

TECH OPS SEVCON INC  
Form 10-Q  
May 17, 2011

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended April 2, 2011

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 04-2985631  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

155 Northboro Road, Southborough, Massachusetts 01772  
(Address of principal executive offices and zip code)

(508) 281-5510  
(Registrant's telephone number, including area code)

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 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)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class                         | Outstanding at May 17, 2011 |
|-------------------------------|-----------------------------|
| Common stock, par value \$.10 | 3,360,322                   |

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TECH/OPS SEVCON, INC.  
FORM 10-Q  
FOR THE QUARTER ENDED APRIL2, 2011  
INDEX

|   | PAGE  |
|---|-------|
| <u>PART I - FINANCIAL INFORMATION</u>   | 3     |
| <u>Item 1 Financial Statements (unaudited)</u>  | 3     |
| <u>Consolidated Balance Sheets</u>  | 3     |
| <u>Consolidated Statements of Operations</u>  | 4     |
| <u>Consolidated Statements of Comprehensive Income (Loss)</u>                                       | 4     |
| <u>Consolidated Statements of Cash Flows</u>  | 5     |
| <u>Notes to Consolidated Financial Statements</u>   | 6-13  |
| <u>Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 14-19 |
| <u>Item 3 Quantitative and Qualitative Disclosures about Market Risk</u>                            | 20-21 |
| <u>Item 4 Controls and Procedures</u>   | 21    |
| <u>PART II - OTHER INFORMATION</u>  | 21    |
| <u>Item 1 Legal Proceedings</u>   | 21    |
| <u>Item 1A Risk Factors</u>   | 21    |
| <u>Item 2 Unregistered Sales of Equity Securities and Use of Proceeds</u>                           | 23    |
| <u>Item 3 Defaults upon Senior Securities</u>   | 23    |
| <u>Item 4 [Removed and Reserved]</u>  | 23    |
| <u>Item 5 Other Information</u>   | 23    |
| <u>Item 6 Exhibits</u>  | 23    |
| <u>SIGNATURES</u>   | 23    |
| <u>INDEX OF EXHIBITS</u>  | 24    |

## PART I. FINANCIAL INFORMATION

## Item 1 Financial Statements

## CONSOLIDATED BALANCE SHEETS

Tech/Ops Sevcon, Inc. and Subsidiaries

|   | (in thousands of dollars except per share data) |  |
|---|---|--|
|   | April 2,<br>2011                                | September<br>30,<br>2010                   |
|   | (unaudited)                                     | (derived<br>from<br>audited<br>statements) |
| <b>ASSETS</b>   |   |  |
| <b>Current assets:</b>  |   |  |
| Cash and cash equivalents   | \$1,114   | \$803                                      |
| Trade receivables net of allowances for doubtful accounts of £51 at April 2, 2011 and \$53 at September 30, 2010  | 4,904   | 4,678                                      |
| Other receivables   | 1,219   | 599  |
| Inventories   | 6,447   | 5,048                                      |
| Prepaid expenses and other current assets   | 1,306   | 1,410                                      |
| <b>Total current assets</b>   | <b>14,990</b>                                   | <b>12,538</b>                              |
| <b>Property, plant and equipment:</b>   |   |  |
| At cost   | 10,813  | 11,326                                     |
| Less: accumulated depreciation and amortization   | 8,380   | 8,232                                      |
| <b>Net property, plant and equipment</b>  | <b>2,433</b>                                    | <b>3,094</b>                               |
| Long-term deferred tax assets   | 2,603   | 2,806                                      |
| Goodwill  | 1,435   | 1,435                                      |
| Other long-term assets  | 11  | 11   |
| <b>Total assets</b>   | <b>\$21,472</b>                                 | <b>\$19,884</b>                            |
| <b>LIABILITIES AND STOCKHOLDERS' INVESTMENT</b>   |   |  |
| <b>Current liabilities:</b>   |   |  |
| Current portion of long-term debt   | \$39  | \$84                                       |
| Accounts payable  | 4,159   | 3,717                                      |
| Accrued expenses  | 2,102   | 1,591                                      |
| Accrued and deferred taxes on income  | 41  | 40   |
| <b>Total current liabilities</b>  | <b>6,341</b>                                    | <b>5,432</b>                               |
| Liability for pension benefits  | 7,272   | 8,203                                      |
| Long-term debt  | 137   | 153  |
| <b>Total liabilities</b>  | <b>13,750</b>                                   | <b>13,788</b>                              |
| <b>Stockholders' equity:</b>  |   |  |
| 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 3,360,322 shares at April 2, 2011 and 3,340,322 shares at September 30, 2010 | 336   | 334  |

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|  |          |          |
|--|----------|----------|
| Premium paid in on common stock            | 5,209    | 5,132    |
| Retained earnings                          | 8,265    | 7,755    |
| Accumulated other comprehensive loss       | (6,088 ) | (7,125 ) |
| Total stockholders' equity                 | 7,722    | 6,096    |
| Total liabilities and stockholders' equity | \$21,472 | \$19,884 |

The accompanying notes are an integral part of these consolidated financial statements.

INDEX

- 3 -

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## CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

Tech/Ops Sevcon, Inc. and Subsidiaries

|   | (in thousands of dollars except per share data) |                  |                  |                  |
|---|---|------------------|------------------|------------------|
|   | Three months ended                              |                  | Six months ended |                  |
|   | April 2,<br>2011                                | April 3,<br>2010 | April 2,<br>2011 | April 3,<br>2010 |
| Net sales                                     | \$7,787   | \$6,171          | \$14,670         | \$12,532         |
| Cost of sales                                 | (5,099 )  | (3,847 )         | (9,614 )         | (7,927 )         |
| Gross profit                                  | 2,688   | 2,324            | 5,056            | 4,605            |
| Selling, research and administrative expenses | (2,481 )  | (2,261 )         | (4,816 )         | (4,381 )         |
| Gain on sale of fixed assets                  | 451   | -                | 451              | -                |
| Operating income                              | 658   | 63               | 691              | 224              |
| Interest expense                              | -   | (8 )             | (31 )            | (10 )            |
| Interest income                               | 2   | -                | 2                | 26               |
| Foreign currency (loss) gain                  | (75 )   | (14 )            | (71 )            | 47               |
| Income before income taxes                    | 585   | 41               | 591              | 287              |
| Income taxes provision                        | (80 )   | (14 )            | (81 )            | (101 )           |
| Net income                                    | 505   | 27               | 510              | 186              |
| Basic income per share                        | \$.15   | \$.01            | \$.15            | \$.06            |
| Fully diluted income per share                | \$.15   | \$.01            | \$.15            | \$.06            |

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

Tech/Ops Sevcon, Inc. and Subsidiaries

|  | (in thousands of dollars) |                  |                  |                  |
|--|---------------------------|------------------|------------------|------------------|
|  | Three months ended        |                  | Six months ended |                  |
|  | April 2,<br>2011          | April 3,<br>2010 | April 2,<br>2011 | April 3,<br>2010 |
| Net income                               | 505                       | 27               | 510              | 186              |
| Foreign currency translation adjustment  | 190                       | (206 )           | 137              | (249 )           |
| Pension liability adjustment, net of tax | 842                       | 8                | 900              | 17               |
| Comprehensive income (loss)              | \$1,537                   | \$(171 )         | \$1,547          | \$(46 )          |

The accompanying notes are an integral part of these consolidated financial statements.

