

TECH OPS SEVCON INC
Form 10-K
December 23, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-K

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended September 30, 2010 or

- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____.

Commission File Number 1-9789

TECH/OPS SEVCON, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

04-2985631
(I.R.S. Employer Identification No.)

155 Northboro Road, Southborough, Massachusetts 01772
(Address of Principal Executive Offices) (Zip Code)

Registrant's Area Code and Telephone Number (508) 281 5510

Securities registered pursuant to Section 12(b) of the Act:

(Title of Each Class)	(Name of Exchange on Which Registered)
COMMON STOCK, PAR VALUE \$.10 PER SHARE	NASDAQ CAPITAL MARKET

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes No

As of April 3, 2010, 3,338,322 common shares were outstanding, and the aggregate market value of the common shares (based upon the closing price on the Nasdaq Stock Market) held by non-affiliates was \$12,550,000. As of December 1, 2010, 3,340,322 common shares were outstanding.

Documents incorporated by reference: Portions of the Proxy Statement for Annual Meeting of Stockholders to be held January 25, 2011 are incorporated by reference into Part III of this report.

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Schedules other than the one referred to above have been omitted as inapplicable or not required, or the information is included elsewhere in financial statements or the notes thereto.

Unless explicitly stated otherwise, each reference to “year” in this Annual Report is to the fiscal year ending on the respective September 30.

PART I

ITEM 1 BUSINESS

- General Description

Tech/Ops Sevcon, Inc. (“Tech/Ops Sevcon” or the “Company”) is a Delaware corporation organized on December 22, 1987 to carry on the electronic controls business previously performed by Tech/Ops, Inc. (Tech/Ops). Through wholly-owned subsidiaries located in the United States, England, France, South Korea and Japan, the Company designs and sells, under the Sevcon name, microprocessor based controls for zero emission and hybrid electric vehicles. The controls are used to vary the speed and movement of vehicles, to integrate specialized functions and to prolong the shift life of vehicles’ power source. The Company’s customers are manufacturers of on-road, off-road and industrial vehicles including automobiles, motorcycles, buses, fork lift trucks, aerial lifts, mining vehicles, airport ground support vehicles, utility vehicles, sweepers and other battery powered vehicles. In 2009, the Company became increasingly involved in developing products for the on-road electric vehicle (“EV”) market. In recent years, the Company has outsourced the manufacturing of its controllers to independent subcontractors headquartered in Poland and the U.S.; the U.S. subcontractor has plants in Mexico and China in which the Company’s product is manufactured. Through another subsidiary located in the United Kingdom, Tech/Ops Sevcon manufactures special metalized film capacitors for electronics applications. These capacitors are used as components in the power electronics, signaling and audio equipment markets. Approximately 94% of the Company’s revenues in 2010 were derived from the controls business and 6% from the capacitor business. The largest customer accounted for 7% of sales in 2010 compared to 14% in 2009.

In 2010, sales totaled \$26,053,000 compared to \$20,339,000 in the previous year. Foreign currency fluctuations accounted for an increase of \$197,000 or 1% in reported sales. Excluding the foreign currency impact, sales volumes increased by 27% compared to 2009. There was an operating profit of \$329,000 in 2010, after giving effect to a \$507,000 gain from freezing a pension plan, compared to an operating loss of \$1,866,000 in the previous year. There was a net profit for the year after income tax benefit of \$866,000, or \$.26 per diluted share, compared to a net loss after income tax benefit of \$1,475,000, or \$.46 per diluted share, last year. See Management’s Discussion and Analysis of Financial Condition and Results of Operations for a more detailed analysis of 2010 performance.

- Marketing and sales

Sales are made primarily through a full-time marketing staff. Sales in the United States were \$13,585,000 and \$10,787,000 or 52% and 53% of total sales respectively in years 2010 and 2009. Approximately 49% of sales are made to ten manufacturers of electric vehicles in the United States, Europe and the Far East. See Note 8 to the Consolidated Financial Statements (Segment Information) in this Annual Report for an analysis of sales by segment, geographic location and major customers, and the risk factors beginning on page 4 regarding sales and operations outside the United States, which are incorporated by reference herein.

- Patents

Although the Company has international patent protection for some of its product ranges, the Company believes that its business is not significantly dependent on patent protection. The Company is primarily dependent upon technical competence, the quality of its products, and its prompt and responsive service performance.

- Backlog

Tech/Ops Sevcon's backlog at September 30, 2010 was \$6,121,000 and \$3,691,000 at September 30, 2009, an increase of 66%. The increase in backlog is due in part to increased demand for the Company's products, but also to the impact of the continuing global shortages of raw materials and components on the Company's ability to meet its customers' needs. Accordingly, the Company does not believe that the backlog is necessarily indicative of future sales levels.

- Raw materials

Tech/Ops Sevcon's products require a wide variety of components and materials. The Company has many sources for most of such components and materials. However, the Company relies principally on two main suppliers for all of its requirements for certain components, sub-assemblies, and finished products: Fideltronik in Poland and Keytronic in the U.S. Keytronic manufactures the Company's components at two separate plants, in Mexico and China. The Company is taking steps to diversify its risk and reduce its reliance on any single subcontractor by duplicating certain test facilities at both Fideltronik and Keytronic manufacturing locations.

