets. All told, the acquisition of Bassi enables us to expand our addressable share of the high-growth vehicle electrification market by approximately 35%.

Secondly, we have opportunities to deploy Sevcon's marketing and sales resources to accelerate standalone sales of Bassi's products and solutions. This includes selling products through our joint venture in China.

Thirdly, the acquisition will enable us to pursue opportunities to cross-sell our own offerings along with Bassi's in each company's respective markets.

And finally, Bassi offers us the opportunity to enhance earnings by adding an immediately accretive business, excluding transaction costs.

With that as our strategic rationale, let me provide you with some additional information on Bassi. They operate out of a combined headquarters and production facility in Lugo di Ravenna, Italy, which is not far from the city of Bologna. Their manufacturing is highly vertically integrated, with all necessary processes on site.

Bassi will operate at its current location under Sevcon, and Andrea Bassi will continue to lead the business. We look forward to having him and Bassi's 100 employees become part of the Sevcon team.

I will close these prepared remarks by echoing Andrea's comment in our press release. We believe this transaction is an opportunity to combine two outstanding and complementary organizations. Both companies have long been committed to innovation and the highest levels of customer service. Most importantly, we share the same vision – that is, to play a key role in the word's quest for more efficient and environmentally sustainable transportation. We are thrilled to welcome Bassi's world-class engineering and production teams to the Sevcon family.

With that, Paul and I will be happy to take your questions. Operator, you can proceed with the Q&A now.