INDEX

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

Tech/Ops Sevcon, Inc. and Subsidiaries

|   | (in thousands of dollars) |                  |
|---|---------------------------|------------------|
|   | Six months ended          |                  |
|   | April 2,<br>2011          | April 3,<br>2010 |
| Cash flow from operating activities:  |                           |                  |
| Net income  | \$510                     | \$186            |
| Adjustments to reconcile net income to net cash from operating activities:              |                           |                  |
| Depreciation  | 316                       | 283              |
| Gain on sale of fixed assets  | (451 )                    | -                |
| Stock-based compensation  | 79                        | 63               |
| Pension contributions less than pension expense   | 150                       | 258              |
| Deferred tax provision  | 90                        | 23               |
| Increase (decrease) in cash resulting from changes in operating assets and liabilities: |                           |                  |
| Receivables   | (733 )                    | (1,644 )         |
| Inventories   | (1,303 )                  | 34               |
| Prepaid expenses and other current assets   | (42 )                     | (133 )           |
| Accounts payable  | 351                       | 1,656            |
| Accrued expenses  | 555                       | (119 )           |
| Accrued and deferred taxes on income  | (113 )                    | 528              |
| Net cash (used by) generated from operating activities                                  | (591 )                    | 1,135            |
| Cash flow generated from (used by) investing activities:                                |                           |                  |
| Acquisition of property, plant and equipment  | (414 )                    | (267 )           |
| Proceeds of sale of fixed assets  | 1,278                     | -                |
| Net cash generated from (used by) investing activities                                  | 864                       | (267 )           |
| Cash flow used by financing activities:   |                           |                  |
| Repayment of long term debt   | (18 )                     | -                |
| Net cash used by financing activities   | (18 )                     | -                |
| Effect of exchange rate changes on cash   | 56                        | (188 )           |
| Net increase in cash  | 311                       | 680              |
| Beginning balance - cash and cash equivalents   | 803                       | 632              |
| Ending balance - cash and cash equivalents  | \$1,114                   | \$1,312          |
| Supplemental disclosure of cash flow information:                                       |                           |                  |
| Cash paid for income taxes  | \$-                       | \$-              |
| Cash paid for interest  | \$31                      | \$10             |

The accompanying notes are an integral part of these consolidated financial statements.

INDEX

TECH/OPS SEVCON, INC.

Notes to Consolidated Financial Statements – April 2, 2011

(Unaudited)

(1) Basis of presentation

Tech/Ops Sevcon, Inc. (“Tech/Ops” 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. Through wholly-owned subsidiaries located in the United States, the United Kingdom, 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, buses, fork lift trucks, aerial lifts, mining vehicles, airport ground support vehicles, utility vehicles, sweepers and other battery powered vehicles. Through another subsidiary located in the United Kingdom, Tech/Ops manufactures special metalized film capacitors that are used as components in the power electronics, signaling and audio equipment markets.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of only normally recurring accruals) necessary to present fairly the financial position of Tech/Ops as of April 2, 2011 and the results of operations and cash flows for the six months ended April 2, 2011. These unaudited interim financial statements should be read in conjunction with the 2010 annual consolidated financial statements and related notes included in the 2010 Tech/Ops Annual Report filed on Form 10-K (the “2010 10-K”). Unless otherwise indicated, each reference to a year means the Company’s fiscal year, which ends on September 30.

Certain prior period balances have been reclassified to conform with current period presentation.

The results of operations for the six month period ended April 2, 2011 are not necessarily indicative of the results to be expected for the full year.

(2) Summary of significant accounting policies

Other than the following update to the Company’s revenue recognition policy, there have been no changes since the end of 2010 to the significant accounting policies followed by Tech/Ops.

Revenue Recognition

The Company recognizes revenue in certain circumstances before delivery has occurred (commonly referred to as bill and hold transactions). In such circumstances, among other things, risk of ownership has passed to the buyer, the buyer has made a written fixed commitment to purchase the finished goods, the buyer has requested the finished goods be held for future delivery as scheduled and designated by them, and no additional performance obligations exist by the Company. For these transactions, the finished goods are segregated from inventory and normal billing and credit terms are granted.

Infrequently the Company enters into fixed-price non-recurring engineering contracts. Revenue from these contracts is recognized in accordance with the percentage-of-completion method of accounting.

(3) Stock-based compensation plans

Under the Company's 1996 Equity Incentive Plan (the "Plan") there were 238,000 shares reserved and available for grant at April 2, 2011. There were no options granted or exercised in the periods ended April 2, 2011 and April 3, 2010.

Recipients of grants must execute a standard form of non-competition agreement. The Plan provides for the grant of Restricted Stock, Restricted Stock Units, Options, and Stock Appreciation Rights ("SARs"). SARs may be awarded either separately, or in relation to options granted, and for the grant of bonus shares. Options granted are exercisable at a price not less than fair market value on the date of grant.

INDEX

A summary of option activity for all plans for the six months ended April 2, 2011 is as follows:

|  | Options<br>No. of<br>shares | Weighted<br>average<br>Exercise<br>Price | Weighted<br>average<br>remaining<br>contractual<br>life (years) | Aggregate<br>Intrinsic<br>Value |
|--|-----------------------------|--|---|---------------------------------|
| Outstanding at September 30, 2010                    | 46,000                      | \$5.62                                   | 2.3 years   | \$25,400                        |
| Granted  | -                           | -  | -   | \$-                             |
| Exercised  | -                           | -  | -   | \$-                             |
| Cancelled  | -                           | -  | -   | \$-                             |
| Outstanding at April 2, 2011                         | 46,000                      | \$5.62                                   | 1.7 years   | \$44,000                        |
| Exercisable at April 2, 2011                         | 37,500                      | \$5.72                                   | 1.6 years   | \$35,000                        |
| Exercisable and expected to<br>vest at April 2, 2011 | 46,000                      | \$5.62                                   | 1.7 years   | \$44,000                        |

The aggregate intrinsic value included in the table above represents the difference between the exercise price of the options and the market price of the Company's common stock for the options that had exercise prices that were lower than the \$5.74 and \$5.19 closing market price of the Company's common stock at April 2, 2011 and September 30, 2010 respectively.