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• Competition

The Company has global competitors which are divisions of larger public companies, including Danaher's Motion division, Sauer Danfoss, Hitachi and the motors division of General Electric. It also competes on a worldwide basis with Curtis Instruments Inc., Zapi SpA. and Iskra, private companies based in U.S., Italy and Slovenia, respectively that have international operations. In addition, some large fork lift truck and on-road vehicle manufacturers make their own controls and system products. The Company differentiates itself by providing highly reliable, technically innovative products, which the Company is prepared to customize for a specific customer or application. The Company believes that it is one of the largest independent suppliers of controls for electrically powered and hybrid vehicles.

• Research and development

Tech/Ops Sevcon's technological expertise is an important factor in its business. The Company regularly pursues product improvements to maintain its technical position. Research and development expenditures amounted to \$3,042,000 in 2010, compared to \$2,643,000 in 2009. Of the increase in reported research and development expense of \$399,000 in 2010, \$350,000 was due to increased expenditure, largely on the Company's new range of alternating current ("A.C.") controls and \$49,000 was due to unfavorable foreign currency fluctuations.

• Environmental regulations

The Company complies, to the best of its knowledge, with federal, state and local provisions which have been enacted or adopted regulating the discharge of materials into the environment or otherwise protecting the environment. This compliance has not had, nor is it expected to have, a material effect on the capital expenditures, earnings, or competitive position of Tech/Ops Sevcon. In 2009 the Company achieved accreditation to ISO14001, the international standard for Environmental Management Systems.

• Executive officers

Information about our executive officers is incorporated by reference from Part III, Item 10 of this report.

• Employees and labor relations

As of September 30, 2010, the Company employed 101 full-time employees, of whom 12 were in the United States, 79 were in the United Kingdom (of whom 23 were employed by the capacitor business), 7 were in France, and 3 were in the Far East. Tech/Ops Sevcon believes its relations with its employees are good.

ITEM 1A RISK FACTORS

In addition to the market risk factors relating to foreign currency and interest rate risk set out in Item 7A on page 12, the Company believes that the following represent the most significant risk factors for the Company:

Capital markets are cyclical and weakness in the United States and international economies will harm our business

The Company's traditional customers are mainly manufacturers of capital goods such as fork lift trucks, aerial lifts and railway signaling equipment. These markets are cyclical and depend heavily on worldwide transportation, shipping and other economic activity. They experienced a significant decline in demand due to the recent global economic recession which significantly reduced sales in 2009, and demand still remains substantially lower than the peak in 2007 and 2008. Further, as our business has expanded globally, we have become increasingly subject to the risks

arising from adverse changes in global economic conditions. The recent recession caused a general tightening in the credit markets, lower levels of liquidity, increases in the rates of default and bankruptcy, and extreme volatility in credit and equity markets. These developments have already had an adverse impact on the Company's business and may materially negatively affect the Company's business, operating results or financial condition in a number of additional ways. For example, current or potential customers may be unable to fund purchases or manufacturing of products, which could cause them to delay, decrease or cancel purchases of our products or not to pay the Company or to delay paying for previously purchased products. In addition, the effect of the crisis on the Company's banks and other banks may cause the Company to lose its current overdraft facilities and be unable otherwise to obtain financing for operations as needed.

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The global shortage of components and raw materials may continue to increase our costs and hurt our ability to meet customer demand

During the recent global recession, the Company's suppliers of raw materials and key components suspended manufacturing operations due to reduced demand. As economic conditions have improved, some of them have not yet resumed production at pre-recession levels. The resulting shortages vary across types of raw materials and components depending on many fluctuating factors. As a result, we have had difficulty meeting our customers' demands for our products, which has had an adverse impact on our business. The shortages have also led to increased costs as we have competed with others for the limited supply. We cannot predict with certainty how quickly any of our suppliers will be able to increase their production to meet our needs. If we are unable to compete successfully for the components and materials we need, or identify alternative suppliers, the adverse impact on our ability to grow revenues, our operating results, and our financial condition will continue and may be material.

Demand for on-road electric vehicles incorporating our products may not materialize

The Company has become increasingly involved in developing products for the on-road electric vehicle market. We have relationships with several customers who incorporate our products into their EV products. Our competitors and others are also developing products for other entrants in the EV market, with similar and competing technologies. If our customers' products or technology are not successful commercially, or if worldwide demand for EVs fails to grow as much as we hope, we may not realize the anticipated demand for our products in the EV market, which may have a material adverse effect on our results of operations.

The Company relies on a small number of key customers for a substantial portion of its revenues

Ten customers accounted for 49% of the Company's revenues in 2010 and the largest customer accounted for 7% of revenues. Although we have had business relationships with these customers for many years, there are no long-term contractual supply agreements in place. Accordingly our performance could be adversely affected by the loss of one or more of these key customers.