A summary of restricted stock activity for the six months ended April 2, 2011 is as follows:

|                                   | Number of<br>shares of<br>Restricted<br>Stock | Weighted<br>Average<br>Grant – Date<br>Fair Value |
|-----------------------------------|---|---|
| Outstanding at September 30, 2010 | 60,000  | \$3.20  |
| Granted                           | 20,000  | \$8.75  |
| Vested                            | (30,000 )                                     | \$3.56  |
| Outstanding at April 2, 2011      | 50,000  | \$5.21  |

In January 2011, the Company granted 20,000 shares of restricted stock to eight non-employee directors, which will vest on the day before the 2012 annual meeting providing that the grantee remains a director of the Company, or as otherwise determined by the Compensation Committee. The aggregate fair value of the stock measured on the date of grant was \$175,000, based on the closing sale price of the stock on the date of grant. Compensation expense is being charged to income on a straight line basis over the twelve month period during which the forfeiture conditions lapse. The charge to income for these restricted stock grants in the first six months of fiscal 2011 was \$29,000 and the subsequent charge will be approximately \$44,000 on a quarterly basis.

Stock based compensation expense for the three and six month periods ended April 2, 2011 was \$43,000 and \$79,000, respectively and for the three and six month periods ended April 3, 2010 was \$24,000 and \$63,000, respectively. At April 2, 2011 there was \$234,000 of unrecognized compensation expense related to share options and restricted stock granted under the plan. The Company expects to recognize that cost over a weighted average period of 1.7 years.

INDEX

## (4) Cash dividends

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.

## (5) Calculation of earnings per share and weighted average shares outstanding

Basic and fully diluted earnings per share were calculated as follows:

|   | (in thousands except per share data) |                  |                  |                  |
|---|--------------------------------------|------------------|------------------|------------------|
|   | Three Months ended                   |                  | Six Months ended |                  |
|   | April 2,<br>2011                     | April 3,<br>2010 | April 2,<br>2011 | April 3,<br>2010 |
| Net income  | \$505                                | \$27             | \$510            | \$186            |
| Weighted average shares outstanding - basic   | 3,307                                | 3,277            | 3,296            | 3,265            |
| Basic income per share  | \$.15                                | \$.01            | \$.15            | \$.06            |
| Common stock equivalents  | 28                                   | 9                | 36               | 12               |
| Weighted average shares outstanding - diluted   | 3,335                                | 3,286            | 3,332            | 3,277            |
| Diluted income per share  | \$.15                                | \$.01            | \$.15            | \$.06            |
| No. of options that are anti-dilutive excluded from calculation of common stock equivalents | 10                                   | 46               | 10               | 46               |

## (6) Segment information

The Company has two reportable segments: electronic controls and capacitors. The electronic controls segment produces microprocessor based control systems for zero emission and hybrid electric vehicles. The capacitors segment produces metalized film capacitors for sale to electronic equipment manufacturers. Each segment has its own management team and sales force and the capacitors segment has its own manufacturing facility.

The significant accounting policies of the segments are the same as those described in Note 1 to the 2010 10-K. Inter-segment revenues are accounted for at current market prices. The Company evaluates the performance of each segment principally based on operating income. The Company does not allocate income taxes, interest income and expense or foreign currency translation gains and losses to segments. Information concerning operations of these businesses is as follows:

|                             | (in thousands of dollars)        |            |           |         |
|-----------------------------|----------------------------------|------------|-----------|---------|
|                             | Three months ended April 2, 2011 |            |           |         |
|                             | Controls                         | Capacitors | Corporate | Total   |
| Sales to external customers | \$7,154                          | \$633      | \$-       | \$7,787 |
| Inter-segment revenues      | -                                | 15         | -         | 15      |
| Operating income (loss)     | 796                              | 151        | (289 )    | 658     |
| Identifiable assets         | 20,142                           | 1,084      | 246       | 21,472  |

  

|                         | Three months ended April 3, 2010 |            |           |        |
|-------------------------|----------------------------------|------------|-----------|--------|
|                         | Controls                         | Capacitors | Corporate | Total  |
|                         | Sales to external customers      | \$5,802    | \$369     | \$-    |
| Inter-segment revenues  | -                                | 7          | -         | 7      |
| Operating income (loss) | 105                              | 16         | (58 )     | 63     |
| Identifiable assets     | 17,032                           | 846        | 260       | 18,138 |



(in thousands of dollars)

|                             | Six months ended April 2, 2011 |            |           |          |
|-----------------------------|--------------------------------|------------|-----------|----------|
|                             | Controls                       | Capacitors | Corporate | Total    |
| Sales to external customers | \$13,540                       | \$1,130    | \$-       | \$14,670 |
| Inter-segment revenues      | -                              | 18         | -         | 18       |
| Operating income (loss)     | 799                            | 208        | (316 )    | 691      |
| Identifiable assets         | 20,142                         | 1,084      | 246       | 21,472   |

|                             | Six months ended April 3, 2010 |            |           |          |
|-----------------------------|--------------------------------|------------|-----------|----------|
|                             | Controls                       | Capacitors | Corporate | Total    |
| Sales to external customers | \$11,767                       | \$765      | \$-       | \$12,532 |
| Inter-segment revenues      | -                              | 14         | -         | 14       |
| Operating income (loss)     | 320                            | 37         | (133 )    | 224      |
| Identifiable assets         | 17,032                         | 846        | 260       | 18,138   |

In the electronic controls segment, the revenues were derived from the following products and services:

|  | (in thousands of dollars) |                  |                  |                  |
|--|---------------------------|------------------|------------------|------------------|
|  | Three Months ended        |                  | Six Months ended |                  |
|  | April 2,<br>2011          | April 3,<br>2010 | April 2,<br>2011 | April 3,<br>2010 |
| Electronic controls for zero emission and hybrid electric vehicles | \$6,207                   | \$3,315          | \$9,908          | \$7,182          |
| Accessory and aftermarket products and services                    | 947                       | 2,487            | 3,632            | 4,585            |
| Total electronic controls segment revenues                         | \$7,154                   | \$5,802          | \$13,540         | \$11,767         |

(7) Research and development

The cost of research and development programs is charged against income as incurred and was as follows:

|  | (in thousands of dollars) |                  |                  |                  |
|--|---------------------------|------------------|------------------|------------------|
|  | Three Months ended        |                  | Six Months ended |                  |
|  | April 2,<br>2011          | April 3,<br>2010 | April 2,<br>2011 | April 3,<br>2010 |
| Research and development expense, net of grants receivable | \$563                     | \$819            | \$1,259          | \$1,495          |
| Percentage of sales  | 7.2%                      | 13.3%            | 8.6%             | 11.9%            |

In the second quarter of 2010 and the first quarter of 2011, the Company was awarded research and development grants by One North East, the Regional Development Agency responsible for the support of business in the North East of England, to accelerate the development of two new products. These two projects were completed in March 2011 as required by the grant awards. The Company recorded grant income of \$217,000 and \$383,000 in the first and second quarters of 2011, respectively, associated with research and development expense of \$620,000 and \$1,094,000 in the first and second quarters of 2011, respectively, on these two projects. The grant income was recorded as a reduction of research and development expense.