The Company has substantial sales and operations outside the United States that could be adversely affected by changes in international markets

A significant portion of our operations and business are outside the United States. Accordingly, our performance could be adversely affected by economic downturns in Europe or the Far East as well as in the United States. A consequence of significant international business is that a large percentage of our revenues and expenses are denominated in foreign currencies that fluctuate in value versus the U.S. Dollar. Significant fluctuations in foreign exchange rates can and do have a material impact on our financial results, which are reported in U.S. Dollars. Other risks associated with international business include: changing regulatory practices and tariffs; staffing and managing international operations, including complying with local employment laws; longer collection cycles in certain areas; and changes in tax and other laws.

Single source materials and sub-contractors may not meet the Company's needs

The Company relies on a few suppliers and sub-contractors for its requirements for most components, sub-assemblies and finished products. In the event that such suppliers and sub-contractors are unable or unwilling to continue supplying the Company, or to meet the Company's cost and quality targets or needs for timely delivery, there is no certainty that the Company would be able to establish alternative sources of supply in time to meet customer demand.

Damage to the Company's or sub-contractors' buildings would hurt results

In the electronic controls segment the majority of the Company's finished product is produced in three separate plants in Poland, Mexico and China; these plants are owned by sub-contractors. The capacitor business is located in a single plant in Wales. In the event that any of these plants was to be damaged or destroyed, there is no certainty that the Company would be able to establish alternative facilities in time to meet customer demand. The Company does carry property damage and business interruption insurance but this may not cover certain lost business due to the long-term nature of the relationships with many customers.

Product liability claims may have a material adverse effect

The Company's products are technically complex and are installed and used by third parties. Defects in their design, installation, use or manufacturing may result in product liability claims against the Company. Such claims may result in significant damage awards, and the cost of any such litigation could be material.

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ITEM 2 PROPERTIES

The U.S. subsidiary of the Company leases approximately 13,500 square feet in Southborough, Mass., under a lease expiring in 2013. The United Kingdom (U.K.) electronic controls business of Tech/Ops Sevcon is carried on in two adjacent buildings owned by it located in Gateshead, England, containing 40,000 and 20,000 square feet of space, respectively. The land on which these buildings stand is held on ground leases expiring in 2068 and 2121, respectively. The U.K. subsidiary sub-lets approximately 11,000 square feet of unused space in one of its buildings for a five-year term expiring in March 2011. The capacitor subsidiary of the Company owns a 9,000 square foot building, built in 1981, in Wrexham, Wales. The properties and equipment of the Company are in good condition and, in the opinion of the management, are suitable and adequate for the Company's operations.

ITEM 3 LEGAL PROCEEDINGS

None.

ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5 MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Company's Common Stock trades on the NASDAQ Capital Market under the symbol TO. A summary of the market prices of the Company's Common Stock is shown below. At December 1, 2010, there were approximately 949 shareholders of record.

	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Year
2010 Quarters					
Common stock price per share-High	\$3.67	\$5.20	\$5.30	\$5.53	\$5.53
-Low	\$2.11	\$2.20	\$4.39	\$4.25	\$2.11
2009 Quarters					
Common stock price per share - High	\$5.08	\$3.99	\$2.73	\$3.81	\$5.08
- Low	1.93	1.33	1.11	2.03	1.11

The Company suspended the payment of dividends at the beginning of 2009 in order to conserve cash to meet the needs of the business during the global recession. The Board of Directors will consider whether to resume paying dividends as conditions and the Company's operating results improve.

ITEM 7 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD LOOKING STATEMENTS

Statements in this discussion and analysis about the Company's anticipated financial results and growth, as well as those about the development of its products and markets, are forward-looking statements that involve risks and uncertainties that could cause actual results to differ materially from those projected. These include the risks discussed in Item 1A to this Annual Report, entitled 'Risk Factors', and others discussed in this report.

CRITICAL ACCOUNTING ESTIMATES

The Company's significant accounting policies are summarized in Note 1 of its Consolidated Financial Statements in this Annual Report. While these significant accounting policies impact the Company's financial condition and results of operations, certain of these policies require management to use a significant degree of judgment and/or make estimates, consistent with generally accepted accounting principles, that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the date of the financial statements and the reported amounts of income and expenses during the reporting periods. Since these are judgments and estimates, they are sensitive to changes in business and economic realities, and events may cause actual operating results to differ materially from the amounts derived from management's estimates and judgments.

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The Company believes the following represent the most critical accounting judgments and estimates affecting its reported financial condition and results of operations:

Bad Debts

The Company estimates an allowance for doubtful accounts based on known factors related to the credit risk of each customer and management's judgment about the customer's business. Ten customers account for approximately 49% of the Company's sales. At September 30, 2010, the allowance for bad debts amounted to \$53,000, which represented 1% of receivables.

Because of the Company's long term relationships with the majority of its customers, in most cases, the principal bad debt risk to the Company arises from the insolvency of a customer rather than its unwillingness to pay. In addition, in certain cases the Company maintains credit insurance covering up to 90% of the amount outstanding from specific customers. The Company also carries out some of its foreign trade, particularly in the Far East, using letters of credit.