INDEX

## (8) Employee benefit plans

Tech/Ops has a defined benefit plan covering the majority of its U.K. employees; U.S. employees and certain employees in the capacitor business have a defined contribution plan. The following table sets forth the components of the net pension cost:

|  | (in thousands of dollars) |                  |                  |                  |
|--|---------------------------|------------------|------------------|------------------|
|  | Three Months ended        |                  | Six Months ended |                  |
|  | April 2,<br>2011          | April 3,<br>2010 | April 2,<br>2011 | April 3,<br>2010 |
| Service cost                           | \$111                     | \$80             | \$221            | \$164            |
| Interest cost                          | 319                       | 295              | 636              | 605              |
| Expected return on plan assets         | (277 )                    | (228 )           | (550 )           | (465 )           |
| Amortization of net loss               | 71                        | 50               | 139              | 118              |
| Amortization of prior service cost     | (21 )                     | 12               | (9 )             | 24               |
| Net periodic benefit cost              | 203                       | 209              | 437              | 446              |
| Net cost of defined contribution plans | \$7                       | \$6              | \$14             | \$13             |

Amounts recognized in the balance sheet consist of:

|                         | (in thousands of dollars) |                  |
|-------------------------|---------------------------|------------------|
|                         | April 2,<br>2011          | April 3,<br>2010 |
| Non current liabilities | \$7,272                   | \$8,203          |

Amounts recognized in accumulated other comprehensive loss consist of:

|   | (in thousands of dollars) |                  |                  |                  |
|---|---------------------------|------------------|------------------|------------------|
|   | Three Months ended        |                  | Six Months ended |                  |
|   | April 2,<br>2011          | April 3,<br>2010 | April 2,<br>2011 | April 3,<br>2010 |
| Amortization of net actuarial loss net of tax benefit | \$51                      | \$-              | \$100            | \$-              |
| Amortization of prior service cost net of tax benefit | (15 )                     | 8                | (6 )             | 17               |
| Actuarial gain net of tax benefit                     | 806                       | -                | 806              | -                |
| Net cost of defined contribution plans                | \$842                     | \$8              | \$900            | \$17             |

Tech/Ops did not contribute to its U.S. pension plan in the six months ended April 2, 2011; it presently anticipates contributing \$75,000 to fund its U.S. plan in the remainder of 2011. In addition, employer contributions to the U.K. defined benefit plan were \$287,000 in the first six months and are estimated to total \$614,000 in 2011.

In the second quarter of 2011, the Company changed the inflation index used to calculate the annual increase in accrued benefits for deferred pension plan members of the U.K. defined benefit pension plan. The change in inflation index was from the Retail Prices Index ("RPI") to the Consumer Prices Index ("CPI"). Deferred pension plan members are current or former employees of the Company who have left the pension plan, retaining a right to future pension benefits, but not having yet brought those benefits into payment. The change of inflation index was for this one class of pension plan member only. As a result of this change, the Company recorded a one-time decrease in the liability for pension benefits of \$806,000, net of a tax benefit. This decrease was recorded in the second quarter of 2011 through other comprehensive income as a reduction to remaining prior service costs of \$212,000 and the remaining \$594,000 is being amortized as a component of net period benefit costs over 34 years, this being the estimated life expectancy of the deferred members of the U.K. pension plan.



The table below presents information about the Company's pension plan assets measured and recorded at fair value as of April 2, 2011 and indicates the fair value hierarchy of the inputs utilized by the Company to determine the fair values.

| (in thousands of dollars)                                     |  |  |  |
|---|--|--|--|
|   | Level 1*<br>(Quoted<br>prices<br>in active<br>markets) | Level 2**<br>(Significant<br>observable<br>inputs) | Level 3***<br>(Unobservable<br>inputs) |
| <b>Mutual Funds</b>   |  | -  | -                                      |
| Standard Life Pension Global Absolute Returns Strategies Fund | 5,339  | -  | -                                      |
| Standard Life UK Indexed Linked Fund                          | 1,337  | -  | -                                      |
| Standard Life Long Corporate Bond Fund                        | 1,291  | -  | -                                      |
| CF Ruffer Absolute Return Fund                                | 5,466  | -  | -                                      |
| BNY Mellon Large Cap Stock Fund                               | 812  | -  | -                                      |
| BNY Mellon U.S. Core Equity 130/30 Fund                       | 92   | -  | -                                      |
| BNY Mellon Short Term U.S. Government Securities Fund         | 80   | -  | -                                      |
| BNY Mellon Intermediate Bond Fund                             | 587  | -  | -                                      |
| BNY Mellon Bond Fund Class M                                  | 484  | -  | -                                      |
| <b>Other Types of Investments</b>                             |  |  |  |
| Cash  | 309  | -  | -                                      |
| <b>Total</b>  | <b>15,797</b>  | <b>-</b>   | <b>-</b>                               |

\*Level 1 investments represent mutual funds for which a quoted market price is available on an active market. These investments will primarily hold stocks or bonds, or a combination of stocks and bonds.

\*\* The Company currently does not have any Level 2 pension plan financial assets.

\*\*\* The Company currently does not have any Level 3 pension plan financial assets.

The following estimated benefit payments, which reflect future service, as appropriate have been or are expected to be paid:

|             | (in thousands of<br>dollars) |
|-------------|------------------------------|
| 2011        | \$ 361                       |
| 2012        | 360                          |
| 2013        | 453                          |
| 2014        | 644                          |
| 2015        | 716                          |
| 2016 – 2020 | 3,945                        |

INDEX

The following table sets forth the movement in the liability for pension benefits in the six months ended April 2, 2011 and April 3, 2010:

|   | (in thousands of dollars) |                  |
|---|---------------------------|------------------|
|   | Six Months ended          |                  |
|   | April 2,<br>2011          | April 3,<br>2010 |
| Liability for pension benefits at beginning of period | \$8,203                   | \$7,166          |
| Net periodic benefit cost                             | 437                       | 446              |
| Plan contributions                                    | (287 )                    | (188 )           |
| Amortization of net loss                              | (138 )                    | -                |
| Amortization of prior service costs                   | 9                         | (24 )            |
| Actuarial gain  | (1,139 )                  | -                |
| Effect of exchange rate changes                       | 187                       | (294 )           |
| Balance at end of period                              | \$7,272                   | \$7,106          |

(9) Inventories

Inventories were comprised of:

|                 | (in thousands of dollars) |                          |
|-----------------|---------------------------|--------------------------|
|                 | April 2,<br>2011          | September<br>30,<br>2010 |
| Raw materials   | \$1,025                   | \$536                    |
| Work-in-process | 88                        | 68                       |
| Finished goods  | 5,334                     | 4,444                    |
|                 | \$6,447                   | \$5,048                  |

(10) Fair value of financial instruments

The Company's financial instruments consist mainly of cash and cash equivalents, short-term investments, accounts receivable and accounts payable. The carrying amount of these financial instruments as of April 2, 2011 and September 30, 2010 approximates fair value due to the short-term nature of these instruments. The Company also has debt in the form of a U.K. bank loan, the carrying value of which at April 2, 2011 approximated to fair value based on current interest rates.