The Company reviews all accounts receivable balances on a regular basis, concentrating on any balances that are more than 30 days overdue, or where there is an identified credit risk with a specific customer. A decision is taken on a customer-by-customer basis as to whether a bad debt reserve is considered necessary based on the specific facts and circumstances of each account. In general, the Company would reserve 100% of the receivable, net of any recoverable value added taxes or insurance coverages, for a customer that becomes insolvent or files for bankruptcy, and lesser amounts for less imminent defaults. To a lesser degree, the Company maintains a small bad debt reserve to cover the remaining balances based on historical default percentages.

If the financial condition of any of the Company's customers is worse than estimated or were to deteriorate, resulting in an impairment of its ability to make payments, the Company's results may be adversely affected and additional allowances may be required.

Inventories

Inventories are valued at the lower of cost or market. Inventory costs include materials and overhead, and are relieved from inventory on a first-in, first-out basis. The Company carries out a significant amount of customization of standard products and also designs and manufactures special products to meet the unique requirements of its customers. This results in a significant proportion of the Company's inventory being customer specific. The Company's reported financial condition includes a provision for estimated slow-moving and obsolete inventory that is based on a comparison of inventory levels with forecast future demand. Such demand is estimated based on many factors, including management judgments, relating to each customer's business and to economic conditions. The Company reviews in detail all significant inventory items with holdings in excess of estimated normal requirements. It also considers the likely impact of changing technology. It makes an estimate of the provision for slow moving and obsolete stock on an item-by-item basis based on a combination of likely usage based on forecast customer demand, potential sale or scrap value and possible alternative use. This provision represents the difference between original cost and market value at the end of the financial period. In cases where there is no estimated future use for the inventory item and there is no estimated scrap or resale value, a 100% provision is recorded. Where the Company estimates that only part of the total holding of an inventory item will not be used, or there is an estimated scrap, resale or alternate use value, then a proportionate provision is recorded. Once an item has been written down, it is not subsequently revalued upwards. The provision for slow moving and obsolete inventories at September 30, 2010 was \$414,000, or 8% of the original cost of gross inventory. If actual future demand or market conditions are less favorable than those projected by management, or if product designs change more quickly than forecast, additional inventory write-downs may be required, which may have a material adverse impact on reported results.

Warranty Costs

The Company provides for the estimated cost of product warranties at the time revenue is recognized. While the Company engages in product quality programs and processes, the Company's warranty obligation is affected by product failure rates and repair or replacement costs incurred in correcting a product failure. Accordingly, the provision for warranty costs is based upon anticipated in-warranty failure rates and estimated costs of repair or replacement. Anticipating product failure rates involves making difficult judgments about the likelihood of defects in materials, design and manufacturing errors, and other factors that are based in part on historical failure rates and trends, but also on management's expertise in engineering and manufacturing. Estimated repair and replacement costs are affected by varying component and labor costs. Should actual product failure rates and repair or replacement costs differ from estimates, revisions to the estimated warranty liability may be required and the Company's results may be materially adversely affected. In the event that the Company discovers a product defect that impacts the safety of its products, then a product recall may be necessary, which could involve the Company in substantial unanticipated expense significantly in excess of the reserve. There were no significant safety related product recalls during the past three years.

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Goodwill Impairment

At September 30, 2010, the Company's balance sheet reflected \$1,435,000 of goodwill relating to the controls business. The Company carries out an assessment annually or more frequently if events or circumstances change, to determine if its goodwill has been impaired. The assessment is based on three separate methods of valuing the controls business based on expected free cash flows, the market price of the Company's stock and an analysis of precedent transactions. These valuation methods require estimates of future revenues, profits, capital expenditures and working capital requirements which are based on evaluation of historical trends, current budgets, operating plans and industry data. Based on all of these valuation methods, management concluded in 2010 that the goodwill had not been impaired. If, in future periods, the Company's results of operations, cash flows or the market price of the Company's stock were to decrease significantly, then it may be necessary to record an impairment charge relating to goodwill of up to \$1,435,000.

Pension Plan Assumptions

The Company makes a number of assumptions relating to its pension plans in order to measure the financial position of the plans and the net periodic benefit cost. The most significant assumptions relate to the discount rate, the expected long term return on plan assets and the rate of future compensation increase. If these assumptions prove to be incorrect then the Company may need to record additional expense or liabilities relating to the pension plans, which could have a material effect on the Company's financial position and results of operations. At September 30, 2010 there was a pension liability on the Company's balance sheet of \$8,203,000. The Company's pension plans are significant relative to the size of the Company. At September 30, 2010, pension plan assets were \$15,434,000, plan liabilities were \$23,637,000, and the total assets of the Company were \$19,884,000. In accordance with FASB guidance, changes in the funded status of the pension plans (plan assets less plan liabilities) are recorded in the Company's balance sheet and could have a material effect on the Company's financial position.

In common with most other defined benefit pension plans in the U.S. and U.K. there has been a significant deterioration in recent years in the funded status of the Company's pension plans. The funded status of the Company's defined benefit pension plans declined from a deficit of \$7,166,000 at September 30, 2009 to a deficit of \$8,203,000 at September 30, 2010. The increase in this liability was due to several factors, principally, a reduction in the weighted average discount rate from 5.65% at September 30, 2009 to 5.25% at September 30, 2010 and, in addition, a lower growth rate in the value of pension plan assets due to the current economic climate.

The table below sets out the approximate impact on the funded status of the Company's pension plans at September 30, 2010 that the Company estimates would arise from the following respective changes in significant plan assumptions:

Plan Assumption	Change in Assumption	Favorable (unfavorable) Impact on Funded Status (in thousands of dollars)	Change in funded status
Assumptions impacting accumulated benefit obligation:			
Discount rate	(0.1)%	\$ (544)	7%
Inflation rate	0.1%	(331)	4%
Salary Increase	0.5%	(511)	6%
Mortality rate	1 year	(527)	6%

Income Taxes

The Company's effective tax rate is dependent on many factors, including the impact of enacted tax laws in jurisdictions in which the Company operates, the amount of earnings by jurisdiction, varying tax rates in each jurisdiction and the Company's ability to utilize foreign tax credits related to foreign taxes paid on foreign earnings that will be remitted to the U.S.

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The Company accounts for income taxes under the asset and liability approach, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequence of events that have been recognized in the Company's financial statements or income tax returns. Income taxes are recognized during the period in which the underlying transactions are recorded. Deferred taxes are provided for temporary differences between amounts of assets and liabilities as recorded for financial reporting purposes and such amounts as measured by tax laws. If the Company determines that a deferred tax asset arising from temporary differences is not likely to be utilized, the Company will establish a valuation allowance against that asset to record it at its expected realizable value. If the Company later determines, based on the weight of available evidence, that the deferred tax assets are more likely than not to be realized in the future, the allowance may be reversed in whole or in part. Management considers many factors when assessing the likelihood of future realization of the Company's deferred tax assets, including recent cumulative earnings experience by taxing jurisdiction, expectations of future taxable income, the carry-forward periods available for tax reporting purposes and other factors. The range of possible estimates relating to the valuation of the Company's deferred tax assets is very wide. Significant judgment is required in making these assessments and it is very difficult to predict when, if ever, management may conclude that any portion of the deferred tax assets is realizable. During the fourth quarter of 2010, management re-evaluated the realizability of the Company's deferred tax assets as a result of improving global economic conditions and revised estimates of pre-tax income in the near-term based on recent operating results. Based on this review, the Company reversed \$150,000 of the \$379,000 deferred tax valuation allowance recognized in 2009. As of September 30, 2010, there remained a valuation allowance of \$2.8 million against net deferred tax assets. If future experience is significantly different from that which was projected in making these assessments, there could be significant additional adjustments to the Company's deferred tax assets and income tax expense.

The Company recognizes uncertain tax positions when it is more likely than not that the tax position will be sustained upon examination by relevant taxing authorities, based on the technical merits of the position. Although the Company believes that its tax positions are appropriate, the final determination of tax audits and any related litigation could result in material changes in the underlying estimates.

- A) Results of Operations

2010 compared to 2009

The following table compares the 2010 results, for both the controls and capacitor segments, with the prior year, showing separately the percentage variances due to currency exchange rate changes and volume.

	(in thousands of dollars)		Favorable (unfavorable) % change due to:		
	2010	2009	Total	Currency	Volume
Sales					
Controls - to external customers	\$24,434	\$18,783	30	1	29
Capacitors- to external customers	1,619	1,556	4	2	2
Capacitors - inter-segment	30	37	(19)	2	(21)
Capacitors – total	1,649	1,593	3	2	1
Total sales to external customers	26,053	20,339	28	1	27
Gross Profit					
Controls	8,347	6,321	32	2	30
Capacitors	773	701	10	3	7
Total	9,120	7,022	30	2	28

Selling, research and administrative expenses,
restructuring charge and pension curtailment

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gain					
Controls	8,215	7,531	(9)	(1)	(8)
Capacitors	697	637	(3)	(2)	(1)
Restructuring charge	-	356	100	-	100
Pension curtailment gain	(507)	-	100	-	100
Unallocated corporate expense	386	364	(6)	-	(6)
Total	8,791	8,888	1	(1)	2
Operating income (loss)					
Controls	639	(1,528)	142	-	142
Capacitors	76	26	192	16	176
Unallocated corporate expense	(386)	(364)	(6)	-	(6)
Total	329	(1,866)	118	-	118
Other income and expense	177	(201)	188	167	21
Income (loss) before income taxes	506	(2,067)	125	17	108
Benefit for income taxes	360	592	(39)	41	(80)
Net income (loss)	\$866	\$(1,475)	159	40	119

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The Company's products in the controls segment are used in electric vehicles to efficiently convert the electrical energy from the power source and control its use by the electric motors. The Company's main customers in this segment manufacture electric vehicles for on-road, off-road and industrial applications including, construction, distribution, mining, airport ground support and utility applications. In 2009, reduced activity in these sectors due to the global economic environment resulted in some of the Company's customers experiencing between 60% and 85% reduction in demand for new vehicles. This led to a substantial reduction in output by these vehicle manufacturers and a corresponding weakness in demand for the Company's products that was both broad and deep in several application areas. In 2010 the Company has seen some stabilization in these markets due to increased shipping and manufacturing activity, which led to a modest recovery in order intake during the year. In addition, new product introduction has led to customer gains in on-road vehicle applications.