(11) Accrued expenses

Set out below is an analysis of other accrued expenses at April 2, 2011 and September 30, 2010, which shows separately any items in excess of 5% of total current liabilities:

|  | (in thousands of dollars) |                          |
|--|---------------------------|--------------------------|
|  | April 2,<br>2011          | September<br>30,<br>2010 |
| Accrued compensation and related costs | \$1,054                   | \$884                    |
| Warranty reserves                      | 70                        | 96                       |
| Other accrued expenses                 | 978                       | 611                      |
|  | \$2,102                   | \$1,591                  |



## (12) Warranty reserves

The movement in warranty reserves was as follows:

|  | (in thousands of dollars) |                  |                  |                 |
|--|---------------------------|------------------|------------------|-----------------|
|  | Three Months ended        |                  | Six Months ended |                 |
|  | April 2,<br>2011          | April 3,<br>2010 | April 2,<br>2011 | April 3<br>2010 |
| Warranty reserves at beginning of period   | \$119                     | \$237            | \$96             | \$217           |
| Decrease in beginning balance for warranty obligations settled during the period | (26 )                     | (50 )            | (26 )            | (56 )           |
| Other changes to pre-existing warranties   | (25 )                     | 16               | (25 )            | 16              |
| Foreign currency translation adjustment  | 3                         | (8 )             | 2                | (7 )            |
| Net increase in warranty reserves for products sold during the period            | (1 )                      | 16               | 23               | 41              |
| Warranty reserves at end of period   | \$70                      | \$211            | \$70             | \$211           |

## (13) Debt

At April 2, 2011 the Company had \$176,000 (September 30, 2010, \$190,000) outstanding under a U.K. bank loan entered into in April 2010, with a fixed interest rate of 6.8%. The loan, which was entered into by the U.K. metalized film capacitor subsidiary to purchase an item of capital equipment, is denominated in British Pounds. The loan agreement provides for equal monthly installments comprising interest and principal for a five year period which commenced in May 2010. Of the total amount outstanding at April 2, 2011, \$39,000 is shown in the current liabilities section of the accompanying consolidated balance sheet under current portion of long-term debt, representing the principal element of the loan installments in the twelve months commencing April 2, 2011. Included in long term debt, at April 2, 2011, is \$137,000 which represents the principal element of the loan installments for the years 2012 to 2015. The carrying value of the debt at April 2, 2011 approximated to fair value based on current interest rates.

In March 2011, the Company's U.K. bank renewed the overdraft facilities of the Company's U.K. subsidiary operations. The Company's U.K. subsidiaries have a multi-currency overdraft facility of \$1,450,000 which is secured against real estate owned by the U.K. subsidiary companies. In common with bank overdrafts in Europe, the facility renewal is for a twelve month period although in line with normal practice in Europe, it can be withdrawn on demand by the bank.

Annual principal payments on long term debt at April 2, 2011 are as follows:

|         | (in thousands of dollars) |    |
|---------|---------------------------|----|
| 2011-12 | \$                        | 39 |
| 2012-13 |                           | 42 |
| 2013-14 |                           | 44 |
| 2014-15 |                           | 51 |

## (14) Subsequent events

In preparing these interim consolidated financial statements, the Company has evaluated, for potential recognition or disclosure, events or transactions subsequent to the end of the most recent quarterly period and through the date these financial statements were available to be issued. No material subsequent events were identified that require recognition or disclosure in these financial statements.



Item 2 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 referred to and described under "Risk Factors" below and others discussed in this report.

CRITICAL ACCOUNTING ESTIMATES

As of April 2, 2011, there were no material changes to the critical accounting estimates described in the Company's 2010 10-K. However, if the continuing worldwide economic uncertainty continues to have a negative effect on our business, estimates used in future periods may vary materially from those included in the Company's previous disclosures.

For example:

- (i) if the financial condition of any of the Company's customers deteriorates as a result of further business declines, the Company may be required to increase its estimated allowance for bad debts;
  - (ii) if actual future demand is less than previously projected, inventory write-downs may be required;
- (iii) significant negative industry or economic trends that adversely affect our future revenues and profits, or a reduction of our market capitalization relative to net book value, among other factors, may change the estimated future cash flows or other factors that we use to determine whether or not goodwill has been impaired and lead us to conclude that an impairment charge is required.

All of these factors, and others resulting from the current economic situation, may have a material adverse impact on the Company's results.

INDEX

## OVERVIEW OF SECOND QUARTER AND FIRST SIX MONTHS

## Results of Operations

Three months ended April 2, 2011 and April 3, 2010

The following table compares the results by segment for the three months ended April 2, 2011 with the same period in the prior year. The table shows the effect of currency and volume changes in percentage terms.

|  | Three months ended |                  | Favorable (unfavorable)<br>% change due to: |          |        |
|--|--------------------|------------------|---|----------|--------|
|  | April 2,<br>2011   | April 3,<br>2010 | Total                                       | Currency | Volume |
| <b>Sales:</b>  |                    |                  |   |          |        |
| Controls - to external customers   | \$7,154            | \$5,802          | 23  | 1        | 22     |
| Capacitors - to external customers   | 633                | 369              | 72  | 12       | 60     |
| Capacitors - inter-segment   | 15                 | 7                | 107   | 72       | 35     |
| Capacitors – total   | 648                | 376              | 72  | 13       | 59     |
| Total sales to external customers  | 7,787              | 6,171            | 26  | 1        | 25     |
| <b>Gross Profit:</b>   |                    |                  |   |          |        |
| Controls   | 2,359              | 2,153            | 10  | (7 )     | 17     |
| Capacitors   | 329                | 171              | 92  | 8        | 84     |
| Total  | 2,688              | 2,324            | 16  | (6 )     | 22     |
| <b>Selling, research and administrative expenses<br/>and gain on sale of fixed assets:</b> |                    |                  |   |          |        |
| Controls   | (2,014 )           | (2,048 )         | 2   | (2 )     | 4      |
| Capacitors   | (178 )             | (155 )           | (15 )                                       | (4 )     | (11 )  |
| Unallocated corporate expense  | (289 )             | (58 )            | (398 )                                      | -        | (398 ) |
| Gain on sale of fixed assets   | 451                | -                | 100   | -        | 100    |
| Total  | (2,030 )           | (2,261 )         | 10  | (3 )     | 13     |
| <b>Operating income (loss):</b>  |                    |                  |   |          |        |
| Controls   | 796                | 105              | 658   | (199 )   | 857    |
| Capacitors   | 151                | 16               | 844   | 55       | 789    |
| Unallocated corporate expense  | (289 )             | (58 )            | (398 )                                      | -        | (398 ) |
| Total  | 658                | 63               | 944   | (318 )   | 1,262  |
| Other income and expense   | (73 )              | (22 )            | (232 )                                      | 35       | (267 ) |
| Income before income taxes   | 585                | 41               | 1,327                                       | (469 )   | 1,796  |
| Income taxes   | (80 )              | (14 )            | (471 )                                      | (45 )    | (426 ) |
| Net income   | \$505              | \$27             | 1,770                                       | (736 )   | 2,506  |