In 2010 sales were \$26,053,000, an increase of \$5,714,000, or 28%, compared to 2009. In 2010 approximately 48% of the Company's sales were made outside the United States and were denominated in currencies other than the U.S. Dollar, principally the Euro and the British Pound; accordingly, those revenues are subject to fluctuation when translated into U.S. Dollars. In 2010, the average U.S. Dollar exchange rate was 2% and 0.5% higher compared to the British Pound and the Euro, respectively, than in 2009. As a result, foreign currency sales denominated in British Pounds and Euros translated into more U.S. Dollars. The overall impact to 2010 was that reported sales increased by \$197,000, or 1%, due to currency rate changes, but this was a substantially lower impact than the \$2,175,000 decrease in sales cause by rate changes in 2009. Excluding the currency impact, volumes shipped in the controls business segment were \$5,487,000 or 29% higher than in 2009, with higher shipment volumes in all geographic areas in which the Company operates. Volumes shipped in the United States were higher in the aerial lift, fork lift truck and airport ground support markets, although shipments to the mining sector were lower than last year. The most significant growth area in the United States was in the other electric vehicle market, principally motorcycles and cars, due to increased private and government support for "green" technologies. Volumes shipped in Europe and the Far East increased significantly in 2010 after the significant reduction in customer demand experienced last year. Shipments in Europe and the Far East to the Company's traditional markets of aerial lift, fork lift truck and airport ground support were largely in line with last year although, as in the United States, there was significant additional demand from the other electric vehicle market led by new product introductions and customer gains in on-road vehicle applications. However, it is too early in the development of these opportunities to say whether they will have a material effect on future results.

In the capacitor business, reported sales to external customers increased by \$63,000, or 4%, compared to 2009. Currency exchange rate changes increased sales by \$34,000, or 2% and capacitor volumes shipped were \$29,000, or 2%, higher than last year due to higher demand in the audio capacitor segment, which was partly offset by lower demand in the railway signaling market.

Cost of sales was \$16,933,000 compared to \$13,317,000 in 2009, an increase of \$3,616,000. The increase in cost of sales was due to the 27% increase in volumes shipped in 2010 compared to the prior year.

Gross profit was \$9,120,000, or 35.0% of sales, compared to \$7,022,000 or 34.5% of sales, in 2009. Foreign currency fluctuations had a net favorable impact on gross profit of \$273,000. This was due to the U.S. Dollar being marginally weaker in 2010 than in 2009 compared with the British Pound and the Euro, which had a favorable impact on sales of \$197,000 and a further favorable impact on cost of sales of \$76,000. In the controls segment, gross profit of \$8,347,000, or 34.2%, was 0.5% higher than last year; this was largely due to lower overhead costs in 2010 compared to last year. In the capacitor segment gross profit of \$773,000 was largely in line with 2009 gross profit of \$701,000. The gross profit was 46.9% of sales in 2010 compared to 44.0% of sales in 2009. The increase in the capacitor business gross profit percentage was mainly due to an increase in the proportion of sales to higher margin audio capacitor customers. The table below analyzes the year-to-year change in sales, cost of sales and gross profit.

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(in thousands of dollars except percentages)

	Sales	Cost of sales	Gross Profit	Gross Profit %	
Actual 2009	\$20,339	\$13,317	\$7,022	34.5	%
Change in 2010 due to:					
Foreign currency fluctuations	197	(76)	273	1.0	%
Increased volume, assuming 2009 gross profit percentage	5,517	3,614	1,903	-	
Other cost of sales changes, net	-	78	(78)	(0.5	%)
Actual 2010	\$26,053	\$16,933	\$9,120	35.0	%

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Selling, research and administrative expenses before a one-time pension curtailment gain in 2010 of \$507,000 and the 2009 restructuring charge of \$356,000, increased by \$766,000, or 9%, compared to 2009. Unfavorable foreign currency fluctuations increased reported operating expenses by \$117,000, or 1%. In 2010, expenditure on new product engineering increased by \$350,000 and selling expenses reduced by \$87,000, before the impact of currency fluctuations. The increase in new product engineering costs was largely due to the increase in activity during the year and increased expenditure on new product development. The reduction in selling expenses was due to the retirement, part way through the year, of the Company's vice president of sales who was not replaced until after the end of the year. However, management anticipates that expenditure on selling expenses will increase in 2011 as a result of the hiring of a replacement vice president of sales and marketing in the first quarter of the year. Administrative expenses, including corporate expense, increased by \$386,000 before the impact of currency fluctuations. Salaries and fees for employees and directors were restored to previous levels in December 2009 following the 10% salary and fee sacrifice implemented in April 2009.