Sales in the second quarter of 2011 increased by \$1,616,000, or 26%, to \$7,787,000 compared to \$6,171,000 in the same quarter last year. This increase was due to increased shipment volumes, which were \$1,533,000 or 25% higher than last year, resulting mainly from sales of the Company's Gen4 AC product to new applications, including on-road and off-road electric vehicles ("EV") applications. There was also continued improvement in demand for the Company's products in its traditional markets. Foreign currency fluctuations increased reported sales in the second fiscal quarter by \$83,000, or 1%, mainly due to a weaker U.S. Dollar compared to both the British Pound and the Euro than in the prior year period.

INDEX



In the controls business segment, volumes shipped were higher in Europe and North America by 72% and 18% respectively, but were 36% lower in the Far East, compared to the same period last year. The increase in sales volume in Europe and North America was in part due to continued customer gains in a range of on-road and off-road EV applications, while the decrease in the Far East is largely attributed to a reduction in domestic Japanese demand. In addition, shipment volume increased 22% in the Company's traditional markets of industrial applications for construction, distribution, mining, airport ground support and utility applications. In the capacitor business, volumes shipped were 72% higher than in the same period last year, which was largely due to higher demand from customers in the industrial sector. Currency changes, mainly the weaker U.S. Dollar compared to the British Pound, increased reported sales in the capacitor business by \$44,000, or 12%, from the same period in 2010.

Gross profit of \$2,688,000 was 34.5% of sales in the second quarter compared to \$2,324,000 or 37.7% of sales in the same quarter last year. Foreign currency fluctuations decreased the reported gross profit by \$145,000, or 1.9%, compared to the same period last year. There was a further reduction in the gross profit margin for the current quarter of 1.4% due largely to start up costs of new Gen4 A.C. business together with increases in material costs and higher production-related overhead costs compared to the prior year.

Selling, research and administrative expenses in the second quarter of 2011 were \$2,481,000, an increase of \$220,000, or 10%, compared to the same period last year. Foreign currency fluctuations increased operating expense by \$55,000 or 2%, compared with the same quarter last year. The increase in operating expense was largely due to higher salary and fringe costs compared to the same period last year. The higher compensation costs were due to the hiring of additional staff associated with the increase in sales and pay increases in the first quarter of 2011. Although sources of raw materials and components have improved over the past year, rising commodity prices and fuel costs (affecting freight) will also continue to have an adverse effect.

In the second quarter of 2010 and the first quarter of 2011, the Company was awarded research and development grants by One North East, the Regional Development Agency responsible for the support of business in the North East of England, to accelerate the development of two new products. These two projects were completed in March 2011 as required by the grant awards. The Company recorded grant income of \$383,000 in the quarter associated with research and development expense in the quarter of \$1,094,000 on these two projects. The grant income was recorded as a reduction of research and development expense in the quarter.

Operating income in the second quarter was \$658,000, which was an improvement of \$595,000 compared with the \$63,000 reported in the same period last year. This was despite adverse foreign currency fluctuations which reduced operating income by \$200,000 in the quarter and also included a one-time gain of \$451,000 from the sale of a surplus U.K. facility. Other than the gain arising from the sale of the U.K. facility, the increase in operating income was due to the higher demand for the Company's products compared to the previous year partially offset by higher operating costs. In the capacitor business segment, there was operating income of \$151,000 compared to income of \$16,000 in the second quarter last year.

In the second quarter of fiscal 2011 there was a foreign currency loss of \$75,000 compared to a loss of \$14,000 in the same period last year. The foreign currency loss in the second quarter of 2011 was due to the stronger U.S. Dollar compared to the British Pound and the Euro in the prior year period. Should the present weakness of the U.S Dollar compared to the British Pound and the Euro continue, this will further increase the Company's Euro denominated raw material costs and also increase reported operating expenses in both the British Pound and the Euro.

The Company recorded income taxes provisions of 13.7% and 34.1% in the second quarter of fiscal 2011 and 2010, respectively. The reduction in effective income tax rates from 2010 to 2011 was due to a number of factors. In the second quarter of fiscal 2011 the Company recorded a worldwide effective income taxes rate of 19% of pre-tax income; this low effective rate was largely due to there being no income taxes payable in respect of the gain on the U.K. property recognized in the second quarter of 2011. In addition, the Company recorded a \$176,000 provision to

reduce the balance sheet value of U.K. deferred tax asset due to a change in the U.K Corporation tax rate from 28% to 26%, effective April 1, 2011. The Company also re-evaluated the realizability of its deferred tax assets as a result of recent economic conditions, the Company's recent operating results, and the Company's revised estimate of pre-tax income in the near-term. Based on this review, the Company reversed, in the second quarter of 2011, \$207,000 of a \$379,000 deferred tax valuation allowance recognized in 2009. This valuation allowance relates primarily to deferred tax assets in the U.S.

INDEX

- 16 -

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The Company recorded income before income taxes of \$585,000 in the second quarter of 2011 compared to income before income taxes of \$41,000 in the same period last year. There was net income for the quarter of \$505,000 or \$.15 per share compared to net income of \$27,000 and net income of \$.01 per share in the second quarter of fiscal 2010.

Six months ended April 2, 2011 and April 3, 2010

The following table compares first half year results by segment for the six months ended April 2 2011 with the same period in the prior year. The table shows the effect of currency and volume changes in percentage terms.