An analysis of the year-to-year change in selling, research and administrative expenses, before restructuring charges and pension curtailment gain, is set out below:

	(in thousands of dollars)
Selling, research and administrative expenses, before restructuring charges and pension curtailment gain	
Reported expense in 2010	\$9,298
Reported expense in 2009	8,532
Increase in expense	766
Increase due to:	
Effect of exchange rate changes	117
Higher research and sales and marketing expense, net of currency effect	263
Higher administrative expense, net of currency effect	386
Total increase in selling, research and administrative expenses, before restructuring charges in 2009 and pension curtailment gain in 2010	\$766

In 2010 the Company took the decision to freeze the defined benefit pension plan for U.S. employees effective September 30, 2010. This decreased the projected benefit obligation by \$507,000 as of September 30, 2010 and as this eliminated all future service for the purposes of benefit accrual, this amendment was treated as a curtailment under FASB authoritative guidance. Accordingly, the entire effect of the amendment was recognized as a gain in the year in the consolidated statement of operations.

In 2009 the Company incurred a restructuring charge of \$356,000 to reduce operating expense in both the controls and the capacitor segments in response to the severe economic downturn and the resultant lower demand for the Company's products. The program resulted in the termination of 23 employees across the Company's operations in the U.S., the U.K., France and Japan. The restructuring charge comprised one-time employee severance costs, associated professional fees and other costs relating to this program.

There was an operating profit for the year of \$329,000 compared to an operating loss of \$1,866,000 in 2009, an improvement of \$2,195,000. This was mainly due to the significant increase in sales volumes shipped and the one-time pension curtailment gain partly offset by higher operating expenses. The controls business reported operating income of \$639,000 compared to an operating loss in 2009 of \$1,528,000. Operating income in the capacitor business was \$76,000 compared with operating income of \$26,000 in 2009.

Other income and expense was a net income of \$177,000 in 2010 compared to a net expense of \$201,000 in the previous year. This was largely due to a foreign currency exchange gain of \$158,000 in 2010, compared to a foreign

currency exchange loss of \$174,000 in 2009. Interest expense was \$49,000 which was \$32,000 lower than the prior year. Interest income was \$14,000 higher at \$68,000 compared to \$54,000 in 2009.

Income before income taxes in 2010 was \$506,000 compared to a loss before income taxes of \$2,067,000 in 2009, an improvement year on year of \$2,573,000. Foreign currency fluctuations increased pretax income by \$340,000 in 2010; the pre-tax result, before the effect of the favorable currency fluctuations was \$2,233,000 higher than the prior year. The Company recorded an income tax benefit of 71.1% of the pre-tax income for the year compared to an income tax benefit of 28.6% of the pretax loss in 2009. The income tax benefit of \$360,000 in 2010 arose largely from \$412,000 of research and development tax credits in the Company's U.K. operations and \$150,000 arising from the partial reversal of a deferred tax valuation allowance in the U.S. Of the \$412,000 of research and development tax credits in the Company's U.K. operations, \$253,000 related to research activity in 2010 and \$159,000 related to additional research incentives claimed in 2010 related to research activity in 2009. During the fourth quarter, the Company re-evaluated the realizability of its deferred tax assets as a result of improving global economic conditions and the Company's revised estimate of pre-tax income in the near-term based on recent operating results. Based on this review, the Company reversed \$150,000 of the \$379,000 deferred tax valuation allowance recognized in 2009. The lower tax rate in 2009 was mainly due to that valuation allowance against a domestic deferred tax asset partly offset by \$300,000 of foreign taxes recovered as a result of additional tax relief from research and development expenditure and the carry back of trading losses from prior years.

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The Company recorded net income after income taxes of \$866,000 compared to a net loss of \$1,475,000 last year, an increase of \$2,341,000. Basic and diluted income per share was \$.26 in 2010 compared to a basic and diluted loss per share of \$.46 in 2009.

• B) Liquidity and Capital Resources

The Company's operating activities generated \$938,000 of cash during 2010 compared with cash flow used by operating activities for 2009 of \$536,000. Acquisitions of property, plant and equipment amounted to \$848,000 compared to \$243,000 in 2009. The Company partly financed the purchase of an item of capital equipment for the capacitor business with a long term bank loan of \$189,000 during the year.

Exchange rate changes decreased cash by \$108,000 in 2010 compared to a decrease of \$121,000 last year. As a result, in 2010, reported cash balances increased by \$171,000, compared to a decrease of \$998,000 in 2009. At September 30, 2010 the Company's cash balances were \$803,000 compared to \$632,000 last year.

The main changes in operating assets and liabilities in 2010 were an increase in accounts receivable of \$1,950,000 and an increase in accounts payable of \$1,998,000; both movements being due to the significant increase in the operating activity of the business in 2010 compared with 2009.

The Company has a bank loan of \$190,000 of which \$37,000 was short-term and \$153,000 long-term debt at September 30, 2010. It has overdraft facilities in the United Kingdom amounting to \$630,000 which were unused at September 30, 2010 and September 30, 2009. The overdraft facility of the U.K. capacitor subsidiary company is secured by a legal charge over the facility owned and occupied by that company. The overdraft facility of the U.K. controls business is secured by a legal charge over a facility owned by that company which is partly occupied by it and partly sub-let. Both facilities are due for renewal in December 2011 but, in line with normal practice in Europe, can be withdrawn on demand by the bank. Management believes that, if these facilities were withdrawn, adequate alternative credit resources would be available. However, this would depend on the Company's situation and the economic environment at the time. The Company owns real estate property in the U.K. that could be used as collateral for raising additional borrowings, if appropriate.