|  | Six months ended |                  | Favorable (unfavorable)<br>% change due to: |          |        |
|--|------------------|------------------|---|----------|--------|
|  | April 2,<br>2011 | April 3,<br>2010 | Total                                       | Currency | Volume |
| <b>Sales:</b>  |                  |                  |   |          |        |
| Controls - to external customers   | \$13,540         | \$11,767         | 15  | (1 )     | 16     |
| Capacitors - to external customers   | 1,130            | 765              | 48  | 4        | 44     |
| Capacitors - inter-segment   | 18               | 14               | 26  | 35       | (9 )   |
| Capacitors - total   | 1,148            | 779              | 47  | 4        | 43     |
| Total sales to external customers  | 14,670           | 12,532           | 17  | (1 )     | 18     |
| <b>Gross Profit:</b>   |                  |                  |   |          |        |
| Controls   | 4,504            | 4,258            | 6   | (2 )     | 8      |
| Capacitors   | 552              | 347              | 59  | 2        | 57     |
| Total  | 5,056            | 4,605            | 10  | (2 )     | 12     |
| <b>Selling, research and administrative expenses<br/>and gain on sale of fixed assets:</b> |                  |                  |   |          |        |
| Controls   | (4,156 )         | (3,938 )         | 6   | 1        | 5      |
| Capacitors   | (344 )           | (310 )           | (11 )                                       | -        | (11 )  |
| Unallocated corporate expense  | (316 )           | (133 )           | (138 )                                      | -        | (138 ) |
| Gain on sale of fixed assets   | 451              | -                | 100   | -        | 100    |
| Total  | (4,365 )         | (4,381 )         | -   | -        | -      |
| <b>Operating income (loss):</b>  |                  |                  |   |          |        |
| Controls   | 799              | 320              | 150   | (25 )    | 175    |
| Capacitors   | 208              | 37               | 462   | 23       | 439    |
| Unallocated corporate expense  | (316 )           | (133 )           | (138 )                                      | -        | (138 ) |
| Total  | 691              | 224              | 208   | (32 )    | 240    |
| Other income and expense   | (100 )           | 63               | (259 )                                      | (87 )    | (172 ) |
| Income before income taxes   | 591              | 287              | 106   | (44 )    | 150    |
| Income taxes   | (81 )            | (101 )           | 20  | (20 )    | 40     |
| Net income   | \$510            | \$186            | 174   | (79 )    | 253    |

Sales in the six months ended April 2, 2011 were \$14,670,000, an increase of \$2,138,000, or 17%, compared to the same period last year when sales were \$12,532,000. Foreign currency fluctuations accounted for a reduction in reported sales of \$114,000, or 1%. Excluding the currency impact, the increase was due to increased volumes shipped, which were \$2,252,000, or 18%, higher than in the same period last year.

INDEX

In the controls business segment, volumes shipped were higher in Europe and North America by 58% and 11% respectively, but were 37% lower in the Far East due largely to lower domestic demand in Japan, compared to the same period last year. The increase in sales volume in Europe and North America is in part due to continued customer gains in a range of on-road and off-road EV applications. In addition, the Company's traditional markets of industrial applications for construction, distribution, mining, airport ground support and utility applications have seen healthy recovery from the significant reduction in customer demand experienced in the recession of 2009 with volumes shipped up 22% over the same period last year. In the capacitor business, volumes shipped were 48% higher than during the first half of last year, which was largely due to higher demand from customers in the industrial sector. Currency changes, mainly the weaker U.S. Dollar compared to the British Pound, increased reported sales in the capacitor business by \$27,000, or 4%, from the same period in 2010.

Gross profit of \$5,056,000 was 34.5% of sales in the first half of 2011 compared to \$4,605,000 or 36.7% in the comparable period in fiscal 2010. Foreign currency fluctuations reduced reported gross profit by \$93,000 as compared with the prior year period; excluding the impact of foreign currency fluctuations, gross profit increased by \$544,000, or 12%, compared to the first half of last year due to the increase in volumes shipped in the period. Excluding the impact of foreign currency fluctuations, in the controller business, gross profit increased by \$347,000, or 8%, compared to the first six months of fiscal 2010 due to increased volumes shipped; in the capacitor business, gross profit increased by \$197,000, or 57%, due to significantly higher demand in the first half year compared to the prior year. The increase in shipment volume in the capacitor segment was largely due to increased demand from the railway signaling sector.

Selling, research and administrative expenses were \$4,816,000, an increase of \$435,000, or 10%, compared to the last year. Foreign currency fluctuations decreased reported selling, research and administrative expenses by \$21,000, or 1%, due to the stronger U.S. Dollar compared to both the British Pound and the Euro in the prior year period. Excluding the adverse effect of currency fluctuations, selling, research and administrative expenses in the first six months of the year were \$456,000, or 11% higher than the same period last year due largely to higher salary and fringe costs compared to the same period last year. The higher compensation costs compared to the same period last year were due to the hiring of additional staff associated with the increase in sales and also the award of a pay increase in the first quarter of 2011. The Company recorded grant income of \$600,000 in the period associated with research and development expense of \$1,714,000 on the two research and development projects outlined above. The grant income was recorded as a reduction of research and development expense in the period.

Operating income in the first half of fiscal 2011 was \$591,000 compared with \$287,000 last year, an increase of \$304,000. Foreign currency fluctuations resulted in a \$127,000 decrease in reported operating income for the Company and there was a one-time gain of \$451,000 from the sale of a surplus U.K. facility. Excluding the adverse currency impact and the gain from the facility sale, operating income was \$431,000 higher than last year due to higher demand for the Company's products partially offset by higher operating costs compared to the same period last year.

In the first half of fiscal 2010 there was a foreign currency loss of \$71,000 compared to a gain of \$47,000 in the same period last year, mainly due to a stronger U.S. Dollar compared to both the British Pound and the Euro in the prior year period.

The Company recorded a profit before income taxes of \$591,000 compared to \$287,000 in the same period last year, an increase of \$304,000; this included the gain on the sale of a surplus U.K. facility of \$451,000. Foreign currency fluctuations decreased pretax income by \$127,000.

The Company recorded income taxes provisions of 13.7% and 35.2% in the first half of fiscal 2011 and 2010, respectively. The reduction in effective income tax rates from 2010 to 2011 was due to a number of factors. In the first half of fiscal 2011 the Company recorded a worldwide effective income taxes rate of 19% of pre-tax income; this low effective rate was largely due to there being no income taxes payable in respect of the gain on the U.K. property

recognized in the second quarter of 2011. In addition, the Company recorded a \$176,000 provision to reduce the balance sheet value of U.K. deferred tax asset due to a change in the U.K Corporation tax rate from 28% to 26%, effective April 1, 2011. The Company also re-evaluated the realizability of its deferred tax assets as a result of recent economic conditions, the Company's recent operating results, and the Company's revised estimate of pre-tax income in the near-term. Based on this review, the Company reversed, in the second quarter of 2011, \$207,000 of a \$379,000 deferred tax valuation allowance recognized in 2009. This valuation allowance relates primarily to deferred tax assets in the U.S.

INDEX

- 18 -

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The Company recorded net income for the first half of fiscal 2011 of \$510,000 or \$.15 per share compared to net income of \$186,000 and \$.06 per share in the same period in fiscal 2010.

#### Financial Condition

While the Company has paid regular quarterly dividends in the past, due to the continuing uncertain economic outlook, the Board of Directors continues to suspend the payment of dividends and will consider whether to resume paying dividends on a quarter by quarter basis.

Cash balances at the end of the second quarter of fiscal 2011 were \$1,114,000, compared to \$803,000 on September 30, 2010, an increase in cash of \$311,000 in the first six months of fiscal 2011. The quarter-end balance reflected the proceeds from the sale of the surplus U.K. facility of \$1,278,000.

In the first six months of fiscal 2011, there was net income of \$510,000 and operating activities used \$591,000 of cash. Excluding the impact of currency fluctuations, receivables increased by \$733,000 and inventories increased by \$1,303,000, both of which reduced cash during the period. Payables and accrued expenses decreased by \$351,000 and \$555,000, respectively, which generated cash during the period. The number of days sales in receivables increased slightly in the first six months of 2011 from 61 days at September 30, 2010 to 63 days at April 2, 2011. Capital expenditures in the first six months were \$414,000. Exchange rate changes increased reported cash by \$56,000 in the first six months of fiscal 2011 as compared with the prior year period due to the weakening of the U.S. Dollar compared to both the British Pound and the Euro during the period.

The Company has a bank loan of \$176,000, of which \$39,000 was short-term and \$137,000 long-term debt at April 2, 2011. In January 2011, the Company negotiated an increase in its overdraft facilities in the United Kingdom from \$645,000 to \$1,450,000; the available facilities were unused at April 2, 2011 and September 30, 2010. The overdraft facilities are secured by legal charges over buildings owned and occupied by the Company and its capacitor subsidiary. Both facilities were renewed in the second quarter of 2011 for a further period of twelve months 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. Accordingly, management does not rely on their availability in projecting the adequacy of the Company's capital resources.

There were no significant capital expenditure commitments at April 2, 2011. It is estimated that the Company will make contributions to its U.K. and U.S. defined benefit pension plans of approximately \$614,000 in fiscal 2011; should the Company suffer a material reduction in revenues in 2011 this commitment could adversely impact the Company's financial position. In order to capitalize on a range of new business opportunities, management are currently exploring ways to raise additional finance to assist the working capital needs of those opportunities. However, the outlook continues to remain uncertain, given the continuing worldwide economic uncertainty and in particular the low economic growth in Europe and North America. 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.

INDEX

## Item 3 Quantitative and Qualitative Disclosures about Market Risk.

## Foreign currency risk

The Company sells to customers throughout the industrialized world. The majority of the Company's products are manufactured in, or sourced from, the United Kingdom. In the first six months of 2011, approximately 54% of the Company's sales were made in U.S. Dollars, 22% were made in British Pounds and 24% were made in Euros. Approximately 70% of the Company's cost of sales was incurred in British Pounds and Euros. 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. The Company has trade accounts receivable and accounts payable denominated in both British Pounds and Euros that are exposed to exchange fluctuations.

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

The following table provides information about the Company's foreign currency accounts receivable, accounts payable and firmly committed sales contracts outstanding as of April 2, 2011. The information is provided in U.S. Dollar amounts, as presented in the Company's consolidated financial statements. The table presents the amounts at which the Company's foreign currency accounts receivable, accounts payable and firmly committed sales contracts as of April 2, 2011 are expected to mature based on the exchange rate of the relevant foreign currency to U.S. Dollars at April 2, 2011:

|   | (in thousands of dollars)                |             |            |
|---|--|-------------|------------|
|   | Expected maturity or<br>transaction date |             | Fair Value |
|   | Fiscal 2011                              | Fiscal 2012 |            |
| <b>On balance sheet financial instruments</b> |  |             |            |
| <b>In \$ U.S. Functional Currency</b>         |  |             |            |
| Accounts receivable in British Pounds         | 933                                      | -           | 933        |
| Accounts receivable in Euros                  | 2,194                                    | -           | 2,194      |
| Accounts payable in British Pounds            | 1,767                                    | -           | 1,767      |
| Accounts payable in Euros                     | 2,574                                    | -           | 2,574      |
| <b>Anticipated Transactions</b>               |  |             |            |
| <b>In \$ U.S. Functional Currency</b>         |  |             |            |
| <b>Firmly committed sales contracts</b>       |  |             |            |
| In British Pounds                             | 755                                      | 133         | 888        |
| In Euros                                      | 3,106                                    | 8           | 3,114      |

INDEX

## Interest Rate Risk

The Company's policy is to invest surplus funds in instruments with maturities of less than 12 months at both fixed and floating interest rates. This investment portfolio is generally subject to general credit, liquidity, counterparty, market and interest rate risks that may be exacerbated by the current global economic instability. If the banking system or the fixed income or credit markets deteriorate further or remain volatile, the values and liquidity of these investments could be adversely affected. The Company did not have any surplus funds invested as of April 2, 2011.

At April 2, 2011, the Company had \$176,000 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 invests 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.

## Item 4 Controls and Procedures.

(a) Evaluation of disclosure controls and procedures. The Company's principal executive officer and principal financial officer, after evaluating the effectiveness of the Company's "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934 Rule 13a-15(e)), have concluded that, as of April 2, 2011, these disclosure controls and procedures were effective.

(b) Changes in internal control over financial reporting. Our principal executive officer and principal financial officer have identified no change in the Company's "internal control over financial reporting" (as defined in Securities Exchange Act of 1934 Rule 13a-15(f)) that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1 Legal Proceedings

None.

### Item 1A Risk Factors

In addition to the market risk factors set forth in Part I, Item 1A of our 2010 10-K and the considerations set out in Part I, Items 2 and 3 above, 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 may 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 during the recent global recession. Further, as our business has expanded globally, we have become increasingly subject to the risks arising from adverse changes in global economic conditions. While market conditions appear to be improving, economic instability remains. As a result, 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.



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 levels that allow the Company to meet increasing demand for its product. The resulting shortages vary across types of raw materials and components depending on many fluctuating factors. They have 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 46% of the Company's revenues in the first half of 2011 and the largest customer accounted for 9% 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 is located, and a significant portion of our business comes from, 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 certain key component suppliers and sub-contractors for its requirements for most components, sub-assemblies and finished products. In the event that such component suppliers and sub-contractors are unable or unwilling to continue supplying the Company, or to meet the Company's volume, 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.

INDEX

- 22 -

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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.

Item 2 Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3 Defaults upon Senior Securities

None.

Item 4 [Removed and Reserved]

Item 5 Other Information

None.

Item 6 Exhibits

See Exhibit Index immediately preceding the exhibits.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TECH/OPS  
SEVCON,  
INC.

Date: May 17, 2011

By: /s/ Paul  
N. Farquhar  
Paul N.  
Farquhar  
Chief  
Financial  
Officer  
(Principal  
Financial  
Officer)



INDEX OF EXHIBITS

Exhibit Description

- 3.1 Certificate of Incorporation of the registrant (incorporated by reference to Exhibit (3) (a) to the Company's Quarterly Report on Form 10-Q for the quarter ended July 3, 2004).
- 3.2 By-laws of the registrant (incorporated by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K filed on September 19, 2008).
- 31.1 Certification of Principal Executive Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 31.2 Certification of Principal Financial Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 32.1 Certification of Principal Executive Officer and Principal Financial Officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).