There were no significant capital expenditure commitments at September 30, 2010. The Company's capital expenditures are not expected, on average over a two to three year period, to significantly exceed the depreciation charge, which averaged \$613,000 over the last three years. It is estimated that the Company will make contributions to its U.K. and U.S. defined benefit pension plans of approximately \$619,000 in 2011; should the Company suffer a material reduction in revenues in 2011 this commitment could adversely impact the Company's financial position. In the opinion of management, the Company's requirements for working capital to meet projected operational and capital spending needs in both the short and long-term can be met by a combination of existing cash resources, future earnings and existing borrowing facilities in Europe. However, the outlook remains uncertain, given the slow recovery in certain geographic markets from the worldwide economic deterioration. Any material reduction in revenues will have a materially adverse impact on the Company's financial position, which would be exacerbated if any of the Company's lenders withdraws or reduces available credit. If the Company is unable to generate sufficient cash from operations and if the bank overdraft facilities are withdrawn, the Company would need to raise additional debt or equity capital from other sources to avoid significantly curtailing its business and materially adversely affecting its results.

• C) Off balance sheet arrangements

The Company does not have any off balance sheet financing or arrangements.

ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's operations are sensitive to a number of market factors, any one of which could materially adversely affect its results of operations in any given year.

Foreign currency risk

The Company sells to customers throughout the industrialized world. In 2010 approximately 60% of the Company's sales were made in U.S. Dollars, 21% were made in British Pounds and 19% were made in Euros. In the controller business the majority of the product is produced in three separate plants in Poland, Mexico and China and cost of sales is incurred in a combination of British Pounds, Euros and U.S. Dollars. This resulted in the Company's sales and margins being exposed to fluctuations due to the change in the exchange rates of the U.S. Dollar, the British Pound and the Euro.

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In addition, the translation of the sales and income of foreign subsidiaries into U.S. Dollars is subject to fluctuations in foreign currency exchange rates.

The Company had no foreign currency derivative financial instruments outstanding as of September 30, 2010.

The following table provides information about the Company's foreign currency accounts receivable, accounts payable and firmly committed sales contracts as of September 30, 2010. The information is provided in U.S. Dollar amounts, as presented in the Company's consolidated financial statements.

(in thousands of dollars, except average contract rates)

	Expected maturity or transaction date	
	FY2011	Fair Value
On balance sheet financial instruments:		
In \$ U.S. Functional Currency		
Accounts receivable in British Pounds	1,033	1,033
Accounts receivable in Euros	1,754	1,754
Accounts payable in British Pounds	1,186	1,186
Accounts payable in Euros	1,394	1,394
Anticipated Transactions		
In \$ U.S. Functional Currency		
Firmly committed sales contracts		
In British Pounds	877	877
In Euros	623	623

Interest Rate Risk

The Company currently has \$190,000 of interest bearing debt related to a bank loan for the purchase of capital equipment by the Company's U.K. metalized film capacitor business. The Company does invest surplus funds in instruments with maturities of less than 12 months at both fixed and floating interest rates. The Company incurs short-term borrowings from time-to-time on its overdraft facilities in Europe at variable interest rates. Due to the short-term nature of the Company's investments at September 30, 2010 the risk arising from changes in interest rates was not material.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

CONSOLIDATED BALANCE SHEETS

Tech/Ops Sevcon, Inc. and Subsidiaries

September 30, 2010 and 2009

(in thousands of dollars)

ASSETS	2010	2009
Current assets:		
Cash and cash equivalents	\$803	\$632
Receivables, net of allowances for doubtful accounts of \$53 in 2010 and \$92 in 2009	5,277	3,383
Inventories	5,048	4,723
Prepaid expenses and other current assets	1,410	1,398
Total current assets	12,538	10,136
Property, plant and equipment, at cost:		
Land and improvements	22	22
Buildings and improvements	1,878	1,955
Equipment	9,426	8,768
	11,326	10,745
Less: accumulated depreciation and amortization	8,232	7,874
Net property, plant and equipment	3,094	2,871
Long-term deferred tax assets	2,806	2,357
Goodwill	1,435	1,435
Other long-term assets	11	11
Total assets	\$19,884	\$16,810

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Current debt	\$84	\$-
Accounts payable	3,717	1,730
Accrued expenses	1,591	1,611
Accrued taxes on income	40	-
Total current liabilities	5,432	3,341
Liability for pension benefits	8,203	7,166
Other long term liabilities	153	48
Total liabilities	13,788	10,555
Commitments and contingencies (note 6)	-	-
Stockholders' equity		
Preferred stock, par value \$.10 per share - authorized - 1,000,000 shares; outstanding - none	-	-
Common stock, par value \$.10 per share - authorized - 8,000,000 shares; outstanding 3,340,322 shares in 2010 and 3,326,322 shares in 2009	334	333
Premium paid in on common stock	5,132	5,033
Retained earnings	7,755	6,889
Accumulated other comprehensive loss	(7,125)	(6,000)
Total stockholders' equity	6,096	6,255
Total liabilities and stockholders' equity		